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COMMISSION STAFF WORKING PAPER

IMPACT ASSESSMENT

Common Agricultural Policy towards 2020

Accompanying the document

Proposals for a
REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

- establishing rules for direct payments to farmers under support schemes within the framework of the common agricultural policy
- establishing a common organisation of the markets in agricultural products (Single CMO Regulation)
- on support for rural development by the European Agricultural Fund for Rural Development (EAFRD)
- on the financing, management and monitoring of the common agricultural policy
and the
Proposal for a
COUNCIL REGULATION
determining measures on fixing certain aids and refunds related to the common organisation of the markets in agricultural products

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Common Agricultural Policy towards 2020

Assessment of Alternative Policy Options

This report commits only the Commission services involved in its preparation and does not prejudge the final form of any decision to be taken by the Commission.

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Contents

LIST OF ABBREVIATIONS

AKIS – Agriculture Knowledge and Innovation System

AEM – Agri-Environmental Measures

AWU – Annual Working Unit

CAP – Common Agricultural Policy

CMEF – Common Monitoring and Evaluation Framework

CMO – Common Market Organisation

CSF – Common Strategic Framework

DDA – Doha Development Agenda

DG – Directorate General

EIP – European Innovation Partnership

ENRD –European Network for Rural Development

ESD – Effort Sharing Decision

ETS – Emission Trading Scheme

EU – European Union

EU-12 – Members States of the European Union that have joined the EU since 1st of May 2004

EU-15 – Member States of the European Union before 1st of May 2004

FAS – Farm Advisory System

FNVA – Farm Net Value Added

GAEC – Good Agricultural and Environmental Conditions

GDP – Gross Domestic Product

GHG – Green House Gases

HNV – High Nature Value

IACS - Integrated Administration and Control System

IBO – Interbranch Organisation

LAGs – Local Action Groups

LFA – Less Favoured Areas

MMF – Multiannual Financial Framework

NHA – Natural Handicap Areas

NREAP - National Renewable Energy Action Plan

OECD - Organisation for Economic Co-operation and Development

PEA – Potentially Eligible Area

PG – Producer Group

PO – Producer Organisation

PSE – Producer Support Estimate

SPS – Single Payment Scheme

SWOT – Strengths, Weaknesses, Opportunities, Threats

UAA – Utilised Agricultural Area

WTO – World Trade Organisation

1. THE CAP IMPACT ASSESSMENT PROCESS

Agriculture is at a crossroads and in the headlines: EU agriculture and its Common Agricultural Policy (CAP) are no exception.

Challenges, impacts and solutions worldwide vary, but a common theme is also emerging: sustainability is at the core of any solution. This is why the overarching objective for the future CAP should be sustainable competitiveness to achieve an economically viable food production sector, in tandem with sustainable management of the EU's natural land-based resources.

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

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

1.1. Organisation of the process

Discussions and preliminary analyses of the possible paths for the future of the CAP were initiated by the Directorate General for Agriculture and Rural Development (DG AGRI) of the European Commission in April 2010 in the context of the preparation of the EU Multiannual Financial Framework 2014-2020. These were steered by an Inter-Service Steering Group (ISSG) working on the basis of a commonly agreed mandate. The ISSG met fifteen times with participants from twenty-one DGs, and incorporated in its work contributions from stakeholders in the consultation process.

The report provides an overview of the effects of reforming the CAP taking into account the orientations of the Multiannual Financial Framework (MFF) for 2014-2020. This would translate into changes in the legal framework in three main areas, namely market measures (Council Regulation (EC) No 1234/2007), direct payments (Council Regulation (EC) No 73/2009) and rural development policy (Council Regulation (EC) No 1698/2005), as well as legal changes in horizontal provisions of the CAP.

The underlying problems of EU agriculture which these policies aim to address are usually complex, linking biophysical and socioeconomic factors. To provide consistent and coherent solutions, particular policy instruments have to be complementary to successfully address these underlying problems. This report identifies these complementarities, synergies and trade-offs, to build a composite picture of the impacts of policy on EU agriculture.

Box 1. The Commission proposal for the MFF for 2014-2020

The Commission proposal for the Multiannual Financial Framework for 2014-2020 (the MFF proposal)[1] sets the budgetary framework and the main orientations for the Common Agricultural Policy. The basic two pillar structure of the Common Agricultural Policy will be maintained; 30 % of direct support will be made conditional on "greening", i.e. environmentally supportive practices defined in legislation; the levels of direct support will be progressively adjusted and capping will apply; the allocation of rural development funds will be revised on the basis of more objective criteria and better targeted to the objectives of the policy. The Commission proposes to allocate 281.8 billion EUR for Pillar I of the Common Agricultural Policy and 89.9 billion EUR for rural development for the 2014-2020 period. This funding will be complemented by additional sums committed for research and innovation on food security, the bio-economy and sustainable agriculture (4.5 billion EUR), food safety (2.2 billion EUR), food support for most deprived persons (2.5 billion EUR), a new reserve for crises in the agriculture sector (3.5 billion EUR) and the opening of the European Globalisation Fund to farmers (up to 2.5 billion EUR) (all figures above in constant 2011 prices).

Individual analysis of policy issues and policy tools is available in the Annexes of the report. Annex (1) provides a detailed account of the current economic and social situation in EU agriculture and rural areas together with prospects for agricultural markets and farm income (the economic baseline). Annex (2) focuses on the environmental situation and options for reforming the direct payments and rural development policy to maximise the provision of environmental public goods. Annexes 2-5 analyse various options of specific policy instruments within the three broad intervention areas (direct payments, rural development and market measures) and their impacts. Annexes 6-8 focus on cross-cutting approaches (risk management, research and innovation, simplification) which influence a whole range of policy tools and are crucial for the success of reforms. Annex (9) provides an overview of contributions of stakeholders in the public consultation. Annex (10) gives detailed background information on the income impact of various options at farm and regional level. Annex (11) provides background on the methodology and lists and summarises supporting evidence in selected studies and evaluations. Finally, Annex (12) analyses the reform from a development perspective.

Following the Impact Assessment Board opinion and advice, considerable changes have been made to the report in order to provide ample evidence base and facilitate its use to support decision making. Namely, the lessons of evaluations were better integrated in the report, the elements of analysis of sub-options in the integration scenario were brought forward from the annex to sections 5 and 6, the analysis of simplification effects was expanded, the implementation issues were better spelled out and the revised monitoring and evaluation framework with regard to indicators was linked to all stages of the policy cycle. In order to provide a full picture of the challenges for the EU agriculture, the report, together with annexes, analyses the implications of the main broad policy orientations which underpin the choices proposed by the Commission in the Multiannual

[1] Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions *A budget for Europe 2020*, COM(2011)500 final, 29.6.2011.

Financial Framework for 2014-2020 and of the further detailed policy choices to be made in terms of the functioning of the CAP.

1.2. Consultation of the Stakeholders

Interested parties were invited to submit their contributions and additional analysis between the 23rd of November 2010 and the 25th of January 2011 and an advisory committee with stakeholders was organised on the 12th of January 2011.[2] Altogether, 517 contributions were received by the Commission (of which 72 from private persons). Of the contributions from organisations, 44% came from the farming and processing sector and 40% from national, regional and local authorities, environmental organisations, think-tanks and research institutes as well as development organisations, the trade sector, and consumer organisations. Other organisations (12%) participating in the consultation included health protection organisations, water management bodies or civil society representatives.

The main elements of the opinions received in the stakeholder consultation can be summarised as follows:[3]

– There is broad agreement among stakeholders on the need for a strong Common Agricultural Policy, based on its two-pillar-structure, in order to address the challenges ahead.

– Stakeholders have diverse opinions concerning the targeting of support (especially the redistribution of direct aid and the capping of payments).

– There is agreement that both pillars can play an important role in stepping up climate action and increasing environmental performance for the benefit of EU society. Whereas many farmers believe that this already takes place today, the broader public argues that Pillar I payments can be used more efficiently.

– Most respondents find that the CAP should play a role in stabilizing markets and prices.

– The respondents want all parts of the EU, including less favoured areas, to be part of future growth and development.

– The need to better integrate the CAP with other EU policies, such as environmental, health, trade, development, was emphasised by many respondents.

– Innovation, development of competitive businesses and provision of public goods to the EU citizens are seen as ways to align the CAP with the Europe 2020 strategy.

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2 http://ec.europa.eu/agriculture/events/cap-towards-2020_en.htm

3 The stakeholders' views have been integrated in the report on key issues. A review of the replies to each consultation question is provided in Annex 9.

1.3. Methodological approach

Analysis of the potential impacts of the different policy options for the future CAP has been carried out on the basis of two complementary approaches: the Impact Assessment made extensive use of quantitative analysis which was then complemented with quantitative and qualitative information from the literature and public consultations (mostly on the social and environmental impacts). In the context of the Steering Group, thematic clusters were created on selected issues.[4]

The core quantitative analysis of the economic situation of EU agriculture until 2020 and the impacts of alternative policy scenarios have been conducted on the basis of DG AGRI analytical tools in close collaboration with the Institute for Prospective Technological Studies (IPTS) of the European Commission's Joint Research Centre.[5]

The medium-term projections for agricultural markets until 2020 were established under a set of status quo assumptions on agricultural and trade policies (taking into account all currently foreseen CAP provisions) with macroeconomic projections based on market statistics and other information available at the end of September 2010 and validated in expert discussions.[6]

The results formed the baseline scenario which was then used to simulate the effects of changing the level of direct payments as a result of the redistribution of payment and the alternative possibilities for the components of the direct payment (for small farmers, natural constraint areas, greening, coupled component as well as capping) on farm income and profitability. [7] This simulation allowed the calculation of farm income based on the Farm Net Value Added (FNVA) per Annual Work Unit (AWU), an indicator which represents the amount available to remunerate the factors of production (labour, land and capital).[8]

In order to address the limits of the analysis with regard to volatility on agricultural markets, sensitivity analysis was conducted with alternative assumptions, including higher crop yield growth, faster technological prospects, higher variable costs, higher GDP growth in emerging economies, faster or slower economic growth and higher or lower crude oil price and an alternative biofuel scenario (higher oil prices with lower transport fuel demand). To address the limits of the farm-level modelling which does not take into account changes in the structure of the sector, trends in labour productivity

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4 A list of issues considered by the groups is provided in chapter 9.

5 A detailed account of the modelling tools and data used are provided in Annex 11a: Methodology for the market and income effect of the CAP reform.

6 An external review of the baseline and uncertainty scenarios was conducted in a seminar organised by the JRC IPTS on 5-6 October 2010 in Brussels, gathering high-level policy makers, modelling and market experts from the EU, the United States, the Organisation for Economic Co-operation and Development, the United Nation's Food and Agriculture Organisation and the World Bank. See: http://ipts.jrc.ec.europa.eu/publications/pub.cfm?id=4199.

7 For results and detailed description of the farm level analysis see Annex (10) "Impact of Scenarios on the Distribution of Direct Payments and Farm Income" and Annex 2d: "Partial analysis of greening measures".

8 FNVA/AWU= (output – intermediate consumption + subsidies – taxes – depreciation)/Annual Work Units.

were introduced exogenously, with three assumptions: i) fixed labour productivity, ii) growth reflecting recent trends and iii) growth following long-term trends.

Against the baseline scenario, the economic, environmental and social impacts of three alternative paths of CAP reform have been assessed based on how their responses compare to the status-quo with respect to the challenges that EU agriculture is facing in terms of competitiveness and productivity growth, viability of farms, rural growth, environmental sustainability, climate change objectives and territorial cohesion.

The analysis of the economic impact assesses their effect on competitiveness and growth, the viability of farming and its vulnerability to crisis situations. The analysis of social impacts considers the potential effects on employment and income. Finally, the analysis of environmental impacts assesses the role of particular policy choices in adopting environmentally-friendly agricultural practices and supporting agricultural areas which are particularly beneficial for the environment and climate action.

Budgetary ceilings for Pillar I and II in the various scenarios reflect the Commission proposal for the Multiannual Financial Framework 2014-2020 (unless otherwise stated in section 4), compared to the baseline where current budget trends are maintained until 2020.

2. POLICY CONTEXT, PROBLEM DEFINITION AND EU VALUE ADDED

The EU primary sector - agriculture, hunting and forestry - provides food, feed and renewable energy, and accounts for 1.6% of the total GDP and 5.4% of the total employment. These figures, both exhibiting decreasing trends, mask wide variations in farm structures between Member States. At the same time agriculture, together with forestry, covers 84% of the total EU territory, thus playing an important role in land management and the preservation of natural resources. Finally, agriculture accounts for 10.3% of EU27 greenhouse gas emissions, a decrease of 22% as compared with 1990 (as compared to a 17.4% drop for all emissions).[9]

Over the last two decades, the CAP has undergone a substantial reform process, which reflects changing societal concerns related notably to environment, food quality and safety, territorial balance, as well as the evolving needs of the EU economy. This chapter presents the evaluation of current policy and the emerging policy issues related to concerns about productivity, competitiveness, environmental and climate change and territorial impacts of agricultural production.

2.1. The CAP reform path

The CAP has its roots in the post-World War II situation, where agriculture had been crippled and food supplies could not be guaranteed. Incentives to produce were provided through a system of high support prices to farmers, combined with border protection and export support with financial assistance for the restructuring of the sector.

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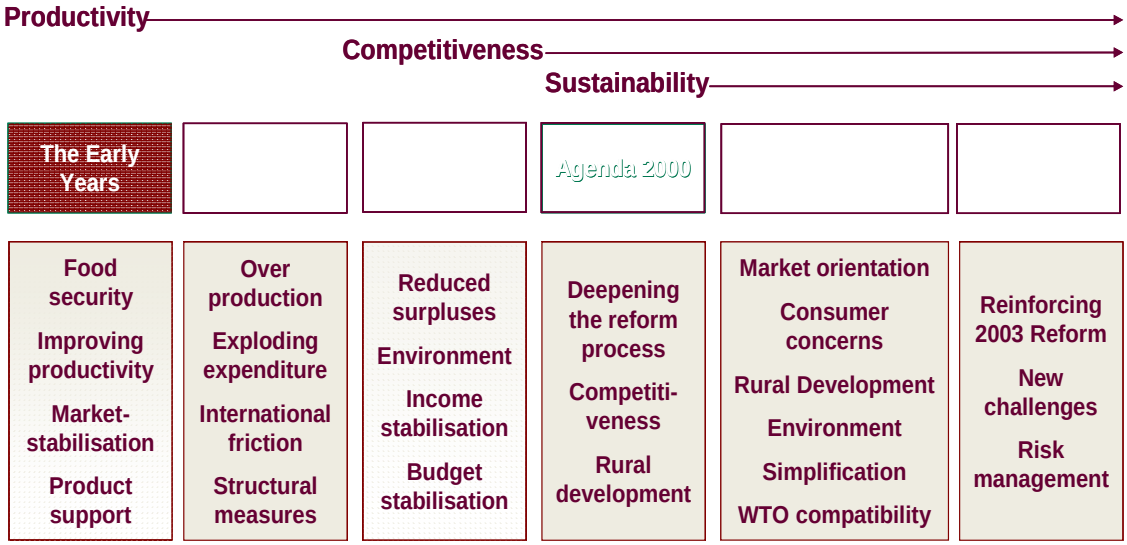
[9] This share, which excludes Land Use, Land Use Change and Forestry (LULUFC), is above emissions from industrial processes (7%) and residential (9.3%) and below manufacturing industries and construction (11.5%), transport (20.2%) and public electricity and heat production (26.6%).

Although the CAP was very successful in moving the EU towards self-sufficiency, by the 1980s the EU had to contend with almost permanent surpluses of the major farm commodities, some of which were exported (with the help of subsidies), while others had to be stored or disposed of within the EU. These measures had a high budgetary cost, distorted some world markets, did not always serve the best interests of farmers and became unpopular with consumers and taxpayers. At the same time society became increasingly concerned about the environmental sustainability of agriculture.

This led to a fundamental reform process of the CAP which started in 1992 and was later deepened and extended in 1999 with Agenda 2000 (in summery form, this path is outlined in Figure 1). This reform started the shift from product support (through prices of commodities) to producer support (through income support to farmers). This also meant that transfers to producers from consumers (through higher prices) were replaced by transfers from taxpayers, reducing the impact on consumers and the processing industry.

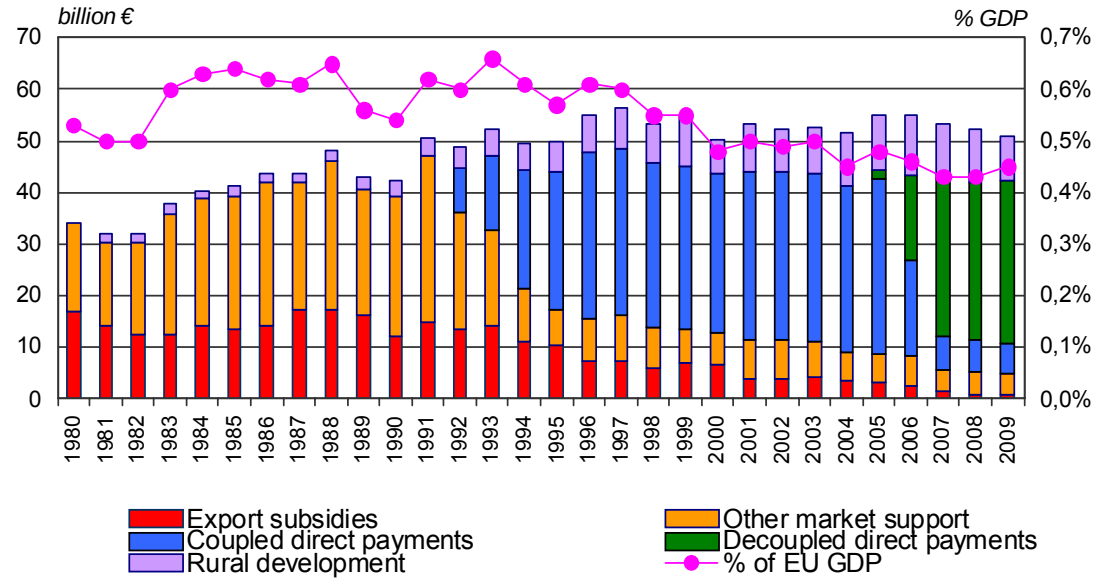
Figure 1: Historical development of the CAP



The 1992 reform started the process of reduction in support prices and the introduction of direct payments for a few key agricultural sectors. A new set of reforms initiated in 2003 and continued in 2008 with the Health Check, aimed at enhancing the competitiveness of the farm sector, promoting a market-oriented, sustainable agriculture and strengthening rural development policy. A central element of the latter reforms was to 'decouple' the majority of direct payments from production. That is, farmers were no longer to receive payments related to a specific type of production. Instead, payments were linked to entitlements based on the value of historical subsidy receipts, conditioned to the provision of environmental public goods. In parallel, a comprehensive rural development policy was introduced as Pillar II of the CAP; this policy encouraged many rural initiatives while also helping farmers to diversify, to improve their product marketing and to otherwise restructure their businesses.

Figure 2 depicts this evolution of the CAP in terms of the shift in expenditure on various measures. The graph reflects both the decline of the most trade-distorting elements of the CAP and their replacement with minimally or non trade distorting measures, as well as the declining share of the CAP in the EU GDP (and thus in the EU budget).

Figure 2: The path of CAP expenditure 1980 – 2009 (in 2007 constant prices)



Source: DG Agriculture and Rural Development.

The recent OECD evaluation of CAP reform confirmed that this reform process led to a significant decrease in the distortion of production and trade and an increase of income transfer efficiency (see Figure 3).[10]

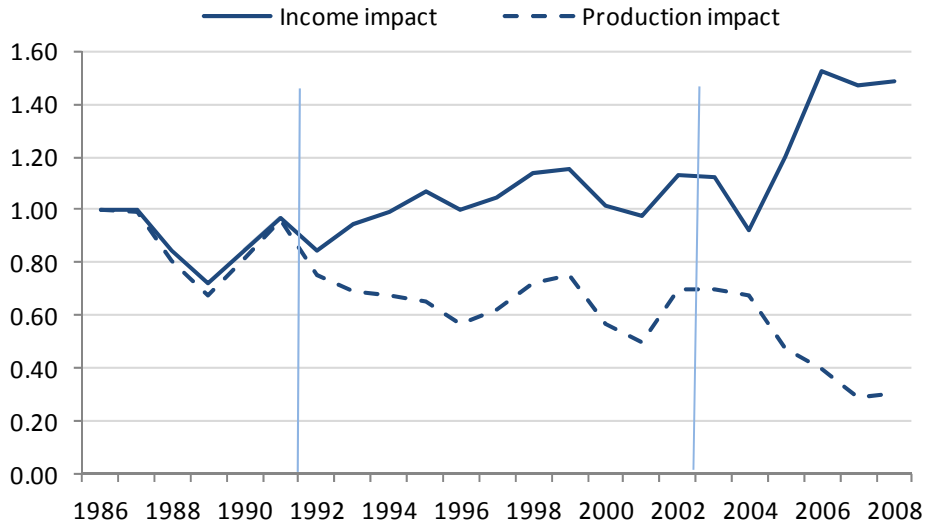
Measuring the amount and type of support to producers using the OECD Producer Support Estimate (PSE) indicator, the share of potentially most distorting support in PSE decreased from 92% to 34% between 1986-88 and 2007-09; it is projected to further decrease to 27% when the Health Check reform is completed. The share of gross farm receipts derived from support to producers decreased from 39% to 23% between 1986-88 and 2007-09, close to the OECD average of 22% in 2007-09.[11]

The effects of the policy on the restructuring of the sector are difficult to separate from other factors, but while there may be cases of disincentives to exit, the overall decline in farm numbers has been steady since the mid-90s and is projected to continue. At the same time the report pointed to the need to better target income support, improve policy coherence between Pillars I and II and with other policies to improve competitiveness, the environmental performance and strengthen the regional approach for rural development.

[10] Evaluation of Agricultural Policy Reforms in the European Union, OECD, TAD/CA/APM/WP(2010)26/FINAL.

[11] ibid.

Figure 3: Effect of the CAP on production and income, 1986-2008 (1986=100)



Note: Income is defined as producer surplus accruing to farm owned inputs, which include the farmer's own labour, quota rents, the livestock herd, and land (which for this figure is assumed owned by farmers).
Source: OECD PEM Model

The external evaluations of the rural development policy framework for 2007-13 show the positive impact of the strategic approach.[12] Member States have made considerable efforts to develop strategies on the basis of an analysis of strengths, weaknesses, opportunities and threats (SWOT) so as to best tailor their intervention to policy objectives. Still, there has been some evidence of path dependency in programming and of difficulties experienced by certain areas and groups in using funding.

2.2. Current policy framework

Currently two complementary pillars of the CAP provide the general framework that allows the policy to address competitiveness and sustainability challenges of agriculture and rural areas across the EU territory.[13]

Pillar I includes instruments related to the functioning of agricultural markets and the food supply chain (Council Regulation (EC) No 1234/2007) and to direct payments (Council Regulation (EC) No 73/2009) conditional upon statutory management requirements and good agricultural and environmental conditions.[14] Combined, these measures provide a fundamental layer of support that allows keeping sustainable farming in place throughout the EU.

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[12] See the evaluation *Synthesis of ex-ante evaluations of rural development programmes 2007–2013 (2008)*; the study *Defining EU Priorities: A Review of Rural Development Instruments (2008)*; and the final report of the Thematic Working Group 1 of the ENRD *Targeting rural territorial specificities and needs in rural development programmes 2007-2013*.

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

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

Pillar I measures are mandatory for Member States and, with very few exceptions, there is no co-financing. This ensures the application of a common policy within the Single Market, monitored by an integrated administration and control system (IACS).

Pillar II – rural development policy (Council Regulation (EC) No 1698/2005) - includes measures that aim at improving the competitiveness of the agriculture sector, delivering specific environmental public goods and promoting the diversification of economic activity and quality of life in rural areas. These measures are largely voluntary, contractual, co-financed and delivered within a strategic framework which links policy action to European, national, regional and local needs.

The appropriate combination of Pillar I basic annual payments at EU-wide level and Pillar II measures adapted to local specificities in a strategic approach creates a policy-mix that combines direct support with targeted actions and assures that the policy acquires a critical mass to make a difference at an EU-scale.[15]

As agriculture returns to the spotlight with the boom, bust, and then again boom in commodity prices, the policy framework requires re-examination. The recent developments exposed the sensitivity of our society to the issue of food provision, urban-rural relations, the role of the agricultural sector in the discussions on climate change adaptation and mitigation, and reinforced concerns about sustainability and the legacy of present policies for future generations. While EU consumers are spending on average only 16% of their household expenditure on food, concerns are refocusing on access to food by low-income households,[16] availability of safe and high quality nutritious food and the social and environmental "footprint" of agricultural products.[17]

2.3. Agriculture under growing economic pressure...

In recent years, trends in agricultural markets reversed, and three new developments altered previously held beliefs. First, agricultural prices seem to have reversed, at least for the foreseeable future, their previous long-term downward trend, and have significantly increased both their level and their volatility. This development parallels the movement of prices in other commodity markets (Figure 4). The causes are multiple, linked, among other things, to macroeconomic developments, structural characteristics of the sector and the steady increase in demand, and exacerbated by short-term economic and policy issues (weather events, export restrictions) which contribute to high volatility of agricultural prices.[18]

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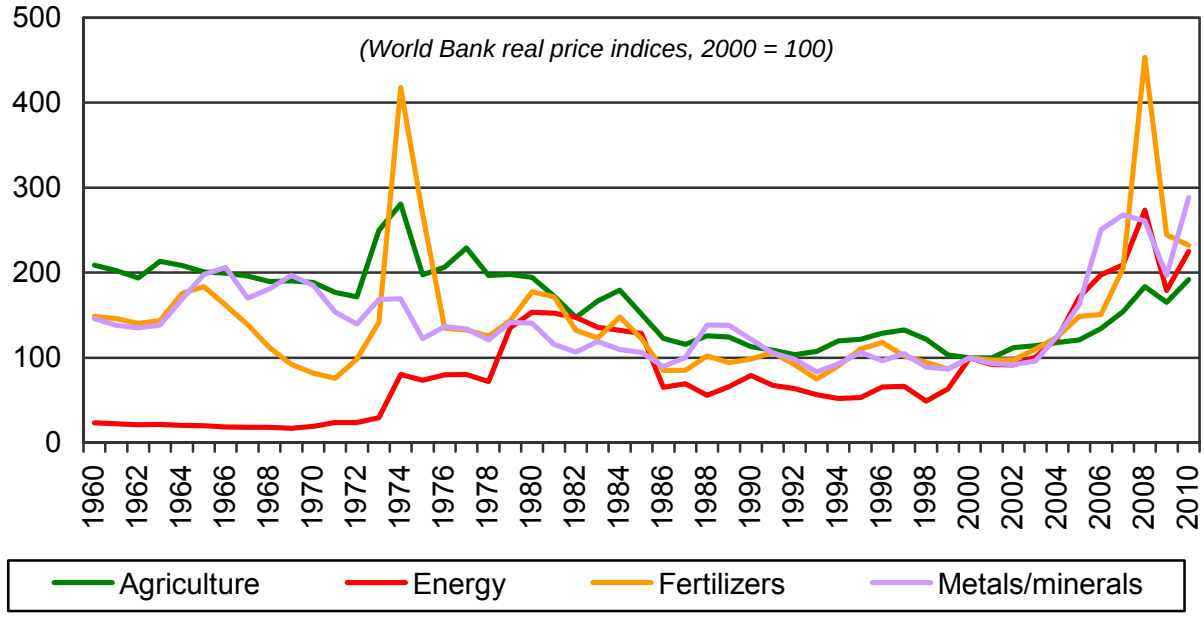
[15] Targeting and critical mass are two key elements for effective policies identified in the evaluation prepared for the European Commission "Meta-study on lessons from existing evaluations as an input to the Review of EU spending", Euréval – Ramboll Management, January 2008.

[16] An analysis of the food security for low income households is provided in the Impact Assessment accompanying the Commission proposal on the food distribution for the most deprived, SEC(2008) 2436/2.

[17] The challenges faced by agriculture are highlighted in the 3rd Foresight Exercise by this Standing Group on Agricultural Research "Sustainable food consumption and production in a resource-constrained world"

[18] See issues paper on high food prices, DG AGRI, May 2008, http://ec.europa.eu/agriculture/analysis/tradepol/foodprices_en.pdf and "High commodity prices and

Figure 4: Price developments for energy, agriculture and fertilisers, 1960-2010

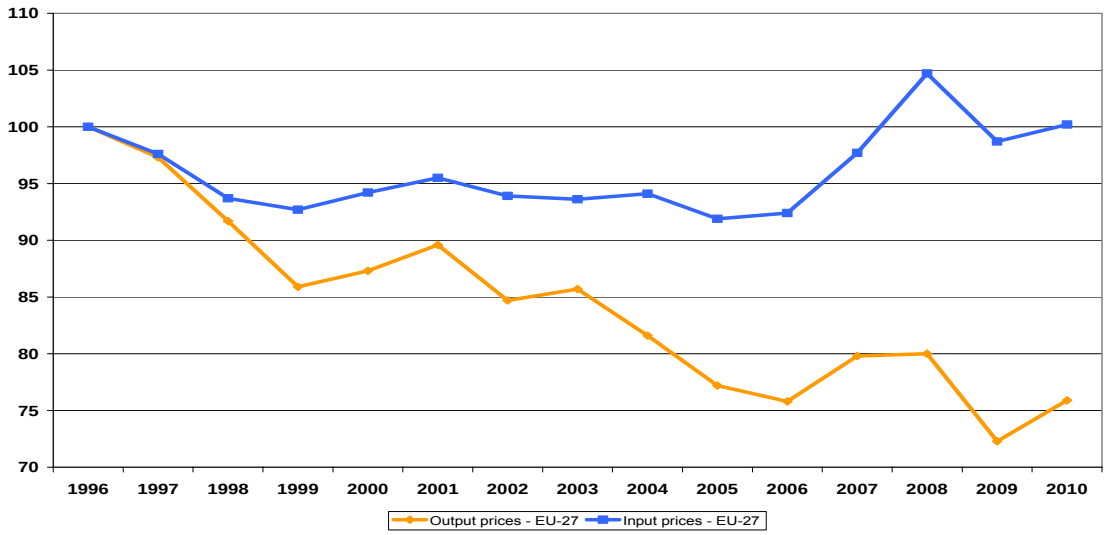


Source: World Bank

Secondly, prices for inputs used in agriculture have increased even further, resulting in the global deterioration of the terms of trade agriculture faces today worldwide. In recent years in particular, this has become more pronounced. During the 2004-2010 period, the average level of world agricultural prices increased by 50% from its corresponding level in 1986-2003; by comparison, energy prices jumped by 220% and fertiliser prices by 150%. EU agriculture was no exception, as Figure 5 indicates. While EU agricultural output prices are almost a quarter below their levels of fifteen years ago in real terms, input prices have climbed back to where they were in 1996.

volatility …what lies behind the roller coaster ride?", Agricultural Markets Brief, DG AGRI, June 2011, http://ec.europa.eu/agriculture/analysis/tradepol/commodityprices/market-briefs/01_en.pdf

Figure 5: EU-27 developments in agricultural input and output prices in real terms (1996=100)



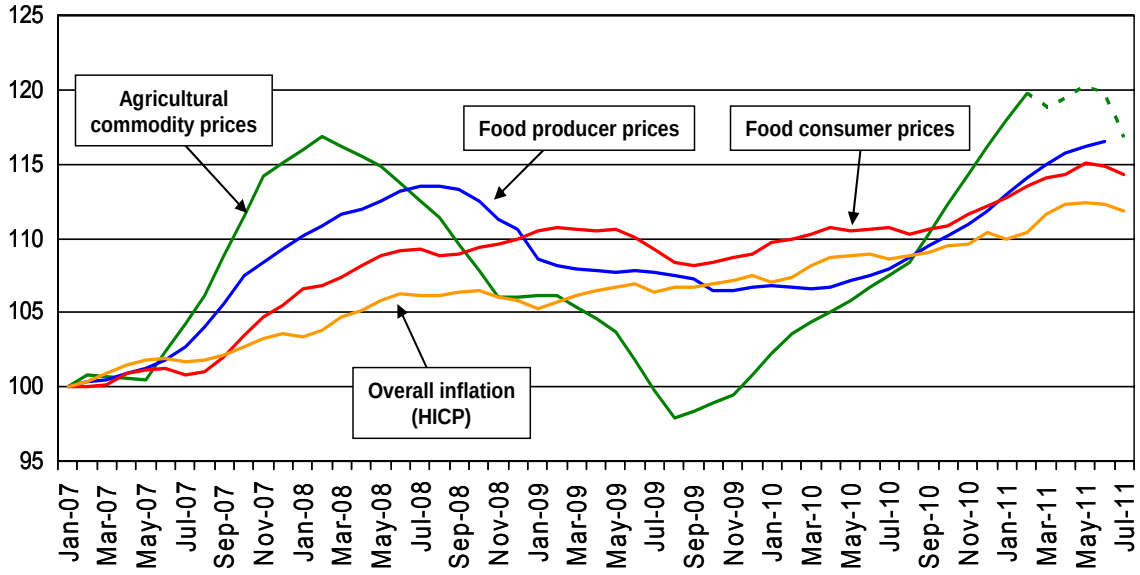
Source: Eurostat

Thirdly, as a result of the combined effects of these two developments, this 'margin squeeze' for producers has had an impact on the added value of the EU agricultural sector which fell by 13% in real terms since 2000 (and by 30% since the mid-90s).[19] And while higher prices were expected to provide a clear market signal to the sector, the slowdown in factor productivity growth (land, energy, fertiliser, labour), the uneven and asymmetric transmission of price changes in the food supply chain (Figure 6) and the declining share of agriculture in the value added of the chain put additional pressure on farm profitability in the EU, implying that substantial investment in more productive methods is required to survive on the market.[20]

[19] For a detailed description of the recent trends and projections of agricultural income see Annex 1.

[20] The situation differs by product. Individual developments can be traced using the European Food Prices Monitoring Tool created by Eurostat. http://epp.eurostat.ec.europa.eu/portal/page/portal/hicp/methodology/prices_data_for_market_monitoring

Figure 6: Price developments in the EU food supply chain, 2007-2011



Source: Eurostat

Moreover, today farmers experience increased exposure to income risks due to factors that are mainly external to the farm sector, such as increased price volatility, trade liberalisation, and climate change.[21]

About 20% EU farms show a drop in farm income by over 30% each year, compared to their average income of the previous three years. While EU farm income per person in real terms has been increasing by 1.5% per year on average between 2000 and 2010, this hides large differences between the evolution in EU-15, where it stagnated at 2000 level and in the EU-12, where it doubled since 2000.

Income disparity in absolute terms between EU farms is still very large.[22] Even if the average agricultural income per worker is estimated to have increased by 12% in 2010, this increase followed two years of sharp decline so that the recovery of 2010 has not been sufficient to bring it back to the 2007 level.[23]

The income per worker in the agricultural sector is significantly below the income in the rest of the economy. For the period 2008-2010, the average agricultural income in the

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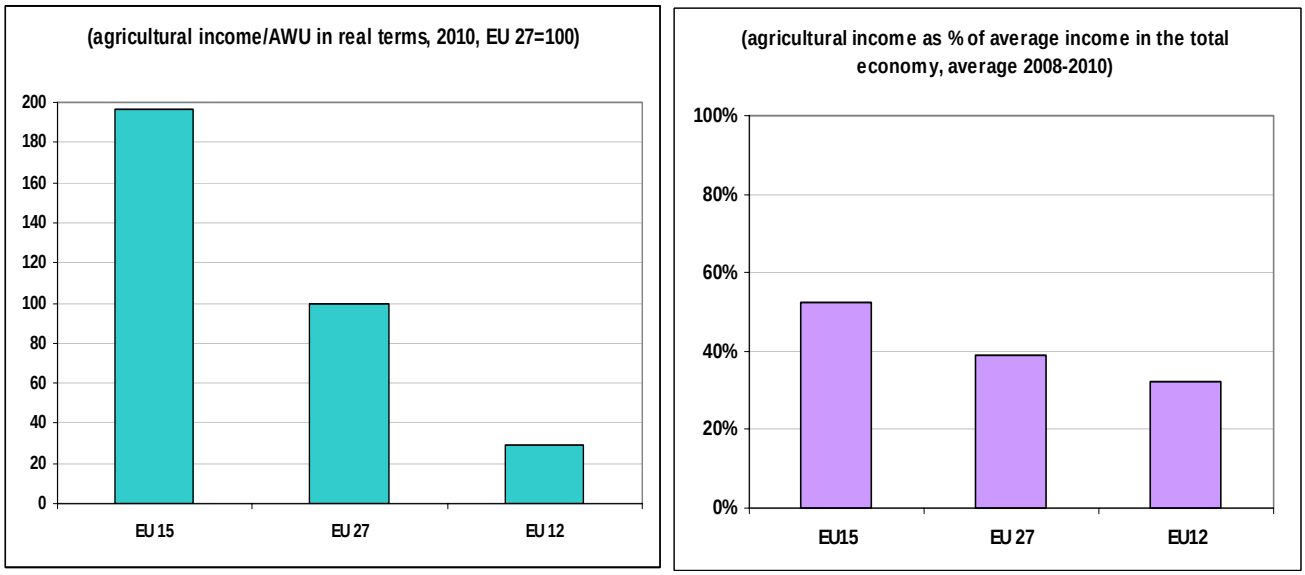
[21] Key climatic concerns to agriculture and food production include carbon dioxide concentration and temperature changes, climate variability and climate-related hazards, precipitation patterns and water resources, incidence of pests and diseases and impacts on soils (see "Adapting to climate change: the challenge for European agriculture and rural areas" SEC(2009) 417).

[22] In 2007 the average annual income per worker in the EU15 was around 26 000 EUR (for comparison value added per occupied person in Small and Medium Enterprise (SMEs) is 39 000 EUR), with about 10% of farms above 53 000 EUR, and over 50% below 17 500 EUR. In the EU10 average annual income was around 7 900 EUR, while over 50% of the farms were below 4 000 EUR. In the EU2, half the farms had an annual income below € 1 300 per worker.

[23] A more detailed analysis of income is provided in the report "Developments in the income situation of the EU agricultural sector", DG AGRI, December 2010.
http://ec.europa.eu/agriculture/rica/pdf/hc0301_income.pdf

EU-27 was slightly less than 40% of the average wage in the total economy.[24] In the EU-15 the income gap has widened over time. It decreased from 70% in the year 2000 to 53% during the 2008-2010 period. In the EU-12 the gap is even more pronounced but has declined over time. The ratio increased from less than 20% in 2000 to more than 30% over the 2008-2010 period.

Figure 7: Relative situation of agricultural income in the EU, 2008-2010



Source: European Commission - DG Agriculture and Rural Development, based on Eurostat data

Farmers' capacity to respond to competitive pressures is affected by structural issues. One aspect relates to the size of farms: out of the 13.7 million farm holdings, 47% are very small, accounting for 23% of labour force and 7% of agricultural area. At the other end of the spectrum, 11% of farms above 20 ha account for 77% of agricultural area. While the trends show a steady decrease in the number of farms and increase of farm size, the existence of small holdings will remain an important feature in the EU agriculture, especially in EU-12[25]. The other is the unbalanced demographic structure: the share of farm holders below 35 years stood at 6.1% in 2007 (6.7 in 2005), while it reached34.1% for those over 65 (33.2% in 2005).

In order to stay competitive, large farms have a better potential to mobilise resources to focus on increasing efficiency and improving marketing[26]. For the smaller farms, the fragmented structure and relatively low profitability, combined with insufficient human capital in the sector has limited the possibility of many individual farmers to optimise

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[24] The figures above reflect the agricultural entrepreneurial income/AWU as % of wages and salaries/AWU in the total economy. Note that these figures should be interpreted with care owing to conceptual differences between the measurement of farmers' income from agricultural activities and average wages in the economy, and to the lack of reliable data on full-time equivalent labour statistics for the total economy for some Member States.

[25] An analysis of characteristics that could define a small farm are discussed in: *What is a small farm*, EU Agricultural Economic Briefs, No 2, July 2011.

[26] The characteristics of large farms are presented in Eurostat publication: *Large Farms in Europe*, C. Martins, G. Tosstorff, Eurostat Statistics in Focus 18/2011.

their production and marketing decisions, as well as their degree of cooperation to strengthen their bargaining power in their relations vis-à-vis a more concentrated upstream and downstream industry. [27]

A number of factors determine the degree of cooperation, such as historical and cultural attitudes toward cooperation, farm structure (it is more difficult to encourage cooperation of small holdings), the importance of a large scale retail sector, unwillingness to jeopardize existing marketing channels, perceived benefit and the credibility with respect to payments and the purchase of production and product specific factors.

The creation of associations of producer organisations has been very limited overall because it requires a change of the business approach: producer organisations must replace the competition approach by a co-operation approach. This occurs mainly when producer organisations need to improve their competitiveness in order to comply with the requirements of large retail chains.

Policy role

There are various policy instruments which impact the economic situation of farmers. While the existing market measures provide for a safety-net in time of crises, the experience of the 2008-09 dairy crisis demonstrated not only the need to maintain an effective safety-net mechanism and to further reflect on the availability of risk management instruments, but also to streamline these tools across sectors.

Moreover, subsequent reflections of the High Level Expert Group on Milk[28] pointed to the renewed need for improvement in the functioning of the food supply chain and creating the right conditions for the farm sector to become more competitive and innovative, also through encouraging collaborative actions whilst at the same time ensuring competition in the sector.[29]

The widening gap between input and output prices reveals the important role of continuing decoupled income support, which act as a cushion against income volatility. This was also indicated in the evaluation of the effects of the direct support schemes on the income of farmers.[30]

The share of total operating subsidies in agricultural factor income (defined as receipts plus net subsidies less intermediate consumption and depreciation) has been rather stable since 2004 and amounts to around 40%, with significant variations between Member States. Direct payments amount to around 30% in EU-15 and 20% in EU-12 (Figure 8).

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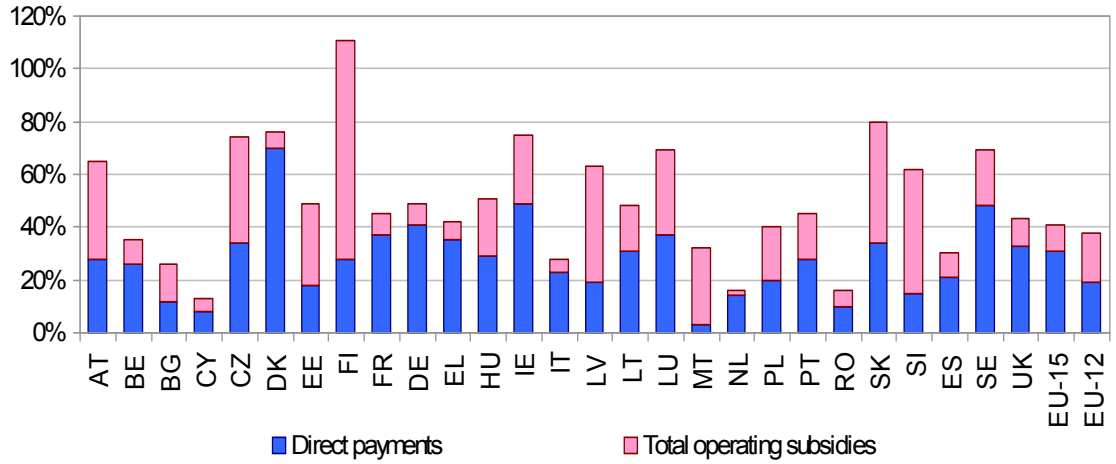
27 These issues have been explored in the Commission Communication on the better functioning of the food chain COM(2009) 591.

28 http://ec.europa.eu/agriculture/markets/milk/hlg/report_150610_en.pdf

29 With regard to broader food supply chain, the European Commission set up a High Level Forum for a Better Functioning Food Supply Chain which follows the implementation of initiatives outlined in the Communication "A better functioning food supply chain in Europe." Moreover, the additional actions are taken in the fields of resilience of food supply chain, especially with regard to animal and plant health as well as animal welfare and food safety.

30 Evaluation of income effects of direct support, AGROSYNERGIE, May 2011, http://ec.europa.eu/agriculture/eval/reports/income/index_en.htm.

Figure 8: Level of direct payments and total operating subsidies as a percentage of agricultural factor income (avg. 2007-2009)[31]



Source: DG AGRI

Future trends – status quo

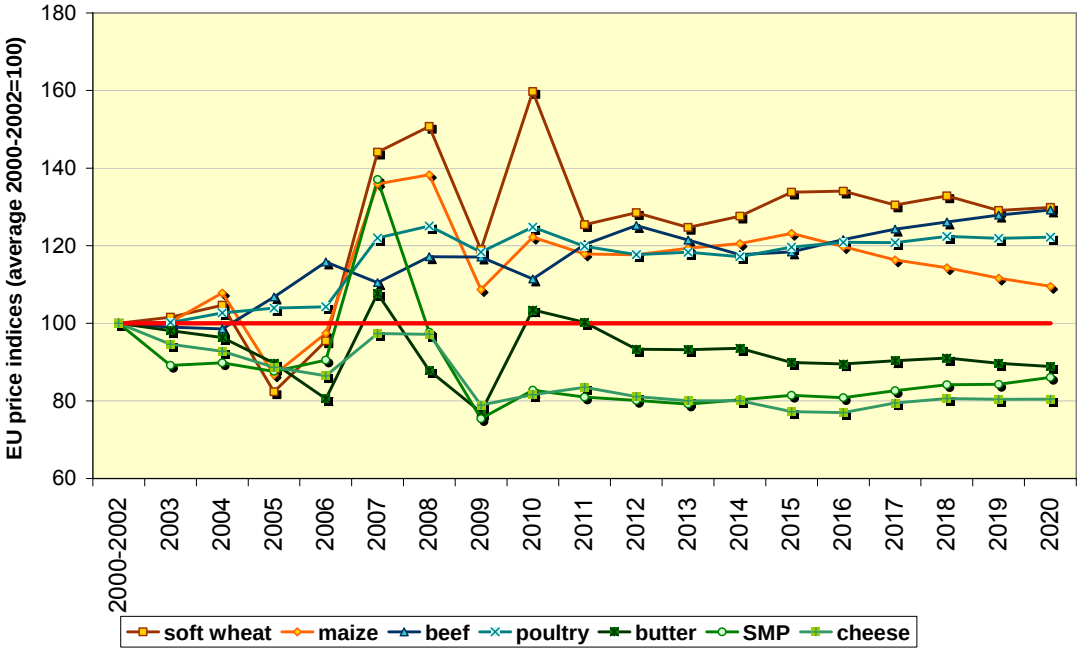
Baseline price projections for the main agricultural commodities indicate that the strong volatility observed recently on EU agricultural markets is expected to persist over the medium term due to the gradual alignment of EU and world prices as well as the growing uncertainty linked to climatic conditions, the macroeconomic situation and the increasingly close links between energy, financial markets and agricultural commodity markets.[32] In addition, although agricultural prices are set to remain high, this is partly linked to demand growth (which is projected to increase, but at lower rates than in previous decades), but also to increasing costs of production.[33]

[31] Total operating subsidies includes state aids granted by Member States.

[32] For a detailed analysis of the agricultural commodity markets projections see Annex 1.

[33] For details on market projections for different sectors and the impact of cost factors see Annex 1.

Figure 9: Medium-term projections for EU agricultural commodity prices (2000-2002=100)[34]



Source: DG AGRI

In such an environment as the one described above, there is little scope for systematic public market intervention to support income, which instead is best supported by direct payments which mitigate the effect of income volatility stemming from market developments.

Agricultural income per farmer is expected to recover from the significantly low level of 2009 with an outlook for a gradual, albeit modest growth in aggregate EU income over the coming decade that would exceed the 2005-2009 average (base) level by around 20% in 2020. Again, this overall gain would mask uneven developments for the EU-15 and EU-12: whereas agricultural income in the EU-15 would show a more moderate increase to almost 10% above the base level, income in the EU-12 is forecast to rise 45% above the base level by 2020 converging towards the EU average.

2.4. … while having to meet EU ambitions on environment and biodiversity protection, climate action and energy efficiency…

The CAP plays an important role in maintaining sustainable agriculture across the EU territory and in promoting environmentally and climate friendly practices. This is particularly important as modern farming puts many pressures on the environment and animal and plant health. For example, the recent tendency towards arable monoculture or short crop rotations increases the risk of depleting soil fertility, releasing greenhouse gases from lost soil carbon, and increasing inputs of fertilisers and plant protection products, which can pollute water and harm biodiversity; uncovered soils on arable and

[34] Note that the medium-term developments in dairy price are strongly influenced by the drop in support price at the beginning of the period.

permanent crop farms can lead to soil erosion, and the pollution of water by nitrates, phosphorus and pesticides. The removal of farmland features such as hedges, trees and ponds reduces the habitats available for wildlife on farmland, so threatening biodiversity on and beyond the farm.

The ploughing up of grasslands, in particular, has a major impact on climate change (soil carbon), as well as leading to the loss of grassland habitats, and other ecosystem functions of grassland such as flood prevention. These, in turn, risk further damaging the long term perspectives of farming, reliant as it is on soil, water, pollination for its survival.

By contrast, certain farming systems and practices are particularly favourable for the environment and climate objectives as well as public health[35]. These include extensive livestock and mixed systems, traditional permanent crop systems or organic farming. 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. At the same time, new approaches to agricultural management are gaining ground: organic farming and the use of integrated crop management techniques (including integrated pest management) are developing in many pesticide-intensive farming systems. Much of EU farming provides culturally valued landscapes.

Biodiversity

The EU biodiversity strategy to 2020 requires further integration of biodiversity in key sectors such as agriculture and forestry in order to meet the ambitious EU headline target[36]. For agriculture the strategy includes the following target: maximising areas under agriculture across grasslands, arable land and permanent crops that are covered by biodiversity-related measures under the CAP. The aim is to ensure the conservation of biodiversity and to bring about a measurable improvement in the conservation status of species and habitats that depend on or are affected by agriculture and to provide ecosystem services as compared to the EU 2010 Baseline, thus contributing to enhance sustainable management.

Climate and energy

The Europe 2020 Strategy establishes the reduction of greenhouse gases as one of the EU's five headline targets.[37] In terms of reduction of greenhouse gases, non-CO2 emissions from agriculture fell by some 20% in the period 1990-2005, thus

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35 In addition, forest ecosystems provide wood and a wide range of non-wood products, regulate watersheds, purify air and drinking water, protect against soil erosion and support soil fertility.

36 Our life insurance, our natural capital: an EU biodiversity strategy to 2020, COM(2011)244 final.

37 In the Climate and Energy Package of 2008, the EU committed unilaterally to reduce its overall greenhouse gas emissions (GHG) by 20% below 1990 levels by 2020, and by 30% if other parties to the United Nations Framework Convention on Climate Change would commit to comparable efforts. 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 (including agriculture) under the Effort Sharing Decision (ESD) to reduce emissions by 10% below 2005 levels.

outperforming other economic sectors with regard to their contribution to the reduction in GHG emissions.[38]

Being dependent on natural resources and favourable climatic conditions in order to function, the EU agricultural sector would largely benefit from a stabilised climate. Additionally, agriculture is both an emitter and a sink of greenhouse gases and further effort is required to not only mitigate but to adapt to climate change also.

With on average 100 and 150 tonnes of carbon per hectare on arable and grass land respectively in the EU in 1990[39], agricultural soils contain a large stock of terrestrial carbon in the form of soil organic matter.[40] Agricultural practices can have a positive or a negative effect in terms of soil organic matter levels. The drainage of peatlands and their conversion to arable land, grassland or forestry gives rise to large losses of carbon.

In the Climate and Energy Package, the EU also committed to increase renewable energy uses in order to reach a 20% share in total EU final energy consumption in 2020. This will contribute to reducing GHG emissions as well as increasing the security of supply. This commitment is implemented through the Renewable Energy Directive[41]. Agriculture can play a very important role but priorities must be set and trade off addressed. On the one hand, agriculture can provide biofuels that can substitute fossil fuels helping both energy security and GHG mitigation. However this production must take care of avoiding undue land competition.

This is one of the purposes of the sustainable criteria, established by the Renewable Energy Directive, to be respected when producing biofuels. On the other hand, agriculture can provide solid and gaseous biomass for energy in heating, cooling and electricity. Together with biomass from forestry and organic waste, agricultural biomass currently contributes around 7% of final energy consumption in the EU-27 in the three energy sectors (transport, heating and electricity).

According to the National Renewable Energy Action Plans (NREAPs)[42], submitted in 2010 by Member States to the European Commission under the Renewable Energy Directive, biomass would contribute to more than 10% of EU final energy consumption by 2020 and the contribution of EU domestic biomass from the agricultural sector is

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[38] More information about the challenges of climate change adaptation and mitigation for agriculture can be found in the Commission reports "Adapting to climate change: the challenge for European agriculture and rural areas" SEC(2009) 417 and "The role of European agriculture in climate change mitigation" SEC(2009) 1093 final.

[39] To a depth of 30 cm. Elaboration on the basis of data from the European Soil Database of the Joint Research Centre (EU-27, except Cyprus; the average for grassland doesn't include Finland and Sweden as well).

[40] Soil organic matter is a major contributor to soil fertility, as it binds nutrients to the soil; it is the home for soil organisms; and it also maintains soil structure.

[41] Directive 2009/28/EC on the promotion of the use of energy from renewable sources

[42] http://ec.europa.eu/energy/renewables/transparency_platform/action_plan_en.htm.

expected to significantly increase.[43] Also, the agricultural sector is an important actor in developing other renewable energy sources on farms (wind energy, solar energy).

In the longer term, the impact assessment of the EU low carbon economy roadmap identifies agriculture as an important supplier of bioenergy, increasing its contribution to 85 and 183 Mt oil equivalent by 2030 and 2050 respectively (compared to estimated 22 Mtoe in 2005) thereby overtaking forestry as the current main source.[44] Biomass from agriculture for bio-based products also plays an important role in gradually substituting fossil hydrocarbons as a feedstock. The EU is currently developing its Strategy towards a sustainable bioeconomy by 2020 which will be accompanied by an action plan where agriculture will play a prominent role.

Policy role

The environmental sustainability of farming is related to farmers' decisions regarding whether, what and how to produce, while market prices do not reflect the externalities linked to agricultural production and in many cases the supply of environmental public goods is insufficient. The main drivers affecting the environmental sustainability of agriculture relate to intensification of production in some areas with abandonment and under management of land in others, as well as changing land use patterns and agricultural and forestry practices.

The CAP, notably through its rural development policy, is the major provider of EU financial support for land management measures to protect and benefit the environment, reflecting the fact that farmers and forest managers are the main managers of land. Of the current EU contribution to rural development funds (which is doubled by Member States' match funding, state aids, farmers' and other private contributions) about one half goes to measures which protect or enhance the environment.

Although direct payments support both basic income and provision of public goods, through cross-compliance, their current amount and distribution is based on historic production criteria. As a result they are concentrated in the most productive regions (to a lesser extent in the regional model) without being explicitly adjusted to environmental objectives beyond the link to basic standards under cross compliance. The level of aid is also generally lower in natural handicap areas (NHA), while income needs and the provision of public goods in these areas are important.

The link of direct payments to cross compliance (together with farm advisory services) has increased the awareness of farmers of existing environmental standards and of good environmental and agricultural practices, but there is still an information gap which needs to be addressed.

Rural development agri-environment measures (AEMs) support the provision of a wide range of environmental public goods and services going beyond legal obligations - from the preservation of biodiversity and landscapes to care for water and soil, mitigation and

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[43] According to article 2 of the Renewable Energy Directive, biomass means the biodegradable fraction of products, waste and residues from biological origin from agriculture (including vegetal and animal substances), forestry and related industries including fisheries and aquaculture, as well as the biodegradable fraction of industrial and municipal waste.

[44] SEC(2011) 288 final.

adaptation to climate change and the conservation of genetic resources. These measures often address a number of environmental and climate objectives simultaneously. For example, improvements in the use of chemical inputs can have a positive impact on water quality while also preserving biodiversity and helping farmers to mitigate climate change and adapt to it.

Agri-environmental measures overall have unquestionably delivered strong environmental benefits over an area which covers approximately 25 % of the utilised agricultural area in the EU[45]. However, in limited cases the commitments proposed were only marginally above the baseline of legal obligations, or demanding commitments were not matched by an appropriate payment rate (discouraging take-up). Finally, linking more complex agri-environment measures to support for relevant training for farmers and land managers was at times found to be difficult.

Future trends – status quo

Despite the progress that has been made in integrating environmental concerns into the CAP and in introducing environmental legislation at farm level, 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.

The assessment of the conservation status of Europe's most vulnerable habitat types and species protected under the Habitats Directive shows that nearly 65 % of all habitat assessments are unfavourable, and generally habitat types associated with agriculture have an inferior conservation status than other types.

Longer term projections on climate change show that emissions in agriculture are predicted not to decrease at the same rate as the other sectors unless further action is taken. The modelling assessment made in the EU low carbon economy roadmap, based on the current CAP, concluded that the EU agricultural sector could decrease its GHG emissions by between 36 and 37% by 2030 and 42 and 49% by 2050 depending on the decarbonisation scenarios used.[46]

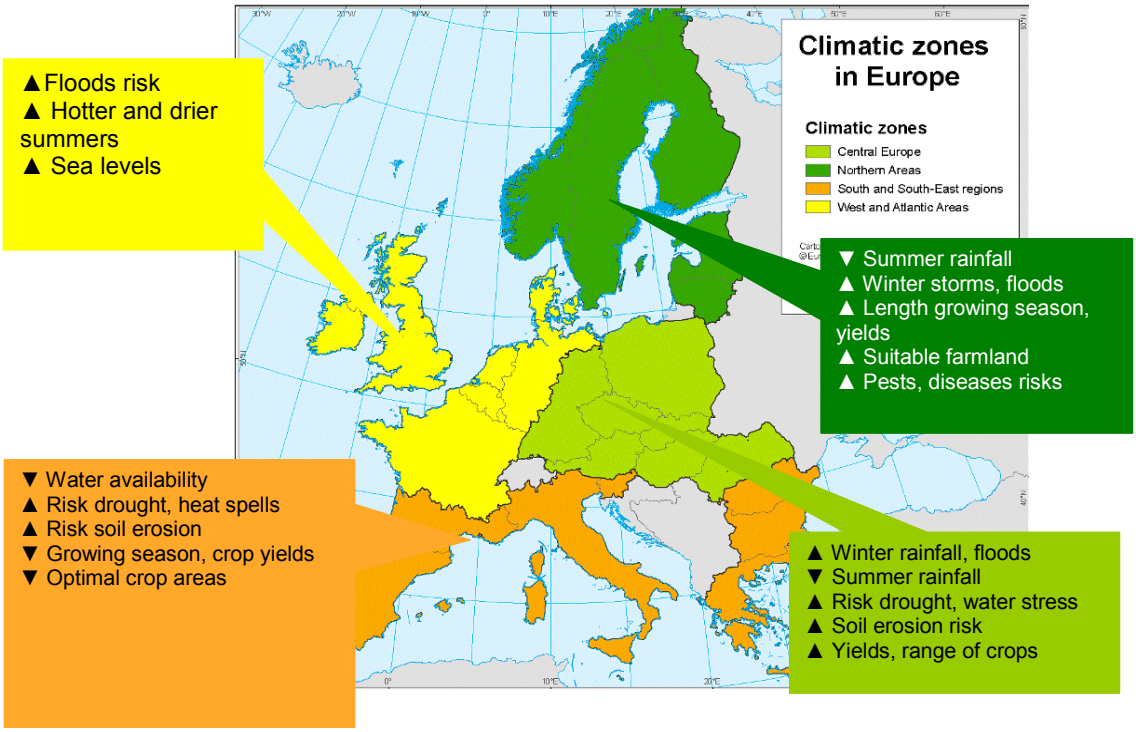
Mitigation will play a role in preventing these extreme events from being as severe as often projected. However adaptation must be managed in a strongly coordinated fashion in order to allow farmers and foresters to be prepared and equipped with the knowledge and infrastructure necessary to develop resilient agricultural systems.

Figure 10 clearly outlines the future climate change challenges that may be faced by different regions across Europe.

[45] An assessment of agri-environment payments is made in Annex 4.

[46] A Roadmap for moving to a competitive low carbon economy in 2050, COM(2011) 112 final.

Figure 10: Climate change – Possible impacts on EU agriculture



Source: DG Agriculture and Rural Development, based on EEA reports, JRC and academic studies

2.5. … and to contribute to inclusive growth in rural areas

There are large disparities between rural areas themselves, with the picture becoming increasingly diverse with the successive enlargements. In some cases this depends on their proximity to urban areas: from peri-urban areas, which are well integrated in the metropolitan systems to remote rural areas, which suffer from poor access to services of general interest and population decline. In the EU-27, 54% of the territory is classified as predominantly rural (NUTS3)[47] areas and represent 19% of the EU population. The income per inhabitant in these regions represents only 68% of the EU-27 average, whereas in intermediate and predominantly urban regions it reached 84% and 126% respectively of the EU-27 average.

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

[47] NUTS (Nomenclature of territorial units for statistics) is a geographical nomenclature subdividing the territory of the European Union (EU) into regions at three different levels (NUTS 1, 2 and 3, respectively, moving from larger to smaller territorial units).

links with the rest of the rural economy[48]. Moreover, remote rural areas have the most limited access to general services, such as schools, primary health care and banking.[49]

The important role of small and medium towns as centres of key services and social life for the surrounding rural communities and as provider of territorial cohesion has to be recognised. These towns also provide access to a large number of mobile consumers which represent an opportunity for small-scale producers of "niche" and high quality agri-food products (developing short and local supply chains); in the most accessible areas, this process creates positive migration trends (counter-urbanisation).

However, many rural areas are now driven by urban economies as in-migration has occurred around metropolitan centres, and most economic activity in rural areas depends on the service sector. The average annual increases of both employment and added value in the non-agricultural sector for all regions stood at around 1.3% and 2.5% per year respectively between 2002 and 2007: as a result, in 2007, 85% of employment and 95% of value added in predominantly rural areas of the EU-27 came from the non-agricultural sectors.

A stronger linkage between urban and rural areas, especially peri-urban rural areas, is leading to interesting counter-urbanisation developments and new forms of rural growth. At the same time urban sprawl is expanding, generating strong pressure on peri-urban natural resources. The increasing value placed by society upon rural environment and heritage creates important diversification opportunities in areas with a high level of recreational amenities attracting urban populations.

The key sectors in terms of potential growth for rural areas include tourism (nearly three quarters of bed places in the EU-27 are located in rural areas) and the renewable energy sector (in 2005 it generated gross value added of over 9 billion € in the primary sector and sustained 210,000 jobs)[50].

Policy role

In the rural development policy, there is a comprehensive toolkit of measures to assist with the sustainable development of rural areas throughout the EU; lessons learned from the current period have however shown the need to make adjustments in some cases. For example, business creation and diversification measures are particularly important in areas where there is a high share of part-time farmers or where significant restructuring of the agricultural sector is still under way. However, the limitation of the measure to micro-enterprises has been criticised and it is judged that supporting small enterprises would also lead to considerable benefits.

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48 For more information see ENRD Thematic Working Group 2: Linkages between Agriculture and the wider rural economy, Final report, December 2010, http://enrd.ec.europa.eu/thematic-initiatives/twg2/en/twg2_home_en.cfm.

49 Investing in Europe's future, Fifth report on economic, social and territorial cohesion, European Commission, November 2010

50 http://ec.europa.eu/energy/renewables/studies/doc/renewables/2009_employ_res_report.pdf.

Leader has successfully brought local actors together and allowed for the development of local governance capacities. However, its mainstreaming in the current period has in some cases meant that the specificities of this innovative bottom-up approach were compromised, due to the narrowing of the scope to pre-defined measures and to the lack of clear distinction of roles between managing authorities, paying agencies and LAGs.[51] In response to feedback from various sources – including Special Report No. 5/2010 from the European Court of Auditors - the Commission assured its more flexible implementation.

In terms of coherence with other EU policies and source of funding, Member States have generally been successful in setting demarcation lines and ensuring coordination between rural development and other policies. On the other hand, less attention was paid to moving beyond simple demarcation to a better complementarity between policies – i.e. there were less initiatives to find synergies between policies and avoid funding gaps. [52]

Future trends – status quo

A recent study on employment and growth in rural areas identified the following important drivers for rural economies: natural resources and environmental quality, the sectoral structure of the economy, quality of life and cultural capital, infrastructure and accessibility.[53] The analysis also identified the following key barriers to growth: demographic developments, infrastructure and accessibility and the sectoral nature of the economy.

2.6. Implementation issues across Member States

The reform of the CAP allows addressing a series of issues related to the implementation of Pillar I and Pillar II instruments and the process of removing administrative burden.

The distribution of direct payments

The efficiency of direct payments is rather high at macro level, yet very uneven at farm level.[54] Thus the main challenge stemming from the evaluation of Pillar I is the need to redistribute support in a more effective and equitable manner, both among and within Member States.

This finding is also present in the European Court of Auditors Special report published in 2011, which found that the introduction of the decoupled payment scheme positively contributed to the objectives of the CAP, notably by encouraging farmers to respond

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[51] See also Ex-post evaluation of Leader+ (2010) and the work of the ENRD focus group 1 on 'Implementation of the bottom-up approach of Leader'.

[52] Report on Policy Delivery Systems and their relations with types of governance models, F. Mantino, M. Bolli, P. Fagiani, S. Tarangioli, RUDI - Assessing the impact of rural development policies, http://www.rudi-europe.net/uploads/media/RuDI_WP3_D_3_3.pdf

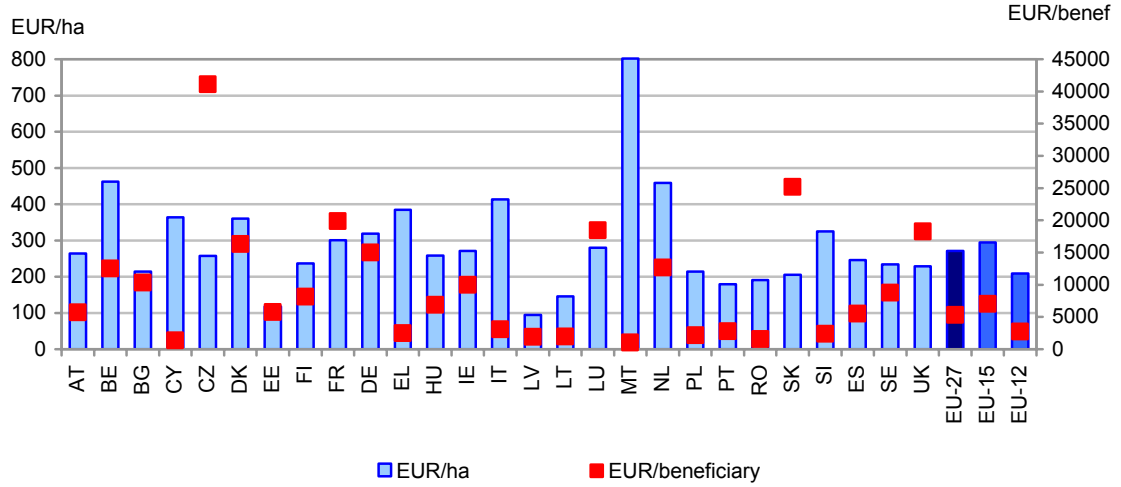
[53] See *Study on employment, growth and innovation in rural areas (SEGIRA*), and the report of the thematic group on rural development and territorial cohesion.

[54] Evaluation of income effects of direct support, AGROSYNERGIE, May 2011, http://ec.europa.eu/agriculture/eval/reports/income/index_en.htm

better to market demand and by supporting the income of the agricultural sector as a whole, but better targeting is needed.[55]

This criticism is not new. The current distribution of direct payments is based on historic parameters that reflect the production and support of farms in a reference period, which in most cases is already a decade old. The flexibility left to Member States in their choice of direct payment model (historic, regional, hybrid) led to large variations in the level of aid per hectare received by farmers, depending on the region they are located in. The same distribution has a different impact owing to the economic situation of Member States (see Figure 11 below).

Figure 11: Average payments per beneficiary and per hectare[56]



Source: DG AGRI

While the volume of support reflects, at least partly, objective criteria, it does not reflect the fact that farm structures and production patterns have changed since the reference periods. Furthermore, the large number of small beneficiaries (i.e. farms with small size) adds considerably to the administrative burden and require support that is better targeted to their needs.[57]

The historical basis helped the introduction and acceptance of decoupling from 2005, not just in political terms but also in economic terms by limiting the potential impact of significant changes in the level of support on land, and thus asset values.

However, this reference to past production is difficult to justify with the new policy targeting priorities. In the case of EU-12 the level of direct payments was established on the basis of production in a pre-accession period which was strongly influenced by national policies and budget considerations. After the enlargement structural changes in

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[55] European Court of Auditors, Special Report No 5/2011: "Single payment scheme (SPS): issues to be addressed to improve its sound financial management"

[56] This figure is based on the national envelopes of Member States after full phasing-in of direct payments in the EU-12 and the number of potentially eligible hectares in IACS for 2008.

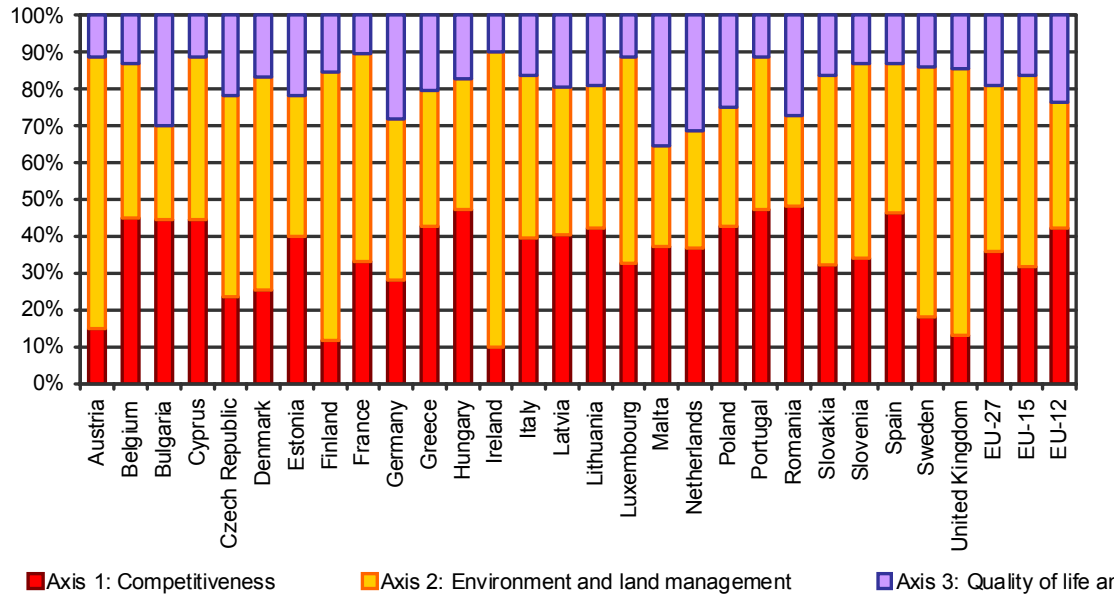
[57] The CAP impact on small farms is one of the issues discussed in the FP6 Research project Structural Change in Agriculture and Rural Livelihoods (SCARLED) www.scarled.eu

agriculture and the trend toward gradual alignment of the cost of production among Member States makes it difficult to justify continuation of this historical distribution in the future.

Management of rural development policy
Member States draw and co-finance rural development programs by drawing from a common toolkit of measures to address their particular needs as identified on the basis of a SWOT analysis. The measures of rural development policy are divided up according to "axes". There is one axis for each of the three objectives of the policy: improving the competitiveness of agriculture and forestry, improving the environment and the countryside and promoting economic diversification and quality of life in rural areas (a cross-cutting axis 4 is related to the Leader approach).

A given measure is assumed to contribute to the objective attached to the axis to which it "belongs" – and only to this objective. Within its Rural Development Program, a Member State or region must spend a minimum proportion of its EU rural development funding on each axis, for the sake of balance between objectives (see Figure 12).

Figure 12: Relative importance of the three axes by Member State (2007-2013 period)



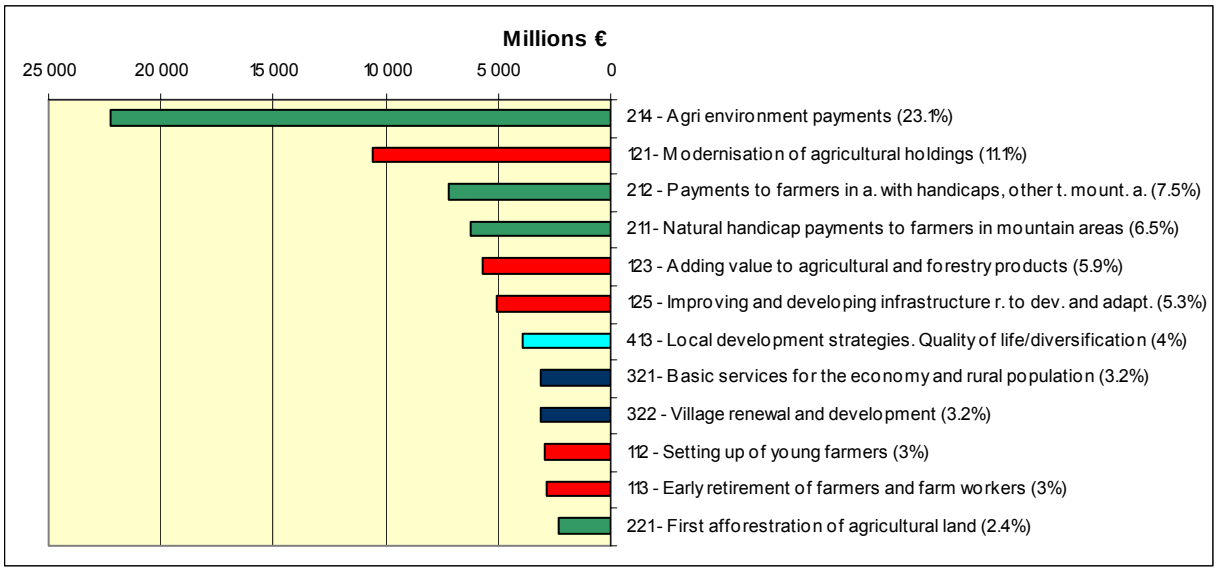
Source: DG AGRI

The axis system provides only a crude guarantee for the allocation of resources to objectives, which relies on a simplified intervention rationale and may thus at times mislead since a single measure often serves more than one objective. In addition, the ring fencing introduced in the Health Check of the CAP to match the additional funds made available with the new priorities has considerably increased the administrative burden of the system.

That being said, the current approach of strategic targeting marks a considerable advance from the previous period (2000-2006) – in which Member States or regions simply selected whichever measures they wished from the preset menu and allocated funding with little formal justification. The challenge now is how to ensure the best fit with the

EU priorities, notably the Europe 2020 strategy for smart, sustainable and inclusive growth.

Figure 13: Main rural development measures in the EU-27 (2007-2013 period)



Source: DG AGRI

Simplification

Since its introduction the CAP has established a comprehensive political and legal framework for European agriculture which requires a significant level of management. Reducing red tape in the farm sector by making rules more transparent, easier to understand and less burdensome is thus of great importance to reduce costs for businesses and ensure that European citizens receive value for money.

In 2009 it was assessed that for the agricultural sector the level of administrative burden for farmers and companies concerned had been reduced by 36%, so well above the target of 25% by 2012 established after the 2007 Action Programme to eliminate unnecessary administrative burdens on businesses in the EU[58].

The "rolling" Simplification Action Plan includes initiatives that will lead to further simplification. It is regularly updated with inputs from expert groups and Member States. The challenge for the future CAP is to keep the tools of the reformed CAP as simple as possible while fulfilling all its assigned objectives in the most efficient way. In this context and as a follow up to the Communication on the CAP towards 2020, a simplification conference has been organised with authorities and farmer representatives to discuss the administrative burden concerns.[59]

[58] Communication COM (2009) 544 of 22 October 2009, Actions programme for reducing administrative burdens in the EU. Sectoral reduction plans and 2009 actions.

[59] The results of the conference are summarised in Annex 8. Simplification of the CAP pp.34-57

2.7. The global dimension

Food security is one of the major challenges of the future given the current outlook of increasing global demand faced with considerable uncertainties of supply linked to unpredictable economic and political, but also climatic and biological (e.g. new crop and animal diseases) developments. The first G20 Agriculture Ministers' meeting on 22-23 June 2011 in Paris confirmed the need to bring agriculture, food security and nutrition higher up the international agenda, focusing attention on market information and transparency, international policy coordination, agricultural production, research and risk management.[60]

A strong EU agricultural sector is vital for the highly competitive European food industry to remain an important supplier of high quality and safe agricultural and food products and to contribute to global food security, alongside the efforts to support a sustainable agricultural sector and industry in developing countries. The CAP should promote and support a sustainable agricultural sector participating in the efforts to assure food security in line with overall EU priorities.[61]

The EU is a major trading block and holds a significant weight in international agriculture and food trade. With average annual imports of €83 billion in 2008-2010, the EU is by far the largest importer, although its share in world imports has decreased from 21% in 2007 to 19% in 2009. Exports have reached an annual average of about €82 billion in 2008-2010, placing the EU at a par with the USA with a share of around 18% of world exports.[62] EU agri-food trade has experienced a sustained growth in the last ten years, with the exception of the contraction recorded in 2009 due to the economic recession. In 2010 the value of EU exports reached €91 billion (increasing by 21% compared to 2009) while imports grew by 9% reaching €84 billion, resulting in a positive trade balance for the first time since 2006 (the only other time in the last decade with a trade surplus).

The positive EU trade performance in the last decade took place while respecting the WTO disciplines introduced by the Uruguay Agreement on Agriculture in terms of domestic support, export subsidies and market access. The EU often went further with its reduction commitments as a result of CAP reforms and trade policy changes:

- Domestic support: past CAP reforms have moved support away from price support towards decoupled income support. Today more than 90% of direct payments are decoupled and qualify for WTO green box (with no or limited trade distorting effects).

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60 Action Plan On Food Price Volatility And Agriculture, Meeting of G20 Agriculture Ministers, Paris, 22 and 23 June 2011, http://agriculture.gouv.fr/IMG/pdf/2011-06-23_-_Action_Plan_-_VFinale.pdf

61 These are stated in the EU Food Security Policy Framework in 2010, adopted by the Commission and complemented by Council Conclusions.

http://ec.europa.eu/development/icenter/repository/COMM_PDF_COM_2010_0127_EN.PDF
http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/EN/foraff/114357.pdf

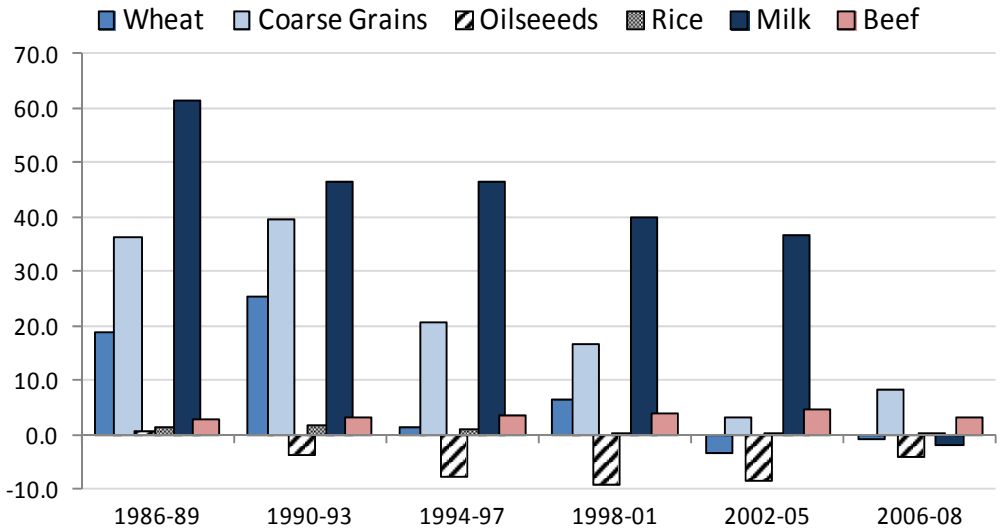
62 *Global and EU agricultural exports rebound,* MAP Newsletter, May 2011, http://ec.europa.eu/agriculture/publi/map/brief3.pdf

- Export refunds: as a result of domestic reform towards more market orientation the use of export refunds has been strongly declining. In 2010, expenditure for export refunds for agricultural products from the European Union was 166 million EUR as compared to 5.6 billion EUR in 2000. This level is well below 1% of CAP expenditure.

- Market access: the EU has been pursuing increased market access especially for least developing countries, and thanks to the Everything But Arms and European Partnership Agreements the EU is by far the largest importer of agricultural products from developing countries: the EU alone imports more from developing countries than the following top 5 importers (US, Japan, Canada, Australia and New Zealand all together).

The role of CAP reforms in diminishing substantially its distortive impact on international markets has been acknowledged by the OECD. Figure 14 below gives an OECD estimate of additional exports which can be attributed to policies in place at the time (cf. Annex (12)).[63]

Figure 14: CAP impacts on EU exports, 1986-2008 (million tonnes)



Source: OECD PEM model

The EU continues 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.

On the other hand, the ongoing trade liberalisation process is expected to exert additional pressure on the economic perspectives of the European farm sector and on agricultural employment. Analysis of the implementation of a possible DDA Agreement under the

[63] Evaluation of Agricultural Policy Reforms in the European Union, OECD, TAD/CA/APM/WP(2010)26/FINAL

WTO[64] indicates that this could lead to a considerable increase in projected EU imports for many products compared to the baseline at the horizon 2020.[65]

EU producer prices could drop for most of the products, with the volume of production expected to fall accordingly. The sharpest price fall (more than 10%) is expected for sugar and beef. Price drops could in most cases trigger an increase in consumption, somewhat mitigating the fall in domestic production. As a whole, the DDA could generate a drop of about 8% in agricultural income in 2020 compared to the baseline.

Average effects mask more pronounced potential impacts at the level of single Member States and regions, especially those specialised in livestock production. Pressure on the extensive livestock sector would have a negative effect on biodiversity in these areas, much of which is a by-product of traditional farming systems there. Additional challenges for EU agriculture stem from further trade liberalisation achieved under bilateral agreements between the EU and various third countries.

In this respect, the possible Free Trade Agreement with the Mercosur could also generate the most significant impacts for EU agriculture potentially leading to a decline in EU farm income and agricultural employment. The precise magnitude would depend on the extent of the liberalisation agreed under the trade deal. As in the case of the DDA, average effects are likely to be unevenly distributed by agricultural sector and at national/regional level. Again, the EU meat sector (in particular beef) is expected to bear the highest losses, as well as Member States and regions dependent on this production.

2.8. EU value added

The basis for the Common Agricultural Policy is formulated in the Treaty on the Functioning of the European Union, where article 38 stipulates that "The Union shall define and implement a common agriculture and fisheries policy" with objectives set out in article 39 and detailed provisions in articles 40-44. 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.

The added value of the CAP is in its ability to[66]:

– respond effectively to transnational goals and cross-border challenges such as mitigating climate change, enhancing biodiversity (agri-environmental measures) and contributing to economic and social cohesion (direct payments), ensuring food safety, increasing consumer confidence and welfare, the development of the Single Market

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[64] Along the broad lines of the Draft Modalities for Agriculture laid down in the Falconer paper rev. 4 of December 2008

[65] The effect of a possible DDA agreement was analysed using the AGLINK-COSIMO model, as compared to the baseline prospects for agricultural markets by 2020 (of December 2010). In this simulation exercise, DDA provisions were implemented for the EU only. Thus, the positive impacts for the EU stemming from the new market access opportunities on third countries' markets are not taken into account.

[66] Examples of EU value added of particular CAP instruments are provided in the Commission Staff Working Paper "The added value of the EU budget" SEC(2011) 867 final (29.6.2011)

and the EU trade policy (common market measures), through a common set of rules, principles and objectives;

– ensure a more efficient use of the budgetary resources of the Member States vis-à-vis the coexistence of national policies (e.g. compared to a single common policy, 27 different policies would have been more costly and certainly less effective inducing different levels of intervention, a major risk for distortion of competition) also by fostering farmers' compliance and Member States enforcement of EU rules;

– help to develop a competitive and balanced European agriculture from an environmental and territorial point of view, which would contribute positively to the competitiveness of the EU food supply chain and trade, and enhance the cohesion of rural areas by encouraging initiatives favouring their economic and social growth.

The added value of the CAP comes partly from the fact that it provides one common legal reference and policy framework. This places a vast reserve of experience and tested policy approaches at the disposal of all Member States and regions. It also helps to ensure that, to a large extent, Member States follow common aims with regard to farming and rural areas, instead of implementing separate national policies which could compete with and partially nullify each other. This also allows for a stronger and more consistent trade policy vis-à-vis our global trading partners, most notably by enhancing its bargaining power. Moreover, an EU approach allows the application of common rules in the single market and therefore provides fair conditions and a level playing field for all Member States.

The added value of the CAP also lies in financial solidarity. A common policy provides the funding necessary to implement valuable policy measures across the EU. If Member States were thrown back on their own financial resources, many of them would not be in a position to help their farm sectors and rural economies along the path of sustainable development. The major role rural development funds play in protecting and enhancing the environment would be particularly under threat. This problem would have been especially acute after EU enlargement, and there would have been a significant danger of rapid and poorly managed restructuring (e.g. with a rural exodus and serious damage to the environment).

At the same time, for the policy to be effective a certain degree of flexibility is necessary in its implementation to allow Member States to adjust the policy to local needs. Direct payments already provide certain parameters of the Single Payment Scheme and the Good Agricultural and Environmental Conditions that reflect such flexibility.

Rural development policy is based on national strategies and programmes drawing on analyses of strengths, weaknesses, opportunities and threats. Within these programmes, appropriate measures are selected from a list agreed at EU level, responding to the needs of Member States and regions, as well as helping them achieve common EU objectives.

3. OBJECTIVES

Today's challenges to EU agriculture have become broader and more complex in particular due to economic pressures such as the deterioration in agricultural terms of trade, the erosion of the sector's competitive potential and the challenge of further liberalisation of agricultural markets; increased environmental threats such as climate

change and the loss of biodiversity; and territorial needs such as keeping the great diversity of rural areas in the EU-27 vital and attractive. In the context of the contribution of agricultural policy to the Europe 2020 strategy the three broad policy objectives for the future CAP are:

– Contributing to a viable, market oriented production of safe and secure food throughout the EU by acting on drivers related to income derived from the market (improving farmers' capacity to add value to their production, improving the functioning of the food supply chain in a pro-competitive way, providing a safety-net in case of excessive price drops), promoting sustainable consumption, enhancing the competitiveness of agricultural holdings (innovation, modernisation, resource efficiency, addressing production difficulties in areas with natural constraints) and helping farmers to deal with income volatility and the below average income and productivity of the sector (income support, risk management for economic and public health risks). This is related to the smart growth objective of the Europe 2020 strategy;

– Ensuring the sustainable management of natural resources, such as water and soil, and the provision of environmental public goods such as preservation of the countryside and biodiversity, integrating and promoting climate change mitigation and enhancing farmers' resilience to the threats posed by a changing climate, fostering green growth through innovation and reducing environmental damage by agriculture. This contributes to the sustainable growth objective of Europe 2020 with the aim of contributing to a low carbon economy, an expanding bioeconomy and protecting the environment;

– Contributing to the balanced territorial development and thriving rural areas throughout the EU by responding to the structural diversity in farming systems and assuring positive spill-over effects from agriculture to other sectors of the rural economy and vice-versa, improving their attractiveness and economic diversification. This is related to the inclusive growth objective of Europe 2020 considering the relatively lower level of development of rural areas and the aims of social and territorial cohesion within and also between Member States.

At an operational level, this implies the need to reform the current CAP framework along the following lines:

Gearing the CAP measures towards increasing the productivity and competitiveness of the agricultural sector by:

– improving the functioning of the advisory system and creating networks (of farmers, advisors, researchers, food operators, consumers etc.) for knowledge creation and transfer and favouring innovative approaches in granting funding for projects for rural development measures

– encouraging pro-competitive joint action among farmers and across the food supply chain in order to foster efficient use of resources, product development and marketing

– providing incentives to use risk management instruments and active prevention strategies

Improving the environmental and climate change performance of the CAP by:

– increasing the number of agricultural areas which are under agricultural practices providing environmental and climate action benefits and encouraging the take-up of more advanced agri-environmental measures by Member States and farmers;

Enhancing the effectiveness and efficiency of the policy by:

– rebalancing the direct payment support to better reflect the objectives of income support and improved environmental performance

– reducing the disparities in direct payment support levels between Member States and farmers

– reducing administrative burden for farmers and managing authorities of existing tools without watering down their efficiency and effectiveness and increasing the risk of errors.

The progress towards achieving these objectives would be steered using quantified impact and output indicators in the context of reforming the monitoring and evaluation framework described in section 7 of the report.

4. POLICY SCENARIOS

For each of the three CAP objectives described in section 3, there is a multitude of possible policy approaches and instruments to address them. All of these instruments can be aligned along a continuum ranging from a free market approach (i.e. no policy intervention) through an incentive-based approach (i.e. through voluntary actions with financial rewards) to a regulatory approach (i.e. through laws and regulations).

To illustrate this for the environmental sustainability objective, voluntary incentive schemes for the supply of environmental public goods would offer a bonus or compensation to farmers for engaging in environmentally beneficial practices while a regulatory approach would enforce a desired level of environmental outcome through prescriptions, bans and sanctions. In this area, a market based approach that would leave the supply of environmental public goods to the play of private demand and supply alone would clearly demonstrate the problem of market failure by leading to a sub-optimal level of environmental outcome.

4.1. Building scenarios on policy options

Following a wide public debate and a series of own initiative positions from EU institutions and particular Member States, the above described continuum of possible approaches to address the policy objectives has been assembled into three coherent policy scenarios, namely the adjustment, integration and re-focus scenarios.

- The adjustment scenario focuses on adjusting the CAP in a limited way by emphasizing those elements that work well in today's CAP and addressing the major shortcomings of the current policy framework without making any fundamental changes to the policy.

- The integration scenario has the purpose of improving the targeting of CAP support to the objectives of the policy, especially by better integrating the contributions of different policy elements, which includes the introduction of new elements into the policy framework as well as substantial changes to structure of the policy.

- The re-focus scenario narrows down the focus of policy intervention of the CAP to environmental and climate change aspects while it is assumed that production capacity can be maintained without support through reliance on market signals and the objective of contributing to the vitality of rural areas and territorial balance would be met by other Community policies.

These scenarios are cross-cutting approaches that each address the three broad policy objectives of the future CAP described in the previous section. They do, however, place different weights on the three objectives and are based, to a certain extent, on different approaches with respect to the necessity of policy intervention. With respect to the analysis of the effects of these scenarios, the reference is the status quo, which does not address the policy shortcomings identified in problem definition and the counterfactual scenario of having no policy at all, which is expected to lead to significant income and environmental problems[67]. The scenarios are presented on the basis of the three main lines of policy intervention, namely market measures (Council Regulation (EC) No 1234/2007), direct payments (Council Regulation (EC) No 73/2009) and rural development policy (Council Regulation (EC) No 1698/2005).

In the adjustment scenario, the moderate increase in the rural development fund through a shift of means from Pillar I that is foreseen under the current policy architecture will continue in line with the orientation of making no major changes to the policy as defined today. The integration scenario does not contain this shift towards Pillar II as in this scenario the contribution to the different objectives of the policy is more balanced between the pillars with increased environmental targeting in Pillar I ("greening") which also requires an appropriate budget.

In the re-focus scenario, a substantial overall decrease of the budget is foreseen due to the end of market support and direct payments. However, the remaining funds for rural development would be substantially more than current Pillar II funding as, in the absence of the contribution that direct payments are currently making to the provision of public goods, substantially higher demands would need to be fulfilled by rural development policy.

While the presented scenarios are consistent and credible in their design they do not, of course, represent the only possibilities of combining measures to address the CAP objectives. Different options and alternative combinations of instruments are possible and through the analysis of particular scenarios in this Impact Assessment alternative policy designs are legitimate.

The reason for applying this broad scenario approach even though a final policy design could combine elements from different scenarios is that this approach is considered as

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[67] Scenar 2020 – Scenario study on agriculture and the rural world, LEI, January 2007 and Scenar 2020-II – Update of scenario study on agriculture and the rural world, LEI, December 2009 http://ec.europa.eu/agriculture/analysis/external/scenar2020ii/index_en.htm

more appropriate to feed the decision-making process because it allows an exploration of the continuum of possible policy evolutions. It makes it possible to present a holistic analysis that also looks at the potential interactions and synergies between the main lines of policy intervention. At the same time, all measures and sub-options are also analysed separately in the Annexes which would make it possible to assess the impact of a final policy design even if it is composed of different elements than the scenarios outlined.

Furthermore, the scenarios described in this Impact Assessment contain only those elements that provide *genuine* development possibilities for the CAP. This means that certain policy instruments that were discussed and suggested in the public debate and in the public consultation are *not* included in the options analysed and reported here. The reason for this is that they were judged to be less relevant to the objectives of the CAP, not complying with the general direction of CAP reform or politically unfeasible.

The most important of these rejected elements are:

– The suggestions to link intervention prices for main commodities to the development of production costs in Europe. The situation relating to operating costs and receipts varies widely across sectors and Member States, and production cost developments are available with a time lag.[68] Therefore, such a proposal would face practical difficulties in its implementation. But its main inconsistency lies in that it could lead to reintroduction of distortions on EU markets, putting the effective functioning of the Single Market in the agri-food sector at risk. It would also prevent productivity gains and decrease the competitiveness of agricultural holdings, generating the risks of sub-optimal allocation of resources and overproduction in some regions.

– The introduction of a counter-cyclical payment that would link direct support back to agricultural prices. Proponents of this idea argue that high prices for agricultural products would make direct support less necessary and should therefore result in its reduction. However, this line of argumentation ignores the fact that recently input prices increased to a much greater extent than agricultural prices, and are expected to remain at high level over the medium term so that high agricultural prices do not necessarily mean high income as the gradual deterioration of the term of trade of the agricultural sector has significantly squeezed farmers' income margins.[69]

  More fundamentally still, the proposal would reverse the market orientation of EU agriculture put in place over the last two decades as it would distort farmers' production decisions by blurring the transmission of market signals. Finally, direct payments linked to price developments could not be classified in the 'green box' of the WTO, thus undermining the EU's trade negotiating position at the WTO. The example of US counter-cyclical payments illustrates their impact on markets, budgetary spending, developing countries and WTO compatibility.

The three scenarios which present the different paths of CAP reform are presented below detailing the options included from each of the three main policy areas market measures, direct payments and rural development policy. A detailed analysis of all of the options

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[68] A discussion of the differences in competitiveness across the EU can be found in Annex II of Annex 5.

[69] The implications of linking support to agricultural prices are also discussed in Annex 6.

(and sometimes sub-options) presented can be found in the Annexes 2-7 on specific policy instruments. A summary of the main elements of the scenarios is given in table 1.

4.2. Adjustment

In the adjustment scenario, the aim of strengthening the CAP's strong achievements and addressing major shortcomings of the current structure would be achieved by improving the functioning of existing market instruments, by addressing the problem of distribution of direct payments between Member States without compromising their role as income support and contribution to the delivery of basic public goods, and by moderately increasing the funding in rural development to be used for particular actions. Many respondents to the public consultation found that the adjustment scenario does not bring much change or that it will lead to a strengthening of the current trends. While for some policy continuity was a positive factor, for others this implied the continuation of unsustainable agriculture and territorial inequalities.

Existing **market instruments** would be simplified and streamlined through the adjustment of the current system without changing support levels. The general architecture of the market management tools, including border measures, would not change (see Annex (5) for details). The main adjustments would consist of:

- Rearranging and streamlining special intervention measures and disturbance clauses, through a horizontal instrument;
- Sugar and isoglucose quota elimination in 2015/2016 or in 2017/2018;
- Intervention: removal of automatic purchases up to the quantitative ceilings for common wheat, butter and SMP. The system will open automatically via tendering procedure;
- Private storage aid: the aid would be foreseen for butter, beef, pig meat, sheep and goat meat, sugar, and olive oil, with optional private storage aid for SMP and flax fibre. As an alternative, private storage would be foreseen as an optional tool only.

In addition, the possibility of a more efficient use of measures currently available is considered, such as the better use of the wide range of cooperation possibilities that farmers have under the current competition rules.

With respect to **direct payments**, the Single Payment Scheme (SPS) would remain a basic policy instrument to address income support and the provision of basic environmental public goods but there would be a focus on the redistribution of direct payments towards greater effectiveness and more equity between Member States and farmers (see Annex (3) for details).

This could be done through various approaches:

- move to the same level of direct aid per hectare for all farmers in the EU ("flat rate");
- a pragmatic approach that ensures that all Member States get at least a share of the EU average (e.g. 80% or 85%);

- use objective criteria both of economic and environmental nature to determine the distribution between Member States (thus reflecting the jointness between the supply of private agricultural products and environmental public goods);

- combining a pragmatic approach towards convergence with objective criteria for the distribution of direct payments between Member States.

Furthermore, cross compliance would be streamlined and its contribution to the climate change objective increased and some coupled payments would remain for those countries which apply them (suckler cow, sheep and goat).

Rural development policy would follow the Health Check model of a moderate increase in the rural development budget within a constant CAP budget while the distribution of funds between Member States would remain the same as in the current period (see Annex (4) for details). Two options for using the additional resources would be:

- either towards the environment ('new challenges' of climate change, water, biodiversity, renewable energy and innovation, as in the Health Check),

- or towards competitiveness / innovation.

With respect to the management system of rural development, the status quo would be maintained.

4.3. Integration

In the integration scenario, the aim of improving the targeting of the CAP to its objectives would be achieved by strengthening the role of producers through appropriate market instruments, by improving the targeting of direct payments to the income needs of farms and environmental and climate change objectives, and by improving the coherence of rural development policy within the CAP as well as with other Community policies. This would also allow a better balance across policy instruments in addressing CAP objectives, e.g. in the way direct payments and market instruments are combined in addressing income issues of farmers or how rural development policy and direct payments interact in supporting environmental needs. This scenario was considered as the most balanced by the stakeholders. Their replies focused on the direct payments redistribution and the impacts on the bargaining power in the food supply chain. Greening was mentioned by many as an appropriate way to reach better environmental quality, increasing the delivery of public goods and creating opportunities for sustainable and climate friendly agriculture. At the same time, there were also many who found that greening Pillar I would have a negative effect on farm income and competitiveness.

In the area of **market instruments**, in addition to the simplification and streamlining of market measures described in the adjustment scenario, this would translate into the improvement of the bargaining power of farmers, their contractual relations and transparency along the food supply chain in order to enhance the share of value added for agriculture and the development of farm incomes (see Annex (5) for details).

While for farmers, participation in horizontal organisations would continue to be on a voluntary basis, three possible options for strengthening farmers' collective action are:

- Flexible cooperation approach: this would encourage and facilitate joint production and marketing that entail efficiency gains, including a consolidation of production assets (in co-operatives), a rationalisation of marketing activities and/or vertical integration into the downstream collection and processing stages within EU competition rules. This would include providing more resources to raising farmers' awareness of these possibilities and supporting farmers wishing to take advantage of the rules and promoting fair business practice.

- Enhanced cooperation approach: this would enhance horizontal and inter-branch organisations through the recognition by Member States of *producer organisations* (POs) and *associations of producer organisations* (APOs) in all sectors covered by the single Common Market Organisation (CMO). The rules for APOs would be based on the existing legislation for the fruit and vegetables, wine and olive sectors, and the recognition by Member States of *interbranch organisations* (IBOs). Support for setting up *producer groups* (PGs) would be provided as a single measure under rural development policy for all sectors covered by the single CMO, in all Member States.

- Regulated cooperation approach: it would extend the measures suggested under the enhanced cooperation approach, to include for example the obligation to use written contracts, and the permission for collective bargaining by POs, with in particular derogation from the prohibition on "price fixing" for all or particular sectors. The latter would suppose additional derogations from EU competition law.

With respect to **direct payments**, there would be a focus on better targeting of payments to achieve a more effective balance of both economic and environmental concerns within Pillar I through redistribution and the introduction of a new architecture for the provision of payments in the context of a small decline in real terms of the overall direct payment budget (see Annex (3) for details). This would consist of:

- The redistribution of the direct payment envelopes so that Member States with direct payments below the level of 90% of the EU average will close one third of the gap between their current level and this level;

- The introduction of different components of direct payments. In each Member State, farmers would receive:

    - a compulsory basic income support distributed in the form of a national/regional flat rate based on entitlements;

    - an optional area-based payment for naturally handicapped areas;

    - a compulsory green payment across the whole EU territory, composed of simple, generalized, annual and non-contractual environmental measures going beyond baseline standards of cross compliance (concerning permanent grassland, green cover, ecological focus areas, crop diversification and a Natura 2000 specific support – with sub-options

regarding the parameters of these measures) in order to enhance the environmental and climate action performance of the Pillar I[70];

- a voluntary coupled support component for specific sectors;

– The progressive capping of all direct payment components except for "greening", with salaried labour, the level of threshold and the degree of progressivity as additional elements for consideration;

– Better targeting of support to active farmers in order to focus CAP income support to those genuinely engaged in agriculture including part-time farmers (with alternative options examined with respect to the definition of active farmer);

– Streamlined cross-compliance by increasing its contribution to the climate change objective and ensuring consistency with the "greening" component;

– A specific regime for small farmers who would replace all components of direct payments with a fixed lump sum was examined, with criteria linked to small beneficiaries, the physical size of farms and the level of support.

– A support scheme for young farmers (defined as farmers starting-up an agricultural activity) based on farm size/number of entitlements and average direct payments in a Member State.

With respect to **rural development policy**, funding would be kept at current levels in real terms while support would be distributed between Member States on the basis of policy objectives (see Annex (4) for details).

The policy would be better aligned with Europe 2020 strategy concerning priorities and related targets by explicitly recognizing innovation, climate change, including the sustainable production of renewable energy, and the environment in general as cross-cutting guiding themes. Moreover, six priorities would be set, with corresponding indicators linked to the transfer of knowledge; competitiveness and farm viability; food chain organisation and risk management; preserving and enhancing ecosystems dependant on agriculture and forestry; low carbon economy and resource efficiency; job potential and development of rural areas. The current toolkit of around 40 measures would be streamlined into approximately 20 measures. With respect to the management system, the strategic approach would be reinforced by improving coordination with other funds, as well as by strengthening strategic programming. Member States and Regions would be expected to draw explicit links between measures and priorities.

Rural development measures fostering innovation in agriculture would be adapted and strengthened in view of supporting innovative approaches in EU agriculture. A European Innovation Partnership (EIP) "Agricultural Productivity and Sustainability" will be set up aiming at an EU agricultural sector that 'achieves more with less'. The EIP will facilitate the application and uptake of innovation-related rural development measures through an innovation network. Within a strengthened system of strategic programming / targeting

[70] Organic farming would qualify automatically for this component due to its environmental benefits.

for rural development policy, in line with the Europe 2020 strategy there would be new "priorities" relevant to competitiveness – e.g. "transfer of knowledge" and "innovation".

Contractual and more complex environmental services and climate actions would continue to be supported by rural development policy, especially the more advanced agri-environment measures, and the agri-environmental measures would continue to play the central role in all rural development programmes. Possibilities for co-operative environmental action would be developed.

The objective of territorial cohesion would be tackled in particular by improving the coordination of certain EU funds that have an impact on rural areas - the European Agricultural Fund for Rural Development (EAFRD), the European Regional Development Fund (ERDF), the Cohesion Fund, the European Social Fund (ESF) and the European Maritime and Fisheries Fund (EMFF) - under a Common Strategic Framework.

Furthermore, the availability of **risk management** instruments to help farmers deal with increased exposure to more volatile agricultural markets would be improved (see Annex (6) for details)[71]. Possible actions in this area would include the extension of the current framework for insurance and mutual funds, the introduction of an Income stabilisation tool (IST) and the creation of a new "Global Agricultural Risk Management Fund" similar to the existing EU Solidarity Fund.

4.4. Re-focus

In the re-focus scenario, the aim of narrowing down the scope of CAP interventions to environmental aspects is achieved by maintaining, in the longer run, only a strengthened rural development policy.[72] This position is based on an assumption that since output prices are projected to stay at a higher level, it will translate into higher incomes for farmers and render income support unnecessary for most of them. In the public consultation, this scenario was criticized by some because of the negative effects on farmers' income and competitiveness, while others thought that it would spur innovation and restructuring of the sector.

All existing **market instruments**, with the exception of disturbance clauses that could be activated in times of severe crises, would be abolished. **Direct payments** would be progressively phased out between 2013 and 2020 to allow a smoother adjustment of the sector towards a situation without direct support. **Rural development policy** would focus on climate change and environment with certain temporary measures to support the phasing-out of direct payments. Funding would be increased significantly and redistributed between Member States while the management system would be simplified.

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[71] Public support for risk management instruments is not included in the re-focus scenario because the larger commercial farms which it favours generally have the capacity to create their risk management strategies based on instruments offered by the private sector.

[72] Such scenarios are presented for example in the papers *Achieving a Transition Away from CAP Direct Payments*, K. Hart, M. Rayment, H. Lee, prepared by the Institute for European Environmental Policy for the Land Use Policy Group or *CAP Reform and Public Services or Agriculture,* Social and Economic Council, Netherlands, July 2008.

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

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

5. ANALYSIS OF IMPACTS

5.1. Adjustment

Under this scenario, which assumes the continuation of the principles of the current policy framework based on market-orientation, farmers, prompted by market signals, are expected to make better use of available policy instruments to increase their competitiveness. At the same time, the redistributed direct payments will shield them from excessive income fluctuations in a more effective and equitable manner throughout the EU. Redistribution would allow higher support for more environmentally beneficial agricultural areas and limit land abandonment, but increased economic pressures would likely drive towards intensification of production in the most fertile regions. Rural development measures would continue to address wider rural issues, but the role of agriculture in the economy, employment and growth or rural areas would diminish.

5.1.1. Economic impacts

The impact of this scenario on competitiveness and growth is expected to come mainly through increased funding for investment and advisory services for farmers and encouragement of increased cooperation/collaborative ventures. The redistribution of direct payments will impact on the economic viability of farms. The end of the sugar quota regime will have important implications for the sugar sector. Safety-net market mechanisms should be adapted to allow a flexible response in time of crisis.

Competitiveness and growth

A moderate increase in the rural development budget should lead to a small overall positive impact on competitiveness owing to investments in human and physical capital that increase productivity. There is evidence of a positive contribution of investment aids to accelerating innovation, reducing production costs and improving quality thus having a positive impact on income.[73] Investment in physical and human capital may also accelerate existing trends towards fewer, larger farms. Increased agri-environment payments and support for LFAs/NHA may help maintain the economic viability of farms that might otherwise disappear.

Innovation and productivity growth is also likely to be boosted by the Farm Advisory Service (FAS). Given that the obligation to establish national FAS is recent and the related advisory bodies have only been certified in the past few years, its outreach should increase, though most likely to modest levels. This would be complemented by rural development support for the use of advisory services by farmers. However, the results in terms of knowledge dissemination and innovation adoption would most certainly fall far short of the challenges, in particular owing to the lack of a coherent framework for the use of available measures. Support under rural development for the use of advisory services by farmers and for the delivery of agricultural knowledge and innovation systems (AKIS) across Member States would be maintained.[74]

The effect of this scenario on consumers is expected to be limited, as agricultural prices and the transmission of price changes along the food supply chain will not change significantly when compared to the status quo.

Sector output and viability

The ability of farms to respond to economic challenges will be affected by the changes to the current policy framework – the redistribution of direct payments and, in the specific case of sugar, the end of the quota system.

A recent study shows that the production and price impacts of redistribution of income support are relatively small.[75] However, substantial changes in payments per hectare will have an impact on farms' asset values (especially land), due to the fact that direct payments are to a certain extent capitalised in land values.[76] This will in turn influence farmers' access to credit and ability to address existing liabilities.

The removal of sugar quotas is expected to lead to higher production and lower prices. Specifically the abolition would result in an increased EU sugar beet area, though offset

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[73] Viaggi D., Bartolini F., Raggi M., Sardonini L., Sammeth F. and Gomez y Paloma S., Farm Investment Behaviour under the CAP Reform Process, *JRC Scientific and Technical Report*, 2011 (Forthcoming); Bartolini F., Viaggi D., Floridi D. (2010) Assessment of present, trends, mechanism and impact of the CAP on structural change and innovation. *CAP-IRE*, Deliverable D4.2. (www.cap-ire.eu).

[74] For analysis of the role of the Farm Advisory System see Annex 7.

[75] Farm level policy scenario analysis, Final report, 15 March 2011 (IPTS contract no 151582-2009 A08-DE).

[76] The move to a regional model throughout the EU is likely to increase the rate of capitalisation of support in land prices as compared to the historic model as the flexibility for activating entitlements with eligible land is reduced due to the existence of only a very limited amount of "naked" land in the regional model.

by lower yields, leading to a limited increase in EU sugar beet production by 2020 by 2.3% under the 2015/16 quota abolition scenario and 3.9% in the phasing out scenario (abolition in 2017/18). The higher level of sugar production would result in lower prices for sugar beet (and white sugar) when compared to the reference scenario, by -8.2% (and -3.5%) under the 2015/16 abolition scenario and -10% (and -5.7%) under the phasing out scenario (abolition in 2017/18). The effects on world prices are expected to be very limited as price transmission between the EU market and the world market is rather low due to the existing trade regime. While remaining a net importer under each scenario, the net trade balance of the EU would improve with quota abolition compared to the status quo.

The effects on the isoglucose market are projected to be limited. Both production and domestic demand for isoglucose would to increase relative to the status quo scenario, although the higher rise in production would result in greater exports.[77] Nevertheless, the elimination of the isoglucose production quotas would allow an increase in economies of scale in the starch industry. This would support the uptake of other bio-based products derived from the same raw materials by encouraging investment and innovation in plant chemistry.

Overall, the abolition of sugar quotas increases competitiveness as production would move to the economically most efficient areas and enables the sector to adapt to limitations in EU exports, with increased market orientation, including the abolition of private storage aid for sugar, but may lead to increased co-movement with world market prices (and hence higher volatility). Comparison of the two quota abolition scenarios shows that the phasing out scenario produces a larger impact on the EU sugar market, in terms of production increase (through higher areas) and consequent price decline. Furthermore, extending the life of the quota system through the transition period prolongs the inefficiencies of the industry.

Crisis and risk responses

The operation of safety net support and risk management tools will continue to play a role if prices decline abruptly. Lessons from recent experience in the dairy sector show that current market instruments proved their worth as a safety-net mechanism in exceptional circumstances. However ad-hoc adaptation of policy instruments was necessary to stabilise the market (i.e. private storage aid for butter was prolonged and intervention continued above quantitative ceilings and beyond the usual buying-in period), illustrating the need to be able to tailor existing measures to the specific needs of each sector. The impacts would be minor under normal market conditions, however in the times of crisis it will allow the EU to act faster and more efficiently.

Opening public purchases via tendering from the very first tonne without fixed price / fixed initial quantities may create some initial uncertainty about the actual level of the safety net. On the other hand, removing the fixed price allows intervention to operate only when necessary in the market place, thus avoiding unnecessary expenditure. The tendering system allows participants to make offers at prices which they themselves consider to be at safety-net level.

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[77] A more detailed overview of the analysis, including methodology and results is provided in Annex 5c – Sugar options with AGLINK-COSIMO.

Subsidies for insurance premia and mutual funds as risk management tools for producers have been limited to a few Member States up until now, but with growing experience and increasing demands from producers, there is scope for better use of the available tools.

5.1.2. Social impacts

The impact of the scenario on agricultural employment will be influenced mostly by the redistribution of direct payments between and within Member States. A moderate increase in investment aids will have some positive impact in terms of securing employment, as this measure has a high leverage effect. In addition, a small positive effect on agricultural employment may result from supporting more extensive production systems, which are generally more labour intensive.

Redistribution between Member States
Both the options of granting a uniform flat rate direct payment across the whole EU and of basing the distribution of support on purely objective criteria reflecting the dual role of the instrument (income support and environmental public goods) would lead to a significant redistribution of funds between Member States, the extent of which would depend on choice of criteria. The resulting impacts on incomes are also substantial. Table 2 below shows the general effect of each criterion on the Member State envelope (compared to a flat rate).

Table 2: Impact of the different criteria compared to the flat rate

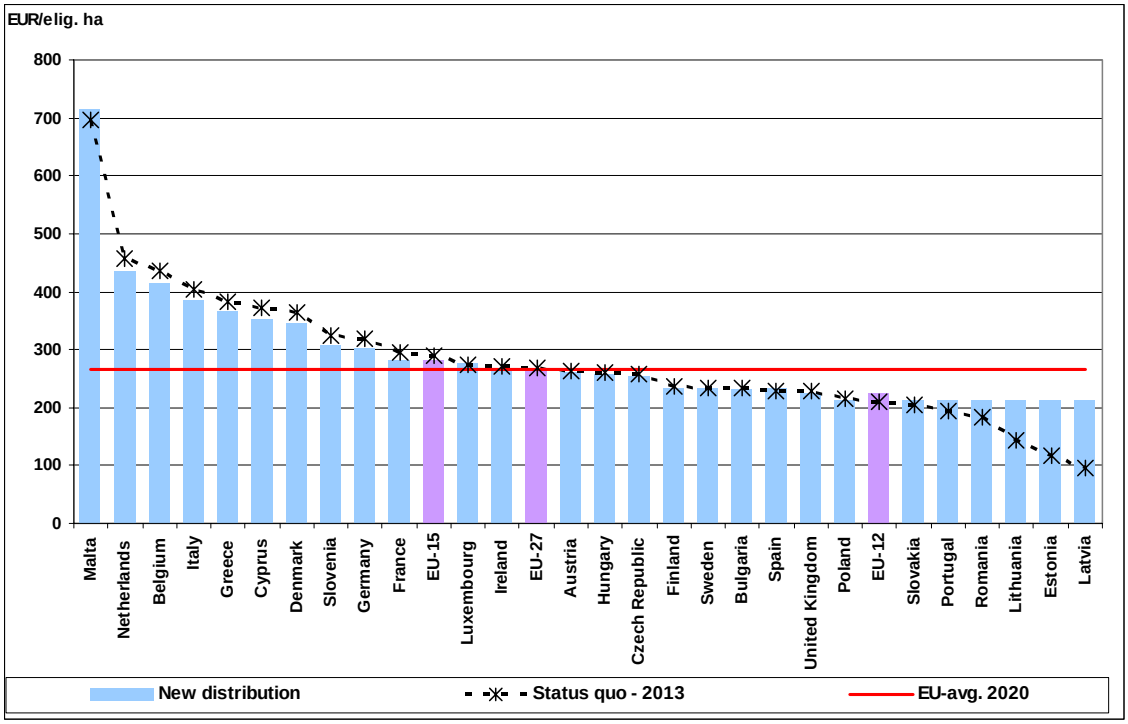
	PPS	GDP/cap	GVA/ha	AWU/ha	LFA / UAA	Natura 2000 / UAA	Permanent grassland / UAA
BE	++	++	++	-	--	-	+
BG	--	--	-	++	--	++	--
CZ	--	-	--	--	-	-	-
DK	++	++	--	--	--	--	--
DE	+	++	-	--	-	-	-
EE	-	--	--	--	-	++	-
IE	+	++	--	--	++	--	++
EL	-	-	+	+	++	++	--
ES	-	+	+	--	++	+	+
FR	+	+	-	--	-	-	-
IT	+	+	++	+	-	+	-
CY	-	-	++	++	+	++	--
LV	--	--	--	+/-	++	+/-	+
LT	--	--	--	-	+	-	-
LU	++	++	-	--	++	+	++
HU	--	--	-	+/-	--	++	--
MT	-	--	++	+/-	++	--	--
NL	+	++	++	+/-	--	--	+
AT	++	++	-	+/-	+	-	++
PL	--	--	-	++	+	+	--
PT	-	--	-	+	++	+	++
RO	--	--	+	++	--	-	+/-
SI	-	-	+	++	++	++	++
SK	--	--	--	--	+	++	--
FI	++	++	--	--	++	++	--
SE	+	++	--	--	-	++	--
UK	-	++	--	--	-	--	--

Annex (3) provides full details of several scenarios that base redistribution of direct payments among Member States on economic or environmental criteria, or a combination of both. The total amount redistributed with the formula based on the objective criteria comes close to € 4.5 billion as compared to the status quo (however the effect depends on the exact implementation, e.g. the weighting of the different objective criteria taken into account) [78]. Although results differ, the conclusion is the same.

The use of solely objective criteria would fail to bridge the gap between EU15 and EU12 (with the exception of the Baltic States) thus failing to bring about more equity between Member States. Using a minimum level of convergence (e.g. that all Member States get at least a certain percentage of the EU average) as a criterion for redistribution would allow this gap to be bridged and the pace of transition would then depend on the convergence criteria used.

Figure 15 presents the results of redistribution in 2020, if a minimum level of convergence of 80% of the EU average is guaranteed. In Figure 16, the minimum level of convergence is set at 90% of the average while objective criteria are used to define the level of Member States currently above the EU average. The total amount redistributed among Member States would be € 0.85 billion (in the case of 80% minimum) and € 2.16 billion (in the case of 90% minimum and objective criteria).

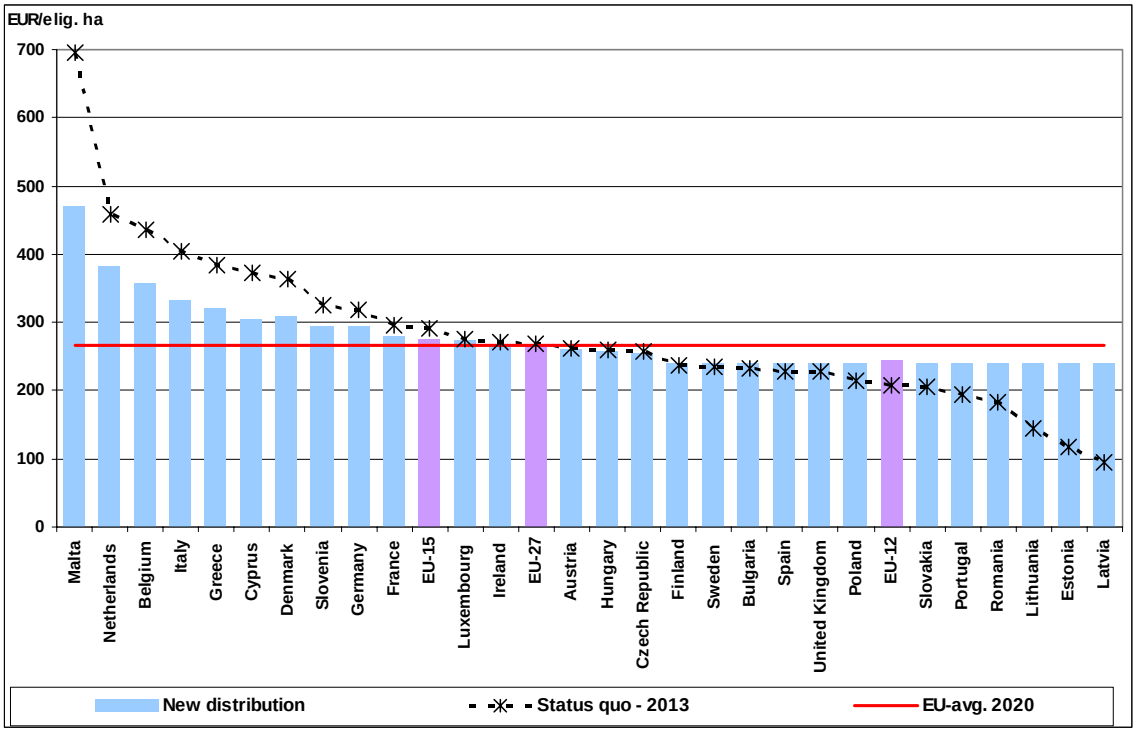
Figure 15: Redistribution of direct payments between Member States - minimum 80%



Source: DG AGRI

[78] In the whole document, the total amount redistributed is calculated by comparing the situation resulting from the existing legislation to the situation after redistribution in the sole year 2020.

Figure 16: Redistribution of direct payments between Member States - minimum 90% with objective criteria



Source: DG AGRI

Effects of moving towards a uniform regional rate– redistribution among producers

Regardless of the option chosen for redistributing the envelopes between Member States, there will be considerable redistribution of support between farms, at least in those Member States currently applying a historic model, since all options imply a move towards a regional model for direct payments.

Within a region, entitlements would then be spread over all eligible hectares declared in a reference year. This would bring currently eligible agricultural lands that are not covered by entitlements (so-called "naked land") into the system. As a result, all eligible land would be granted the same level of payment per hectare, whatever the activity and type of production.

Field crops, mixed and milk farms would lose payments compared to the status quo situation while payments would increase for grazing livestock, wine and horticulture farms. As a general rule, a more uniform direct payment would reduce support in more productive regions and sectors in favour of more marginal and less favoured regions. The impacts of this reduction may be mitigated by a transitional period to allow the adjustment of farm structures.

Territorial balance

The redistribution of direct payments, depending on the criteria used, should have a positive territorial impact by rebalancing support across the EU territory in favour more of EU12 as well as more marginal areas and farming systems and thus contributing to a sustainable agriculture across the EU. The additional funds made available under rural development should also contribute to growth and jobs in rural areas, for example through the development of renewable energy projects.

5.1.3. Environmental impacts

The main environmental benefit is expected to come from the enhancement of GAEC, increased RD funding for environmental measures and redistribution of support to more extensive farming.

Encouraging environmental and climate friendly practices
Cross compliance links receipt of full direct payments to respect of regulatory standards related to environment, plant, animal and public health and animal welfare and to GAEC (Good Agricultural and Environmental Conditions). For instance, GAEC obligations are related to preserving landscape features, soil conservation, permanent grassland conservation and watercourses protection.

The environmental performance of Direct Payments would be improved by a reinforcement of GAEC with climate-friendly measures[79] and the inclusion of the Water Framework Directive in the future, once it is implemented and obligations related to agricultural producers are clearly identified (and control and sanction mechanisms are fully set up).

The impact of such measures could be enhanced with a moderate increase in available rural development funds. However their effects are difficult to quantify since it depends on how Member States use the available funds. Where an increased focus is put on competitiveness and innovation, positive effects would mainly come through increased resource efficiency and through modernisation in implementing more environment and climate-friendly systems.

An increased focus on the environment ('new challenges'), would most likely translate into more funds being used for agri-environment measures with positive effects for biodiversity, water, soil, climate change and renewable energy. However, regarding biodiversity, after the experience of the missed 2010 target, it remains doubtful whether this scenario would be sufficient to ensure the achievement of the Europe 2020 headline target of halting the loss of biodiversity and the degradation of ecosystem services in the EU by 2020, and restoring them in so far as feasible. This target calls for the maintenance of sustainable agriculture with a CAP that covers a considerable area with biodiversity-related measures.

As far as climate change is concerned, positive impacts on GHG emissions reduction would take place through the contribution of the agricultural sector to renewable energy development and fossil fuel substitution. However, regarding GHG from the agricultural sector itself, even if those measures aimed at promoting mitigation could help to increase agriculture sector's contribution to sharing the burden in the short term (targets to be respected by the non-ETS sector under the Effort Sharing Decision (ESD)), in the longer term this would not set the right trajectory to reduce GHG emissions from agriculture by between 36 and 37 % by 2030 and 42 and 49 % by 2050, as estimated in the EU low carbon economy roadmap 2050 modelling exercise.

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[79] Such as better protection of valuable grassland, wetlands or carbon rich soils, a general minimum cover obligation and measures aiming at maintaining the soil organic matter level or the management of stubble and vegetation residues.

Redistribution of support

The redistribution of direct payments between farms would in itself also have an important effect in shifting support towards more environmentally sustainable and climate friendly farming. Grazing livestock farms and those in least favoured areas would benefit from the redistribution, which would to a certain extent favour the maintenance of permanent grassland with its environmental and climate action benefits, while more intensive crop production would be supported to a lesser degree. Although the extent to which this happens will depend on the level of commitment to the environment in Member States if they are given flexibility to regionalize payment levels, the other elements of the reform, especially greening requirements, are likely to work in favour of more environmentally friendly farming.

At the same time, including the natural handicap area criteria as part of the formula for distribution of support between Member States, which should potentially favour the allocation of payments to these areas (associated with better delivery of public goods), has a smaller impact on them than the redistribution of payments itself. Moreover, its precise effects would depend strongly on the implementation, e.g. the distribution of direct payments between regions in Member States.

Regardless of the criteria used, if no additional environmental performance indicators were linked to direct payments (or at least to a part of the direct payments), the targeting of additional amounts to environmentally sensitive regions could be suboptimal.

5.1.4. International dimension

The redistribution of direct payments between Member States and farmers should not affect the classification of EU support under WTO provided that direct payments redistribution at Member State level remains in line with WTO rules (in a manner that ensures that farmer anticipation and effect on production level is avoided).

5.1.5. Administrative issues

In the first year of implementation of the new system, there would be an administrative burden associated with the redistribution (distribution of new entitlements and/or recalculation of the value of entitlements) and possibly transition (defining steps for progressive modifications in subsequent years).

In spite of its many advantages, the implementation of the current intervention system remains complex with numerous different trigger mechanisms, ceilings, and time constraints across sectors. Harmonisation and streamlining of existing parameters could bring about greater efficiency, decreasing administrative costs and easing controls, although the specificity of each sector may imply differing arrangements.

5.2. Integration

This scenario assumes that the enhanced policy framework is geared towards support for competitiveness, development and innovation in the sector and fostering conditions under which farmers, either individually or collectively, would be better able to face upcoming economic, environmental and climate change challenges ahead. Direct payments would provide a stable income, leading not only to more balanced, effective and equitable redistribution but actively targeting certain beneficiaries (small-scale holders, farmers in regions with natural constraints, sectors at risk, etc.). At the same

time the modalities of implementation of the new direct payment scheme (such as regionalisation of the payment) could have significant impact on the quantitative assessment of the various policy measures.

A greening component would also promote certain basic environmental and climate action practices throughout the EU, focusing principally on those farms, often the most competitive, which have moved away from such practices as well as those which are considering abandoning them in the light of current economic pressures.

5.2.1. Economic impacts

The impact of this scenario on competitiveness and growth will be mainly through increased funding for innovative actions and encouragement of increased cooperation and collective action among farmers in tandem with improvements in the functioning of the food supply chain. Better coordination of EU funding sources will also contribute to rural growth. Greening costs will impact on the short-term competitiveness of farms, although this will vary considerably between Member States and type of farm.

Competitiveness and growth

Enhanced productivity and better use of scarce resources can be expected as a result of the increased focus on innovation in the design of rural development programmes. In addition, the setting up of the European Innovation Partnership increases the involvement of stakeholders (researchers, advisors, farmers) in innovation processes.

These developments contribute to achieving EU goals of sustainable agricultural production thereby leading to an agricultural sector with enhanced productivity and a more efficient, and sustainable use of scarce resources. The Agriculture EIP and the creation of an innovation network ensure better flows of information between the stakeholders. This not only increases the use of research results by producers but also allows research programmes to address the needs of stakeholders.

Productivity could be further improved by encouraging cooperation among producers, which could lead to increased efficiencies, such as improved economies of scale in selling and purchasing, the opportunity to increase added value by entering other stages of the food supply chain and easier access to information, thereby helping them to face the environmental and climate change challenges ahead and to assume a stronger position in the food supply chain.

EU competition rules provide farmers with a solid legal framework for developing sustainable forms of cooperation and a stimulus to becoming more efficient, innovative and better equipped to face competition both within and outside EU. This relates in particular to joint production and marketing that entail efficiency gains, including a consolidation of production assets (in co-operatives), a rationalisation of marketing activities and/or vertical integration into the downstream collection and processing stages.[80]

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[80] See DG COMP's Working Paper of February 2010 on "*The interface between EU competition policy and the CAP*" and its explanatory Brochure on "*How EU competition policy helps dairy farmers in Europe*", which are published in DG COMP webpage. Although these documents refer explicitly to the dairy sector, it should be noted they establish *general* principles on the application of competition rules to *all* agricultural sectors.

Apart from cooperatives, which were a traditional response of farmers to the developments in the food supply chain, producer organisations and inter-branch organisations can potentially play useful roles in research, improvement of quality, promotion and diffusion of best practices relating to production, processing and marketing.

An approach of "flexible cooperation" which raises farmers' awareness of the cooperation possibilities, which informs them of their contractual rights and notifies them of best practices should encourage farmers to take up this course of action. While this approach supports pro-competitive cooperation between farmers without recourse to regulatory measures and exemptions from competition rules, nevertheless the scale and scope of cooperation may remain unsatisfactory due to low social capital in many regions where such cooperation would be the most beneficial and financial barriers to the setting up of such initiatives.

Enhanced cooperation between farmers would act as a corrective to the generally small-scale structure of agricultural production without necessarily having to consolidate production by increasing the size of individual farms, providing a stimulus for market operators to improve their performance; better enabling them to face increasing domestic and international competition. The pro-competitive cooperation between farmers without recurrence to regulatory measures and exemptions from competition rules remains at the core of this option.

In the "regulated cooperation" approach, the possibility for farmers to stipulate written contracts may have a positive impact on price stability, diminishing uncertainties regarding quantities and expected revenue. The impact of contract schemes would depend, among others, on the characteristic of the product, processing and marketing, how the food supply chain is organised (vertical integration), market power of the different actors, the share of the internal market on global demand, net trade balance, and even the different application of rules among the Member States.

Although price-fixing agreements may display positive impacts for some farmers in the short run, they would prove self-defeating for farmers in those cases where food processors have the possibility to switch between different supply sources and/or relocate their processing activities within or outside the EU. The effect on EU farmers would become negative in the longer run due to the reduced sales volumes caused by this switch. In regions with limited alternative sources, small and medium processing facilities would also be negatively affected.

The longer-term impacts could also include (depending on the structure of the particular sectors and supply chains): potential risk of excessive producer bargaining power or even producer monopoly, which would be as negative as any other monopoly, potential impact on small and medium enterprises and their capacity to compete and develop; potential slow down in the modernisation path of the industry, as a by-product of the reduced competition; potential loss of long term competitiveness and innovation capacities, as a by-product of reduced competition; potential increase in consumer prices (negative impact in particular on low-income consumers) provided that the rest of the food supply chain operates under competitive conditions.

The impact on consumers is expected to arise from the aggregate effect of policy changes on price transmission, product quality and safety. Agricultural prices in Europe may increase slightly due to the additional costs of greening. However, since they constitute a limited share of food prices, this should only have a limited effect on consumer prices.

The improvement in the functioning of the food supply chain and collaborative actions could be expected to increase choice and quality of products. These developments would be strengthened by the focus on innovation while the support to small farmers could reinforce the local, short supply chains. On the other hand the regulated cooperation option could in many cases stall improvements in quality and innovation, with negative effect on consumers.

Sector output and viability

The effect of greening on the economic viability of farming will depend on striking the right balance between imposing reasonable costs in the short term while enhancing the long-term sustainability of farming. Greening measures may impact farm incomes in several different ways:

– by increasing costs, for instance due to the requirement to seed cover crops during winter time,

– by decreasing the level of production and revenue, for instance in the case of ecological focus areas,

– by impeding the shift to a more profitable production system, for example due to the "opportunity cost" of maintaining permanent pastures,

– by affecting individual production patterns in a way that leads to changes in the level of production which may have an impact on market prices, for instance in the case of ecological focus areas and crop diversification.

The microeconomic analysis looked at the effects on gross margins of cultivating other crops, setting-aside agricultural area for ecological reasons, introducing a green cover on agricultural land, and on the opportunity costs of maintaining permanent grassland. This analysis was limited by two factors.

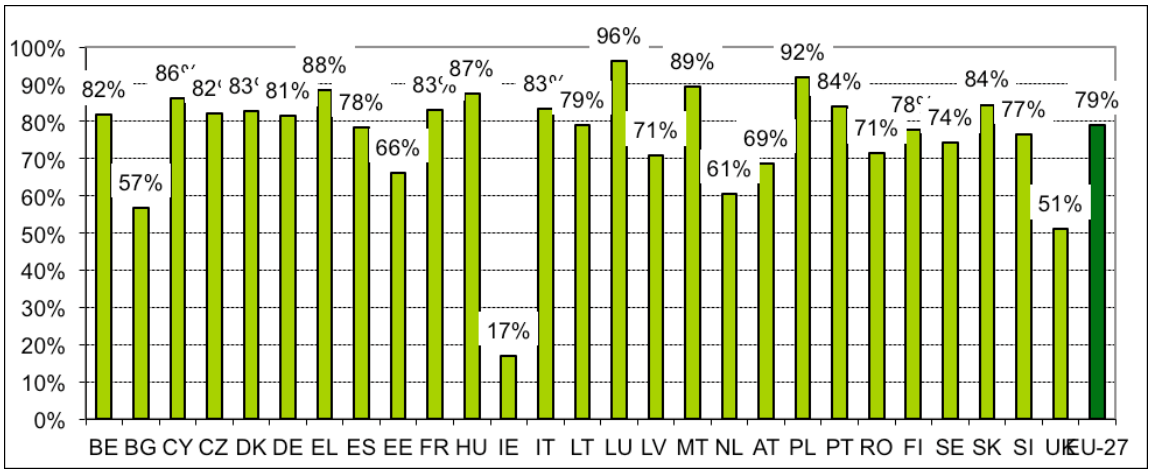
– It was not possible to analyse the opportunity costs of reverting to production methods less favourable for the environment by those agricultural producers who already fulfil the green measures, and so this is not taken into account (except for permanent grassland).[81]

– It was not possible to precisely quantify the economic benefits of greening, due to the lack of data on the impact on yields. Moreover, the benefits (such as improved soil quality and fertility, a reduced risk of desertification, better pollination services, a reduced need for fertiliser and plant protection product inputs, improved resilience to climate change, better water retention etc.) would have in most cases a medium- to long-term time horizon and would vary significantly across regions and farming systems.

As a consequence of the above limitations, the results tend to underestimate the potentially positive impact of greening, as the analysis concentrates on the 79% of EU farms for which greening comes with a cost (Figure 17). The present and expected future pressure on farm costs implies that retaining present practices by those farms that are presently not affected by greening would still have an important, albeit not measurable, impact on sustainability.

[81] The role of different instruments in encouraging environmental actions is explained in Chapter 4 of Annex 2: Greening the CAP.

Figure 17: Share of farms bearing the costs of greening measures

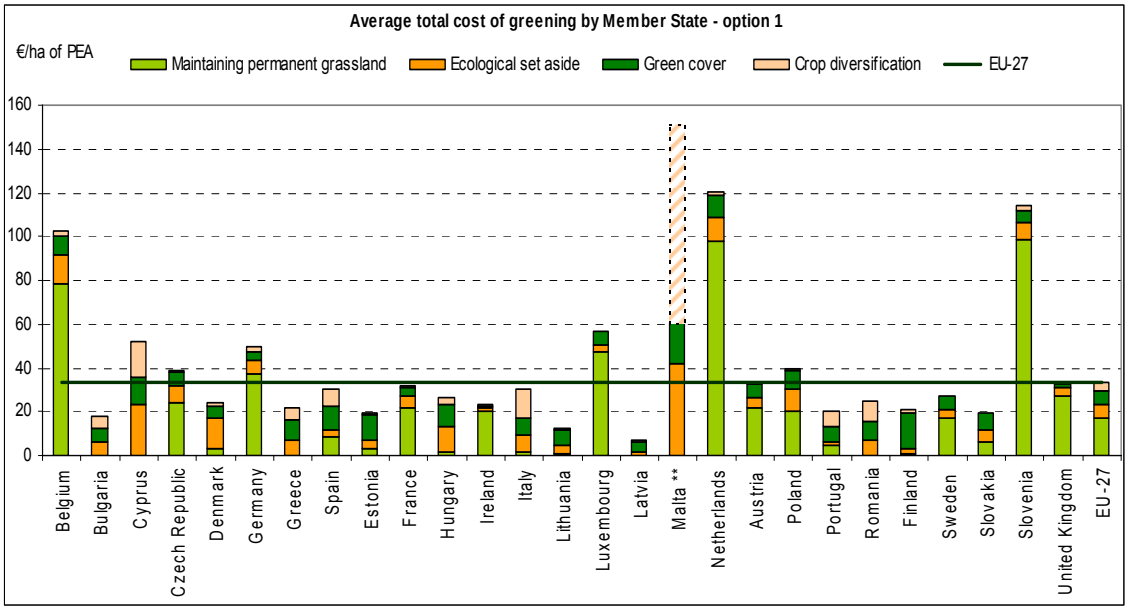


Source: DG AGRI L3

The resulting average costs per ha of all the greening measures together across the EU27 range from € 33 to € 41/ha, depending on the implementation option of greening, with up to half coming from the cost of maintaining permanent grassland (average € 17/ha). Per farm, average costs range from €1041 to €1280. These figures represent average costs spread out over all agricultural area, including area not affected by greening. The relevant costs for the land affected are considerably higher (it is estimated that 25-30% of the agricultural area would see its land use and production methods modified or would face an opportunity cost) (Figure18). For instance, the cost of the permanent grassland measure would reach € 216 per ha of permanent grassland where there are alternative opportunities, while the cost of ecological focus areas would stand at € 261 per ha of land that needs to be set aside.

An ambitious crop diversification (the main crop cannot exceed 50% of the area, instead of 70%) would bring average cost up from € 4 to € 9 per ha. Similarly, a more ambitious regulation for ecological focus areas (10%, instead of 5%, is set aside) would bring average cost up from € 6 to € 14 per ha of agricultural land.

Figure 18: Average total cost of greening per Member State

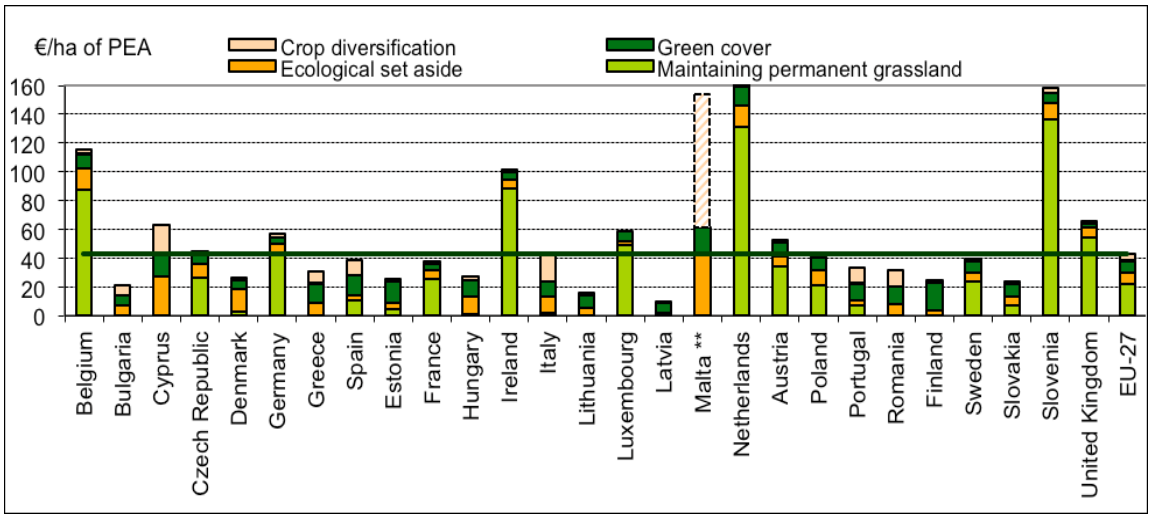


Source: DG AGRI L3

Moreover, these average figures hide wide variations across Member States / regions and farming systems, reflecting differences in land use and profitability as well as in current environmental practices (the extent to which the areas already provide significant environmental services, or put substantial pressure on the environment). The Member States that would be facing the highest overall costs are Netherlands, Slovenia, and Belgium, largely due to the opportunity cost of not ploughing permanent grassland. However, the CAP already sets a limit on the reduction of permanent grassland per Member State, so these opportunity costs could be expected to be somewhat lower than the figures suggest.

In general, higher costs are associated with crop diversification in southern Member States, set aside in Member States with high area productivity, for instance due to the importance of horticulture, green cover in some southern Member States or the Baltic countries, or permanent pastures in Member States where milk and beef production are important and based on both intensive and extensive systems (see Figure 19).

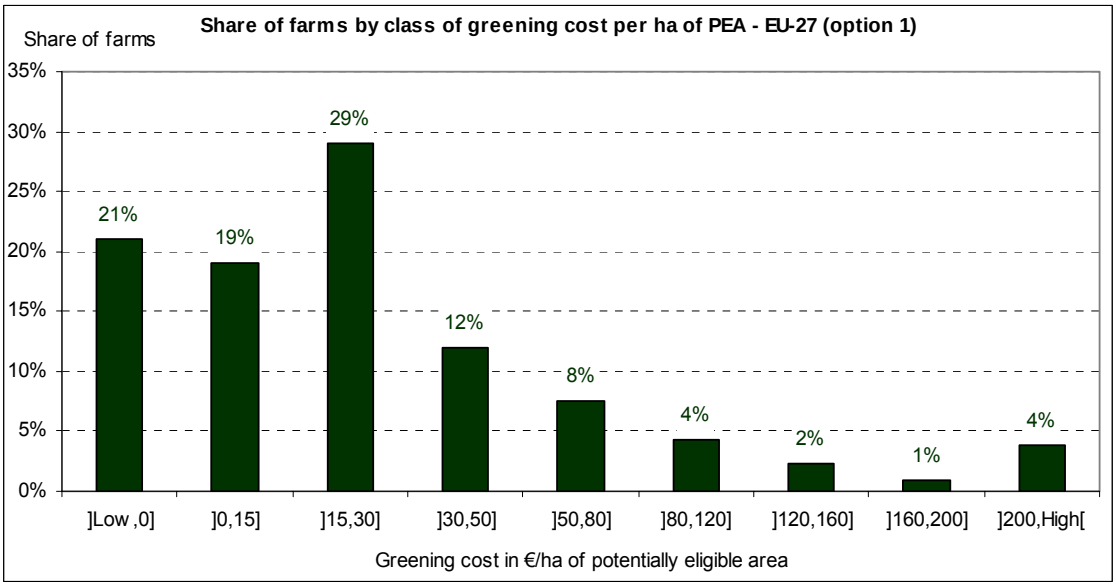
Figure 19: Average total cost of greening – only for farms which bear a cost



Source: DG AGRI L3

Greening costs also vary according to the type of farm and its specific situation. The largest negative impacts are observed for pig and poultry and milk farms due to the increase in feed prices. Field crop farms may benefit from significant crop prices increases induced by some greening measures. Altogether the costs of greening between farms would vary strongly (Figure 20).

Figure 20: The distribution of farms according to greening costs



Source: DG AGRI L3

When estimating the impact on farm income, it is assumed that farmers fully comply with greening and receive their full direct payment amounts; hence, the impact on income is solely driven by the costs of greening. In the EU-27, the various options of greening would result in a decrease in the average income ranging from -3.2% and -1.4%. It is interesting to note that, although the increased costs of more ambitious crop diversification result in a further decrease of farm income, a more ambitious set aside requirement has a positive effect on income. This is due to a higher increase in market margins (in particular for field crops, such as cereals and rice) which offset the cost of greening. As with costs, the impact on income per worker varies significantly across Member States, regions and farming systems.

The market effects of greening measures are expected to be pronounced as a result of the limitation in available arable land and grassland linked to the set-aside requirements and the limited choice in cropping patterns of the crop diversification requirements. The option presented here is an ecological set-aside of 5% and the limitation that no single crop in a farm exceeds 70% of the arable area. Under such conditions, cereal production would decrease by between 0% and -5%, while oilseeds production would show changes ranging between -1% and +5%. The range of impact is linked to the degree of crop specialisation. The reduction in domestic cereal and oilseed production would generate some price increase (+2% for cereals and unchanged for oilseeds), with production in the animal sector expected to decline slightly (from 0% and -1.5%) whereas producer prices would increase by about +1%.

Crisis and risk responses

This scenario provides for the possibility of subsidising insurance, support to mutual funds and introducing an income stabilisation tool through a risk management toolkit in the rural development policy[82]. Offering insurance subsidies and helping mutual funds

[82] For a description of the three tools, CAP role in risk management and analysis of the income stabilisation tool see Annex 6.

will help to embed it better in a strategic framework for a given region and to coordinate with other actions supporting farmers' risk management (prevention actions, advisory and training possibilities etc.). The possibility of financing an income stabilisation tool in areas where private-based instruments (e.g. insurance) are not available gives farmers access to aid in the case of a severe income crisis[83]. At the same time, a European Globalisation Adjustment Fund could provide ad-hoc targeted support for the farmers affected by changing global trade patterns. The effectiveness of such a tool is closely linked to its design and implementing modalities, most notably with regards to its financial procedure and triggering mechanisms as well as its articulation with other CAP measures.

Rural growth

Rural development programmes can make a significant contribution to growth in rural areas. The combination of measures and integrated projects allows Member States to develop an adequate strategy to make the best use of the funds available in line with EU priorities.

The reinforcing of the strategic framework of rural development policy should ensure that rural development responds in a more targeted and complementary manner to the needs of rural areas, while the placing of all EU funds under a common framework reflects a truly territorial approach to development. This, together with other improvements promoting cooperation between actors, has the potential to revitalize rural territories. However, these are ambitious changes to put in place that may strain the administrative capacity of certain rural areas in the EU.

Furthermore, a Common Strategic Framework (CSF) would help the EU funds to complement each other better – at EU level. This would mark a step forward from the current period, in which efforts to ensure complementarity are made essentially at national and regional level. The CSF also has a role to play in helping the funds to work together at sub-regional level (i.e. in Leader-type roles).

At national level, the CSF could translate into Partnership Contracts (PC) concerning the use of the EU funds concerned, including the relevant coordination mechanisms. Within the PCs, Member States would have to explain how they would use the policies covered to serve the thematic objectives of the CSF – in ways which would be in line with their National Reform Programmes set out in the framework of Europe 2020. Other key features of the PCs would include: the specification of indicators for assessing progress on the objectives chosen and a description of national and regional mechanisms for co-ordinating the use of EU funds. This would be reinforced by ex-ante "conditionalities" (i.e. preconditions for the approval of programmes and / or the disbursement of payments through programmes) and a performance reserve, in order to encourage better programme performance.

5.2.2. Social impacts

Redistribution between Member States

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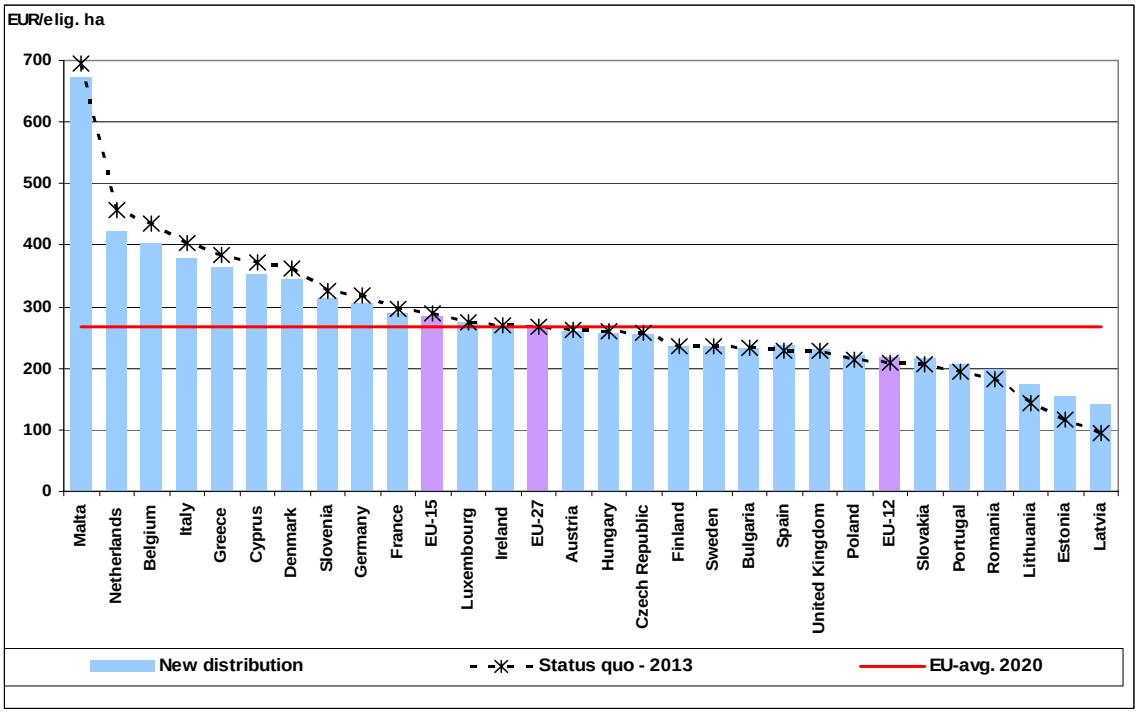
[83] The effectiveness and efficiency of a complementary emergency mechanism to react to crisis situation would critically hinge on its articulation and coordination with market measures as well as other private and public risk management tools.

This option would provide less convergence for the Member States below 90% of the EU average. Consequently, the cost of convergence to be borne by Member States above the EU average would also be more limited. In absolute terms, the biggest beneficiaries would be Romania, Poland and Spain, while the biggest contributors would be Italy, Germany and France. The total amount redistributed would come to EUR 738 million.

Figure 21: Closing one third of the gap between current level and 90% of average



Source: DG AGRI

This scenario also proposes a redistribution of rural development support aimed at improving the allocation of funds between Member States in relation to its objectives.

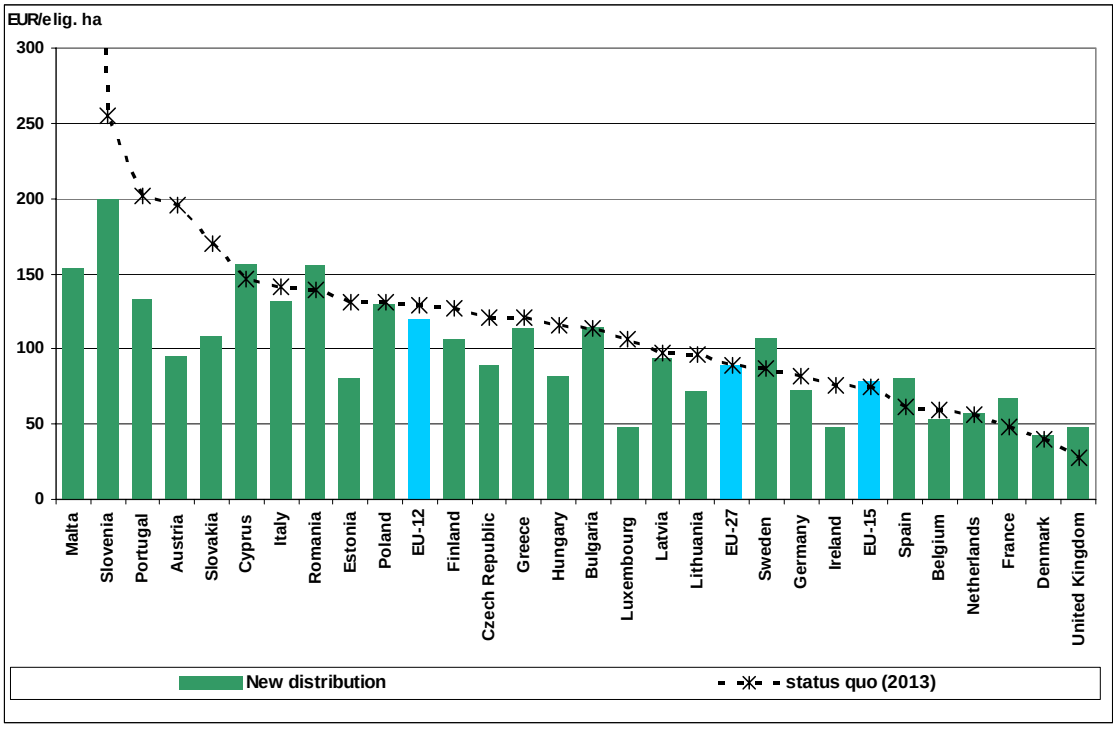
A distribution based on a formula that takes into account the competitiveness of the agricultural sector (e.g. agricultural area, labour force and labour productivity), climate change and the environment (e.g. agricultural area, Natura 2000, LFA, forest and permanent pasture areas), and balanced territorial development (e.g. rural population) would improve the effective support by enhancing its fit to the declared objectives of the policy. It would then be calibrated by a cohesion factor GDP/capita in PPS (the lower the GDP in the Member States, the higher the Member State envelope).[84]

The results of redistribution would differ considerably from the current distribution as shown in Figure 22. Regardless of the redistribution key, some Member States (such as Austria) would lose significantly, while others (such as United Kingdom and Sweden), would gain substantially. It may thus be advisable to rely on the current distribution so as to ensure better policy continuity in administering programs from the current period (Figure 23). Rural development support within a range (e.g. 90%-110%) would reflect

[84] A possible formula taking into account the three elements equally would be: [1/3 [(½ Area + ½ Labour) x labour productivity inverse index] + 1/3 (1/3 Area + 1/3 Natura 2000 + 1/6 Forest + 1/6 Permanent pasture) + 1/3 Rural population] x GDP inverse index

both "an objective element" of contribution to the future policy as well as the distribution in the current period, (which depends mostly on the shares of Member States in the three funds that were brought together to form the EAFRD).

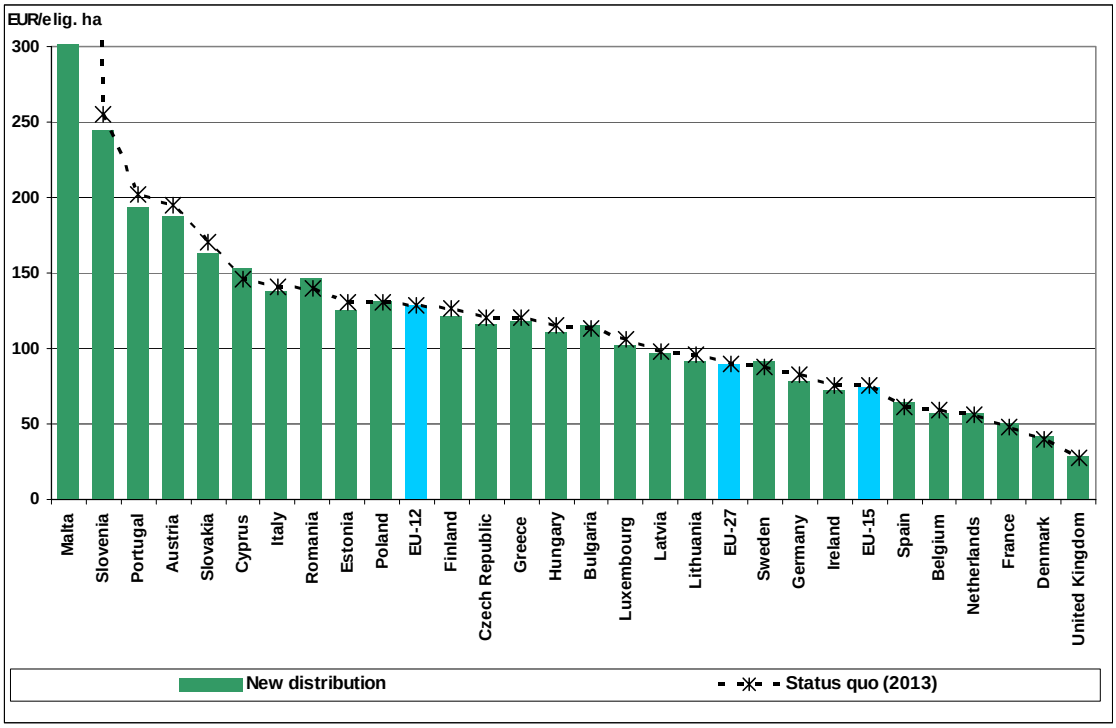
Figure 22: Distribution of RD according to objective criteria[85]



Source: DG AGRI

[85] This distribution key doesn't take into account the transfers made through the market reforms in the tobacco, cotton and wine sectors.

Figure 23: Distribution of RD – pragmatic approach (use of objective criteria within a 90-110% range)



Source: DG AGRI

Targeting of direct payments/redistribution among farmers

The new design of the direct payment scheme divided into components allows a better targeting towards certain types of holdings or geographical areas. Since the basic rate of support which would be calculated on the basis of a share of the total national envelope is the only component of the direct payment system to which all farmers are entitled (subject of course to having entitlements), some farmers may see their basic income support substantially reduced in particular in the Member States whose budget envelopes decrease.

However, farmers who can benefit from many components of the system, such as those located in areas with specific natural constraints and thus eligible for this component of the direct payments and efficiently carrying out the environmental measures of the greening component, can benefit from the new design. The micro-economic analysis shows that grazing livestock farms (beef and sheep) and farms located in LFA would gain the most.

The introduction of capping of direct payments also enables further targeting of payments. Depending on the option chosen with regard to implementation, capping would release between € 278 million and € 835 million for the EU27. This represents between 0.6% and 1.9% of the total amount of direct payments at EU level which is relatively low when compared to the current amount resulting from modulation (around € 3 billions for budget year 2013).[86] However, since reducing the element of the payment

[86] The FADN is a sample survey. As the capping concerns only a very limited number of very large farms it cannot be always guaranteed that this type of large farms is well represented in all Member States. Thus, the figures provided should be considered as indicative.

related to the provision of environmental public goods could have an adverse effect, its exclusion from capping thresholds would be advisable. In this case, the amounts saved would be considerably smaller.

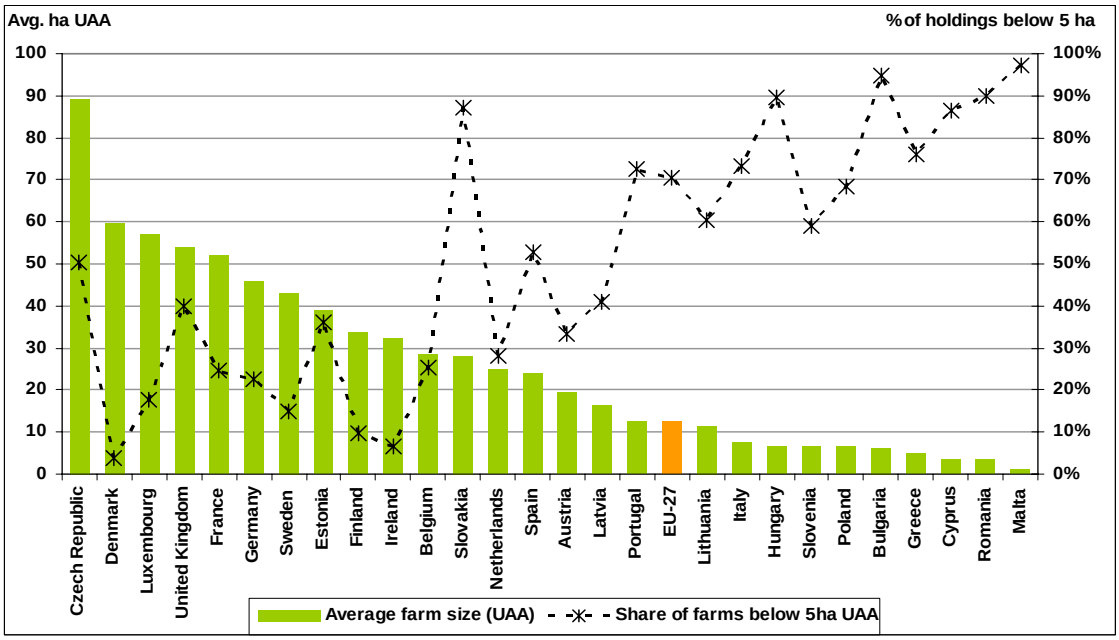
This is due to the thresholds of capping, the rates applied and the possibility for farms to benefit from an "employment" mitigation factor (e.g. by increasing the threshold for capping by wages actually paid or by a lump sum of e.g. EUR 15 000/AWU), which affect only a limited number of farms in comparison to the modulation mechanism. Few countries are affected - mainly Bulgaria and United Kingdom and to a lesser extent Hungary, Slovakia and Romania while some Member States would not be affected at all: Belgium, Cyprus, Ireland, Luxembourg, Malta, Austria, Finland, Slovenia, France or only marginally affected i.e. Poland, Sweden and Portugal. In addition, the average income per unit of labour in EU27 would hardly be affected (between 0 and -0.5%), but there are important variations for some Member States depending on the formula chosen for the mitigation of labour effect. Where the mitigation by labour is the lowest (50% wages), countries most affected would be Slovakia and Bulgaria but also Czech Republic, Hungary and Romania, as they have a high number of large farms, cooperatives, etc.

As regards small farms, a specific scheme would acknowledge the contribution such farms make to rural employment, viable rural areas and cultural heritage in many regions while cutting red tape in the application process. It could allow small farms to restructure, diversify and increase their competitiveness, e.g. by exploring new local market opportunities and providing specific regional products.

To achieve this, the scheme would have to be designed either in a way that encourages development and structural change or allows small farmers to choose the development path they wish (maintaining local small-scale production) by narrowing the income gap with bigger structures. This could be done by introducing a lump sum payment at farm level that replaces all other elements of the direct payment, i.e. the basic rate, the payment for natural constraints, coupled payments and the greening component.

However, a support scheme for small farmers within direct payments would offer only limited possibilities for targeting and therefore needs to be combined with targeted support through rural development policy, focusing on the competitiveness of farms. By contrast, it would cut red tape by simplifying administrative procedures and controls for farmers and national administrations.

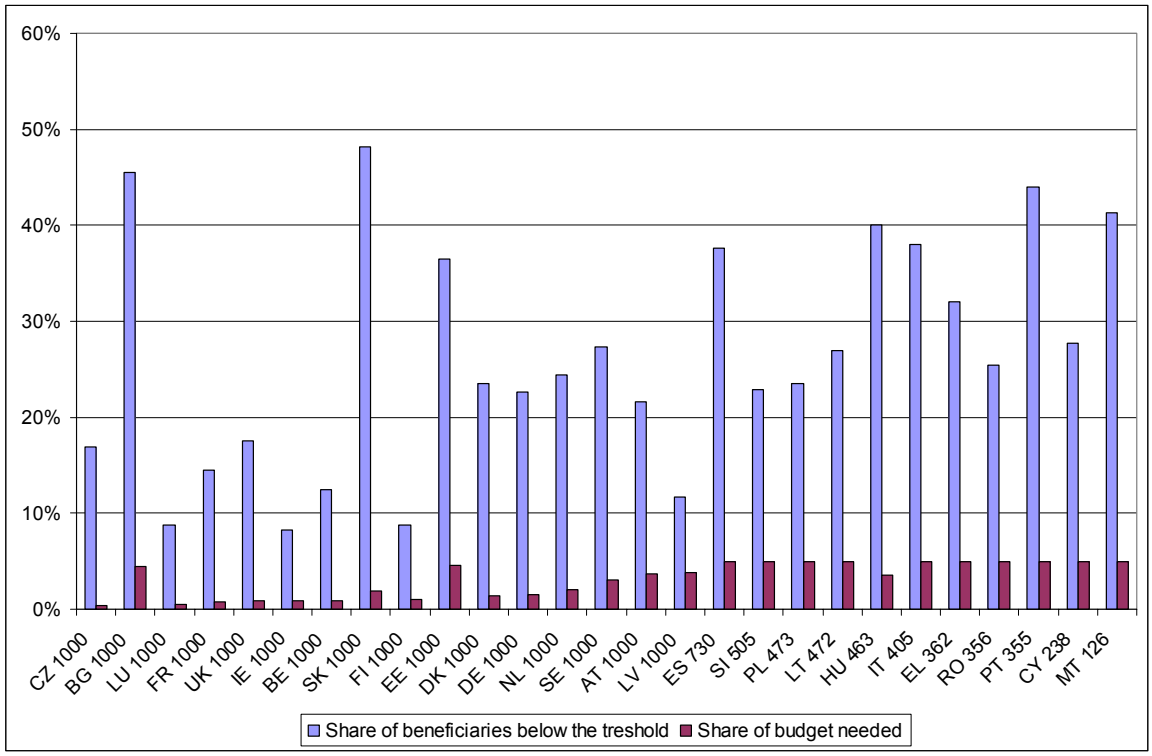
Figure 24: Average farm size and farms below 5 ha UAA



Source: Eurostat Farm Structure Survey 2007

Different options for the design of such a scheme would result in quite different numbers of concerned beneficiaries and budget shares needed for running the scheme. Figure 25 shows the impact if each Member State would try to reach the maximum threshold of €1000/beneficiary or the maximum share of its national direct payment envelope (e.g. 5%). This limitation to 5% of the national envelopes would reduce the threshold of €1000/beneficiary in eleven Member States, but the number of beneficiaries concerned still differs widely between Member States. This is due to the form of the direct payment distribution curves in each Member State, which differs significantly (see for instance Romania and Bulgaria) reflecting different structural characteristics of agriculture.

Figure 25: Budget and number of beneficiaries in the scheme for small farmers[87]



Source: CATS data for financial year 2009, DG AGRI calculation

A specific support scheme for young farmers could encourage the entry of young farmers into the sector and thus improve the age structure in the farming community. A setting-up aid is likely to prove most efficient because it is targeted only at new entrants, not to those young farmers already in the sector. Furthermore, a scheme that would generally target all farmers under a certain age could be challenged as being discriminatory.

In order to avoid double funding and an overlap with similar measures under Pillar II, the young farmer scheme should be designed in such a way as to bring additional income and lower the cost of capital, which would make it complementary to rural development support.

A support scheme for young farmers would offer them an additional payment at the level of 25 % of the average direct payment per hectare in the Member State in which they are located multiplied by the farm size in hectare with a limit of 25 ha in Member States with average holding size below 25 ha and up to the average holding size in other Member States. Such a scheme would not require substantial budgetary resources (estimated at around 0.2% of the direct payment budget at EU-27 level- see Table 3) but could provide an important incentive for young farmers to establish their businesses (cf. Annex 3 on direct payments).

[87] Those figures do not taken account of structural adjustments and of redistribution of direct payment at farm level. For those Member States in which a threshold of 1000€ per beneficiary will absorb more than 5% of the direct payment envelope for small farmers, the threshold has been reduced accordingly and its level appears after the initials of the Member State on the axis.

Table 3: Impact of Young Farmer Scheme (YFS) with a lump-sum support

	number of farmers concerned by YFS*	average farm size of young farmers	average farm size in MS	YFS payment per farmer**	YFS in share of total DP budget
	N°	ha	ha	€	%
BE	369	37,8	28,6	2.887	0,20%
BG	1.890	17,8	6,2	1.039	0,24%
CZ	337	77,7	89,3	4.950	0,19%
DK	365	74,1	59,7	5.135	0,21%
DE	4.001	43,9	45,7	3.375	0,26%
EE	142	70,6	38,9	1.521	0,16%
IE	1.011	44,8	32,3	2.161	0,18%
GR	6.233	10,1	4,7	918	0,28%
ES	5.513	35,0	23,8	1.485	0,16%
FR	3.977	90,3	52,1	3.763	0,20%
IT	6.721	12,3	7,6	1.158	0,20%
CY	173	5,4	3,6	472	0,16%
LV	873	20,1	16,5	711	0,28%
LT	1.438	17,7	11,5	772	0,24%
LU	18	82,4	56,9	3.922	0,21%
HU	4.592	8,9	6,8	575	0,20%
MT	50	0,9	0,9	156	0,16%
NL	564	27,9	24,9	2.638	0,19%
AT	1.939	19,0	19,3	1.234	0,34%
PL	27.489	7,5	6,5	414	0,36%
PT	768	27,0	12,6	1.298	0,16%
RO	19.720	2,9	3,5	147	0,15%
SI	394	9,2	6,5	716	0,20%
SK	315	45,3	28,1	1.512	0,12%
FI	688	42,2	33,6	1.983	0,25%
SE	474	56,4	42,9	2.522	0,17%
UK	1.241	91,5	53,8	3.106	0,10%
EU-27	91.292	17,8	12,6	986	0,21%
EU-15	33.880	35,3	22,0	1.967	0,20%
EU-12	57.412	7,5	6,0	407	0,25%

* based on figures of young farmers assisted in RD programmes and Eurostat

** 25% of average DP/ha x average farm size of young farmers (with limit of 25 ha in MS whose average size of holding is below 25 ha and limit of average size of holdings in the MS where average holding size is more than 25 ha)

Source: Eurostat data, DG AGRI calculation

Better targeting of support to active farmers only would increase the acceptance of direct payments by society at large. However, the definition poses substantial practical difficulties as it needs to exclude non-active farmers while at the same time not affecting the access of genuine farmers to support. This is particularly demanding as the number of beneficiaries potentially affected and the information available at Member State level to define an "active farmer" differs strongly between Member States.

Many of the criteria that could be used to define who is an "active farmer" could be problematic from a WTO point of view or due to the fact that they could lead to unequal treatment of farmers. For example:

– The criteria that the turnover (or income, or receipts) derived from an agricultural activity represents or represented a certain percentage of the total turnover (income, receipts) of a natural or legal person or that farm animals or agricultural crops or farm machinery are present on the agricultural holding could be used. However, these criteria could result in problems with the green box classification of support if they were not linked to a date in the past – which, in turn, would make them questionable for determining who is an active farmer today.

– It could be stipulated that payments should be granted only to those natural or legal persons for whom agriculture forms a significant part of overall economic activities or whose principal business involves exercising an agricultural activity. However, such a criterion could cause problems of unequal treatment or discrimination if applied differently by different Member States.

Decoupling has generally led to improved competitiveness and market-orientation in most sectors. But there remain cases where targeting support to specific types of production which generate benefits for the environment and the social fabric of rural areas, and which may be in danger of disappearing without coupled support, is pertinent.

Farm-level analysis of the beef, sheep and goat sectors shows that the impact on farmers' margins of withdrawing coupled payments varies substantially across those Member States and the different production systems and regions that were analysed. For example, specialist breeders especially in mountainous LFAs are the most sensitive to potential production losses due to decoupling of headage payments, especially in France, Austria and Portugal, where 18% to 44% of the suckler cow population could be affected (see Table 4).

Table 4: Output, margins and Coupled Direct Payments, specialist beef breeders

	AT	AT	ES	ES	FR	FR	PT	PT
	Farms moving to (-)	Total farms	Farms moving to (-)	Total farms	Farms moving to (-)	Total farms	Farms moving to (-)	Total farms
Farms represented	**720**	**1 840**	**1 690**	**43 870**	**16 020**	**70 870**	**2 210**	**8 410**
Farms represented % ot total	**39%**	**100%**	**4%**	**100%**	**23%**	**100%**	**26%**	**100%**
Beef specialisation - % output	67%	65%	80%	85%	82%	84%	79%	75%
Heard affected - total LU	**26 371**	**67 393**	**120 495**		**1 178 545**	**5 213 700**	**86 049**	**327 452**
Share of herd affected	**44%**		**6%**		**18%**		**31%**	
in €/COW								
TOTAL BEEF OUTPUT	729	763	538	797	790	965	388	441
TOTAL BEEF COUPLED DP	265	267	220	160	251	233	226	210
Share of CP in output value	**36%**	**35%**	**41%**	**20%**	**32%**	**24%**	**58%**	**48%**
Gross margin	**-118**	**-33**	**-94**	**279**	**-101**	**142**	**-95**	**68**
Gross margin with CP	**147**	**234**	**126**	**438**	**150**	**375**	**131**	**278**
in €/AWU								
Total output	18 553	18 908	33 110	28 135	35 813	48 220	9 840	12 297
Balance subsidies and taxes	22 132	21 725	18 180	9 772	24 755	26 463	10 894	9 658
of which LFA/AWU	4 598	4 660	693	655	3 070	2 783	1 103	1 023
of which environmental/AWU	8 387	7 934	814	166	2 504	2 621	865	854
Share of all subsidies in total receipts	**54%**	**53%**	**35%**	**26%**	**41%**	**35%**	**53%**	**44%**

Source: DG AGRI – EU-FADN

Headage payments represent a lower share of the margin of the specialist breeders and fatteners; therefore the impact of a total decoupling would be limited for these systems except in France and Portugal where respectively 15% and 36% of cows could be affected. To illustrate the fact that coupled support is of particular importance in

disadvantaged regions, it should be underlined that 84% of the EU-27 beef breeders are located in less favoured areas.

In general, it can be concluded that in rural areas where little other agricultural or general economic activity takes place, beef, sheep and goat production can contribute to providing employment and keeping up the vitality and attractiveness of rural areas. As these types of farming are often located in disadvantaged regions, the continuation of production can be judged favourably from a social and environmental point of view.

Territorial balance
This option best promotes territorial balance by directly addressing the long-term sustainability of agriculture and rural areas in line with Europe 2020. The new model of direct payments, in addition to the redistribution, should allow for a more balanced and better targeted support, including to marginal areas and farming systems.

5.2.3. Environmental impacts

This scenario introduces greening measures into the Pillar I. This frees up funds for more ambitious agri-environmental measures under RD. Farms located in LFAs would see the largest income gains.

Encouraging environmental and climate friendly practices
The expected environmental and climate action benefits of introducing greening measures in the Pillar I are set out in the table below, along with the main costs for farmers, as described above.

Green cover - a temporary plant cover of arable land that would otherwise remain bare at certain times in the year	• Benefits for water quality (esp. reduction of nitrate leaching); soil quality and reduction of erosion; climate change mitigation (increase in soil organic matter and reduction in chemical fertilizers) and adaptation; flood prevention • Costs for seeds, machinery, energy and labour during sowing in autumn and mechanical destruction and ploughing in spring; in the case of winter stubble, income foregone (no selling or grazing of the straw); possible cost savings on fertilizer and impact on yields for the next crop • Opportunity costs for farmers already using green cover but who may be tempted to revert to bare soils *Note: in Nitrate Vulnerable Zones, green cover may already be compulsory*
Crop rotation/diversification - planned and ordered succession of different crops on the same field (usually lasting 3-5 years)	• Benefits for soil organic matter and structure; reduction of soil erosion and nitrate leaching; nutrients management and input reduction; benefits for disease control; water quality and quantity; climate change mitigation and adaptation; improved habitats and landscape diversity • Costs include significant short term implementation costs (may require new equipment and skills, different marketing outlets); income foregone for the main crop, esp. in case of monoculture; short-term negative impact on yields in intensive farming • Long-term benefits (improved yields and profitability over time, improved disease and pest control, less need for plant protection products) require clear quantitative assessment, in addition to qualitative assessment – "fallacy of composition" risk (what is

	good in smaller scale could be bad in larger scale if global price impact too strong) • Opportunity costs for farmers already practicing crop rotation and who may be tempted to revert to monoculture
Permanent grassland - that has not been in arable rotation for at least 5 years, thus ranging from High Nature Value to semi-natural to cultivated grassland	• Benefits for climate change mitigation (esp. organic soils and peatlands[88]) and adaptation, biodiversity, soil, water management, flood prevention and landscape amenities • Opportunity costs of not converting into arable land may be high, given the increased demand for arable land that can be put to a more profitable use; hence the need to support grassland-based livestock systems on environmental grounds • Relatively low cost of maintenance (mowing, grazing, avoiding inappropriate shrubs and bushes) *Note: that there are important differences in the amount of permanent grassland in the different Member States*
Ecological Focus Areas - land left fallow (not in production) for environmental purposes	• Benefits for biodiversity; soil and water quality; climate change mitigation and adaptation; pest control; landscapes • Impacts vary depending on whether set aside is rotational, on how land is maintained and on its location (e.g. buffer strips along water courses) • Opportunity cost of income foregone due to lower production, but this could be balanced with possible increase in prices
Natura 2000 - the EU wide network of Special Areas of Conservation under the Habitats Directive and Special Protection Areas under the Birds Directive	• Benefits for biodiversity, water quality and climate change mitigation largely depend on conservation measures put in place in each Member State • No additional cost since relevant requirements are already mandatory

The greening component of Pillar I foreseen in the integration scenario and environmental schemes under rural development should be developed in a complementary manner aimed particularly at fostering High Nature Value (HNV) farming.[89]

The widespread reach of greening measures will contribute strongly to the EU biodiversity strategy to 2020. The latter points to the need to further improve the integration of biodiversity in key sectors such as agriculture and forestry in order to meet

[88] The most important way in which peatlands can be beneficial in terms of mitigation is either leaving them water-logged (i.e. no drainage and no conversion to arable, grass, forestry) or bringing them back to water-logged conditions.

[89] For a more detailed discussion of the High Nature Farming in the CAP see Annex 2.

the ambitious EU headline target for 2020.[90] The integration scenario is best shaped to achieve this target and is in line with the actions called for in the biodiversity strategy, with the greening component of the Pillar I as a major feature.

The exact implementation of these measures and articulation with cross compliance and agri-environmental measures of rural development play a crucial role for the extent to which environmental benefits can be achieved. For example, the farms (or part thereof) with organic certification (around 7.6 million ha, of which half is permanent grassland) could be exempt from the greening conditions due to their uncontested environmental benefits and possible climate benefits.

The greening component could be complemented by rural development measures on the same issues which add value by being more ambitious and/or better tailored to the local situation, as part of a package of measures, or by encouraging connectivity of environmental features between farms. In such cases, the RD payment would clearly have to go beyond the 'greening' component to avoid double funding for the same measure.

Bottom-up approaches and efforts to enhance collaboration of farmers in terms of implementation of agri-environmental actions will yield higher benefits. In view of this, measures enhancing connectivity for environmental and climate change reasons could be given a higher rate of co-financing and/or farmers should receive transaction cost payments to encourage uptake by Member States and farmers.

The shift of some agri-environmental actions to the green component of the direct payment scheme, would free up some funds that might be used for more targeted and ambitious agri-environment measures, thus producing a further reinforcement of the environmental outcome of the policy. The policy objectives would be fully aligned with Europe 2020 priorities, including the objectives of "Resource Efficient Europe" which refers to biodiversity and climate change targets, including the sustainable production of renewable energy.

The system of setting quantitative targets within rural development programmes would be strengthened. This should provide an incentive for Member States to improve the framing of their policy and to programme and target those measures that have the most beneficial effects. The focus on innovation should improve resource efficiency.

In addition, there would be more guidance in terms of how to best use packages of measures in order to maximise positive outcomes, e.g. advice and training offered alongside demanding agri-environment measures. In this context, the Farm Advisory System has an important role to play in relaying the technical know how necessary to allow for a smooth transition to the adoption of the greening elements of the pillar I, and in encouraging farmers to adopt more advanced measures under rural development.

Concerning climate change the combined positive mitigation effects of greening measures (e.g. permanent pasture, crop diversification offering both reduced emissions and increased carbon sequestration in soils) covering the whole EU territory, complemented with more ambitious rural development targeted measures (investments in

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[90] COM(2011)244 final.

bioenergy, afforestation, agri-environment measures) and by requirements for sustainable agriculture practices promoted by cross compliance applicable to both pillars will enable the agriculture sector not only to fully share the burden of meeting the short-term targets (set under the Effort Sharing Decision (ESD)) but will also help set agriculture on the right path to achieve the required level of reduction in the longer term as estimated in the EU low carbon economy roadmap 2050 modelling exercise[91].

In addition, many of those financial supports to be provided or requirements would have strong win win effects in terms of adaption to climate change. Adaptation will be a necessary component of the success of the EIP, which focuses on increased productivity since without climate adaptation productivity increases will not be possible. This is particularly the case for several greening and agri-environment measures as well as GAECs that will, taken together, strengthen resilience by improving soil quality and water management by promoting more efficient water use.

Redistribution of support

Farms located in LFA/NHA would gain most under the integration scenario. They would benefit both from the additional income support to areas with specific natural constraints in the Pillar I and from the redistribution of direct payments within each Member State (whatever the redistribution option). This would be favourable for the continuation of farming in areas with a high risk of land abandonment, which is in turn positive for biodiversity. In addition, farms in LFA/NHA have generally a high share of permanent pasture. Enhanced support to small farms could further help addressing the risk of land abandonment in marginal areas.

Depending on the detailed measures of and budget allocation to the green component and the specific natural constraints payment of the scheme, the redistribution effect of the integration option towards areas where the maintenance of agriculture is essential for the provision of public goods would be important, in particular areas in Natura 2000 and areas with natural constraints. For instance, if all current less favoured areas are used for the specific natural constraint payment, the direct payment granted to farms located in those areas would increase by 38% at EU level in mountainous areas and by 15% in other LFA compared to the status quo in 2020.

In addition, the possibility to mobilise support from different sources (Pillar I and Pillar II) together with the maintenance of land in Good Agricultural and Environmental Conditions would allow Member States to better calibrate the support needed against risk of land abandonment.

5.2.4. International impacts

The implementation of the targeting of direct payment will have to ensure that all components of the payment are in line with WTO rules. This means in particular that the extent of coupled support would need to remain within clearly defined limits and the

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[91] As the impacts of climate mitigation measures vary widely between regions depending on climatic and soil conditions as well as production systems, it is difficult to provide an aggregate value for the overall EU effects. An overview of the effects of greening measures and selected other actions is provided in Annex 2b: Assessment of selected measures under the CAP for their impact on greenhouse gas emissions and removals, on resilience and on environmental status of ecosystems.

elements used to define an "active farmer" would need to respect WTO green box criteria (in particular they cannot imply an obligation to produce). To retain the WTO green box nature of Pillar I payments, the 'greening' component will need to be a decoupled, fixed payment applying to all farmers in a specific area (Member State or region); in this respect, care should be exercised in rewarding specific types of production e.g. through a grassland premium, and certainly not production *per se*.

5.2.5. Administrative impacts

In this option, the changes having a major impact on the administrative burden of farmers would come from the new architecture for direct payments. For instance capping, the new eligibility criteria of "active farmers" and the "greening" of direct payments could potentially be burdensome as additional documentation would have to be provided to Member State authorities. On the other hand, the small farmer scheme would substantially reduce the number of information obligations of the concerned farmers and the controls of such beneficiaries by Member State authorities.

For controls, the current system as regards decoupled payments relies on two layers: 100% IT cross checks (Land Parcel Identification System) and 5% on-the-spot checks. With the introduction of the greening component, the system will rely essentially on on-the-spot checks, thus higher costs for controls. However, where possible, the use of remote sensing for on-the-spot checks could help keep costs down compared to field visits.[92]

The overall administrative cost of the future direct payment system has been quantified (see details of assumptions taken in annex 8) and would approximately represent a 15% increase in the administrative cost compared to the current situation[93].

5.3. Re-focus

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

5.3.1. Economic impacts

The phasing out of direct payments would lead to strong restructuring in the sector, leading to a more competitive and less diverse sector. Growth in rural areas in less productive regions could be negatively affected.

Competitiveness and growth

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[92] For more detailed analysis about the controls for different measures see Annex 2.

[93] The detailed calculations using the Administrative Burden Calculator are provided in Annex 8. Simplification of the CAP.

This option will imply more reliance on the markets for income in a situation of increasing input prices. Those farms which will continue to be economically viable in the new environment will be larger, more open to innovation leading to cost optimisation and productivity growth and less labour-intensive. The decrease in land values should also attract new entrants. The incentives to use available risk management tools will be higher.

A different agricultural structure would also lead to a change in research and advisory services. While there will be demand for certain type of research and innovation relating to productivity, without FAS obligation at the EU level farmers are not guaranteed advice even on the basic requirements covered by cross-compliance rules. The capacity of producers to improve their environmental standards and to adapt to climate change is likely to be reduced as the initiatives and supply of AKIS services from the private sector will most likely fall short of the farm sector demand for the provision of public goods. In particular, the farming sector of Member States where the development of the AKIS is not a priority, or is strictly resource-constrained, is at a strong disadvantage in comparison with other Member States.

The concentration of production and processing in most productive region and the intensification of production, could impact negatively consumer choices, lead to an increased reliance on long supply chains, and address the ecological concerns of consumers with regard to food production in a more limited fashion.

Sector output and viability
While the decoupled payments do not have a direct influence on farmer's production choice, they nevertheless allow some who would otherwise have been forced out to remain in the sector. In addition, a safety-net intervention system provides support to those farmers who are viable in normal conditions but cannot survive a period of excessively low prices. Therefore, the elimination of those tools would lead to strong restructuring in the agricultural sector.

The end of direct support would result in strong structural changes by accelerating the move towards larger farms. The main impacts would likely be not so much on the overall quantity of agricultural production in the EU as on the way this production is distributed over the EU territory. The lack of regional production in many areas could have negative consequences for local markets and products, and could negatively affect certain up- and downstream enterprises with possible repercussions on territorial cohesion. Since the phasing out would take place gradually, these changes would be mitigated over time.

Rural growth
The socio-economic development of rural areas would be hindered as a result of the loss of valuable social capital formation and the undermining of micro- and family business development, which is currently an essential element of rural economies. This would be especially felt in regions where agriculture is the main driver, as well as in regions most dependent on rural development funding.

The impact of shifting rural development priorities will depend on the region. There will be instances where replacing axis 3 measures by axis 2-type measures would have a positive impact especially in regions with a high share of agriculture (provided that they are not too affected by land abandonment). Repealing current support to diversification measures would also affect already diversified rural economies and in the longer term

would hamper the diversification of agricultural rural region, thus impeding development of the necessary base for rural growth.

5.3.2. Social impacts

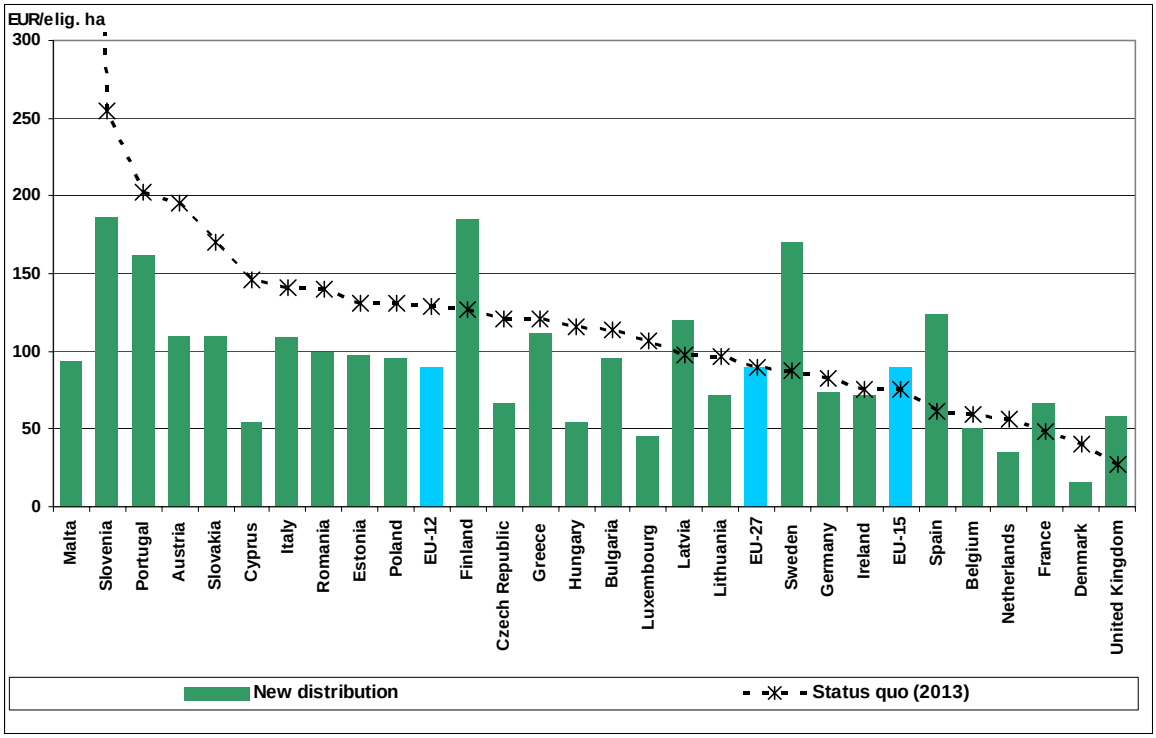
Structural changes in agriculture could lead to loss of employment in the farm sector and possibly also in related sectors. Rural development funds would be redistributed across Member States based on environmental criteria.

Phasing out of direct payments
The phasing out of direct support would lead to substantial reductions in farm incomes, forcing many producers out of business. Structural changes are likely to result in loss of employment in the farm sector and possibly also in up- and downstream sectors.

The income of large field crop, grazing livestock and mixed farms would be particularly affected due to their high dependence on direct support. The additional employment and income opportunities for farmers as land managers under Pillar II will not compensate for the significant impact of the phasing out of direct payments.

Redistribution of support between Member States
The scenario would also imply a major redistribution of rural development funds based on the environmental criteria (agricultural area, Natura 2000 area, forest and permanent pasture)[94].

Figure 26: Distribution of RD budget (environmental criteria)



Source: DG AGRI

[94] (1/3 Area + 1/3 Natura 2000 + 1/6 Forest + 1/6 Permanent pasture) x GDP inverse index

Territorial balance
The absence of direct payments risks undermining a balanced territorial development across the EU, with agriculture concentrating in the most profitable regions with the risk of land abandonment in more marginal areas, consequently hampering the socio-economic development of the areas that are most dependent on agriculture. With predominantly rural areas most likely to be affected, this in turn risks exacerbating existing income disparities. Moreover, despite the doubling of rural development support, the absence of axis 3 measures would also be an issue for those rural areas most dependent on such support.

5.3.3. Environmental impacts

The likely intensification of production in fertile areas and the abandonment of production and land in more marginal regions would have far reaching environmental consequences.

Encouraging environmental and climate friendly practices
The main environmental impacts of ending direct support would be due to the changing territorial distribution of agricultural activity. Both the concentration of production in particularly productive areas and the abandonment of production and land in more marginal regions would have far reaching consequences for the environmental balance in these areas with, e.g. loss of biodiversity and loss of possibilities to contribute to the mitigation of climate change, reduced adaptation or even increased vulnerability (e.g. fires). While there might be benefits from the establishment of 'wilderness' areas in certain situations, the overall result would be increased environmental pressures and the deterioration of valuable agricultural habitats with serious economic and social consequences including an irreversible deterioration of the European agricultural production capacity. The enforcement and sanctioning mechanism of cross compliance would depend on the amount transferred to rural development measures for which cross compliance currently constitutes the baseline.

The extent of many of these impacts also depends strongly on whether and how Pillar II would be adapted to mitigate the consequences. The doubling of funds under this scenario and the clear focus on measures for the improvement of the environment and climate change actions, should normally result in significant positive impacts on these aspects but alone would undoubtedly fall short of addressing all the risks mentioned above. This scenario would seriously undermine the achievement of the recently adopted EU biodiversity strategy to 2020.

Concerning climate change, a large part of the mitigation potential in agriculture will not be unleashed because neither support for climate friendly practices nor requirements will apply on a large part of the territory. So even more ambitious rural development measures will not enable agriculture to achieve the right reduction in emissions estimated in the EU low carbon economy roadmap 2050 modelling exercise. In addition, many win win effects in terms of adaptation to climate change will be lost in those areas not covered by rural development measures.

Redistribution of support
Phasing out direct payments could severely compromise positive environmental outcomes. Without basic income support, the less competitive farmers who very often manage marginal land and land in remote areas in an extensive manner may cease their

agricultural activity because they no longer make a sustainable income. On the other hand, agriculture activity may be concentrated and intensified in the most competitive areas. It is thus questionable to what extent the increased budget that can be made available can make up for the loss of direct payments. While GAEC rules would still apply for the beneficiaries of the rural development aid, they would not cover the entire agricultural sector.

5.3.4. International impacts

The Amber box value related to market support will diminish.

5.3.5. Administrative impacts

In the long run, the phasing out of direct payments would reduce the administrative burden for farmers and authorities, provided Member States would not replace the direct payment system by national policies. The suppression of the control and sanction system of cross compliance would reduce the irritant factor for farmers. As regards rural development, having only one objective for the measures would ease the work of national authorities.

6. COMPARING THE SCENARIOS WITH RESPECT TO OBJECTIVES AND IMPACTS

This section compares the impacts of each of the three broad policy scenarios under consideration on the basis of the analysis in section 5 and assesses the potential of each option in meeting the objectives set in section 3 in the most cost-effective manner. This comparison needs to be put in the broader context of the economic crisis and pressures on public finances to which the EU has responded with Europe 2020.

All three scenarios aim at a more competitive, sustainable and resilient agriculture in vibrant rural areas, and thus seek to better align the CAP to Europe 2020, notably in terms of resource efficiency. They differ in the combination of means to achieve these aims. Their expected economic, social and environmental impacts are summarised in Table 5 below.

Table 5: Comparison of scenarios by impact

		Adjustment	**Integration**	**Re-focus**
Economic	**Sector output**	+++	++	+
	Competitiveness (short/ long term)	++/+	+/++	+++
	Response to crisis	++	+++	+
Social	**Employment**	+++	++	+
	Income	+++	++	+
	Territorial cohesion	++	+++	+
Environmental	**Territorial coverage**	++	+++	+
	Targeted measures	+	++	+++
	Long term sustainability	++	+++	+

Simplification	++	+	+++

In terms of economic impacts, the adjustment scenario will result in the continuation of current trends. In the short term, these will preserve the size of the sector, but will not protect it in the longer term from productivity losses due to environmental constraints and lack of investment in productivity and human capital. Streamlining of market measures would provide a more effective safety-net in emergencies, but will not address the underlying issues that contribute to crises in the sector.

The integration scenario provides instruments that will mobilise the necessary resources to increase productivity through innovation and to pool knowledge and resources through collaborative actions among the farmers and in the food supply chain. To improve the bargaining power of farmers, the sub-option of increasing efficiency and creating higher value added at farm level was favoured over that which focused on affecting price negotiations only.

The refocus scenario leads to an acceleration of structural adjustment in the sector towards greater profitability of farm holdings. However, it also exposes the sector to a significant reduction in size, greater risks in terms of market stability in the absence of appropriate safety nets and risk management tools, as well as the risk of decreased spending on innovation due to the pressure on farm income.

From the perspective of consumers, all scenarios would have a limited impact on food prices, although the integration option is more likely to improve quality and choice of products and assure sustainable production. The effects on world markets (including on developing countries) would also be very limited in all cases. This is the combined result of previous CAP reforms and the present and expected future level of world prices that have turned the EU into a price-taker in agricultural markets.

In terms of social impacts (cf. Table 6), a significant income effect will result from the redistribution of direct payments. The adjustment scenario presents four sub-options of distribution between Member States based on criteria linked to convergence and to the objectives of the scheme. The challenge is how to ensure a more equitable distribution and a better targeted support in line with the policy objectives while avoiding major disturbances. The convergence towards a flatter rate would particularly benefit those Member States that are currently significantly below the EU average. At the same time, the move towards a regional model (together with the inclusion of naked land) would rebalance support between farm types, especially in Member States currently using a historical model, mostly towards more extensive production systems.

The integration scenario provides the tools to fine-tune the redistribution of support by allowing better targeting of support by means of the different components of direct payments (in particular capping, the small farmer scheme, young farmer scheme and the better definition of "active farmers"). In the case of each payment component, different sub-options were analysed to find the right balance between the redistributive and budget impact and to provide the right incentive that is best aligned with the objective of the component.

At the upper extreme of the distribution of direct payments, analysis shows that capping at the level of 150 000 EUR represents the threshold where the number of beneficiaries

and the impact on the sector's income becomes very limited. The introduction of a progressive scale reduces the danger of splitting farms to circumvent limits and a labour mitigation allows to account for the role large farms may play for employment in rural areas. At the lower extreme, a separate lump-sum payment for small farmers leads to a simpler system which, combined with an EU-wide ceiling of 1000 EUR with limit based on the Member State envelope is most cost-efficient with regard to the number of beneficiaries and its impact on income. For the young farmer scheme to provide an appropriate incentive, the premium should be linked to average payment and average size of holding in a Member State. The analysis of options on targeting towards active farmers shows that there is a high risk of discrimination in such an exercise, so an approach based on elimination of those entities which derive most profits from other activities than farming without preventing small part-time farmers from receiving payments appears to be the most practical. Such an option would set a minimum of receipts from agriculture and an exemption for beneficiaries with small amounts of direct payments.

All in all, the adjustment scenario is most likely to remain closest to the current situation with respect to impacts on employment, sector income and farm structure. The integration scenario entails higher short-term costs due to the strengthening of more environmentally friendly farming practices and more funding for productivity. However, the longer term impact would be better conditions for farmers and more balanced rural development, securing employment and income opportunities in rural areas. Structural adjustment under the terms of the refocus scenario would come at a significant social cost with considerable decrease of sector income and employment which is not globally compensated by its more targeted environmental gains.

Table 6: Impact on agricultural income in 2020 compared to status quo[95]

	Adjustment	**Integration**	**Re-focus**
Change in Farm Net Value Added	-2.0 %	- 3.0 %	-23.0 %
Additional % of farms with no remuneration of farm labour	+0.3 %	+1.2 %	+9.6 %

Source: DG AGRI L3

While EU average figures relating to change in sector income hide considerable differences between different Member States and types of farms, they highlight the need to integrate a strong pro-growth element to the policy to balance the effects on FNVA and the number of farms with no remuneration of labour. To this end, it will be essential to improve agricultural productivity and sustainability through research, knowledge transfer and generally promoting collaborative approaches. Hence the importance of the enhanced funding in EU research and innovation, in the new Multiannual Financial Framework, for food security, bio-economy and sustainable agriculture and the

[95] For the detailed calculations of the impact of direct payments redistribution on Member States and different farm types see Annex (10).

upcoming European Innovation Partnership on agricultural productivity and sustainability as a basic pre-condition that cuts across policy options.

In terms of environmental impacts, the adjustment scenario introduces some improvements in the environmental performance of the policy through the redistribution of direct payments towards more environmentally beneficial practices, enhanced cross compliance and the channelling of additional resources into new challenges under rural development. There are however serious doubts as to whether these can adequately address the important climate and environmental challenges in the future, thereby also undermining the sustainability of agriculture itself in the longer term.

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

In this context several sub-options were examined by varying the parameters of concerned measures (permanent grassland, green cover, ecological focus areas, crop diversification and a Natura 2000 specific support). The analysis shows that this is possible although some administrative burden cannot be avoided. The resulting negative impact on income remains moderate on average (but varies significantly between Member States, regions and farming systems); this negative impact would be exacerbated with a more ambitious crop diversification measure, but alleviated in the case of more ambitious provisions for ecological focus areas, due to the market impact. The greening component would also free up funds in rural development to be deployed towards more sophisticated agri-environment and climate focused measures. The combined effect of environmental and LFA measures in both pillars would thus have the potential to significantly enhance the contribution of the policy to the provision of public goods, though it could entail additional administrative efforts to manage a more complex structure and avoid duplication of measures. Provided that the right balance is struck in the design of measures and their implementation by Member States, this scenario best safeguards territorial balance by addressing the long-term sustainability of agriculture and rural areas.

The effects of doubling the spending in the refocus scenario on better targeted environmental measures would not lead to sustainable land management across the EU territory, as the policy would lose the leverage of direct payments coupled with the cross compliance requirements. In addition, the negative social consequences particularly in areas and sectors that are most dependent on direct payments (e.g. large field crops and dairy farms, extensive beef and sheep and goat farms) would be such that the temporary use of measures to support restructuring would not be able to make up for losses from the phasing out of direct payments. The absence of measures for diversification and improving the quality of life in rural areas could threaten the rural fabric, especially in

diversified rural economies, which would be a risk to territorial balance. These results are not new, but echo similar results in the two Scenar 2020 studies. [96]

Finally, there is no doubt that the refocus scenario outperforms the other two scenario as regards simplification, while the improved targeting in the integration option introduces some complexity with the new model of direct payments and the new reinforced strategic targeting in rural development, as well as the greater needs to define the interface between the two pillars. As a result, simplification has been an important consideration in the design of all options, for instance in the streamlining of cross compliance and market instruments.

At the same time, the effects of the policy will also depend on the modalities of the implementation of some elements of the policy,

- The redistribution effects of the regionalisation of payments and subsequent environmental, social and economic benefits will critically hinge on the choices made by Member States with regard to eligibility criteria and delimitation of regions.

- The effectiveness of rural development policy in achieving Europe 2020 objectives will also depend on the right programming by Member States and regions and that the closer coordination with the other funds does not remove the synergies with Pillar I.

- Budgetary effects will depend on the redistribution of support, notably the pace of convergence for direct payments with Latvia, Estonia and Lithuania mostly increasing the average payment per hectare and Belgium, Netherlands and Italy mostly losing out.

Comparing the scenarios with respect to the objectives of food provision, sustainability and territorial balance (cf. Table 7), it should be kept in mind that the means by which they are achieved can either create synergies or require trade-offs. The adjustment scenario focuses mainly on Pillar I income support measures for viable food production and Pillar II for sustainable management of natural resources in a logic that prevented benefiting fully from synergies between productivity and protection of environment. The integration scenario shifts the balance towards achieving viable food production through sustainability in a more balanced territorial development context. The refocus scenario restrains the policy to environmental sustainability, but ignores the interaction with economic and territorial factors.

The integration scenario would maximize the EU value added by concentrating on the elements of the policy which provide the most benefits from common action of Member States. It links the instruments covering the whole of EU territory to EU-wide goals with respect to environment, climate change, ensuring food security and increasing consumer confidence. It reinforces the common framework with tools and networks for sharing expertise, enhancing cooperation and encouraging transfer of know-how and innovative

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[96] Scenar 2020 – Scenario study on agriculture and the rural world, LEI, January 2007 and Scenar 2020-II – Update of scenario study on agriculture and the rural world, LEI, December 2009 http://ec.europa.eu/agriculture/analysis/external/scenar2020ii/index_en.htm

solutions. At the same time, it leaves many decisions related to practical implementation of measures to Member States and regions, where they can be better tailored to local needs. The adjustment scenario continues to derive EU value added of the CAP from having a single common policy, which was especially important in the context of international trade negotiations (especially WTO) and for the reforms of the past two decades to increase its efficiency and effectiveness. The refocus scenario refers to EU-wide goals but focuses on the availability throughout the EU of targeted local measures.

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

Table 7: Comparison of scenarios by objective, EU value added and cost effectiveness

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

On the basis of the above comparison, the preferred scenario is the integration scenario, followed by the adjustment option and finally the refocus scenario.

While the adjustment option may not be sufficiently targeted and the refocus option too risky, the integration option appears to strike the right balance in progressively steering the CAP towards the EU objectives, and this balance will also need to be found in the implementation of the different elements. The integration scenario received more comments than the other two in the consultation process. This was also the most appreciated option, although several stakeholders pointed towards opportunities coming from combining elements from more than one scenario.

7. MONITORING AND EVALUATION

Irrespective of the option to be chosen, it will be important to work on the monitoring and evaluation framework to reflect the changes in the policy, to improve its effectiveness in measuring policy performance and to align with similar work under Europe 2020.

Such work should build on the considerable experience accumulated to date. At present, DG AGRI monitors developments in agricultural markets and rural areas and the use made of CAP funding as reported by Member States. In addition:

- For Pillar I, evaluations are conducted according to a multi-annual evaluation plan, which includes evaluations addressing specific aspects of the policy and markets as well as increasingly broader evaluations, such as the evaluation of market effects of partial decoupling (completed in 2010) and the evaluation of income effects of direct support (to be completed in 2011). An evaluation of the structural effects of direct support will be launched this year.

- For Pillar II, a Common Monitoring and Evaluation Framework (CMEF) was introduced in the current programming period that includes common indicators. Programs are subject to ex ante, mid term and ex post evaluations, and capacity building is supported including the European Evaluation Network.

Finally, the coherence of EU agricultural policy with development objectives is assessed in the context of the Policy Coherence for Development process with biennial reports presented by the Commission.

In the future, it will be important to reinforce monitoring and evaluation for the CAP, including new elements of the design of the policy introduced in Pillar I, such as greening. The future monitoring and evaluation system for rural development should also better reflect the reinforced strategic approach with common indicators based on objectives and priorities and facilitate the use of evaluation as a management tool throughout the programming period (see Annex (4)).

The EU intention of climate mainstreaming, i.e. increasing the proportion of climate related expenditure across the EU budget to at least 20%, (for the CAP this relates particularly to the Pillar I "greening components", cross compliance and Pillar II measures) should be accompanied by a clear cross-cutting obligation to identify where programmes promote climate action or energy efficiency so that the EU is able to set out clearly how much of its spending relates to this goal.

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

– impact indicators linked to general objectives;

– result indicators linked to specific objectives;

– output indicators linked to expenditure under different instruments.

A possible structure for impact indicators for the CAP under the integration scenario could be:

Europe 2020: SMART – SUSTAINABLE (resource Efficiency) – INCLUSIVE			
CAP: Maintain sustainable agriculture throughout the EU			
General objectives	Viable food production	Sustainable management of natural resources and climate action	Balanced territorial development
Impact indicators	**Agricultural income** 1/ development 2/ compared to rest of the	**Greenhouse gas emissions** (including carbon sequestration)	**Employment in rural areas**

	economy **Agricultural productivity** 1/development 2/ compared to rest of the world **Price stability** (agri and food) Terms of trade Growth in food sector Trade balance; share of high value added products in exports	**Soil organic matter** and erosion **Biodiversity** 1/ farmland birds index 2/ HNV farmland areas Water quantity and quality	Poverty in rural areas GDP per capita in rural areas (compared to rest of the economy)

As regards targets, it would not be meaningful to set targets for impact indicators; this is because the policy can only give incentives steering in a certain direction, while the broad economic, environmental and social outcomes measured by such indicators would ultimately also depend on a range of external factors.

As regards result and output indicators, these could be framed in relation to the specific objectives / focus areas of the different instruments, for example:

Instrument	**Direct payments**	**Rural development (incl. EIP)**	**Market measures**
Focus areas	1. income support 2. compensation for production difficulties 3. environment and climate 4. safety, health, animal welfare	5. knowledge transfer 6. competitiveness of agriculture and farm viability 7. food supply chain organization and risk management 8. ecosystems 9. resource efficiency and transition to low carbon economy 10. employment potential and development of rural areas	11. price and market stability 12. cooperation between producers 13. agri part in the food supply chain

The process is being kicked off by a conference aimed at building consensus among stakeholders on monitoring and evaluation for the future policy planned for September 2011, to be followed by further technical meetings.

In addition, to address data gaps relating to indicators at farm level, for instance on sustainability, a pilot project is envisaged that would create a process which would allow better monitoring and evaluation of implemented reforms. The aim would be to make operational across a sample of farms, representative in terms of economic activity and land use, a set of indicators at farm level, for instance on production methods, soil and water use. The exercise would make the best use of existing indicators and ongoing initiatives, such as the Agri-Environment Indicators (joint work of AGRI, Eurostat, DG ENV, JRC and the European Environmental Agency), and in the framework of the CMEF and the FADN, as well as entail new research activity.
Moreover, in collaboration with Eurostat, a particular attention will to be drawn to the identification of administrative data and other information sources maintained under EU legislation, and assessment of their suitability for the production of statistics in order to establish agreements for their stability, accessibility and eventual adaptation to better fit statistical requirements.

8. LIST OF ANNEXES

(1) Situation and Prospects for EU Agriculture and Rural Areas

(2) Greening the CAP

(3) Direct payments

(4) Rural Development

(5) Market Measures

(6) Risk Management

(7) Research and Innovation

(8) Simplification

(9) Report on the Public Consultation

(10) Impact of Scenarios on the Distribution of Direct Payments and Farm Income

(11) Methodology; evaluations and research projects relating to CAP

(12) Developing countries

9. THEMATIC GROUPS OF THE IMPACT ASSESSMENT STEERING GROUP

(1) The benefits for biodiversity and climate change of protecting permanent grassland.

(2) Climate-related priorities (mitigation and adaptation) linked to agriculture in EU-27 - How could different CAP instruments in post-2013 address them and what is the cost-effectiveness of such measures?

(3) Relative merits and budgetary costs of paying for certain basic environmental and climate mitigation measures (e.g. through agri-environment) versus having them as requirements in the environmental baseline (cross compliance).

(4) Consistency and trade-offs between the agricultural sector's contribution to the sustainable management of natural resources, to climate change mitigation and adaptation efforts, and to bioenergy production objectives.

(5) Rural-urban relationships, drivers and conditions of a better attractiveness of rural territories.

(6) Capacity and limits of mechanisms to ensure fair distribution of income across the value chain.

(7) Standards and competitiveness.

(8) Assessing the impacts of EU rules in the area of animal health and welfare, plant health, consumer choice, food and feed safety and public health on agriculture and the food sector[97].

[97] See http://ec.europa.eu/food/cap_toward_2020/index_en.htm