The Mid Term Review of the Common Agricultural Policy: The Future of Rural Development

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Abstract

Since the launch of Agenda 2000 in July 1997, rural development has gained political prominence as the second pillar of CAP. According to the European Commission's recent Mid-Term Review, it will become even more important in the future not only because of its financial impact but also because of its reliance on novel and untested instruments such as modulation and cross-compliance support flexibility. In addition, it will fuel the discussion on the re-nationalisation of some elements of the CAP – the quintessential Community policy. This article will analyse the various aspects of the already fierce debate on these instruments which will certainly generate winners and losers among the Member States.

Introduction: Why a further CAP Reform?

The Common Agricultural Policy (CAP) has been facing several reforms, mostly initiated for either internal budgetary or external reasons such as multinational WTO-commitments prohibiting certain measures. Since the last comprehensive reform in 1992, the MacSharry-Reform, the general trend in the CAP can be characterised by reduction of the traditional price support schemes (intervention prices) that stimulate production and have caused a lot of problems in the past such as costly surpluses. Parallel to the reduction of price support, other measures have been established to compensate farmers' income losses, namely direct payments. These measures are defined for the eligible products within the Common Market Organisations and compose the – originally the one and only – "First Pillar" of CAP. This First Pillar still absorbs the bulk of agricultural budget (see Graph 1).

The first step into Rural Development as part of CAP came with the MacSharry reform which introduced the so-called Accompanying Measures, that were literally meant to accompany First Pillar measures.

But not until the Agenda 2000 was Rural Development politically emphasised as the "Second Pillar" of CAP[1] (see Graph 1).

The need for a further reform of CAP is motivated once again by budgetary and external reasons of enlargement, and the ongoing WTO-negotiation round, that will start with concrete agricultural negotiations in March 2003.

Why is Rural Development important for a further CAP reform?

Especially Rural Development has gained importance in the context of making CAP fit for the future:

- Firstly, it has become a key topic facing Enlargement not only because rural areas are of large relevance within Candidate Countries. From the EU-15's point of view it is much easier to negotiate the application of these measures to new Members than the introduction of First Pillar measures.[2]
- Secondly, Rural Development is used by the EU to back up its position within the ongoing WTO-negotiations. This is because such measures are likely to fall in the category of allowed support of agriculture.[3]
- And finally, Rural Development is used to make the CAP a more accepted and economically justified Policy by improving its "bad" reputation of being protective, trade distorting, highly bureaucratic and not meeting the public demands for environmentally friendly and safe products of high quality.

Main elements of proposed reforms with impact on Rural Development

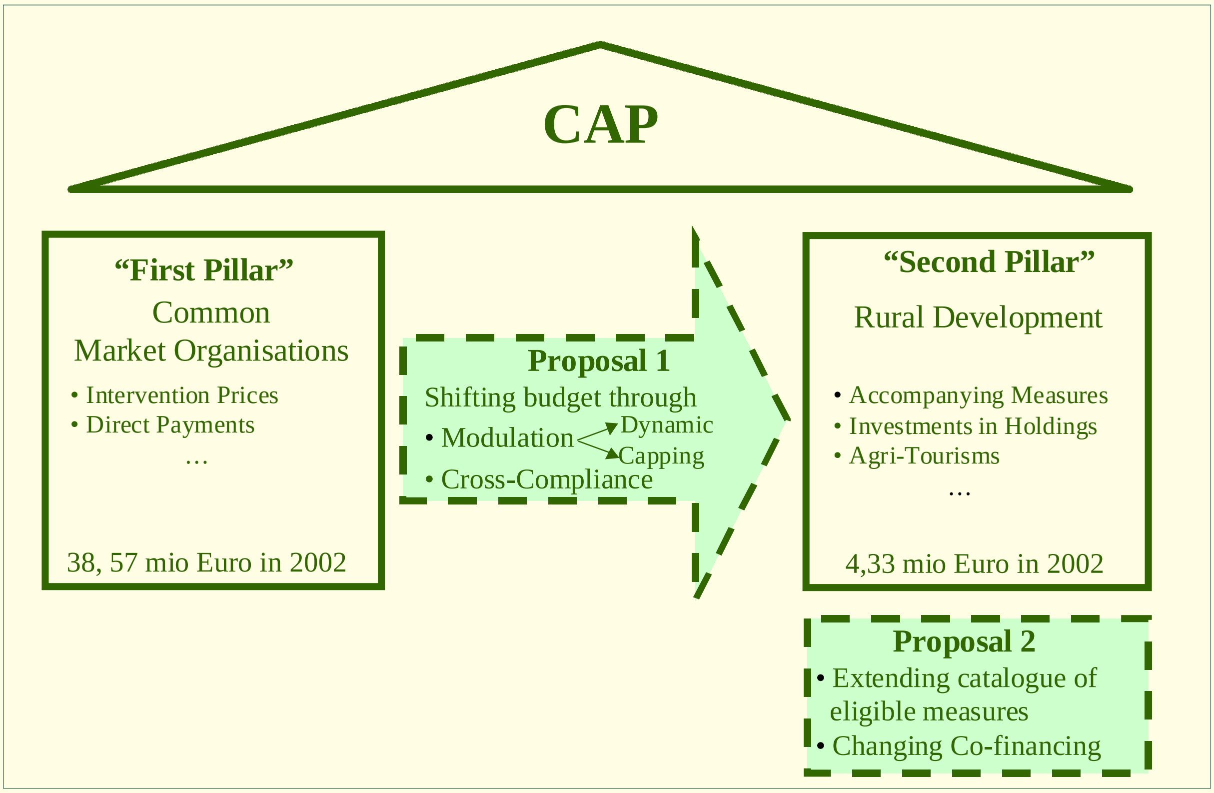
The first step into further reforms was undertaken with the Mid Term Review of the present CAP (MTR)[4] that has recently been published by the Commission.

This Review is based on a mandate for evaluating the Agenda 2000 that was given at the Berlin Summit of March 1999. The Commission was originally aiming at adjusting the level of price support and direct payments by taking into account market developments. But the MTR goes beyond this target as it presents quite concrete and innovative proposals to strengthen Rural Development.

(1) The first proposal aims at **shifting money from the First to the Second Pillar** and thus, making it available for Rural Development. The savings within the First Pillar are based on two main principles: Modulation and Cross-Compliance:

- **Modulation** covers the decrease of direct payments per farm by a certain rate. This

Graph 1: Proposals for Strengthening Rural Development



mechanism consists of two components. First, **dynamic Modulation** is a regular cut of direct payments by an annual rate of 3% leading to a total cut of 20% at the intended final stage. The saved expenditure from this reduction will be re-allocated to the Members States via a certain "key" or formula that still has to be defined. As second component, **Capping,** would be implemented as an additional cut when direct payments exceed the maximum level of € 300,000 per farm per year. In contrast to dynamic Modulation the saved money from Capping would be kept directly in national accounts for Rural Development measures. Modulation has been introduced by Agenda 2000 on a voluntary basis but would now become a compulsory principle.

- **Cross-Compliance** covers the conditionality for direct payments, that is the fulfilment of production standards as criterion for getting the full amount of direct payments. It is proposed to change the current optional into a mandatory implementation and to supplement the recent Environmental Standards by Food Quality and Animal Welfare Standards. Non-fulfilment of these standards would lead to a cut of direct payments and the saved money could be kept directly within national accounts.

  The saved money from both Modulation and Cross-Compliance will only be available for Rural Develop-ment and represents the EU part for Rural Development measures. Therefore it has to be supplemented by national expenditures. This is the co-financing aspect of Rural Development that especially in some Countries leads to problems.

(2) The second proposal regards an extension of the **Second Pillar** itself by integrating new measures for Rural Development:

- Introduction of a Food Quality chapter.
- Introduction of payments for Animal Welfare Measures beyond legal standards.
- Transitional support to fulfil the compulsory standards for Cross-Compliance.

Additionally an increased European co-financing rate for Agri-environmental measures and Animal Welfare is proposed thus, the supplementing national financial part would be lower.

The following analysis concentrates on Modulation and Cross-Compliance as real innovative proposals. By contrast the catalogue of eligible measures has been extending for some time now.

Evaluating Modulation: A New Cohesion Measure?

Even the currently just *voluntary* Modulation has caused problems and has so far just been implemented by the UK. Other countries cancelled its implementation such as France and Portugal. Germany is actually prepared to introduce the current voluntary approach in early 2003 by a new law that has been adopted recently.[5]

The proposed changing of Modulation into a *compulsory* rule is fueling one of the most severe discussions compared to other elements of the MTR because of its distributive effects caused by two elements:

(1) Shifting expenditure from First to Second Pillar

The bulk of the money allocated to the Second Pillar will be derived from the **dynamic Modulation**: preliminary assessments refer to around € 3.4 bn that would be attained by the end of the final stage of reductions in 2010.[6]

- Modulation affects all direct payments but these payments are scheduled just for some products and fixed at very different levels. Therefore countries traditionally specialised in products eligible for high direct payments – such as wheat – are confronted with large cuts.
- Beyond this, Modulation will be applied to the complete amount of direct payments per farm with the exception of a fixed amount (“franchise”), i.e. direct payments below € 5000 per farm per year are excluded from the cut.[7] This would be to the advantage of small farms receiving low payments. Based on a country’s specific holding structure different influences for individual Member States will appear: according to first studies e.g. in Greece, a country with rather small holdings receiving low payments, 37% of the total national payments would fall under the franchise category and thus, will not have to be cut. In Ireland and Austria the franchise will affect just 28% of the overall national payments.[8]
- Whereas the dynamic modulation affects generally all farms, additional **Capping** will only affect large farms specialised in products with traditionally very high payments such as wheat. Some studies, estimate that just 3% of the EU-wide payment volume would fall under the criteria for Capping. The bulk would thereby appear in the New German Länder[9] as there are very large farms with high per farm payments. Therefore, even if supporting the general outline of the MTR, the German Government so far has rejected this element.

(2) “Key” or formula for re-allocation to Member States

The second category of distributive effects is caused by the fact that the attained budget from the dynamic Modulation is proposed to be re-allocated, whereas the money saved from Capping will stay at the national level.

- The key for re-allocation still has to be defined but, as it will generate winners and losers (see table 1), its final determination will become a hot issue especially for Members that are already now protesting their net payer position, like the UK, Sweden and Germany. For Germany an additional problem appears at the national level: the use of the re-allocated budget for Rural

Table 1: Dynamic Modulation – Possible Winners and Losers

	% contribution to Second Pillar	**Re-allocation**	
Member State		**Key 1** % share of current RD Budget	**Key 2** % share of re-allocation similar to SAPARD
B	0.8	1.2	0.8
DK	2.9	1.1	1.3
D	**12.5**	**16.1**	**9.7**
GR	3.9	3.0	4.0
E	**11.9**	**10.6**	**14.0**
F	30.8	17.5	14.3
IRL	1.8	7.3	2.1
I	8.2	13.7	9.3
L	0.1	0.3	0.1
NL	0.3	1.3	1.5
A	1.0	9.7	2.0
P	1.0	4.6	3.4
F	1.6	6.7	1.3
S	3.0	3.4	1.5
UK	20.2	3.5	7.4
EU-15	*100.0*	*100.0*	*100.0*

See N.N., *How Modulation and capping will impact on EU member states*, AgraNet, August 23 (2002) and Philip Lowe, *The Future of CAP – The Challenge for Rural Development*, Presentation within the Seminar „The Mid-Term Review of the Common Agricultural Policy – Implications for the Future, organised by the European Institute of Public Administration Maastricht, 16-17 September 2002.

Development requires for some measures a common responsibility of Federal authorities and the Länder for supplementing the European co-financing rate. Due to strong opposition of the Länder in the past on implementing Modulation because of their budgetary limits the new Modulation Law offers a new financial ratio in favour of the Länder budget.

The following figures indicate the different pattern of winners and losers depending on the specific definition of the key. The figures are based on the assumption that the final rate of Modulation will be implemented (20%). The first key is similar to the current indicative allocation of budget for Rural Development within Agenda 2000[10]. The second key reflects the criteria considered for allocation of the budget for the Special Accession Programme for Agriculture and Rural Development (SAPARD) within Candidate Countries[11] such as agricultural area and farming population.

By applying the first key Germany, for example, would become a net-beneficiary due to the re-allocation whereas the second key would generate a losing position. For Spain the impact would be the other way round: the first key would lead to a losing position, whereas the second key would change the pattern towards a winning position.

Distribution effects have always played a large role within CAP and the Commission is explicitly emphasising this new transfer of budget as a new Cohesion Measure.[12] Nevertheless, from an allocative viewpoint and thereby regarding the optimal supply of public services in rural areas the key should reflect some objective rural needs in terms of criteria with rural relevance as it is the case for SAPARD.

Evaluating Cross-Compliance: Horizontal Integration of Environmental and Quality Criteria into CAP?

Untill now the present voluntary environmental requirements for direct payments have been implemented just for very specific production types and by just a few countries, i.e. France, The Netherlands and Ireland. A large problem that has already appeared with respect to these few and voluntary examples has been the definition of the present environmental standards and this may become even more difficult if they are to apply EU-wide. So far it is not quite clear whether just existing legal standards already considered within legislation like the Nitrate Directive are meant or stricter ones. The Commission is soon to submit a framework for defining these standards, which may bring some light to this issue.

Additionally some more conceptual problems do exist:

(1) One problem is linked to the **standard level** and thereby to the question how strict the required production standards should be:
- From a political viewpoint, there will be pressure to harmonise standards.
- From the economic perspective, and in terms of internalising agricultural spillovers, harmonisation will lead to inefficiency as environmental conditions differ among the EU Member States.

(2) Even more complicated will be the determination of the reductions in payments in case of non-compliance: according to the MTR this should be based on the damage caused. The identification of such damages and even more the estimation of monetary values of spillovers cause severe problems:[13]
- The spread of damaging farming practices makes it difficult to fix the causal relation between polluting farmers and caused pollution. This phenomenon of ”diffuse pollution” leads to the question of how to define penalising cuts for single holdings without being completely arbitrary and without being imprecise in terms of environmental protection.

(3) In addition, the administration of **Control and Monitoring** of these standards for the purpose of deciding, whether a single farmer fulfils the criteria for getting the full amount of direct payments, will become more difficult than the current control of areas for which payments have been applied for. Controlling of eligible areas can easily be supported by satellite systems, whereas the fulfilment, for example, of animal welfare standards has to be checked directly at the farm.[14]

(4) Another general problem refers to the question of whether there should be **financial support** for meeting these standards, even if just transitionally. If the standards will simply reflect existing legal standards there is no need and furthermore no justification for mixing them with income policy.
This violation of the polluter-pays-principle could become difficult to defend against the public perception of CAP and amongst farmers.[15] What does cross-compliance mean for the farmer producing products which do not recieve direct payments, such as potatoes? If they are not confronted with a possible cut of direct payments because they do not get any, are they excluded from fulfilling legal standards?

Conclusions

The Commission will complete its legislative proposals this autumn and intends to finish negotiations by the spring 2003, when the concrete negotiation modalities have to be submitted to the WTO. But a decision on the future of CAP within the existing Financial Perspective of Agenda 2000 is still questionable, as until now there have been strong opponents within the EU-15 and it seems to be a five to ten minority supporting the proposals (D, DK, NL, S and the UK).

The strongest opposition is not primarily based on the proposals for Rural Development but more on its counterpart – the proposed reduction of support within the First Pillar. This will affect mainly countries traditionally specialised in products like wheat where a high level of direct payments had been established as it is the case in France.

Regarding the proposals for the Second Pillar one should be realistic. The proposed shift from the First to the Second Pillar would just change the ratio between both Pillars from the recent 9:1 to a possible 8:2 ratio. In terms of budget the MTR could therefore be understood rather as cautious step towards strengthening Rural Development, than as drastic reform. Nevertheless, in terms of the proposed conditional logic for direct payments the MTR may be the first step towards a reasonable CAP. Despite the remaining problems, cross-compliance may facilitate public acceptance and may provide economic justification for the CAP if agricultural spillovers are going to be addressed.

NOTES

1 Recently one can find a new „Third Pillar" stressed that covers measures linked to Food Quality and Food Safety.

2 So far more budget has been scheduled for Rural Development than for Market Support for new Members. *See* Commission, Issues paper, *Enlargement and Agriculture: Successfully integrating the new Member States into the CAP*, SEC (2002) 95 final, Brussels, 30 January 2002.

3 So-called Green Box Measures. *See* for definition of Green Box Measures Annex 2 of the Agreement on Agriculture. WTO (ed.*)*, The WTO Agreements Series, vol. 3 „Agriculture" (2000): 47.

4 *See* Commission, Communication from the Commission to the Council to the European Parliament, *The Mid term Review of the Common Agricultural Policy*, COM (2002) 394 final, Brussels, 10 July 2002.

5 *See* Bundesregierung, Modulationsgesetz fördert Landwirtschaft. Available under http://www.bundesregierung.de.

6 *See* N.N., *How Modulation and capping will impact on EU member states*, AgraNet, August 23 (2002).

7 An additional franchise is calculated on the basis of labour units per farm.

8 Ibid.

9 Ibid., p. 4.

10 *See* Commission, Factsheet 08/1999, *CAP reform: rural development*, 1999, p.5.

11 *See* N.N., Impact of Modulation on Member States, AgraNet, August 23 (2002).

12 *See* Commission, Communication from the Commission to the Council to the European Parliament Commission, p. 12.

13 *See* OECD, Multifunctionality. Towards an Analytical Framework, OECD Publications, 2001.

14 It is also proposed to introduce a compulsory Farm Audit that could serve as an Internal Quality Management system but is not going be used for external controlling purpose.

15 The Commission justifies this violation by its time-limited application. *See* Martin Scheele, *The Mid Term Review 2002*, Presentation within the Seminar "The Mid-Term Review of the Common Agricultural Policy – Implications for the Future", organised by the European Institute of Public Administration Maastricht, 16-17 September 2002.❑