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**COMMUNICATION FROM THE COMMISSION TO THE COUNCIL, THE
EUROPEAN PARLIAMENT, THE EUROPEAN ECONOMIC AND SOCIAL
COMMITTEE AND THE COMMITTEE OF THE REGIONS**

***The CAP towards 2020:
meeting the food, natural resource and territorial challenges of the future***

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1. INTRODUCTION

The Common Agricultural Policy (CAP) is confronted with a set of challenges, some unique in nature, and most unforeseen, that invite the EU to make a strategic choice for **the long-term future of its agriculture and rural areas**.

In preparation for this Communication, the Commission organised an extensive public debate earlier in 2010 that concluded with a conference in July 2010¹. The Council discussed during four successive Presidencies the reform, the European Parliament (EP) adopted an own-initiative report on the post-2013 CAP², and its link with the Europe 2020 Strategy and both the Economic and Social Committee and the Committee of the Regions (CoR) have come forward with position papers.

In the course of these discussions, the overwhelming majority of views expressed concurred that the future CAP should remain a **strong common policy** structured around its **two pillars**. In broad terms, the views expressed recommended the following strategic aims:

- To preserve the food production potential throughout the EU, so as to guarantee long-term **food security** for European citizens and to contribute to growing world food demand, expected by FAO to increase by 70% by 2050. Recent incidents of increased market instability, often exacerbated by climate change, further highlight these trends and pressures. Europe's capacity to deliver food security in time of crisis is therefore an important long term choice for Europe which cannot be taken for granted.
- To support farming communities that provide the European citizens with **quality** and **diversity of food** produced sustainably, in line with our environmental, water and animal welfare ambitions. The active management of natural resources by farming is a key lever to maintain the rural landscape, to combat biodiversity loss and contributes to mitigating climate change. This is an essential basis for dynamic territories and long term economic viability.
- To maintain viable rural communities, for whom farming is a core economic activity creating local **employment**; this delivers multiple economic, social, environmental and territorial benefits. A significant reduction in local production would also have implications with regards to greenhouse gases (GHG), characteristic local landscapes as well as more limited choice for the consumer.

¹ 5,600 contributions were received in the public debate and the Conference assembled over 600 participants.

² George Lyon report LINK;

Agriculture is an integral part of the European economy and society. In terms of indirect effects, any significant cut back in European farming activity would in turn generate losses in GDP and jobs in other economic sectors – notably within the agri-food supply chain, which relies on the EU primary agricultural sector for high quality, competitive and reliable raw material inputs. Rural activities, from tourism, transport, to local and public services would also be affected. Depopulation in rural areas would probably accelerate. There would therefore be important environmental and social consequences.

Reform of the CAP must also continue, to promote greater competitiveness, efficient use of taxpayer resources and effective public policy returns European citizens expect, with regard to food security, the environment, **climate change** and social and **territorial** balance. The objective should be to build more sustainable, smarter and more inclusive growth for rural Europe.

To achieve this, the future CAP should contain a **greener** and more **equitably distributed** first pillar and a second pillar focussing more on **competitiveness** and **innovation**, climate change and the environment with a view to releasing the latent productivity potential, notably in the new Member States, thus contributing to the Europe 2020 objectives. Targeting support exclusively to **active farmers and remunerating the collective services they provide to society** would increase the effectiveness and efficiency of support and further legitimize the CAP. All this needs to happen within the constraints of limited budgetary resources and taking into account the severe impact of the economic crisis on agriculture.

2. THE CAP REFORM PATH

The main objectives of the CAP set out in the Treaty of Rome have remained the same over the years. However, the reform path of the CAP since the early 1990s has led to a completely new policy structure.

The challenges addressed relate to agriculture's productive capacity, the increasing diversity of agriculture and rural areas following successive enlargements, and the demands by EU citizens on the environment, food safety and quality, animal welfare, the preservation of the countryside, biodiversity and climate change. At the same time, the instruments to achieve the objectives have also changed considerably. Today, they are structured in **two complementary pillars**, with annual direct payments and market measures making up the first, multi-annual rural development measures the second pillar.

The introduction of direct payments has been a lever for consistent market-oriented reforms, enhancing the competitiveness of the agricultural sector by encouraging farmers to adapt to market conditions. Decoupled direct payments provide today basic income support and support for basic public goods desired by European society.

Because of this greater market orientation, the various market measures, which were the main instruments of the CAP in the past, today provide merely a safety net only used in cases of significant price declines.

Rural development aims at promoting competitiveness, the sustainable management of natural resources, and the balanced development of rural areas by more specific and targeted measures. It gives Member States flexibility to address the issues of most concern within their respective territory with co-financing. Other CAP initiatives, such as quality policy, promotion and organic farming, also have an important impact on farmers' situation.

Together, the present set of policy measures results in what is the **main contribution of the CAP** – a **territorially and environmentally balanced EU agriculture** within an open economic environment. Continuing to deliver these public benefits in future will require a strong public policy because the goods provided by the agricultural sector cannot be adequately remunerated and regulated through the normal functioning of markets.

Withdrawing public support would lead to greater concentration of agricultural production in some areas with particularly favourable conditions, using more intensive farming practices, while the less competitive areas would face marginalisation and land abandonment. Such developments would result in increased environmental pressures and the deterioration of valuable habitats with serious economic and social consequences² including an irreversible deterioration of the European agricultural production capacity.

3. WHAT ARE THE CHALLENGES?

3.1 Food security

The primary role of agriculture is to supply **food**. **Therefore** it is essential that EU agriculture maintains its production capacity. A strong agricultural sector is vital for the highly competitive food industry³ to remain an important part of EU economy and trade (the EU is the leading world exporter of, mostly processed and high value added agricultural products)⁴. Moreover, EU citizens demand **high quality** and a **wide choice** of food products, including **local products**.

EU agriculture finds itself today in a considerably more **competitive environment**, as the world economy is increasingly integrated and the trading system more liberalized. Favourable in the medium-term, the perspectives for agricultural markets are expected nonetheless to be characterised by greater **uncertainty** and increased **volatility**.

Moreover, the future CAP will operate in the aftermath of an **economic crisis** that has seriously affected agriculture and rural areas by linking them directly to wider macroeconomic developments affecting its cost of production. After a decade of mere **income** stagnation, agricultural income dropped substantially in 2009 adding to an already fragile situation of an agricultural income significantly lower (by an estimated 40% per working unit) than that in the rest of the economy, and income per inhabitant in rural areas is considerably lower (by about 50%) than in urban areas

3.2 Environment and climate change

Although GHG emissions from agriculture have decreased by 20% since 1990, further efforts will be required to meet the ambitious EU energy and climate agenda, to reduce GHG emission, to adapt and make a positive contribution through carbon sequestration and biomass production based on innovation. The environmental

² See Scenar 2020 – Prospective scenario study on agriculture and the rural world.

³ Food Industry represents 13.5% of total employment and 12.2% of gross value added of European manufacturing Industry.

⁴ Agri –food exports represent 6.8 % of total EU exports.

challenges, such as depletion of soil, water and air quality as well as habitats and biodiversity need to be addressed too.

3.3 Territorial balance

Even if a growing number of **rural areas** have become increasingly driven by factors outside agriculture, agriculture remains the motor of the rural economy in much of Europe. The vitality and potential of many rural areas remain closely linked to the presence of a **competitive and dynamic farming sector**, attractive to young farmers. This is particularly the case in predominantly rural areas where the primary sector represents around 5% of value added and 16% of employment, and in the new Member States where it is important to consolidate the recent gains in productivity and fulfil the full potential of agriculture. In addition, agriculture plays an important role in rural areas through generating additional economic activities, with especially strong linkages with food processing, tourism and trade. In many regions, in particular in the New Member States, agriculture is the basis of local traditions and of the social identity.

4. WHY DO WE NEED A REFORM?

The CAP has evolved, but further changes are necessary in order to respond to the new **challenges** notably:

- to address rising concerns regarding both EU and global food security,
- to enhance the sustainable management of natural resources such as water, biodiversity and soil,
- to deal with both the increasing pressure on agricultural production conditions caused by ongoing climatic changes, as well as the need for farmers to reduce their contribution to climate change,
- to act and stay competitive in a world characterized by **increasing globalisation, with rising price volatility while maintaining agricultural production across the whole European Union,**
- to make best use of the diversity of EU farm structures and production systems, which have increased following EU enlargement, while maintaining its social, territorial and structuring role.
- to strengthen territorial and social cohesion in the rural areas of the European Union, notably through the promotion of employment,
- to make CAP support **more equitable** and **balanced** between Member States and farmers and better targeted to active farmers.

By facing these challenges, the CAP will also contribute to the *EU 2020 Strategy* in terms of:

- *Smart growth* – by increasing resource efficiency through technological knowledge and innovation, developing high value added and quality products; developing green

technologies, investing in training and providing incentives for social innovation in rural areas;

- *Sustainable growth* – by maintaining the food, feed and renewable production base, ensuring sustainable land management, providing environmental public goods, addressing biodiversity loss, promoting renewable energies, further reducing emissions and fully developing the potential of rural areas; and
- *Inclusive growth* – by unlocking economic potential in rural areas, developing local markets and jobs, accompanying the restructuring of agriculture and supporting farmers' income to maintain a sustainable agriculture throughout Europe⁵.

This means **green growth** in the agricultural sector and the rural economy as a way to pursue economic growth while preventing environmental degradation.

5. OBJECTIVES OF THE FUTURE CAP

The three main objectives for the future CAP would thus be:

Objective 1: Viable food production

- To contribute to **farm incomes** and limit farm income variability, recalling that price and income volatility and natural risks are more marked than in most other sectors and farmers' incomes and profitability levels are below those in other sectors.
- To improve the **competitiveness** of the agricultural sector and enhancing its value share in the **food chain**, because the agricultural sector is dispersed compared to other sectors of the food chain which are better organised and have therefore a stronger bargaining power. In addition European farmers face competition from the world market while also having to respect high standards relating to environmental, food safety, quality and animal welfare objectives.
- To compensate for production difficulties in areas with specific **natural constraints** because such regions are at increased risk of land abandonment.

Objective 2: Sustainable management of natural resources

- to guarantee sustainable production practices and secure the provision of **environmental public goods** as many of the public benefits generated through agriculture are not remunerated through the normal functioning of markets.
- to foster **green growth** through **innovation** which requires adopting new technologies, developing new products, changing production processes, and supporting new patterns of demand.
- to pursue **climate change** mitigation actions – and also enable agriculture to adapt to climate change. Because agriculture is particularly vulnerable to the impact of climate

⁵ The CAP in particular will provide contributions to the EU flagship initiatives on "Low carbon, resource efficient Europe", "Innovation Union", and "An European Platform against Poverty".

change, enabling the sector to better adapt to the effects of extreme weather fluctuations, can also reduce the negative effects of climate change.

Objective 3: Balanced territorial development

- to support rural employment and maintaining the social fabric of rural areas;
- to improve the rural economy and promote **diversification** to enable local actors to unlock their potential.
- to allow for **structural diversity** in the farming systems, improve the conditions for small farms and develop local markets because in Europe, heterogeneous farm structures and production systems contribute to the attractiveness and identity of rural regions.

Achieving all these objectives will require that public support to the agricultural sector and rural areas be maintained. Policies set at European level are therefore needed in order to ensure that farmers encounter fair conditions with a common set of objectives, principles and rules. Also, an agricultural policy designed at EU level provides for a more efficient use of budgetary resources than the coexistence of national policies. In addition to single market concerns, several other objectives are better addressed at trans-national level, e.g. cohesion across Member States and regions, cross-border environmental problems, and global challenges such as climate change, water management and biodiversity.

6. REFORM ORIENTATION

6.1. Future instruments

All potential options of the future CAP imply changes in present CAP instruments. This section explores how instruments could be defined in order to respond in a more efficient way to the above objectives.

The future design should be based on a two pillar structure, which was the overwhelming view expressed in the public debate and which is also clearly favoured by the Council, the EP and the CoR. The first pillar should contain the support paid to all farmers on a yearly basis, whereas the 2nd pillar is the support tool for community objectives giving the Member States sufficient flexibility to respond their specificities. The separation between the two pillars should bring about clarity, each pillar being complementary to the other without overlapping and focussing on efficiency.

Direct payments

The necessary adaptations of the direct payment system relate to the **redistribution, redesign** and better **targeting** of support. There is widespread agreement that the distribution of direct payments should be reviewed and made more understandable to the taxpayer. The criteria should be both economic, in order to fulfil to the basic income function of direct payments, and environmental, so as to support for the provision of basic public goods.

The use of a single, flat rate direct payment was one of the proposals floated in the public debate. However, agricultural producers face very different economic and natural conditions across the EU which advocates for an equitable distribution of direct aids.

Thus the fundamental question is how to reach a more equitable distribution that reflects, in a pragmatic, economically and politically feasible manner, the declared objectives of this support, while providing a sufficient transition to avoid major disruptive changes which could have far reaching economic consequences in some regions and/or production systems. A possible route could be a system that limits the gains and losses of Member States by guaranteeing that farmers in all Member States receive on average a minimum share of the EU-wide average level of direct payments.

The future of direct payments to be granted to active farmers could be based on the following principles, taking up the concept proposed by the European Parliament:

- **Basic income** support through the granting of a basic decoupled direct payment, providing a uniform level of obligatory support to all farmers in a Member State (or in a region) based on transferable entitlements that need to be activated by matching them with eligible agricultural land, plus fulfillment of cross-compliance requirements. An **upper ceiling** for direct payments received by large individual farms ("capping") should be introduced to improve the distribution of payments between farmers. Disproportionate effects on large farms with high employment numbers could be mitigated by taking into account salaried labour intensity.
- Enhancement of environmental performance of the CAP through a mandatory "**greening**" component of direct payments by supporting environmental measures applicable across the whole of the EU territory. These could take the form of simple, generalised, non-contractual and annual agri-environmental actions (e.g. permanent pasture, green cover, crop rotation and ecological set-aside). In addition, the possibility of enhancing certain elements of GAEC standards should be analysed.
- Promotion of the sustainable development of agriculture in areas with **specific natural constraints** by providing an additional income support to farmers in such areas in the form of an area-based payment with optional national top-ups on a voluntary basis. The existing support for LFAs granted in the 2nd pillar would come to an end.
- In order to take account of specific problems in certain regions where particular types of farming are considered particularly important for economic and/or social reasons, voluntary **coupled** support, may continue to be granted, within clearly defined limits (with support based on fixed areas, yields or number of heads).
- The loss of employment opportunities in many rural areas could be mitigated with support to **small farmers** by ensuring a minimum level of direct payment.
- Simplification of **cross compliance** rules by providing farmers and administrations with a simpler and more comprehensive set of rules without watering down the concept of cross compliance itself.

These changes in the design of direct payments should go hand in hand with a better definition and targeting of support to "**active farmers**" only, which, responding to the criticism of the European Court of Auditors.

Market measures

The public debate revealed a broad consensus on keeping the overall **market orientation** of the CAP while also maintaining the general architecture of the market management tools.

Indeed the 2009 dairy market crisis highlighted the important role that existing mechanisms play in supporting the market in times of crisis. However, some specific adaptations appear necessary, most notably in **streamlining** and **simplifying** instruments currently in place, as well as in introducing new policy elements with respect to the functioning of the food chain.

Potential adaptations could include the extension of the intervention period, the use of disturbance clauses and private storage to other products, and other revisions to enhance efficiency and improve controls.

A proposal for a revised quality policy will be presented by the end of 2010 to improve possibilities for farmers to communicate specific qualities or attributes of their product to consumers⁶.

The removal of dairy quotas will take place in 2015. Legal proposals are to be tabled at the end of 2010 on the basis of the recommendations of the High Level Expert Group on Milk to enable long-term planning, and thereby ensuring stability, for the dairy sector. In the sugar and isoglucose sectors, the current regime is set to expire in 2014/15. Several options for the future, including a non-disruptive end of the quotas at a date to be defined, need to be examined to bring about increased efficiency and greater competitiveness for the sector.

Finally, improving the functioning of the **food supply chain** is necessary. Long term prospects for agriculture will not improve if farmers cannot reverse the steadily decreasing trend in their share of the value added generated by the food supply chain⁷. Indeed, the share of agriculture in the food supply chain has decreased from 29% in 2000 to 24% in 2005, while over the same period the share of the food industry, wholesale and the distribution sector have all increased.

Without well-functioning transmission of market signals, the long-term prospects of the farm sector and its share of the value added generated by the whole food chain are in jeopardy. Key issues of interest relate to the current imbalance of bargaining power along the chain, the contractual relations, the need for restructuring and consolidation of the farm sector, transparency, and the functioning of the agricultural commodity derivatives markets.

Rural Development

As an integral part of the CAP, rural development policy has proved its value by reinforcing the sustainability of the EU's farm sector and rural areas – economically, environmentally and socially.

There are strong calls for the policy to continue to fully integrate the constraints of the environment and climate change and to deliver a wide range of benefits for farming, the countryside and wider society and contribute to:

- the **competitiveness of agriculture**, by promoting innovation and restructuring and by enabling the farm sector to become more resource efficient;
- the **sustainable management of natural resources**, by taking care of the environment and the countryside, and maintaining the production capacity of the land;

⁶ See COM (2009)234 on quality products and the forthcoming report on the application of the new organic farming Council Regulation (EC) n°834/2007.

⁷ "A better functioning food supply chain in Europe" – COM (2009) 591 of 28/10/2009 :

- the **balanced territorial development** of rural areas throughout the EU by empowering people in local areas, building capacity and improving local conditions.

Within this framework, **environment, climate change** and **innovation** should be guiding themes that steer the policy more than ever before. For example, investments should lift both economic and environmental performance; environmental measures should be more closely tailored to the individual needs of regions and even local areas; measures to help unlock the potential of rural areas should pay close attention to innovative ideas for business and local governance. Support for developing direct sales and local markets should also be important. Addressing the specific needs of young farmers and new entrants will be a priority.

For the policy objectives to translate into results on the ground, **effective delivery mechanisms** are of paramount importance. The current strategic approach would be strengthened by setting quantified targets at EU and then at program level, possibly coupled with incentives. Such a shift towards a more outcome based approach would best steer the policy towards EU priorities and show what it actually achieves. The set of indicators in the Common Monitoring and Evaluation Framework should be both simplified and improved for this purpose.

For the sake of efficiency, it will be essential to strengthen the **coherence** between rural development policy and other EU policies, while also simplifying and cutting red tape where possible. To this end, a **common strategic framework** for EU funds may be envisaged.

In terms of instruments, a wide range of tools would remain useful, from investments and infrastructure to payments for ecosystem services, support for environmental and climate change measures, support for innovation, knowledge transfer and capacity building, business creation, social and institutional development. Improvements may consist in better linking measures together, especially with training, creating packages to address the needs of specific groups or areas (e.g. small farmers, mountain areas), or offering incentives such as preferential aid intensity rates for improved targeting.

In addition, a **risk management toolkit** should be included to deal more effectively with income uncertainties and market volatility that hamper the agricultural sector's possibility to invest in staying competitive. The toolkit would be made available to Member States to address both production and income risks, ranging from a new WTO green box compatible income stabilization tool, to strengthened support to insurance instruments and mutual funds.

As regards the distribution of rural development support among Member States, the use of objective criteria should be considered, while limiting significant disruption from the current system.

It is also essential to further strengthen and simplify the **quality** (including organic farming) and **promotion** policies in order to enhance the competitiveness of the agricultural sector.

6.2. Broad policy options

Three broad policy options, reflecting the main orientations of the public debate without being mutually exclusive, merit further consideration. They are presented here as indicative of potential paths whose impact will be analysed before final decisions are made. All three options are based on a two-pillar structure (with a different balance between pillars).

Option 1: enhanced Status Quo

This option would build upon the well-functioning aspects of the policy and focus on **limited** improvements in specific areas (e.g. more equity in the distribution of direct payments between Member States).

While this option would ensure continuity with the current CAP, thus facilitating long-term planning for operators along the food chain, it could arguably represent a missed opportunity of reforming the CAP into a more effective and legitimate policy tailored to address future challenges and respond to criticism about the balance of support.

Option 2: more balanced, targeted and sustainable support

Another alternative would be to capture the opportunity for reform, and make major overhauls of the policy in order to ensure that it becomes more **sustainable**, and that the **balance** between different policy objectives, farmers and Member States is better met. This would be done through more **targeted** measures which would also be more understandable to the EU citizen.

This orientation would be more suitable to address economic, environmental and social challenges. Moreover, the efficiency of budgetary resource use would be increased thanks to improved targeting, although the required adaptation of delivery mechanisms would need to avoid additional administrative burden.

Option 3: abolished market and income support

Those requesting a more **radical** reform of the CAP advocate moving away from income support and most market measures, and focusing entirely on environmental and climate change objectives. This alternative could have the advantage that it would allow for a clear focus of the policy. However, this would lead to a significant reduction in production levels, farm income, and number of farmers for the most vulnerable sectors and areas, as well as cause land abandonment in some areas and intensification of production in other areas, with serious potential environmental and social consequences. This option would thus imply a loss of synergies between the economic, environmental and social dimensions of the CAP.

7. CONCLUSIONS

The Commission's response to the debate on the future CAP comes in the form of the present Communication, which outlines options and launches the institutional debate around these options. Based on the responses to this debate and to the public consultation launched in the framework of the Commission Impact Assessment inter-service group, legal proposals will be presented in 2011.

The options for reform consist of both major changes that require a new design, and improvements of the elements that have proven their usefulness in their current design. On this basis, the future CAP should become a more sustainable, more balanced, better targeted, simpler and more effective policy, more accountable to the needs and expectations of the EU society.

ANNEX I – DESCRIPTION OF THE THREE BROAD POLICY OPTIONS

	Direct payments	Market measures	Rural development
Enhanced Status Quo	Introduce more equity in the distribution of direct payments between Member States (while leaving unchanged the current direct payment system)	Strengthen risk management tools Streamline and simplify existing market instruments where appropriate	Maintain the Health Check orientation of increasing funding for meeting the challenges related to climate change, water, biodiversity and renewable energy, and innovation.
More balanced, targeted and sustainable support	<p>Introduce more equity in the distribution of direct payments between Member States and a substantial change in their design.</p> <p>Direct payments would be composed of:</p> <ul style="list-style-type: none"> ▪ a basic rate serving as income support, ▪ a compulsory additional aid for specific "greening" public goods through simple, generalized, annual and non-contractual agri-environmental actions based on the supplementary costs for carrying out these actions, ▪ a voluntary additional co-financed payment to compensate for specific natural constraints, ▪ and a voluntary coupled support component for specific sectors and regions⁸, <p>Introduce support towards small farms.</p> <p>Introduce a capping of the basic rate, while also considering the contribution of large farms to rural employment.</p>	Improve and simplify existing market instruments where appropriate	<p>Adjust and complement existing instruments to be better aligned with EU priorities, with support focused on environment and/or restructuring and innovation, and to enhance regional/local initiatives.</p> <p>Strengthen existing risk management tools and introduce an optional WTO green box compatible income stabilization tool to compensate for substantial income losses.</p> <p>Some redistribution of funds between Member States based on objective criteria could be envisaged.</p>
Abolished market and income support	<p>Phase-out direct payments in their current form</p> <p>Provide instead limited payments for environmental public goods and additional specific natural constraints payments</p>	Abolish all market measures, with the potential exception of disturbance clauses that could be activated in times of severe crises	The measures would be mainly focused on climate change and environment aspects

⁸ This would be equivalent to today's coupled support paid through Art 68 and other coupled aid measures.