

## **Review of the challenges of CAP reform**

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**Centre for Rural Economy Discussion Paper Series No. 27**

**April 2010**

### **Summary**

This paper reviews the substantial literature being developed on European Common Agricultural Policy (CAP) reform post 2013. The present policy apparatus is only confirmed until 2013, the end of the current EU Budget cycle. As a consequence of the review of the European Budget currently underway (March 2010), there will be a review of the CAP, which is already attracting considerable attention from policy analysts and stakeholders in Europe. We discuss the major contributions under three substantive headings: *food markets; rural development; environment*.

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## 1. Introduction

The European Union is spending around €50 billion on agriculture each year although agriculture's economic contribution to society has declined substantially. This spending represents approximately half of the total European Union Budget, though it should be remembered that this total budget is constrained to be no greater than 1.25% of European GDP, and hence is tiny compared with national member state government spending (typically around 40% of national GDP). The EU budget is currently subject to review, with the Commission supposed to publish proposals before the end of 2009. Current reports (e.g. [CAP2020](#)) suggest that the CAP was the most controversial topic in the consultation for this review. The latest official news from the Commission relates to a Conference held in [November, 2008](#), at the close of the consultation period, and we still await the Commission's responses and proposals. However, a leaked draft of the European Commission's Reform Agenda for the budget review (EC, 2009b) is quite explicit about the intended budgetary constraints on the CAP.

*"While it is too early to define the detailed contours or the exact intensity of the future reform of the CAP, it is clear that it should be driven by two objectives. First, it should resolutely pursue the modernisation of the CAP, enabling it to respond to new challenges and concentrating spending where it adds most value. Second, it must stimulate a further significant reduction in the overall shape of the EU Budget devoted to agriculture, freeing up spending for new EU Priorities" (EC, 2009b, p.17). It also suggests one possible response to this challenge (EC, 2009b, p.19): "A larger responsibility of current CAP spending could be assigned to the member states, or direct aids could be co-financed by national contributions."*

The European Union's Common Agricultural Policy (CAP) is continually evolving. The growing debate about the future of the EU Budget post 2013 raises major questions about the future of the CAP. A formal Communication on the future of the Common Agriculture Policy (CAP) after 2013 is due to be published by the Commission in the summer/early autumn of this year (2010) – in order to launch a full public debate on the issues, and as a part of the Budget Review of 2011. Formal legislative proposals on the post-2013 CAP will then follow in mid-2011 – together with Commission proposals for the post-2013 Financial Perspectives.<sup>3</sup>

The debate on the future CAP is of more than an agricultural interest. After 2013, it is supposed by many to be required to contribute to meeting the major and diverse challenges of: global food security and climate change; environmental and land conservation and management; rural development; agrarian transition; food quality and safety; bioenergy and biofuels; regional and sectoral competitive (dis)advantages; market volatility and business risk and, no doubt, other issues as well. The debate is already considerable, generating a number of critiques and proposals. This paper reviews this ongoing debate and provides a guide to what is being said by whom. It focuses

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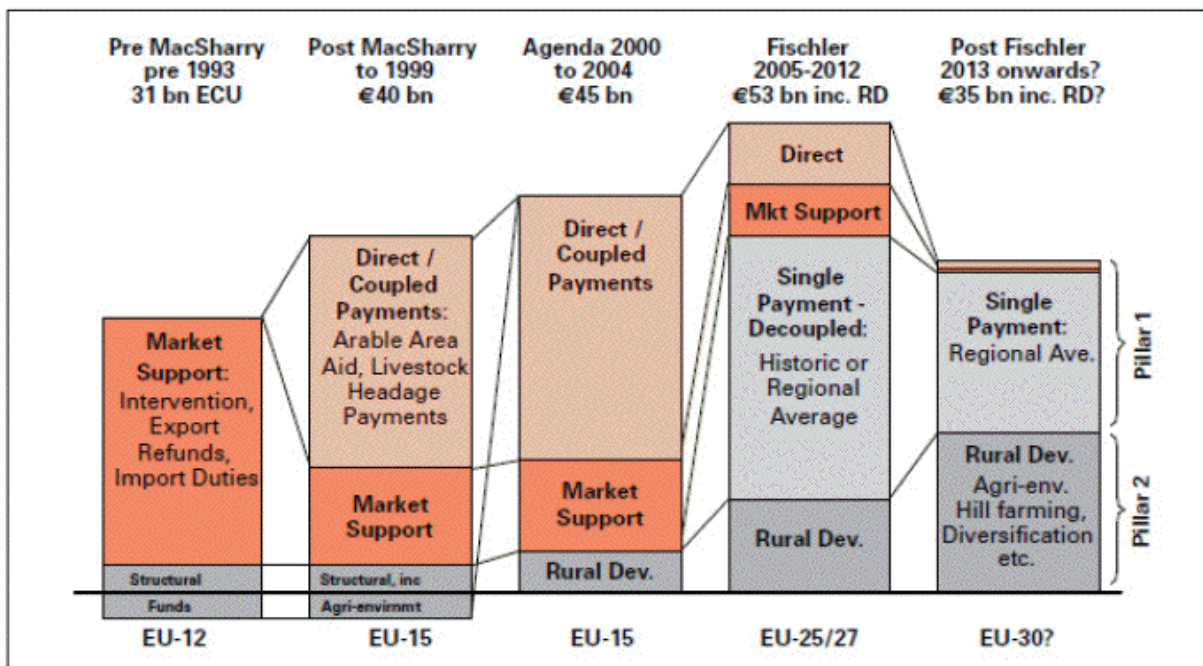
<sup>3</sup> AgraFacts, 42-09, 02.06.2009.

on the major issues which seem to have emerged but it does not review either the history, or the present processes of further CAP reform.<sup>4</sup>

As is to be expected, the major contributions to the debate so far focus on a range of different issues. Some authors focus on Single Farm Payments (SFP) and their possible effects and justification (e.g. Swinnen, 2009), while others are more concerned with food safety and security (e.g. Schmidhuber, 2009), or with the possibility of “greening the CAP” (e.g. Garrod, 2009). At the same time, there are also more comprehensive reviews and proposals (especially Bureau and Mahe, 2008). Individual topics are clearly inter-related and any viable reform will need to address all the current issues to some extent – even if only to rule out some issues as being beyond the competence or resources of a future CAP. On the basis of a major previous review of the CAP (EC, 1997 – the Buckwell Report) and on logical grounds, we consider the current literature into three substantive issues: *food markets; rural development; environment*.

As background to these discussions, it is difficult to improve on a recent summary of the CAP by the bank HSBC – Figure 1. As is illustrated here, the CAP has evolved considerably in the past two decades, and is now dominated by the Single Farm Payment, introduced in the Mid Term review of Agenda 2000 in 2004. As also illustrated, much of the developing debate about the future agrees that the total budget is likely to be reduced, with an increasing emphasis on rural development and the environment, and a reduced role of the SFP.

**Figure 1: The Changing Shape of the CAP**



Source: HSBC, Forward Planning 2010, also summarised in Royal Agricultural Society of England, Members' Agri-Bulletin, Paper 365, February, 2010.

<sup>4</sup> These issues are dealt with in a companion paper by the authors: “Cap Reform Options: A challenge for analysis and synthesis”

## 2. Food Markets

While over half of the workforce remains employed in agriculture in many developing countries, this share in OECD countries has already fallen to about 3 per cent (Brooks, 2009). The process of economic development has resulted in a reduced proportion of total incomes being spent on food, and – hence – fewer people being able to earn a full time living in farming and food production. While consumers in developing countries spend about half of their income on food, the average of OECD countries is around 15% at the retail level (Brooks, 2009). However, there is a consensus amongst the major global institutions that prices of agricultural commodities will remain at a higher average level in the future than over the past decade (OECD and FAO, 2008). In apparent contradiction to these tendencies, and as noted above, the European Union is still spending around €50 billion on agriculture (which is not untypical of many developed countries, especially those experiencing rapid economic development, and those which are traditional importers). This situation generates very substantial pressure for CAP reform, though there are various suggestions about the most appropriate ways of doing so.

### 2.1. Direct payments (Pillar 1)

There is some consensus amongst at least the 'disinterested' analysts that changing the system of *direct payments* should be a major, if not the most important part of the reform process. Created under the MacSharry reform in 1992 and changed dramatically in 2003, a substantial part of direct payments (the Single Farm Payments (SFP) are now decoupled from production, and are considered as meeting WTO criteria for the "green box" (non distorting policies). The EU is spending around €37 billion on direct payments each year, accounting for 75-80% of total agricultural payments (Gorton et al., 2009). According to the European Commission (EC, 2009a), decoupled direct payments not only ensure that farmers respond to market signals but also contribute to maintaining sustainable farming. Despite its basic income support and agricultural retention functions, several criticisms emerge regarding its economic rationale.

According to Swinnen (2009), for instance, this policy instrument is *not effective* in any of these dimensions as (1) agricultural employment is still decreasing despite large and increasing direct support; (2) the majority of farm household incomes come from off-farm sources, reflecting improved integration of rural areas and markets with the general economy; (3) the distribution of support is very uneven amongst farm sizes, perhaps with those most deserving or needing support receiving the least; (4) most support is dissipated to input suppliers and landowners, since payments are based on historical rights and linked to land use, driving land prices up as a consequence. Moreover, as evident from the 2007-08 food crisis direct payments are unable to stabilise markets/incomes. There is no evidence that farm households in industrialised OECD countries have systematically lower incomes than other households, so policies to support incomes across the whole sector are unnecessary (OECD, 2003). A similar conclusion is drawn by a UK Government

report (HM Government, 2010) analysing the price spikes for agricultural commodities in 2007/08. The report concludes that these spikes were exacerbated by poorly performing markets and that there is an urgent need to further open up international agricultural markets by *phasing out agricultural subsidies* such as Pillar 1 of the CAP. However, according to some analysts, phasing out of the current direct payments should be accompanied by *phasing in* new, or re-designed, policy instruments (Anania, 2009).

These views are strengthened by the fact that direct payments are neither evenly distributed by farm sizes, nor by geographical location (Gorton et al., 2009, Zahrnt, 2009a). The 80/20 rule applies – 80% of the support being received by 20% of farmers (recipients). Small farmers, especially, are handicapped in many ways. Though they are also eligible for direct payments, due to the small farm size and administrative procedures, most of them receive marginal amounts or do not even participate in the system. As Zahrnt (*op cit*) also notes, payment rates per hectare are also widely dissimilar, ranging from €500+ in Greece to €174 in Portugal. Moreover, following the EU Copenhagen agreement, direct payments were introduced at lower initial rates in the New Member States (NMS), which have still not reached the level of EU15. Indeed, the NMS are already supplementing their EU funded direct payments with national supplements to make good the difference, so the *common* status of these payments is already compromised. In a more general context, it has also argued that the CAP is not targeted effectively to the NMS, for four main reasons (Gorton et al., 2009): (1) the lack of convergence between rural areas in NMS and EU15; (2) differences in farm structures in terms of both size and organizational type; (3) an inappropriate balance between the two CAP Pillars (direct support and Rural Development); (4) inadequate policy to implement rural development measures in the NMS. Therefore, the system of direct payments, amongst other issues, should be changed and redirected to meet the needs of the NMS.

Apart from phasing them out completely, various other ideas have been proposed for the future of direct payments. Swinnen (2009) suggests that new objectives are needed for the CAP and direct payments should be *drastically reduced and be converted to a safety net*. A similar idea is proposed by Bureau and Mahé (2008), who argue that the system of direct payments should be *converted into a general contractual scheme* of three levels: basic husbandry payments, natural handicap payments and green points payments. In each category, farmers would provide special environmental services, according to their contract for a fixed term ("what you get depends on what you do"). Moreover, these authors propose to extend *co-financing to direct payments* in order to increase accountability and legitimacy, and also suggest 14 objectives<sup>5</sup> that the new CAP should meet.

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<sup>5</sup> 1. To foster the economic performance and the competitiveness of the farm and food-supply chain

2. To provide a buffer for against extreme market or natural conditions and exceptional price falls and to assist in the development of self-sustained schemes to reduce income volatility

3. To ensure the availability of food supplies and to contribute to food security

Similarly, Heissenhuber et al. (2008) suggest a three-step scheme of basic payments, voluntary agri-environmental measures and regional support. Ribbe (2009) argues that all future subsidies, whether they are for investment or paid per unit of area, should be *justified on values recognised by society*, as an amplification of the cross compliance conditions, suggesting that future direct payments must be *conditional on practical "services" rendered by farmers* for the conservation of the natural environment, for animal welfare, as well as quality production and job creation. Zahrnt (2009a) calls for complete elimination of Pillar 1, as well as exploring comprehensive reform of the distribution of CAP spending between member states. He argues that the two-pillar structure should be replaced by a discretionary and a public goods pillar, giving Member States flexibility in how they phase out the SFP, avoiding contentious EU debates about phase-out programmes. Zahrnt also notes that any far-reaching reforms will involve potentially substantial re-distribution of CAP payments across member states. As a consequence, "distributional quarrels between governments and populist appeals to national interests are among the chief obstacles to any efficiency-enhancing reform" (Zahrnt, 2009a, p.31).

## 2.2. Food security and safety

Another important topic relating to Food Markets is of food security and safety. The concept of food security has four dimensions: availability; accessibility; stability; and utilization (FAO, 2009). Food availability and stability were major issues after World War II in Europe (and for the foundation of CAP) as food shortages were vivid. Unfortunately, this is still a major problem for some developing countries where people do not have enough means to produce food, resulting in starvation and chronic undernourishment. In Europe, these dimensions of food security have become less important in the last 20-30 years, though the 2007/08 food crisis brought the food supply issue back towards to the top of the political agenda. Nevertheless, the issue of food security in developed countries and especially in Europe, is only one of access for the poorest consumers - a demand problem (Swinnen, 2009) and not of food production (Schmidhuber, 2009).

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4. To ensure that food products reach consumers at competitive prices
  5. To meet consumer demands for safety and high quality food
  6. To preserve the natural resources of rural areas and to control pollution, with specific attention to environmentally sensitive and high nature-value portions of rural territories, to biodiversity and to ecosystems
  7. To encourage a degree of farming activity in areas with natural handicaps
  8. To ensure that fiscal resources devoted to agriculture and rural programs are effective and that the CAP is consistent with EU priorities and with other EU policies
  9. To harmonise effectiveness of support with equity among individuals and with cohesion across regions and member states
  10. To require methods and processes of food production to be consistent with European values and ethics
  11. To ensure a fair standard of living and to expand earning opportunities for rural populations
  12. To ensure that the poorest or most deprived sections of the population have guaranteed access to food
  13. To preserve the European heritage of food variety
  14. To preserve the rural heritage of EU member states

However, the 2007/8 crisis also heightened anxieties about global food supply capacity. Continued economic growth and rising world population will generate increasing demand for food which may outrun supply capacity, resulting in rising agricultural prices and food shortages. In rich and middle income countries, rising agricultural prices may change eating habits and might require a growing proportion of income to be spent on food, while in poor countries, rising prices will deepen starvation (Marsh, 2009). Haen (2008) proposes a *triple-track approach to food security* in developing countries. The first track is to develop rural livelihoods and to enhance productivity in order to provide income for rural people so that they are able to buy food. The second track is to ensure direct and immediate access to food, while the third is to build resilience against natural disasters in disaster-prone areas. Buckwell (2007) calls for a *common food security and environmental security policy* rather than "the much narrower" construct of an agricultural policy, while both Swinnen (2009) and Schmidhuber (2009) suggest *concentrating on rural poor* and providing them possibilities to earn enough income to buy food. Although the prospect of world food shortage might encourage some to argue that more support for (European) farmers is therefore required to increase supply capacity, none of the analysts reviewed here treat this as an argument worth addressing. However, several (including Swinnen, *op cit.*) call for increased spending on agricultural R&D, both globally and within the EU.

The fourth element of food security (utilisation) includes food safety, according to FAO (2009). The first BSE and dioxin crises drew attention to this issue. Ensuring food safety and quality became effective objectives of the CAP in reforms of 2003 and 2008 (though there is no EU food quality policy at present). The basic aim of food safety policy is to protect consumer health, coordinated by the European Food Safety Authority (EFSA). The EU food safety policy has followed an integrated "*farm to fork*" approach since 2000, and tries to control risk in all stages of food production and distribution (Swinnen, 2009). The EU has also adopted specific sector rules on products of animal origin, use of pesticides, food supplements, colourings, antibiotics and hormones in food production, additions of vitamins, minerals and similar substances in food and products in contact with food stuffs, such as packaging (Swinnen, 2009). Since SFP are conditional on farmers' compliance with the relevant laws and regulations governing food production, it might be argued that the increase in regulation, and consequent increase in costs of production at the farm level, justifies some recompense – provided by the SFP. Again, however, none of the analysts reviewed here regard this argument as worth addressing.

### 2.3. Competitiveness

Competitiveness also has a crucial role in forming the future of food markets. The notion of competitiveness is quite a complicated one without any single measure or definition. Agricultural competitiveness often refers to a multiple of changes in (*inter alia*) market structures, farm sizes, agricultural trade and comparative advantages, efficiency of production, cost and profitability.

Ultimately, however, the competitiveness of a nation's or sector's product is based not in any of these measures but on the quantity and quality of the country's productive resources combined with the effectiveness of its socio-economic systems to exploit these resources.

From the CAP reform point of view, it is clear that agricultural production is still an important (though not the only) function of agriculture and policies concerning agricultural competitiveness should help producing *value added products* and selling them in the domestic and international markets. The basic principle of "supplying the European market with sufficient food at reasonable prices" is today more needed than ever but in a different context than in the fifties (Ciolos, 2008). The new CAP should ensure that agriculture can continue contributing to employment and the economy of rural regions by maintaining agricultural production possibilities throughout the EU (COPA-COGECA, 2008).

Besides that, there exists a worrying slowdown of productivity in agriculture all over the world (IFPRI, 2009). This could cause huge problems in global food security as well as in competitiveness of the EU (Swinnen, 2009). The greatest challenge here is how to feed 9 billion people in 2050 at a low production cost and environmentally friendly way. Agriculture in the European Union still needs structural changes to cope with decreasing productivity. There seems to be a consensus among scholars here to support research and development (R&D) programmes in order to help increase productivity without increasing inputs. The development of new production technologies as well as the development of extension services and education is needed (Bureau and Mahé, 2008). Moreover, GMO products can help easing this problem, despite of their scientific uncertainties and some popular opposition. Furthermore, the simplification of support system would help farmers spending most of their time on their farms rather than in the offices dealing with bureaucracy (Bureau and Mahé, 2008). As Boulanger and Messerlin (2009) argue in their summary, more international trade is also needed to increase global resilience of agriculture as well as better targeted public and private policies would also be critical - including public policies with a budgetary dimension.

Competitiveness policy decisions will affect farm level decisions as well. As Anania (2009) puts it, three levels of European farms will likely to emerge in the future: (1) farms active on markets, characterised by price competition, (2) farms active on markets, characterised by product differentiation and (3) farms which will not be able to adapt and compete profitably. As Anania (2009) stresses, the current CAP does not seem adequate to help EU farm systems cope with the new challenges. Therefore, he argues, support should not be linked to the status of a farmer but should be associated with the "production" of public goods or to a business plan aiming to remove the factors limiting the competitiveness of the farm.



#### 2.4. Market volatility and business risk

Another important topic related to food markets is market volatility and business risk. In the widely known work of Holzmann and Jorgensen (2001), four types/characteristics of market risk can appear in agriculture: (1) market/price risk, (2) production risk, (3) financial risk and (4) institutional/legal risk. All of them can appear on three levels: (1) on the household level (micro-level), (2) community level (meso-level) and (3) regional/national (macro-level). According to these authors, there are a number of possible farm risk management instruments and strategies, based on the typology above. A farm, market or a government can act to reduce (that is, spread), mitigate or cope with agricultural risks. These strategies include, among others, diversification in production, disaster-prevention policies, insurance and contracts, off-farm income, tax provisions, the use of futures and options and various other techniques.

There are ex-ante and ex-post roles of the agricultural policy in risk management in agriculture (Antón, 2009). Ex-ante roles are related to measures creating markets and modifying market incentives, while ex-post roles are income and consumption smoothing. Antón (2009) proposes that agricultural policy should (1) empower farmers to take individual responsibility for risk management, (2) facilitate farmers to take advantage of the correlations between different types of risks, asset returns and sources of income, (3) improve the availability of a variety of instruments, particularly the development of market instruments, (4) facilitate the flow of information on risk as well as the creation of a knowledge base and human capital on risk management, (5) modify existing policies before creating new ones.

Bureau and Mahé (2008) agree that the future CAP should get rid of the idea of fixed incomes, and support private and public insurance programmes (including forward, futures, options and swaps) instead. These authors also propose to convert the intervention system into a strict safety net for exceptional circumstances, controlled by the European Central Bank or the European Food Safety Agency. This system would encourage the private sector to offer risk-management contracts to farmers and can be supported by the budget to a minimum extent, if needed. Swinnen (2009) adds that there are a variety of private sector instruments available and they seem to better cope with agricultural risks than large public programmes with big amount of subsidies.

On the whole we can conclude that topics related to Food Markets are quite complex in nature. Direct payments as well as food security and safety are explicitly addressed in several articles on the future of CAP, while competitiveness and business risk are usually mentioned as parts of wider discussions. Regarding Food Market issues, the following policy measures are advised by most contributions:

1. Invest in R&D to provide innovation and new technologies for those still producing in order to avoid decreasing productivity and possibly increasing shortages (e.g. Bureau and Mahe, 2008, Swinnen, 2009)

2. Boost rural economies by creating job opportunities and thereby creating incomes for rural livelihoods (e.g. Bureau and Mahe, 2008, Swinnen, 2009). This idea is also underpinned by Poole (2009), stating that creating and maintaining markets are the most important in pro-poor development. The author's "Making markets work for the poor" vision is already echoed by various national and international agencies.

3. Increase/create insurance related supports (FAO, 2009). The public sector should only expand insurances to areas not covered by private sector, that is, explicitly to deal with market failures.

4. Subsidize input to boost production. Depending on local conditions, input subsidies are most effective in boosting production, especially in countries with incomplete or non-existing markets.<sup>6</sup> They may need to be placed on developing the infrastructure for input (seeds, fertilizer) supply and accessibility, and promoting effectively targeted input subsidies, especially to rural smallholders (FAO, 2009). However, none of the authors reviewed here suggest that these conditions apply in the EU.

5. Create a safety net for small producers and against possible food crises (FAO, 2009). This would provide a decent living for small producers and serve as a buffer against future food crises. Again, however, these recommendations refer to developing countries, rather than the EU.

### **3. Rural Development**

Besides Food Markets, the second major part of the CAP debate is around the future of Rural Development as a policy instrument, covering 80% of the European Territory and responsible for the balanced development of rural areas. The second Pillar of CAP was created by the Agenda 2000 Reform, designed to recognise the various needs of rural communities and introduce a lasting framework for rural development within the CAP. Agenda 2000 placed rural development under the Rural Development Regulation (RDR) for the period 2000-2006. In 2003, the mid-term review of the CAP added 4 new measures to the existing 22, while in 2005, the Council of Ministers adopted a new RDR for the period 2007-2013, to be implemented through one fund (EAFRD), one management and control system and one type of programming. For the present period, the RDR has the following axes related to the diverse objectives of sustainable development (EC, 2008): (1) improving the competitiveness of agriculture and forestry; (2) improving the environment and the countryside; (3) improving the quality of life in rural areas and encouraging diversification of economic activity. Overarching these three axes is the Leader approach (envisaged as a hub rather than an axis, and emphasising 'bottom-up' organisations through which each of the functional arms or axes are supposed to be delivered). However, experience with rural development policies has been mixed. Contributions to this section of the debate mainly focus on the possible futures of the rural development policy.

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<sup>6</sup> This is an important point. Xu *et al*, 2009, point out that subsidising inputs in well developed markets is likely to result in crowding out of private, commercial, sales, even to the point of reducing overall fertiliser use.

The remit of Pillar 2 is broad. Some elements focus on the economic and social aspects, while Axis 2 is explicitly environmental. However, for many Member States, rural development continues to provide a convenient rationale for maintaining subsidies to farmers (as an alternative to Pillar 1). Bureau (2008) notes that there is little serious analytical work on the impact of rural development policies, and comments that, in many cases, rural development is used as a common and comfortable framework for all kinds of different non-production issues (environmental, social, food safety, organic and other issues).

There is a clear need to rethink the linkage between agricultural production policy, rural development policy and cohesion policy. Rural development and cohesion policy should be different from agricultural policy as the latter is not likely to be efficient or effective in stimulating rural economy (Blandford and Hill, 2008). The principal difference to be kept in mind is that there is no market for rural development (Hodge, 2008). However, the link between rural development policy and cohesion policy is not clear. Should the CAP retain a rural development function or should cohesion policy address such issues? Is there a chance for a "middle road" between the two? The "common menu" form of the Rural Development Programme is also seen as problematic. The menu of programmes is not always appropriate to meet the local needs. It is clear, for instance, that fundamental rural development problems are not being addressed adequately in the NMS (Gorton et al., 2009), where conditions and circumstances are markedly different from those in the EU15.

Some stakeholders propose to shift the 2nd pillar towards cohesion policy and convert/integrate it into a more balanced policy for rural areas. According to WWF (2008), Pillar 2 should be given a stronger environmental focus, with Axis 1 and Axis 3 measures being better funded through the Cohesion Fund. This option is analysed in detail by the "Barca" report, produced for DG Regional Policy. Barca (2009) proposes merging all funding instruments into a single fund to be managed by one Commission Directorate-General. This may be an optimal technical solution, but would require very substantial organisational change. He therefore suggests that a "strategic place-based territorial framework" for Cohesion Policy should be developed, with the rural development actions brought "under the umbrella policy heading of cohesion policy" (Barca, 2009). Hodge (2008) goes further and proposes that we should drop "rural" and concentrate simply on "local" in formulating our policies.

A similar view is expressed by Núñez Ferrer and Kaditi (2006), suggesting that the key role of rural development policies in the future is to generate economic development on a territorial basis. This focus reflects a growing understanding that farm incomes are primarily determined by the opportunity costs of farming – the rewards available from alternative occupations and activities. Bottom-up programmes (such as LEADER) instead of top-down ones and better targeting are supported by majority of the literature. Núñez, Ferrer and Kaditi (2006) suggest refining eligibility rules

so that smaller projects can also be supported. Pezzini (2009) also urges a paradigm shift in rural policies, where traditional rural policies should give way to rural competitiveness enhancing policies, based on integrated development projects and integrated levels of government.

Besides these, there are different financial priorities and resulting allocations between countries and regions among axes (Tietz and Grajewski, 2009, Zahrnt, 2009a). Therefore, rural development policy needs to become better matched to conditions in Central and Eastern Europe and should have real developmental impact, especially where structural assistance is actually needed (Jarc, 2008, Gorton et al., 2009). Given that the system was designed for and by the most developed European Member States, it should not be a surprise that substantial reform is needed for the NMS, especially those in transition from an essentially agrarian economy.

The future of rural development will depend partly on the amount of money allocated to Pillar 2, though past experiences of this intended re-allocation are not favourable. As Buckwell puts it, "the apparent general consensus that the correct direction of CAP reform is to switch from Pillar 1 type measures to the Pillar 2 approach crumbles when it comes to pushing real resources from one to the other" (Buckwell, 2007, p.16).

Brand (2005) offers an interesting and opposing view on the future of rural development policies. He suggests that government should fund not rural development but urbanization as concentration of the population in cities is better for the environment and for the planet as a whole. He argues that cities are more energy efficient, minimize transaction costs and are the main engines of wealth creation. Why do we have to subsidise rural poor instead of urban poor? This question is also underpinned by the fact that there have been more urban than rural residents in the world since 2007 (Pezzini, 2009). Perhaps it is time for economists and analysts to have a closer and more critical look at the "sacred cow" of rural development (Bureau, 2008). At the least, there is wide recognition that maintaining rural development as an arm or axis of the Common Agricultural Policy is largely a consequence of history and policy dependence rather than intellectual logic or empirical necessity.

#### **4. Environment**

The third major group of topics on the future of CAP concerns the rural environment. It is well recognised that there are strong links and interactions between agriculture and the environment. This was first officially recognised in 1992, when agri-environmental schemes, set-aside and programmes for Least Favoured Areas (LFA) were introduced to the CAP, and it now applies much more generally (McGranahan and Thomson, 2008). Agri-environment measures are now co-financed by Member States with an EU expenditure on agri-environment measures representing the 22 % of the expenditure for rural development for 2007 - 2013 period (EC, 2008).

The debate on the future of the CAP and the environment focuses on four main areas. Public (environmental) good provision and, now, climate change mitigation and adaptation are clearly major issues. However, bioenergy and biofuels, although linked to climate change, are sufficiently distinct and frequently addressed in the literature to warrant separate consideration. Finally "greening" of CAP (Agri-Environmental Schemes, organic farming) and their future are concerned. Therefore, this part of the review focuses on these three issues.

#### 4.1. Public goods

Although 'multifunctionality' now seems to have disappeared from the CAP rhetoric, it is clear that the idea of certain forms and patterns of farming being worth preserving for their social, cultural and environmental benefits continues to be an important part of the CAP debate. The multifunctional role of agriculture provides several public goods as by-products to its market commodities (e.g. Romstad, 2002). Landscape management, biodiversity, wildlife habitat preservation and water-land-air management are all common examples of 'goods' provided (mostly as a by-product) by agriculture. However, the lack of a market to provide these public goods creates a need for public policy to intervene and an associated spending programme in order to support the farming systems which deliver these goods (Romstad, 2002). The delivery of public goods is still being used as a justification for the SFP:

*"At the same time, the provision of a basic income payment to all farmers ensures the basic provision of public goods throughout Europe, by encouraging them to stay in farming"* (EC, 2009a, p.11).

However, despite the apparent attraction, production related payments to farmers may be as likely to worsen as to improve multifunctional benefits (Harvey, 2003). It follows that specially targeted programmes are needed to cope with agri-environmental problems.

In EU rhetoric, public goods are quite an imprecise term, potentially referring to both food quality, safety and variety as well as environmental stewardship. According to Legg (2009), agricultural policies, along with their various instruments, should provide desired amounts of commodity output and public goods together. Moreover, Legg (2009) calls for public goods policies subsidizing those actually providing them (having related costs) and not everyone living in a special area/region. Most commentators agree that environmental payments are justified by the public good market failure, and continue the logic to recommend closely targeted payments made to those actually providing the goods (and services). However, Harvey (2003) goes further, to question whether there are strong grounds to believe that government, especially central EU government, is necessarily better than the market at solving the failure. He points out that the market failure results from the fact that the necessary transactions between the providers of the widely heterogeneous public goods and those willing to pay for their provision are prohibitively costly. In this sense, the market does not fail, it simply records the fact that the effort to solve the problem is not worthwhile – the

benefits of solution do not outweigh the costs of doing so. Of course, even when (as is increasingly the case) the market does consider it worthwhile, there is the 'free rider' problem – those who are willing to pay in principle choose not to on the grounds that the public goods and services will be provided by others and there is no need for their own individual contribution. Harvey (2003) argues that the free-rider problem does justify some public (government) contribution towards the provision of public goods by land users, but that the problems of aligning willingness to pay for them with the costs of provision cannot be solved effectively (still less, efficiently) by bureaucracies. There is no necessary correspondence between the need for government support and the requirement for government provision. He argues that we need to encourage quasi-market solutions to the problem, rather than yet more public programmes.

#### *4.2. Climate change*

It is clear that climate change and agriculture are inextricably linked. Agriculture affects climate change by contributing 13.5% of annual greenhouse gas (GHG) emissions worldwide, while climate change affects agriculture by higher temperatures, changes in precipitation patterns or occurrences of droughts/floods (Nelson, 2009). It is clear that climate change will have large effects on agriculture on the long run, but the places/extents are unclear. On the whole, according to FAO forecasts (FAO, 2009), global mean surface temperature is projected to rise between 1.8 °C to 4.0 °C by 2100, depending on the degree of emissions reductions achieved in the next few decades. Nelson (2009) suggest that more research is needed to better understand the relationship between agriculture and climate change and help detect specially vulnerable areas, since it is clear that effects of climate change will differ substantially across the European Union. However, beyond this recommendation, most commentators are rather silent about what sorts of policies are required to meet the challenge of climate change adaptation and mitigation, other than to increase the price of GHG emissions.

#### *4.3. Bioenergy and biofuels*

Bioenergy (biomass and biofuels) has become a subject of increased attention on the several grounds of reducing greenhouse gas emissions, coping with rising energy prices and energy dependency, and generating new income and employment sources in rural areas. Total global energy consumption was about 400 EJ (exajoules) in 2006 and is expected to grow 50 percent by 2025, most of which will occur in developing countries, especially in China and India (Hazell and Pachuari, 2006). Biofuels currently account for 0.2 percent of total global energy consumption, 1.5 percent of total road transport fuels, 2 percent of global cropland, 7 percent of global coarse grain use and 9 percent of global vegetable oil use. These shares are projected to rise over the next decade (FAO, 2009).

Therefore, there is an apparently clear economic, environmental and social need for bioenergy. Bioenergy production from agricultural commodities has increased rapidly in recent years, and is

projected to continue expanding in the future, due primarily to policy support measures and quantitative mandates in the developed countries (FAO, 2009). Production of biofuels, for instance, particularly ethanol and biodiesel for use in the transport sector, has tripled since 2000 and is projected to double again within the next decade (FAO, 2009). However, although global energy supplies have nearly doubled in the last thirty years, the relative contribution of renewable energies has hardly changed at around 13 per cent (Davis, 2009).

Bioenergy has several apparent advantages for agriculture and the broader economy. First, it can create development in agriculture via increased investment and employment. Second, it creates new income sources for farmers working in rural areas. Third, it helps reducing greenhouse gas emissions though they may not be the most cost-effective way of achieving this objective compared with other options. Fourth, bioenergy reduces energy dependency of imports (FAO, 2008).

Besides these apparent advantages, bioenergy (especially biofuels) create several risks from an environmental and social perspective. They threaten food security by generating higher food prices, especially a problem for poor net buyers of food in developing countries (the food-fuel debate). The immediate impact of high food prices on the poor can be mitigated through appropriately designed and targeted safety nets that support access to food. At the same time, it is important to allow rising prices to feed through to farmers so as to trigger the appropriate supply response. Moreover, expanded biofuel production may threaten land and water resources as well as biodiversity, and appropriate policy measures are required to minimize possible negative effects. However, there is a number of open questions. The impact of biofuels on greenhouse gas emissions varies widely, depending on the place where and technology with the various feedstock crops are produced (FAO, 2008). In some cases, increased emissions from land-use change are likely to at least offset if not exceed the greenhouse gas savings, and impacts on water, soil and biodiversity are also concerns. Furthermore, biofuels contribution to energy security is seriously limited, especially considering the upstream energy requirements of current biofuel stocks. However, these relationships can change fast if technology improvement results quickly in second and third generation of biofuels (FAO, 2008).

It is clear that support for first generation of biofuels can hardly be justified just because of the "infant industry" phenomenon. Even in most optimistic scenarios, agro-fuels could replace only 3% of imported petroleum products in the EU. Moreover, their energy balance and cost-benefit analysis are questionable and depend heavily on the methods of calculation (Bureau and Mahé, 2008). Davis (2009) argues that only Brazilian ethanol produced from sugar cane can be regarded as generating market returns greater than the costs of production. Nevertheless, it is clear that at higher oil prices than we have grown accustomed to in the past (\$100/barrel or more, compared with \$40/barrel) will certainly generate increased demand for farm-land for biofuel production,

regardless of public policy. With oil prices in excess of \$60 a barrel, there is a clear interest in bioenergy production (Hazell and Pachuari, 2006). This increased competition for scarce land will clearly have effects on both conservation of the global environment and on food prices (thereby enhancing the "food versus fuel" debate). Therefore, the effects and justifiable costs of biofuels support have to be questioned in relation to the longer-term benefits (Davis, 2009). The energy needs of rapidly growing countries, together with unstable oil supplies, suggest that the days of cheap oil are over. Bioenergy offers an attractive alternative for many industrial and developing countries but long-term commitments and investments in innovation are to be made to fully exploit their possibilities (Hazell and Pachuari, 2006).

#### 4.4. The "greening" of CAP

Since 1992, several environmental measures have been introduced for farmers, aiming to compensate them for the reduced revenue associated with the increased care for the environment. The most important measures are, *inter alia*, agri-environmental schemes (AES), programmes for least favoured areas (LFA), organic farming programmes, cross-compliance and animal welfare measures (set-aside has now been abolished).

These "greening" measures have been delivering some significant environmental benefits, though the effectiveness of these policies differ both geographically and across different types of environmental services (Garrod, 2009). It seems that some policies are not able to deliver the desired quantity and quality of environmental improvement demanded by society, therefore present agri-environment measures need to be revised based on an effective and wider-ranging monitoring process (Garrod, 2009). This evaluation process has only partially been conducted so we have limited knowledge of the effectiveness of these measures. However, a better understanding of the behaviour and preferences of farmers would improve the uptake of such schemes. Such a task might be performed more effectively at a more decentralised level with the greater involvement of local actors (Garrod, 2009).

According to Birdlife International (2007), most important environmental problems in European agriculture are the decline of biodiversity, nutrient pollution, increasing water stress, soil erosion and climate change. Birdlife's opinion is that the 21<sup>st</sup> century CAP should (1) establish a sustainable land management and rural development policy, (2) ensure sufficient funding to public goods, (3) deliver good management of Europe's protected areas, (4) support high nature value farmland, (5) ensure environmental schemes deliver their objectives, (6) create policies to adapt to and mitigate climate change. In order to achieve these goals, Birdlife (2007) would phase out all Pillar 1 payments and transfer the money to Pillar 2, especially to agri-environmental and land management support. Moreover, they would introduce a basic and an advanced agri-environmental support scheme by which the principles "not to harm" as well as "protect the environment proactively" would work at the same time.



Structural and landscape change also affect the greening process of the CAP as well as raising a major challenge for the future. Recent trends in agriculture suggest that small farms will continue to shrink, while large farms will become more specialised, which might imply that landscapes will change towards arable crops production at the expense of grasslands, as livestock production becomes more intensive (at least in some regions). The least productive patches of land may continue to be abandoned, increasing the costs to retain its multifunctionality. The EU is facing a land use challenge in the 21<sup>st</sup> century by trying to improve productivity to meet consumers` demand and, at the same time, improving the condition of the natural environment. This calls for a broader land management policy under which farms and other land-based rural businesses must be environmentally, socially and economically sustainable (Buckwell, 2008). According to the LUPG (2009), these challenges can be met based on a “new contract” between urban taxpayers and managers of the rural land. Sustainable land management schemes should be provided by the future CAP in order to meet this aim. However, while this is easy to say, no real plans for how this is to be achieved have been advanced so far.

Organic farming is often seen as meeting the needs of agricultural production and environmental conservation at the same time, relying on environmentally safe cultivation to maintain soil productivity and control pests, and excluding or strictly limiting the use of synthetic fertilizers and pesticides or livestock feed additives. Organic agriculture is practiced more than 120 countries of the world on almost 31 million hectares of land managed organically by at least 633,891 farms. It had a market of around \$40 billion in 2006, which is projected to increase globally (Willer-Yussefi, 2007). Ribbe (2009) recommends a new policy for the future CAP reform from the viewpoint of the Organic Agriculture Movement. First, he calls for a discussion of what a European agriculture policy is supposed to achieve as the growth model of industrialised agriculture cannot remain the focus of public policy. He suggests that the CAP must concentrate on further elaborating and implementing a “European agrarian model” that follows the principles of multi-functionality and long-term sustainability. Second, organic agriculture should be the “guiding light” of further CAP reform as one able to accomplish the “European agrarian model”, as propagated by former Agriculture Commissioner Fischler. Third he argues that specific subsidies for organic farmers should be developed instead of flat rate payments. However, there is a distinct lack of consensus that this proposal is a realistic or appropriate way forward, although increasing costs of fossil fuel based inputs would be expected to reduce such input use in agriculture.

#### **5. Four major institutional factors**

Although all ideas on CAP reform can be classified into one or more of the three main topics reviewed above, it is also important to consider *four major institutional factors* which will shape the CAP reform process. The first of these is the *EU budget*. At present, Pillar 1 of the CAP continues to be wholly financed by the EU budget, in contrast to all other European policies. As, for instance,

Thurston (2005) and Harvey (2006) have argued, this 'financial solidarity' provision is a relic of the old market intervention CAP, and is neither practically necessary nor logically justified for a CAP dominated by decoupled single payments. At least partly associated with this provision is the UK's budgetary rebate, which continues to raise major political irritation. However, attempts to change radically the distribution of EU budget spending between member states are likely to generate substantial resistance (e.g. Akrill and Kay, 2005). In any event, a leaked draft of the European Commission's Reform Agenda for the budget review, following an extensive consultation exercise (EC, 2009b), is quite explicit about the intended budgetary constraints on the CAP.

*"While it is too early to define the detailed contours or the exact intensity of the future reform of the CAP, it is clear that it should be driven by two objectives. First, it should resolutely pursue the modernisation of the CAP, enabling it to respond to new challenges and concentrating spending where it adds most value. Second, it must stimulate a further significant reduction in the overall shape of the EU Budget devoted to agriculture, freeing up spending for new EU Priorities" (p17). This paper also suggests one possible response to this challenge (p.19): "A larger responsibility of current CAP spending could be assigned to the member states, or direct aids could be co-financed by national contributions."*

There is no doubt that there are rapidly growing competing claims on the very limited EU budget. Based on the assessment of the current budget, and taking into account prospects for the coming decades, Ecorys (2008) conclude that three policy packages are of increased importance: (1) Climate change and energy resources; (2) Knowledge and innovation; (3) Common security and foreign affairs. If so, then the CAP funds can expect to be substantially squeezed.

The second factor is the *WTO and the current Doha round* of negotiations over international trade policy rules and restrictions on national action. Current calls for a return to market intervention (on the grounds of food security, for instance) are inconsistent with present WTO rules, to say nothing of the revised rules which will be agreed sometime under Doha. Recent studies (DG IPOL, 2009, Adler et al. 2009) stress that the CAP is presently 'WTO-compliant' – in that the SFPs, particularly, can be included in the 'green' (non-distorting) box, exempting them from either control or dispute through the WTO. So long as this is the case, further negotiated reductions in import tariffs, and elimination of export subsidies may well generate strong pressure within the EU for increases in SFPs in compensation for the reduced market support, as has happened to date.

EC (2009a) claims that the SFPs are in the WTO's Green Box: *"In the WTO classification of agricultural support measures, these payments fall within the 'green box', which implies that they are not distorting trade between the EU and its trading partners. Thus, decoupled direct payments not only allow the EU to ensure a minimum stream of revenue to its farming community while encouraging the production of safe and high quality food, the support method chosen also ensures that the impact on the rest of the world is minimal"* (EC, 2009a, p.6).

However, there is a critical paradox at the heart of the claim that SFPs are WTO green: if, indeed, SFPs do not distort farm production decisions, what, exactly, do they do? If these payments help farmers at all, they must result in farms staying in business when they otherwise would not, and

therefore cannot help but affect the structure of production. Whether or not this structural effect also and necessarily affects the total European volume of production, and if so, in what direction, remains an empirical question. Moreover, the Commission's brief says (EC, 2009a, p.7.):

*"In fact, research has shown that the absence of agricultural support in the EU would not drastically affect the overall level of production, but it would affect the territorial and environmental balance of production."*

Depending on the meaning of 'drastically', it may still be possible to defend claims for green box status for the SFP system, though this is not guaranteed. World trading partners can be expected to continue to seek ways of challenging the green status of SFPs so long as the inherent paradox remains.

The third critical element is the *EU law and practice for regulating competition* between member states, which will continue to prevent individual member states from seeking to advantage its own nationals at the expense of the other member states. The European Parliament has argued (see, e.g. Buckwell, 2007) that re-nationalisation of the CAP (i.e. obliging national contributions to Pillar 1, and thus providing member states with discretion over the level of these payments) will encourage the richer and/or more agriculturally conscious member states to unfairly advantage their own farmers and agricultural sectors at the expense of the rest of the Union. However, as Buckwell points out, such an argument effectively undermines the EU claim that these payments are non-distorting and WTO green. How can SFPs be non-distorting at the European level, yet distort trade between EU member states? In addition, EU competition law (as it applies to state aid, and control of direct and indirect aid) provides, at least in principle, the means to counter such member state manipulation of direct payments to their own nationals' advantage. In any event, the current disparity in the application of direct payments between the western member states and the NMS has very clearly already breached the notion of a 'common' policy, and has, in effect, already 'nationalised' the policy as far as the NMS are concerned.

The fourth critical element is the *Lisbon Treaty*, which, *inter alia*, gives the European Parliament (as well as national parliaments) both stronger and more direct control over European policy than in the past. The European Parliament (and its new Agricultural Committee) now has co-decision powers with the Council of Ministers, which means that no EU Policy will be passed without the full agreement of the EP. The clear intention is that this co-decision will make the EU policy process more democratic. A common presumption is that this extension of the decision-making process will delay and even frustrate further policy development. National and European Parliament elections (together with the farming lobby) may also have a more important role in the common agricultural decision making process in the future as political parties with different views can shape the future of European agriculture more directly. However, it is not clear that the direct engagement of the Parliament will necessarily strengthen the hand of the farm lobby (and the farm ministers) in resisting

radical change. It is possible that the Parliament, constituted on the basis of total population distribution, may find that conflicting and competing demands for very limited European budget resources generates pressure for more, rather than less radical reform of the CAP.

## **6. Summary of common ideas**

The major themes of the current debate on the future of the CAP reviewed here can be summarised as follows.

1. The *objectives* of the CAP, based on the Treaty of Rome, *need to be updated* (or at least to be substantially re-interpreted) with greater reference to the current challenges for Food Markets, Rural Development and Environment. These new challenges require a much broader range of policies than those used in the past, and they require private as well as public actors and actions.
2. The CAP is designed and based on the conditions of EU15 countries. The experiences of the first five years in the new member countries show that even with the possible modifications, *this system does not fully fit* for the conditions of the New Member States. Greater convergence is needed in the future between the Old and New Member States, requiring more coherent policies for agrarian transition, rural development and environmental conservation.
3. *Agricultural policies cannot be responsible for everything* (e.g. social welfare, public health, environmental or energy goals, socio-economic development of rural areas and so on). Rather, agricultural policies should be carefully integrated with other strategic policies of the EU, since both efficiency and effectiveness require specific policies for specific issues (Marsh, 2009, Anania, 2009).
4. The future CAP *cannot ignore the evolution of the agricultural sector*. The declining role of agriculture during economic development implies that fewer people will be able to earn a full time living in farming and food production. However, if world prices of agricultural commodities strengthen in the future, then pressures to support farmers directly will ease. Policy recommendations in line with global and macroeconomic trends are: (1) invest in R&D, (2) assist the transition towards a more careful and productive agriculture, (3) increase/create insurance related instruments.
5. *Direct payments* are not effective or justified, and should be reduced or totally phased out. They should be at least converted to a safety-net, while more radical reform requires greater conditionality on practical "services" rendered by farmers to the society ("what you get depends on what you do"). This implies that direct payments should be converted to a general contractual scheme, under which payments are made only to those delivering clear and measurable outcomes.
6. The new and changing meanings of *food security and safety* call for new policies. Food security in developed countries is not a supply but a demand problem. Policies for farming and rural land are irrelevant to European food security – which should be dealt with through general social security policies. Food safety and reliability policies should continue to follow the "from farm to fork" approach.

7. Besides macroeconomic tendencies, agricultural production and *competitiveness* are still important issues. Policies for agricultural competitiveness should assist the production and marketing of value added products. In order to cope with decreasing productivity, serious structural changes are needed. The development of new production technologies (again R&D) as well as the development of extension services and education is needed.

8. Agriculture is a risky business and there are various types of *risks in agriculture*. However, there is no clear consensus about the role of policy, other than that direct payments to provide fixed incomes is an obsolete idea and ineffective in practice. The private sector offers several risk management possibilities seeming to better cope with agricultural risks than large public programmes with big amount of subsidies.

9. *Rural development*, as it applies to the Pillar 2 of the CAP, refers to a number of measures. For future policy there is a clear need to rethink the linkages between agricultural production, land use and food market policies, rural development policy and cohesion policy. The majority of commentators argue, in one way or another, that rural development is about the geographical distribution of economic development and needs to be bottom-up or endogenous to be sustainable. The effectiveness of rural development programmes is an issue which deserves and requires more attention from researchers.

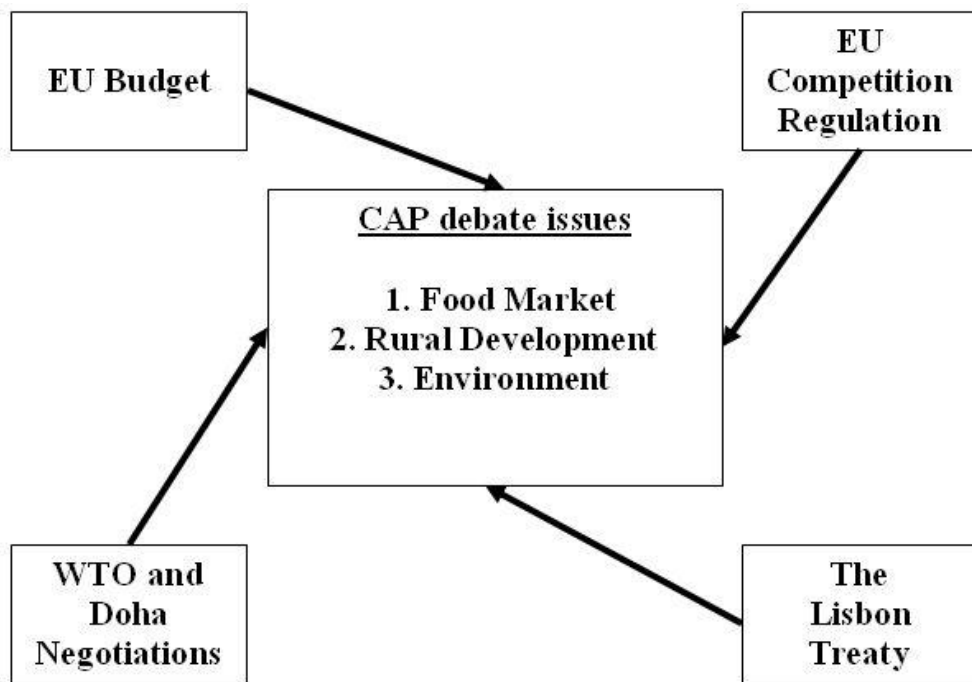
10. There is a clear consensus that one of the greatest challenges CAP and EU policies generally should face in the future is *climate change* and *public goods*. Climate change will have large effects on agriculture on the long run, but the places/extents are unclear. On the one hand, there is a clear need to increase R&D support in order to better understand the relationship between agriculture and climate change and help detect vulnerable areas and critical issues. On the other hand, the CAP or its descendants should encourage the provision of public goods (including climate change mitigation) by paying those actually providing them.

11. *Bioenergy (biomass and biofuels)* has become a subject of increased attention recently as it may help coping with greenhouse gas emissions, rising energy prices, energy dependency and create an opportunity of new income and employment source in rural areas. They have several advantages and disadvantages (overriding-effects), which policies should take into consideration. The common sense is that support for first generation of biofuels can hardly be justified, but further research should address the issues of energy balances, competing land uses and consequences of rising real fossil fuel prices.

12. *Agri-environmental policies* in the future should be better targeted through the development of basic and advanced agri-environmental support (payment) schemes, providing different levels of subsidies to different target groups. It seems that some policies are not able to deliver the desired quantity and quality of environmental improvement demanded by society, therefore present agri-environment measures needs to be revised based on effective and wider-ranging monitoring processes.

Figure 2 illustrates the logic of this review, representing the main forces challenging CAP reform.

Figure 2: Forces challenging CAP reform for 2014-2020



Source: Own composition

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[Notre Europe](#): Proposals for the CAP post-2013 "In the perspective of a CAP reform and changes of the agricultural budget after 2013, *Notre Europe* undertakes a prospective study on the conditions under which European agriculture could fit into the world economy over the next twenty five years. This study scrutinises the factors set to affect agricultural activity in Europe and comes up with proposals for a new agricultural policy. Contrary to studies undertaken over the last twenty years, this research paper does not confine itself to economic issues. It also takes into account agriculture's political and sociological dimensions, setting its questions in a European framework." (accessed 01.02.10)

[Institute for European Environmental Policy \(IEEP\)](#): CAP 2020 "CAP2020 provides a platform to share thoughtful commentary and analysis on the future development of European agriculture and rural development policy." (accessed 01.02.10)

[CAP Reform](#): "This is the place to come for news, views and analysis relating to the European Union's Common Agricultural Policy. The blog brings together the work of [researchers, activists and analysts](#) from across Europe and elsewhere. Many of the contributors are also involved in a sister project, [farmsubsidy.org](#), which is bringing greater transparency and accountability to the Common Agricultural Policy." (accessed 01.02.10)

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