



The EU's Common Agricultural Policy Post 2020:

Directions of Change and Potential Trade and Market Effects

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International Centre for Trade
and Sustainable Development

Issue Paper

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ABBREVIATIONS

AECM	agri-environment and climate measure
BTAMS	Bound Total Aggregate Measurement of Support
CAP	Common Agricultural Policy
CAPRI	Common Agricultural Policy Regionalised Impact agricultural sector model
CTAMS	Current Total Aggregate Measurement of Support
EU	European Union
GAEC	good agricultural and environmental condition
IA	impact assessment
LDC	least developed country
MFF	Multi-annual Financial Framework
MFN	most favoured nation
SAPS	Single Area Payment Scheme
SDG	Sustainable Development Goal
UK	United Kingdom
WTO	World Trade Organization

FOREWORD

Farm policy in the EU and other major economies can have significant implications not just for producers, consumers and other market actors domestically, but also at the international level. In particular, trade-distorting support for the farm sector can affect the global allocation of scarce resources, the competitiveness of market actors in different world regions, and can have significant implications for food price volatility and the proper functioning of food commodity markets. Furthermore, poor producers in developing countries can be especially vulnerable to the effects of trade-distorting support on markets of importance to them, including the implications of sudden shocks.

In 2015, world leaders met at the United Nations and agreed to take action to end hunger and all forms of malnutrition by 2030, as part of the Sustainable Development Goals (SDGs). SDG 2.B specifies that countries will “correct and prevent trade restrictions and distortions in world agricultural markets,” as a “means of implementation” for achieving the broader goal. In addition, SDG 2.C commits governments to “adopt measures to ensure the proper functioning of food commodity markets and their derivatives and facilitate timely access to market information, including on food reserves, in order to help limit extreme food price volatility.”

At the World Trade Organization, progress in talks on trade-distorting agricultural domestic support remains a priority topic for most members, despite the inability to agree to consensus outcomes or a roadmap for future work at the organisation’s ministerial conference in Buenos Aires, Argentina, in December 2017. Nonetheless, negotiations on the issue are continuing, on the basis of Article XX of the WTO’s Agreement on Agriculture, and the instructions from trade ministers at past ministerial conferences, such as that held in 2015 in Nairobi, Kenya.

One of the obstacles to achieving progress in negotiations at the WTO is a lack of understanding in national capitals and in Geneva concerning the underlying policy objectives other countries are seeking to pursue, and also the nature of the instruments which they are using to do so. While delays in submitting domestic support notifications to the WTO have contributed to this problem, many trade officials also find it hard to access accurate current information regarding farm policy goals and instruments, and in relating this information back to the existing framework of WTO rules.

At the same time, domestic policy makers and constituencies are often unaware of or unable to articulate the connections between various farm policy options and their implications for global trade. While WTO commitments and negotiations have contributed to informing successive past reforms of the EU’s Common Agricultural Policy (CAP), policymakers in other countries may be unfamiliar with the policy objectives that the EU is seeking to achieve, as well as the specific instruments which are under consideration for the 2021-2027 period.

This paper, by Alan Matthews, Professor Emeritus of European Agricultural Policy at Trinity College Dublin, Ireland, therefore seeks to provide international trade negotiators, capital-based policymakers in various countries, and other policy actors with an impartial, evidence-based analysis of the likely implications of the new CAP for global food and agriculture trade and markets, with a particular focus on how various scenarios could affect products and value chains of importance to developing countries. As such, we believe it represents a valuable contribution to the ongoing debate in this area.



Ricardo Meléndez-Ortiz
Chief Executive, ICTSD

EXECUTIVE SUMMARY

The European Union (EU) plays a central, if declining, role in global agri-food trade, accounting for around 17 percent of global exports and imports excluding intra-EU trade. Changes in the EU's agricultural policy, known as the Common Agricultural Policy (CAP), can therefore be expected to have impacts on other countries, including developing countries. These impacts will affect the EU's trading partners but also other countries through possible changes in its net trade position and thus effects on world market prices, through supply chain effects resulting from the EU's import demand for agricultural commodities, and indirectly through its impact on agricultural greenhouse gas emissions and the contribution made to global warming.

The EU completed a review of its CAP in 2013 and the new legislation that took effect in 2015 sets out its agricultural policy until the end of 2020. At the beginning of 2017 the EU launched a process that will lead to further changes in its agricultural policy after 2020. On 1 June 2018 the European Commission published a set of legislative proposals based around key ideas of simplifying and modernising the CAP. These proposals are now under deliberation in the EU's two co-legislators, the Council of Ministers (representing member states) and the European Parliament (directly elected by European citizens). At the same time, the Commission has published proposals for the EU's Multi-annual Financial Framework (MFF) for the period 2021-2027. The MFF sets out maximum spending limits on EU policies, including the CAP, during this period as well as proposing how the EU budget should be financed.

This paper sets out to give those that may be affected by these changes, particularly in developing countries, an authoritative account of the Commission's proposals, bearing in mind that changes may be made to the proposed legislation in the process of approval by the co-legislators. The context for the Commission's proposal is an awareness that agriculture must be encouraged to play a bigger role in helping to achieve the EU's commitments to the UN Sustainable Development Goals including its targets under the Paris Agreement on climate change.

The UK's announced departure from the EU is another contextual factor which has a particular importance for the future EU budget, given that the UK has been the second largest net budget contributor. The Commission's proposal for the budget framework for EU agricultural policy after 2020 would result in an overall reduction in the CAP budget of 3-5 percent in nominal terms and 12-15 percent in real terms. The Commission has prioritised spending on direct payments for income support (financed by Pillar 1 of the CAP). The reduced budget will disproportionately affect spending on rural development programmes (financed by Pillar 2 of the CAP). Spending on voluntary agri-environment-climate schemes will be maintained by a stronger ring-fencing of the Pillar 2 budget and the possibility to allocate some of the Pillar 1 direct payments to a new 'eco-scheme' with environmental and climate action objectives.

The Commission's objectives in its legislative proposal are to simplify and modernise the CAP, while addressing more ambitious environmental and climate policy goals. The proposal's most innovative element is to move to a new delivery model entailing greater responsibility and flexibility for member states to design their agricultural policies, albeit still within a common EU framework. Control over member state interventions would shift from a compliance framework (are payments to farmers in compliance with the rules set at EU level for these payments?) to a performance framework (in which the Commission will focus on auditing outcomes based on achieving agreed performance indicators).

Other changes are proposed to the rules governing coupled payments, risk management instruments, crisis interventions, the targeting of direct payments as well as to the architecture

of environmental obligations and supports. The result will likely be a small increase in the EU's Current Total Aggregate Measurement of Support notified to the World Trade Organization, though this would remain well below the EU's bound commitment on trade-distorting domestic support.

The impact assessment that accompanied the Commission's CAP proposal allows some inferences to be drawn on the scale of the likely production and trade impacts, although none of the options examined correspond exactly to the legislative proposal. Farm income is expected to be lower, in part because of the impact of the cut in the CAP budget, but also if member states choose to give priority to environmental objectives relative to income support. The proposed redistribution of direct payments from larger to small and medium-sized farms may also have small production impacts to the extent that farms of different sizes specialise in different types of products. Simulations show that imports are likely to increase, and exports decrease, relative to a continuation of the current CAP legislation, but the changes are expected to be small in magnitude.

These changes may open some new market access opportunities for developing countries, particularly those that export under preferential access arrangements. For least developed countries (LDCs) that benefit from 100 percent duty and quota-free access to the EU market, an examination of existing trade statistics highlights that the inability to meet the EU's strict sanitary and phytosanitary standards on food exports may well be a barrier to taking advantage of any new opportunities that may arise.

Most LDCs are now net food importers even if many also depend on exports of specific agricultural commodities. Depending on the extent of price transmission from world markets to domestic markets, the Commission proposal might lead to some (very minor) upward pressure on domestic producer and food prices, all else assumed unchanged. Food producers would benefit while poorer food consumers would be (very slightly) disadvantaged. LDCs can best respond by increasing their own domestic support to the agricultural sector so that it can provide remunerative employment opportunities and meet growing domestic and regional demands

Even if the direct market and trade impacts of the Commission's CAP legislative proposal are expected to be small, its specific provisions can be of interest to the EU's trading partners in that they explicitly recognise the need to address the UN's Sustainable Development Goals. The prospect of stronger interventions to reduce agricultural greenhouse gas net emissions will be welcomed by LDCs and developing countries generally, given that these countries are most at risk from global warming. Whether the provisions are far-reaching enough or are likely to be effective or not are now topics of intense debate within the EU that will influence the position of the co-legislators on the final legislation. Although the Commission hopes that final agreement can be reached in sufficient time to allow the legislation to come into force from 1 January 2021, possible delays in reaching agreement on the MFF budget proposal as well as European Parliament elections in May 2019 could well mean that there will be a need for a transitional period in which the current CAP rules are extended for a period of time.

1. INTRODUCTION

The European Union (EU) plays a central role in global agri-food trade. It is the world's single largest exporter and importer of agri-food products. However, its share of global exports and imports has been falling as the share of new players and markets among the emerging economies has grown. Excluding intra-EU trade, the EU's share of global agri-food exports was 20 percent in 2000 and has now fallen to 16-17 percent. Its global import share has fallen even faster, from 27 percent in 2000 to around 17 percent today.¹

The structure and design of the EU's agricultural policy—known as the Common Agricultural Policy (CAP)—is of interest to the EU's trading partners because of its potential influence on the EU's production potential and its net trade position. The EU is also committed to implementing the UN 2030 Agenda for Sustainable Development and its 17 Sustainable Development Goals (SDGs) across all its internal and external policies (Council of the European Union 2017). Policy coherence for sustainable development, the requirement to take into account the objectives of development co-operation in all external and internal policies that are likely to affect developing countries, is a fundamental part of the EU's contribution to achieving the SDGs. The EU has identified five areas where policy impacts should be given particular attention: trade and finance; ensuring global food security; addressing climate change; making migration work for development; and strengthening the links between security and development. In making legislative proposals, the Commission is required to consider in its impact assessment any potential impacts on developing countries, and particularly the Least Developed Countries (LDCs).²

The CAP has evolved in important ways in recent decades as the EU's agricultural policy has moved in a more market-oriented direction. With respect to agricultural trade policy, the EU tariffed its variable import levies in 1995 and reduced its bound tariffs as part of its commitments under the Uruguay Round Agreement on Agriculture. No further reductions in its most-favoured nation (MFN) bound and applied tariffs have taken place since then due to the failure of the World Trade Organization (WTO) Doha Round negotiations to reach agreement on another round of tariff reductions. The EU was a proponent of the WTO Nairobi Ministerial Decision on Export Competition in 2015 and has not used export subsidies on agricultural exports since July 2013. It is also actively pursuing bilateral free trade agreements with both developed and developing countries, which have provided additional market access for its free trade partners.

Significant changes have also taken place with respect to domestic support provided under the CAP. High levels of market price support have been gradually reduced since the first substantial reform of the CAP took place in 1994. Producer incomes are now supported by direct payments, most of which are decoupled from production and are notified in the Green Box in the EU's WTO notifications. A greater share of the agricultural budget is allocated to rural development measures, including payments to farmers for adopting measures beneficial to the environment and climate action (Matthews 2011; OECD 2011).

At the beginning of 2017, the European Commission initiated a public consultation seeking views on the “modernisation and

1 These shares are calculated based on data for WTO agricultural products in the USDA Global Agricultural Trade System <https://apps.fas.usda.gov/Gats/default.aspx>.

2 The Commission Impact Assessment guidelines now include specific guidance and a tool box for analysing the potential impact of important EU policy initiatives on developing countries, see in particular Tool #34 “Developing countries,” available at https://ec.europa.eu/info/sites/info/files/file_import/better-regulation-toolbox-34_en_0.pdf.

simplification” of the CAP. Based on the findings of this consultation (ECORYS 2017), the Commission published a Communication in November 2017 *The Future of Food and Farming* (European Commission 2017b) outlining its ideas for a further reform of the CAP to coincide with the introduction of the next EU Multi-annual Financial Framework (MFF) for the period 2021-2027. Following a period of intense debate and further consultation, including with the European Parliament and the member states, the Commission published its legislative proposals for the CAP post 2020 on 1 June 2018 (European Commission 2018c).

The most striking innovation in the Commission’s proposal is a new model of governance and division of responsibilities between the Union level and member states. The Commission proposes to move away from a detailed steering of agricultural policy through defining explicit requirements in EU legislation to a more enabling approach. Union-level legislation will be confined to setting out broad policy guidelines and a menu of interventions. It will be up to member states to draw up CAP Strategic Plans at national level following an inclusive consultation process which will define levels of policy ambition and future expenditure priorities. The Commission will ensure that there is still a “common” agricultural policy by reserving the right to approve the national Strategic Plans and by linking the payment of CAP monies to the achievement of plan targets (performance-basis) rather than the fulfilment of EU rules (compliance-basis).

One month previously, on 2 May 2018, the Commission had published its proposal for the EU budget framework for the 2021-2027 period including recommendations for its financing (European Commission 2018a). The MFF framework sets out the proposed budget resources for EU agricultural policy during this period. Both proposals (the MFF and CAP regulations) are now (November 2018) under deliberation in the two EU co-legislators consisting of the European Parliament (directly elected by citizens across the EU) and the

Council of Ministers (representing the member states). The Commission is hopeful that both can be agreed during 2019 to enable the new agricultural policy to come into force at the beginning of 2021 but, as we will see, this is an ambitious timetable.

Agreement on the new budgetary framework is complicated by another defining moment in the history of the European Union, namely, the announced departure of the United Kingdom (UK) from the EU on 29 March 2019. The UK is a major net contributor to the EU budget. Its exit (“Brexit”) leaves a gap in the financing of EU expenditure which is an additional complicating factor in the negotiations on the MFF 2021-2027. Since 29 March 2017 when the UK announced its intention to withdraw, negotiations have been taking place on a Withdrawal Agreement with the EU-27 (the remaining 27 EU member states) as well as on a framework for its future relations with the EU-27. At the time of writing (November 2018), the outcome of these negotiations is unclear. Any agreement reached will have to be ratified by the respective procedures of the two parties (approval by the UK Houses of Parliament, on the one hand, and by the European Parliament and Council, on the other hand). Brexit will have important consequences for agricultural trade with developing countries (Matthews 2018a). It also has implications for the future WTO commitments of both the UK and the EU-27 (McMahon 2018). In this paper, Brexit will be discussed only insofar as it has implications for the future funding of the CAP.

The paper sets out to provide an authoritative overview of the Commission’s proposal for the CAP post 2020 and to examine its potential implications for global food and agricultural trade and markets. It describes those areas of continuity but also innovation with respect to the CAP provisions in the 2014-2020 period. The proposed budget allocation as well as the specific changes to the CAP architecture are highlighted. The likely impact of the proposal on the EU’s notifications of domestic support under the WTO Agreement on Agriculture is assessed. Attention is paid to how various

scenarios could affect products and value chains of importance to developing countries and LDCs.

Because the Commission's proposal will almost certainly be modified in the process of approval by the co-legislators, any assessment of the likely impacts must be considered provisional. The proposal gives a good deal more autonomy to member states to design the agricultural policy that best fits their specific objectives. The fact that member states would gain greater powers to shape agricultural policy is an additional factor of uncertainty around the implementation of EU agricultural policy after 2020. How member states might make use of their enhanced flexibility to set expenditure priorities cannot yet be known.

The Commission's legislative proposals are only about domestic support to EU agriculture. They can have implications for production patterns and thus trade, but they have no implications for EU agricultural trade *policy* which is implemented along a separate track (Swinbank 2018). This is particularly relevant for developing countries that access the EU market under preferential agreements of various kinds. The new CAP proposals do not have any direct implications for these arrangements. Developing country exporters will be affected by Brexit and by whether the EU enters into further bilateral trade agreements that change market access conditions, but the future CAP proposals reviewed in this paper have no direct implications for future EU strategy with respect to agricultural trade policy.

2. POLICY CONTEXT FOR THE COMMISSION PROPOSAL

The most recent reform of the CAP was concluded in 2013 and entered into force in 2015. It is thus somewhat surprising that the Commission launched a public consultation and published a Communication setting out the need for further reform already in 2017. The two themes justifying this early review were the needs for simplification and for modernisation of the CAP (European Commission 2017b). A third factor was the presentation of the next EU MFF budget framework for the period 2021-2027 which will determine the resources that are available for the CAP budget in those years.

Simplification. The EU's agricultural policy is jointly managed by the Commission and the member states based on EU legislation. The legislation sets out detailed rules, for example, on eligibility for payments or permitted supports. Member state administrations make the actual payments to farmers and other rural businesses. These payments are subject to Commission audit to make sure that the detailed rules have been followed. Over time, the rules both for farmers and member state administrations have become increasingly complex. The centrepiece of the 2014-2020 CAP reform was the allocation of a 30 percent share of member state direct payments budgets to a greening payment which farmers receive in return for complying with a set of measures designed to benefit the environment and climate action. The greening payment has come in for particular criticism, proving complex to administer and disappointing in its results (Alliance Environment and the Thünen Institute 2017; European Court of Auditors 2017). The requirement to programme rural development expenditure to meet identified priorities, although seen as positive in principle, has also been criticised as too

complex and insufficiently focused on results (European Court of Auditors 2017b).

The risk of penalties associated with non-compliance with complicated and sometimes confusing rules has led to risk averse policy design in many member states as well as risk averse behaviour by farmers (Mottershead et al. 2018). For example, a recent evaluation of the greening measures showed that for member states the desire to make the measures relatively straightforward to implement, reducing administrative burden as well as avoiding mapping errors and risks of disallowance were key factors determining the implementation choices made, rather than ambition in seeking results (Alliance Environnement and Thünen-Institut 2017). The demand for simplification is a clear driver of the Commission's proposal. The main pressure is from member states for a reduction in the complexity of the CAP's rules and from farmers for fewer and less intrusive inspections of their compliance.

Modernising the CAP. The second main driver is the need to modernise the CAP to reflect heightened challenges and new commitments. In its November 2017 Communication, the Commission emphasised particularly the need to better harness innovation and advances in digital technologies both to improve the implementation and monitoring of CAP instruments as well as their practical application in rural areas; and the need to better meet societal expectations regarding farming and food concerning food safety, food quality, environmental and animal welfare standards. Issues around sustainable farming are widely debated, and there is strong public support for a greater emphasis in CAP spending on environment and climate issues.³

³ The public consultation highlighted environment and climate issues as one of the top three challenges most important for the EU and rural areas (41 percent of all responses). In the most recent Eurobarometer survey about the CAP, respondents identified the most important reasons for spending a high proportion of the EU budget on the CAP as ensuring sustainable farming and addressing environmental needs, significantly ahead of guaranteeing food supply and responding to investment needs (European Commission 2018b).

Pressure to embed environmental and climate action even more centrally into the CAP has also moved up the political agenda. The EU is signed up to, and committed to action on, the 2015 Paris Agreement on climate (translated into EU emission reduction goals for 2030 to which agriculture and the land using sectors must contribute) and the UN 2030 Agenda for Sustainable Development and its 17 SDGs.

Many of the SDGs have a direct relevance to agriculture. SDG 2 commits to end hunger, achieve food security and improved nutrition and promote sustainable agriculture. SDG 3 seeks to ensure healthy lives and promote well-being for all at all ages, in part by substantially reducing the number of deaths and illnesses from hazardous chemicals and air, water and soil pollution and contamination. SDG 12 commits to ensuring sustainable consumption and production patterns by 2030, including sustainable management and efficient use of natural resources as well as halving global food waste and reducing food losses. SDG 13 undertakes to take urgent action to combat climate change and its impacts, including strengthening resilience and adaptive capacity to climate-related hazards and natural disasters as well as integrating climate change measures into national policies and strategies. SDG 15 sets out to protect, restore and promote sustainable use of terrestrial ecosystems, sustainably manage forests, combat desertification, and halt and reverse land degradation and halt biodiversity loss, calling for urgent and significant action to reduce the degradation of natural habitats and halt the loss of biodiversity. The future CAP will be expected to address and contribute to each of these individual Goals.

The budgetary context. The Commission's legislative proposal for the CAP post 2020 was

published in the context of its proposal for the next EU long-term budget, the Multi-annual Financial Framework (MFF) for the period 2021-2027, which was announced on 2 May 2018. The MFF legislation decides the overall size of the EU budget, sets down maximum spending ceilings for the various programmes financed by the EU, including the CAP, as well as laying down how the EU budget should be financed.

The Commission faced three major challenges in drawing up the 2021-2027 MFF. First, new EU priorities such as strengthening the EU external borders, addressing migration, and greater co-operation in defence equipment procurement, had to be funded. Second, the exit from the EU of the UK in 2019, given that it is the second largest net contributor to the EU budget, will leave a significant gap in funding existing expenditure. Third, several net contributor member states are opposed to raising the share of the EU budget as a percentage of the EU's gross national income above the "political ceiling" of 1.0 percent agreed for the 2014-2020 MFF.

The Commission's proposal is a compromise between these conflicting pressures.⁴ It proposes what some might see as a small increase in the size of the EU budget (from 1.0 percent to 1.08 percent of EU gross national income). It also allocates additional funding to specific priority areas but reduces spending on the two big-ticket items in the EU budget, cohesion policy and CAP spending, by around 5 percent each in nominal terms compared to spending in the current MFF period (Table 1). For the CAP this translates into a reduction of around 12 percent in real terms, compared to the resources available for the CAP in the 2014-2020 MFF period (Table 2).⁵ Most of this budget (apart from a small amount

4 The Commission also proposes to include the European Development Fund within the MFF which would add a further 0.3 percent of EU gross national income, thus the headline figure for the size of the EU budget in the 2021-2027 period is 1.11 percent of EU gross national income.

5 There are different ways to compare the CAP budgets in the two MFF periods. The Commission favours the comparison with the year 2020 (the last year of the 2014-2020 MFF) multiplied by 7 (column E in Table 1 and Table 2). The total resources made available over the two periods can also be compared (column F). The comparisons are complicated by the fact that the UK is included in the 2014-2020 MFF but is excluded in the 2021-2027 MFF.

of market expenditure directly managed by the Commission) is pre-allocated to member states at the beginning of the MFF period.

The CAP is currently organised in two Pillars. Pillar 1 addresses income support and market management and is 100 percent financed through the EU budget by the European Agricultural Guarantee Fund (EAGF). Pillar 2 addresses rural development including agri-environment-climate measures and is co-financed jointly through the EU budget

by the European Agricultural Fund for Rural Development (EAFRD) and by member states. The CAP budget reductions are not evenly spread across the two Pillars. The Commission's priority was to protect the budget for income support (EAGF, financing Pillar 1 expenditure) in nominal terms. All the nominal reduction will fall on EAFRD financing Pillar 2 expenditure. Part of this reduction will be offset by an increase of 10 percentage points in the share of member state co-financing of rural development expenditure.

Table 1. CAP sub ceilings in the Multi-annual Financial Framework (commitments in € million - current prices)

	EU-28 2014-2020 A	EU-27 2020 (x 7) B	EU-27 2014-2020 C	EU-27 2021-2027 D	% B/D change E	%C/D change F
1. EAGF	302,797	284,803	280,351	286,195	0.5	2
2. EAFRD	100,273	97,670	95,078	78,811	-19	-17
3. Total CAP	403,070	382,473	375,429	365,005	-5	-3
4. Total MFF	1,115,919	1,151,866	1,063,101	1,279,408	11	20
5. % CAP (3/4)	36.1%	33.2%	35.3%	28.5%		

Source: Massot and Negré (2018)

Table 2. CAP sub ceilings in the Multi-annual Financial Framework (commitments in € million - constant 2018 prices)

	EU-28 2014-2020 A	EU-27 2020 (x 7) B	EU-27 2014-2020 C	EU-27 2021-2027 D	% B/D change E	%C/D change F
1. EAGF	309,064	273,743	286,143	254,247	-7	-11
2. EAFRD	102,004	93,877	96,712	70,037	-25	-28
3. Total CAP	411,068	367,621	382,855	324,284	-12	-15
4. Total MFF	1,136,105	1,107,138	1,082,320	1,134,583	2	5
5. % CAP (3/4)	36.1	33.2	35.3	28.5		

Source: Massot and Negré (2018)

Note: Column A in each table gives the total resources allocated to the CAP and its two Pillars separately for the EU-28 during the current programming period 2014-2020. In Table 1, the figures are in current (nominal) prices. In Table 2, the figures are in real terms, adjusting for inflation to constant 2018 prices using a 2 percent annual deflator. Two baselines are shown in Columns B and C in each table for comparison with the Commission's proposed MFF allocations for the EU-27 in 2021-2027 shown in Column D. The baseline in Column B takes expenditure in the last year of the seven-year programming period (2020) excluding the UK and multiplies it by 7, thus avoiding the effect due to the phasing in of direct payments to newer member states during the period. The other baseline in Column C reports the total resources allocated in the MFF over the 2014-2020 period (as in Column A) but removes expenditure earmarked for the UK. Columns E and F in each table show the percentage changes in the resources allocated in the Commission's 2021-2027 MFF proposal for the CAP compared to these two baselines, respectively, in both nominal and constant prices.

Under the Commission's CAP proposals, it will be possible for member states to transfer resources between Pillars. A member state will be able to transfer up to 15 percent of its Pillar 1 allocation (also referred to as its national ceiling or national envelope) to its Pillar 2 budget, or alternatively up to 15 percent of its Pillar 2 envelope to its Pillar 1 budget. A further transfer of up to 15 percent of its Pillar 1 envelope to its Pillar 2 budget will be possible if this transfer is used specifically for interventions to address environmental and climate objectives. Finally, a transfer of up to 2 percent of Pillar 1 envelopes can be transferred to the Pillar 2 budget if used for assistance for young farmers.

There will also be a shift in the distribution of Pillar 1 resources between member states as a result of the process known as external convergence. For historical reasons, the value of the income support per hectare differs significantly between member states. Those member states with below-average levels (mainly some of the newer member states) have argued that this puts their farmers at a disadvantage relative to farmers in other member states and have called for a uniform value of income support per hectare across all member states to level the playing field. Other member states point out that the value of income support cannot be seen in isolation from other factors such as the level of prices and average living standards. The 2014-2020

CAP reform moved some distance towards a greater convergence of payments and the Commission proposes a further move in this direction in its legislative proposal.

This MFF proposal (including the decisions on how the budget should be financed) is now (November 2018) taken up for negotiation by the EU member states in the Council of Ministers. Member states have expressed differing views on the Commission's proposal. Many member states have expressed their opposition to the CAP budget reduction and have called for an overall increase in the MFF to allow the level of CAP spending to be maintained. Other member states have called for the Commission's budget proposal to be even further reduced, including further cuts in CAP spending. The final agreement must be ratified unanimously by the European Council, comprising the heads of state and government of the EU member states. The final agreement also requires the consent of the European Parliament. The Parliament has also voiced its criticism of the Commission proposal and put forward its own proposal for a much larger MFF equal to 1.3 percent of EU gross national income and for the maintenance of CAP spending in real terms (European Parliament 2018). The Commission has urged the Council and Parliament to reach agreement on the 2021-2027 MFF before the coming elections to the European Parliament in May 2019. Whether agreement can be reached within this timescale is open to question.

3. THE COMMISSION'S PROPOSAL FOR THE CAP 2021–2027

The Commission's legislative package consists of three separate proposals:

- a regulation on the CAP strategic plans (European Commission 2018f).
- a regulation on the single common market organisation (European Commission 2018g).
- a horizontal regulation on financing, managing and monitoring the CAP (European Commission 2018e).

The package was accompanied by an impact assessment (European Commission 2018d).

The Commission's proposal does not fundamentally alter the objectives of the CAP which focus on the economic viability, resilience and income of farms, on an enhanced environmental and climate performance, and on the strengthened socio-economic fabric of rural areas. These general objectives are transcribed into nine specific objectives in much greater detail than previously (Table 3). Moreover, fostering knowledge, innovation and digitalisation in agriculture and rural areas is a cross-cutting objective.

Table 3. The proposed general and specific goals of the CAP in the period 2021-2027

Fostering a smart and resilient agricultural sector ensuring food security	Bolstering environmental care and climate action and contributing to the environmental- and climate-related objectives of the EU	Strengthening the socio-economic fabric of rural areas
(a) Support viable farm income and resilience across the EU territory to enhance food security	(d) Contribute to climate change mitigation and adaptation, as well as sustainable energy	(g) Attract young farmers and facilitate business development in rural areas
(b) Enhance market orientation and increase competitiveness including greater focus on research, technology and digitalization	(e) Foster sustainable development and efficient management of natural resources such as water, soil and air	(h) Promote employment, growth, social inclusion and local development in rural areas, including bio-economy and sustainable forestry
(c) Improve farmers' position in the value chain	(f) Contribute to the protection of biodiversity, enhance ecosystem services and preserve habitats and landscapes	(i) Improve the response of EU agriculture to societal demands on food and health, including safe, nutrition and sustainable food, as well as animal welfare
Fostering knowledge, innovation and digitalisation in agriculture and rural areas		

Source: Erjavec et al. (2018)

The New Delivery Model. The main novelty in the Commission's legislative proposals is the New Delivery Model. It represents a shift from a compliance-based to a performance-based or results-based governance system for the CAP. As set out in a recital to the CAP legislation:

In the CAP based on delivery of performance ('delivery model'), the Union should set the basic policy parameters, such as objectives of the CAP and basic requirements, while member states should bear greater responsibility as to how they meet the objectives and achieve targets. Enhanced

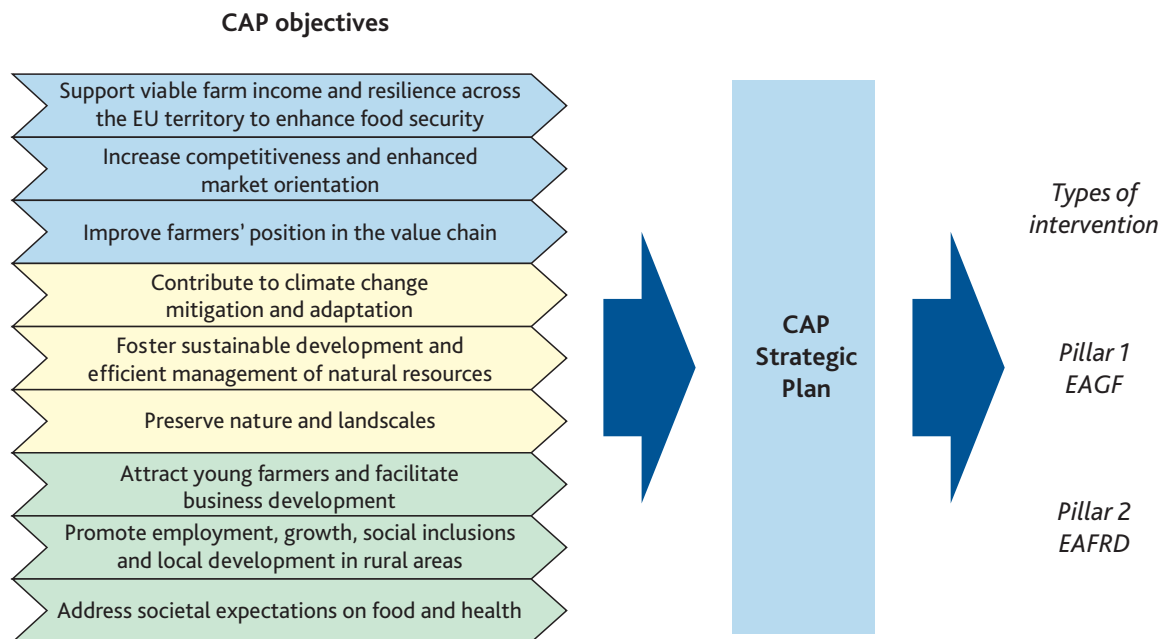
subsidiarity makes it possible to better take into account local conditions and needs, tailoring the support to maximise the contribution to Union objectives.

The new governance model is proposed mainly to address the need for simplification of the CAP but is also in line with the Commission's initiative for a "budget focused on results."

The key instrument to underpin the New Delivery Model will be the requirement for each member state to draw up a Strategic Plan setting out its assessment of needs, the specific CAP objectives it intends to address, its intervention strategy including the targets it intends to achieve with respect to these objectives, and the interventions it plans to

use drawing from the list of interventions set out in the Strategic Plan Regulation. Member states will be required to develop these plans based on a broad and transparent participation of environmental and climate authorities, regional and local authorities, economic and social partners, and bodies representing civil society. These Plans must be approved by the Commission in the light of the need to address all nine specific objectives at the EU level. Member states have in the past used this programming approach in drawing up Rural Development Programmes justifying their choice of measures for Pillar 2 expenditure. What is new in the Strategic Plans is that they should cover both Pillar 1 and Pillar 2 interventions and make an even clearer link with performance-based outcomes.

Figure 1. The proposed CAP strategic planning framework



Source: European Commission

Central to the results-based model will be a new Performance Monitoring and Evaluation Framework. Performance will be measured in relation to the nine specific CAP objectives using a set of common indicators. Different types of indicators are set out in the legislation. Overall policy performance will be assessed multi-annually based on impact indicators. Annual policy performance follow-up will rely on result indicators. Output

indicators will annually link expenditure with the performance of policy implementation. Considerable investment will be required to ensure that the indicators used are relevant, robust and reliable.

This new performance framework will, in turn, allow a change in the way expenditure by member states is audited and member states are held to account. The Commission

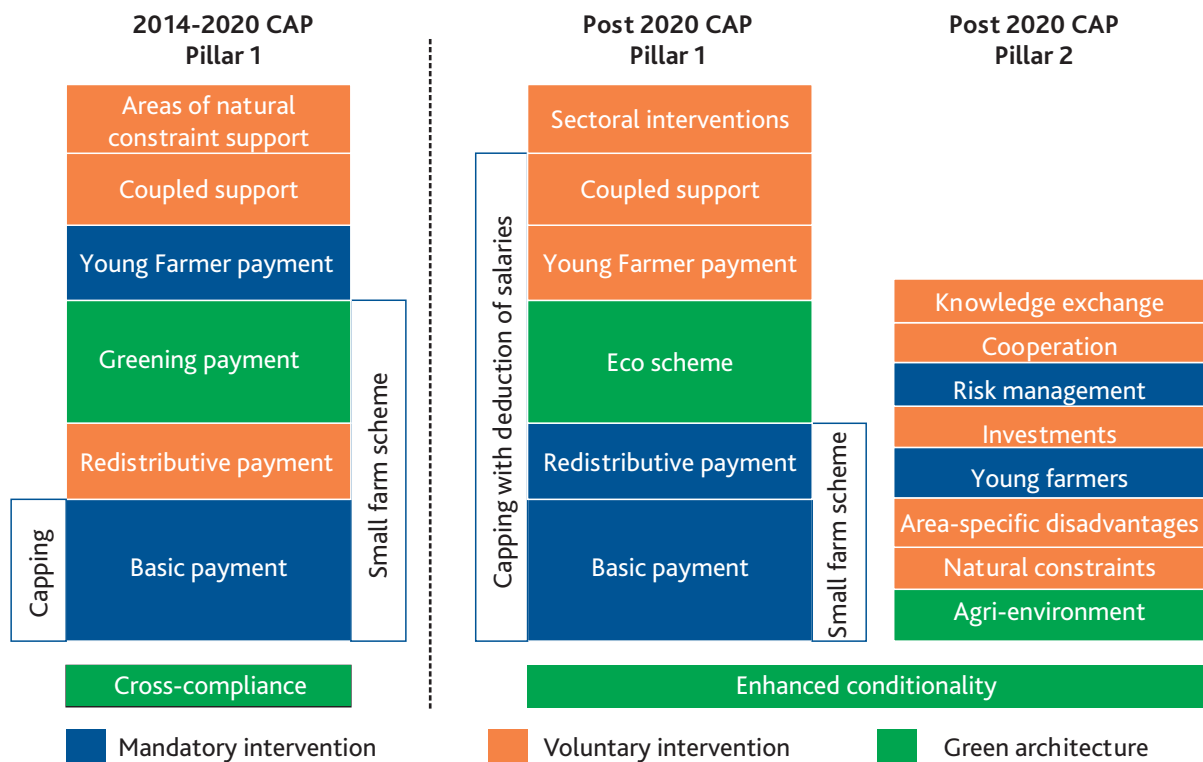
will no longer be involved in checking on the legality and regularity of payments to individual farmers and other beneficiaries. Member states will devise their own control and penalty systems, subject only to basic Union rules. Member states' payments will be deemed eligible if they are matched by corresponding outputs and are in compliance with the applicable basic Union requirements. The Commission believes that this will be a major simplification for member state administrations.

3.1 Types of Interventions in the Form of Direct Payments

An overview of the interventions that can be funded under the two Pillars in the proposed CAP post 2020 is shown in Figure 2. For Pillar 1 where

more significant changes in the architecture of measures is proposed, a comparison is shown with the structure in the 2014-2020 CAP. The figure covers measures that can be programmed by member states in the context of their Strategic Plans. Market management expenditure undertaken directly by the Commission which is funded from the Pillar 1 budget is not included in this diagram. Some measures are mandatory and must be included in the Strategic Plans (marked in blue). Other measures are voluntary if member states wish to make use of them (marked in orange). Measures shown in green are part of the CAP's "green architecture" of measures specifically geared to environmental and climate objectives. These are also mandatory for member states and, in the case of cross-compliance/conditionality, also mandatory for farmers.

Figure 2. Schematic diagram of CAP architecture



Source: Own presentation, not drawn to scale

Direct payments play an essential role in guaranteeing income support to farmers in the EU, accounting for 72 percent of the CAP budget. They contribute 27 percent

of EU agricultural factor income, although dependence of farm income on direct payments varies between member states and is over 40 percent in several member states.⁶

⁶ See European Commission, "Share of direct payments and total subsidies in agricultural factor income (2011-15 average)," March 2017, available at https://ec.europa.eu/agriculture/sites/agriculture/files/cap-post-2013/graphs/graph5_en.pdf, accessed 21 October 2018.

In the Commission's proposals, a basic decoupled payment per eligible hectare (relabelled as the "basic income support for sustainability") will continue to be paid to all eligible farmers in the Union. Those entitled to receive payments are called 'active farmers' in the current CAP programming period. In the Commission proposal, they are referred to "genuine farmers." Member states will have the power, within a basic framework set out in the legislation, to define in their Strategic Plans which farmers are not "genuine farmers" based on conditions such as income tests, labour inputs on the farm, or inclusion in company registers.

Administrative mechanisms. The basic payment is administered in two different ways. The older member states and some newer member states pay decoupled payments based on a system of entitlements (called the Single Payment Scheme). Farmers are allocated entitlements based on the area of eligible agricultural area they managed in a specific period in the past (with special arrangements made for new entrants). Entitlements can be traded or transferred with land. An entitlement has a specific unit value and entitles the holder to a decoupled payment of that amount, provided it can be matched with a hectare of eligible land. Most of the newer member states did not adopt this entitlements system to administer decoupled direct payments. Instead, they received a derogation that allowed them to make the payment as a uniform amount per eligible hectare to all eligible farmers (called the Single Area Payment Scheme or SAPS). In a major attempt at simplification, the Commission proposes that any member state can now opt for this mechanism to pay decoupled payments in the future.

For historical reasons, the value of entitlements and hectare payments can differ significantly within as well as between member states. The process of external convergence designed to reduce differences in the average value of payments per hectare between member states (discussed above)

is mirrored by a similar process of internal convergence designed to equalise the unit value of payments among farmers within a member state (though account can be taken of differences in socio-economic or agronomic conditions between territories when deciding these unit values). The Commission proposes that member states should continue this process of internal convergence, such that no entitlement has a value less than 75 percent of the average for the specific territory by 2026.

In both the 2014-20 CAP and the Commission proposal, provision is made for member states to pay the decoupled payment as a lump-sum to small farmers for administrative reasons.

Targeting of payments. The Commission has made a better targeting of direct payments and a fairer distribution of income support an important element of its proposal. Two mechanisms are put forward. The voluntary redistributive payment scheme in the 2014-2020 CAP will be made mandatory for member states (and is renamed the 'Complementary redistributive income support for sustainability'). This scheme ensures the redistribution of support from bigger to smaller and medium-sized farms by providing a top-up to the basic payment on farms below a certain size in area. Member states will be able to decide on the size of the top-up, as well as the maximum number of hectares to which it will apply, as part of their CAP Strategic Plans.

The other redistributive mechanism in the Commission's proposal is the reduction and capping of payments above certain thresholds. In the 2014-2020 CAP, all basic payments above €150,000 are reduced by at least 5 percent. Member states on a voluntary basis could go further and make a reduction of up to 100 percent, thus effectively capping the basic payment at this level. Also on a voluntary basis, member states could decide to allow salaries paid to be offset against the basic payment before the threshold is applied. This provision is designed not to penalise

larger farming units, particularly in some of the newer member states, which provide significant employment.

The Commission proposal would go further in this direction. Capping and reduction of payments is extended to all direct payments. Payments between €60,000 and €100,000 would be reduced, and there would be a cap on payments above €100,000. However, it would be mandatory for member states to take account of salaries paid (as well as the imputed cost of unpaid family labour) in calculating the thresholds to which these reductions and cap would apply. Calculations suggest that the mandatory deduction of labour costs will mean that very few farms will, in practice, be affected by capping (Matthews 2018b).

Coupled payments. The EU made extensive use of coupled payments at the start of its reform process in 1994 (more accurately, these were partially-coupled payments as they were paid on hectares of arable crops or number of livestock rather than output as such). Most coupled payments were converted to decoupled payments following the 2003 CAP reform but member states still had the possibility to provide coupled support to beef and sheep producers and as specific support under other limited circumstances.⁷

The 2014-2020 CAP gave member states greater flexibility to use part of their Pillar 1 direct payment envelopes for voluntary coupled support schemes, subject to specific conditions. All sectors were made eligible for coupled support (except for tobacco). However, only sectors or regions of a member state where specific types of farming or specific agricultural sectors that are particularly important for economic, social or environmental reasons undergo certain difficulties were entitled to support. Relevant difficulties were defined as a risk of abandonment or of decline of production due to, *inter alia*, the weak profitability of the activity which would negatively affect the

economic, social or environmental balance in the region or sector concerned.

Further, coupled support could only be granted to the extent necessary to create an incentive to maintain current levels of production in these sectors or regions. Coupled support had to be granted within defined quantitative limits and be based on fixed areas and yields or on a fixed number of animals. These limits should not be greater than the maximum yields, area cultivated, or number of animals reached in the targeted region or sector in at least one year in the period of five years preceding the year of the decision. The amount of coupled support is also limited as a percentage share of a member state's direct payments envelope.

Changes were made to the coupled support scheme in a revision of the CAP 2014-2020 legislation in 2017 enacted in the Omnibus (Agricultural Provisions) Regulation (EU) No. 2017/2393. These changes removed the requirement that coupled support may only be granted to the extent necessary to create an incentive to maintain current levels of production. Instead, coupled support is now defined as “a production-limiting scheme that shall take the form of an annual payment based on fixed areas and yields or on a fixed number of animals and shall respect financial ceilings to be determined by member states for each measure and notified to the Commission.” This change meant that there is no longer any ceiling on the fixed area or number of animals to which coupled payments may apply.

The Commission's legislative proposal goes further in relaxing the conditions attached to coupled support. The list of eligible commodities is extended to other non-food crops (excluding trees) used in the production of products that have the potential to substitute fossil materials. Any restrictions on the use of coupled support (for example, by requiring that the sector is in difficulty) or to limit its production impact

⁷ The conditions for specific support were set down in Article 68 of Council Regulation (EC) No. 73/2009 and were often referred to as “Article 68 support.”

(for example, by requiring that the number of hectares or animals supported must be limited) are removed. The one exception concerns coupled support for oilseeds where there is a provision to ensure that the total supported area does not exceed the maximum support area included in the *Memorandum of Understanding between the European Economic Community and the United States of America on oilseeds under GATT*.⁸ Coupled support for cotton has a different legal basis to other coupled supports as it is mandated in a specific protocol attached to the 1979 Act of Accession for Greece, Portugal and Spain. As a result, the crop-specific payment for cotton is limited to a specific number of base hectares and for fixed yields in four member states (Bulgaria, Greece, Spain and Portugal).

The Commission proposes to limit the maximum share of direct payment envelopes that can be allocated to coupled support to 10 percent. This is an increase from the 8 percent threshold in the 2014-2020 CAP. However, many member states could use up to 13 percent of their envelopes for coupled support where they had made significant use of coupled support previously or paid decoupled payments under SAPS. For these member states, the 10 percent limit represents a reduction in flexibility. Also, in the 2014-2020 CAP, some member states could seek a derogation to use more than 13 percent of their direct payments envelope on approval by the Commission. These member states may continue to use more than the 10 percent limit up to their current limit. As in the 2014-2020 CAP reform, these percentages can be increased by up to 2 percentage points for all member states if this excess is used for support for protein crops.

Young farmers payment. Assistance from member states to help young farmers get started in farming has always been possible as part of Pillar 2 rural development interventions. As concern has grown about the ageing of the EU farm workforce, greater efforts have been made to attract younger

farmers into the sector. In the 2014-20 CAP, member states are required to use up to 2 percent of their direct payment envelopes to make a top-up payment to young farmers (defined as those under 40 years of age when submitting their application and who have set up in farming within the previous five years). The Commission proposes to give more flexibility to member states in how young farmers are supported in future. The top-up scheme is made voluntary, but member states are required to spend a minimum of 2 percent of their direct payment envelopes on young farmer assistance, either in the form of a top-up in Pillar 1 or as an installation allowance in Pillar 2.

Sectoral support programmes. Under the 2014-20 CAP, member states can design operational programmes for a series of sectors: fruit and vegetables, apiculture, wine, hops, and olives. These programmes support producers who come together through producer organisations to take common actions in favour of the environment or fostering a better position in the food chain. Under the Commission's proposal, these operational programmes (also called sectoral interventions) will continue and member states will have the possibility to extend such programmes to any other sectors (except tobacco) if they consider it necessary. Member states can set aside up to 3 percent of their Pillar 1 budget for these sectoral interventions.

The final intervention possible using Pillar 1 funds is the eco-scheme. This is described in the next section which describes the changes in the green architecture proposed by the Commission.

3.2 Types of Interventions - the New Green Architecture

The CAP's green architecture (shown in green in Figure 2) refers to those measures and interventions that are specifically aimed at improving environmental outcomes and

8 Official Journal OJ L 147, 18.6.1993, p. 26-27, http://data.europa.eu/eli/memorandum_underst/1993/355/oj.

promoting climate action. In the 2014-20 CAP, they include cross-compliance requirements for eligibility for all area-based and coupled payments, the greening payment in Pillar 1 and agri-environment-climate measures (AECMs) in Pillar 2. The mandatory greening payment to farmers who adopted practices favourable for the environment and climate action was a major innovation in the 2014-2020 CAP. As previously noted, the effectiveness of this payment has been limited and it is heavily criticised for the additional administrative efforts required to monitor compliance. The green architecture in future will consist of enhanced conditionality requirements for eligibility for area-based and coupled payments, eco-schemes in Pillar 1 and AECMs in Pillar 2. The greening payment has been eliminated in the Commission's proposal. The practices associated with this payment will now be included as part of the new conditionality.

From cross-compliance to conditionality. Cross-compliance in the 2014-2020 CAP links receipt of CAP support to the compliance by beneficiaries with basic standards concerning the environment, climate change, public health, animal health, plant health and animal welfare. The basic standards include both statutory management requirements set down in EU legislation and standards of good agricultural and environmental conditions of land (GAECs). Farmers who are found to be in breach of these obligations face penalties and a reduction in their CAP payments.

The Commission's proposal raises the bar with respect to the requirements that farmers should observe to be eligible to receive CAP payments, specifically with respect to environmental and climate obligations. This is reflected in the change of nomenclature from cross-compliance to enhanced conditionality. There are two broad sets of changes. One is to incorporate the obligations associated with the greening payment in the 2014-20 CAP into the conditionality requirements. New GAEC standards are proposed to ensure the maintenance of permanent pasture,

crop rotation and a minimum share of agricultural area devoted to non-productive features or areas (e.g. hedges, fallow land, terraces). In addition, new GAEC standards introduce an obligation to protect carbon-rich soils, to require all farmers to develop a nutrient management plan, and to ban the conversion of grassland in Natura 2000 sites (the EU network of nature protection sites and important habitats). The number of statutory management requirements is also increased with the addition of requirements to respect obligations under the EU Water Framework Directive and Sustainable Use of Pesticides Directive (as well as a further regulation on transmissible animal diseases although this is outside the scope of environmental issues).

The significance of these changes is that conditionality sets the baseline for the practices for which farmers can be remunerated through the eco-scheme and AECMs. Raising the baseline allows these schemes to target more ambitious agri-environmental and climate measures.

Voluntary AECMs in Pillar 2. AECMs are a well-established part of the green architecture of the CAP. They allow member states to design schemes that pay farmers and other land managers for management commitments that go beyond the mandatory standards included in the cross-compliance (and, in future, conditionality) baseline. Support may also be granted in the form of locally-led, integrated or cooperative approaches and result-based interventions. Examples of the management commitments that can be supported include organic farming premia for the maintenance of and the conversion to organic land; payments for other types of environmentally friendly production systems such as agroecology, conservation agriculture and integrated production; premia for forests and establishment of agroforestry systems; animal welfare; and the conservation, sustainable use and development of genetic resources. Payments under AECMs must observe the WTO criteria for environmental payments set out in paragraph 12 of Annex 2 of the Agreement

on Agriculture that they cover only additional costs and income foregone resulting from these commitments.

In the 2014-20 CAP member states have an obligation to ensure that 30 percent of their Pillar 2 envelopes are allocated to agri-environment and climate objectives, including both AECMs as well as payments to farmers in areas of natural constraints. This provision has been tightened in the Commission proposal in that member states will no longer be able to claim the payments to farmers in areas of natural constraints within this 30 percent limit. As the overall Pillar 2 budget will be reduced, this stricter ring-fencing will help to maintain expenditure on AECMs in absolute terms. The Commission also proposes to increase the EU share of the cost of financing these interventions to 80 percent (compared to its normal contribution to Pillar 2 expenditure of 43 percent (or 70 percent in the case of less developed and outermost regions). Furthermore, member states will be able to transfer an additional 15 percent of their Pillar 1 envelopes to Pillar 2 to finance AECMs without any requirement for national co-financing. The Commission in this way hopes to encourage additional spending on agri-environment and climate measures in the CAP post 2020.

Eco-schemes. Eco-schemes will involve payments by member states granted either for incentivising and remunerating the provision of public goods by agricultural practices beneficial to the environment and climate or as a compensation for the introduction of these practices. It will be up to member states to define these practices provided they contribute to the three specific CAP objectives linked to bolstering environmental and climate action. Examples given in the legislation include enhanced management of permanent pastures and landscape features, organic farming, or “entry-level schemes” which might be a condition for taking up more ambitious commitments that could be funded by Pillar 2 measures. As such schemes can also be managed as AECMs in Pillar 2, the

question arises as to why eco-schemes have been introduced in Pillar 1.

The main difference is that payment levels under eco-schemes are defined simply as a payment additional to basic income support. The link made in the EU legislation between AECM payments and costs incurred or income foregone is removed. Payments under eco-schemes will be annual payments, whereas farmers enrolling in AECMs enter a multi-annual contract. On the other hand, only genuine farmers can benefit from eco-schemes because they are confined to beneficiaries of direct payments, whereas AECMs are also open to other land managers. Eco-schemes can provide an income stream to farmers in return for the provision of ecosystem services in ways that AECMs cannot. There will be an inbuilt tension between the income and environmental objectives in the design of these schemes.

Member states are required to provide support for eco-schemes in their Strategic Plans, although no minimum expenditure level is proposed. However, for all green architecture measures taken together, there is a requirement for increased ambition regarding environmental- and climate-related objectives. Specifically, member states must show in their Strategic Plans how the measures they include will achieve a greater overall contribution to these objectives than realised under the measures adopted in the 2014-2020 CAP period.

3.3 Types of Interventions for Rural Development

Many interventions are possible using Pillar 2 funding (Figure 2). There is considerable continuity with the range of measures allowed in the 2014-20 CAP, although the legislative text has been greatly simplified leaving greater discretion to member states in drawing up their Strategic Plans. The measures fall broadly into three groups: those intended to improve the competitiveness of farming; those addressing land management, forestry, environmental and climate objectives; and

those seeking to improve rural infrastructure and the quality of life in rural areas.

Improved agricultural competitiveness.

Permitted interventions here include investment support, support for the installation of young farmers, support for risk management tools, support for co-operation (including producer groups), as well as support for knowledge exchange and information (e.g. advisory services). These schemes broadly continue those currently available in the 2014-2020 CAP though with minor tweaks (for example, the maximum amount of installation aid for young farmers is increased to €100,000, and there is greater encouragement for the use of financial instruments, e.g. loan guarantees, rather than outright grants).

The draft legislation confirms the changes introduced in the 2017 Omnibus (Agricultural Provisions) Regulation designed to make the use of risk management tools more attractive. Support can be provided either through financial contributions to premiums for insurance schemes, or through financial contributions to mutual funds (mutual funds can be used to administer an income stabilisation tool either on a sectoral basis or for all farmers). Support can be granted for losses greater than 20 percent of either production or income. As this threshold is lower than the 30 percent specified in the criteria for eligibility for the Green Box in the WTO Agreement on Agriculture either for income insurance or safety-net programmes or for crop insurance or relief from natural disasters, this support would no longer qualify for the Green Box after 2020. Up to 70 percent of losses can be reimbursed. Unlike in the current programming period, support for risk management tools will be a mandatory element in member state strategic plans.

Addressing land management, forestry and agri-environment and climate objectives.

The support for management commitments under AECMs has already been described. In addition, member states can schedule support for farms in Areas of Natural Constraints. This support, as is currently the case, must

be limited to compensating beneficiaries for all or part of the additional costs and income foregone related to the natural or other area-specific constraints in the area concerned. Farmers can also be compensated for additional costs or income foregone because of disadvantages incurred arising from restrictions that may be imposed for nature protection or river basin management under EU legislation. Several measures to support forestry are also included, including the afforestation of land and the creation and regeneration of agroforestry systems; investments to guarantee and enhance forest conservation and resilience; and measures and investments in support of the renewable energy and bio-economy.

Improved socio-economic fabric of rural areas.

Investment measures can also be used to improve basic services in rural areas, to support rural business start-ups linked to agriculture and forestry or farm household income diversification; as well as business start-ups of non-agricultural activities in rural areas being part of local development strategies. The cooperation measure can be used to support the community-led local development initiative known as LEADER.

3.4 Market Management

The proposed CAP legislation confirms market orientation as a key element of the CAP. The Single Common Market Organisation Regulation No. 1308/2013 sets out the rules used to organise the single market for agricultural products. These rules cover a wide range of issues: the market safety net (public intervention and private storage aid), exceptional measures in case of market disturbance, marketing standards, the school scheme offering milk and fruit and vegetables to school children, as well as certain trade provisions. Only some provisions agreed for the 2014-20 CAP are modified in the Commission legislative proposal.

Crisis reserve. Of most relevance to the EU's trading partners is the safety-net measure available to the EU in case of market

disturbance. In principle, the Commission has wide-ranging powers to support markets in case of market disturbances whether through a price collapse or a collapse in consumer confidence. There is mandatory public intervention for a limited number of products, plus the possibility of subsidising private storage to keep products off the market for a temporary period. Crisis income support can be provided to producers in difficulty. Although the legislation allows a wide range of interventions, the constraint is that there is only a very limited budgetary provision to make use of them.

The MFF does not usually make explicit provision for market crisis expenditure. Funding for anticipated needs can be authorised as part of EAGF (Pillar 1) spending in the annual budget process, but care must be taken that total EAGF spending (including direct payments) remains under the sub-ceiling agreed in the MFF. In general, there is limited headroom available under the MFF sub-ceiling because most of the sub-ceiling is committed to pre-allocated envelopes to be transferred to member states for Pillar 1 direct payments. Some additional resources may be available from assigned revenue, which are additional payments into the agricultural budget resulting from fines and penalties paid by member states. In extreme situations, if crisis expenditure threatens to break through the MFF sub-ceiling, the Commission can make use of a financial discipline mechanism to reduce the level of Pillar 1 direct payments to make sure this does not happen.

The 2014-20 MFF included, as a novelty, provision for an agricultural crisis reserve by withholding each year an amount equal to €400 million (in 2011 prices) from the direct payments paid to farmers. Not only is this a tiny budget (for comparison, the value of EU agricultural output excluding direct payments was around €45 billion in 2017), but member states showed a great reluctance to use it even when a crisis occurred (e.g. the sharp fall in milk prices in 2015-2016) because it means compensation to some farmers is paid by other farmers. The EU could provide

significant financial assistance to farmers adversely affected by the Russian ban on imports of many EU agri-food exports in 2014, as well as the milk price crisis in 2015-16, only because of unexpected revenue inflows from fines and penalties to the agricultural budget. The Commission proposes to modify slightly the way the crisis reserve operates post 2020 but the overall amount of funding has not been increased.

Export subsidies. The other change proposed by the Commission of interest to the EU's trading partners is to incorporate the commitments on export subsidies taken by the EU and its member states in the context of the World Trade Organization Nairobi Ministerial Decision. The provisions allowing export refunds previously included in the Single Common Market Organisation Regulation will now be deleted.

3.5 Timing and Scheduling Issues

The Commission's legislative proposal published in June 2018 foresees that member states will have drafted and presented their CAP Strategic Plans by 1 January 2020, to allow a period of one year for approval of these Plans and the necessary administrative changes at national and regional levels to enable the new CAP rules to enter into force on 1 January 2021. However, at the time of writing (November 2018), the legislation itself is still under review in the two legislative bodies, the Council of Ministers and the European Parliament. Both bodies can suggest amendments during the negotiation process, and both bodies must agree on the same text before the legislation is agreed. The process is complicated by three major events: the parallel negotiations on the EU medium-term MFF budget; the departure of the UK (in March 2019); and the next elections to the European Parliament (in May 2019).

Because the size of the CAP budget is an important parameter in negotiating changes to the CAP regulations, it is hard to imagine how the CAP legislation can be decided before the MFF proposal (including the Commission's

proposal for a new system of own resources to finance the EU budget) is agreed. The decisions on the MFF ceilings and how to finance the EU budget are taken unanimously by the European Council, and also require the consent of the European Parliament. The most optimistic timing is that these MFF decisions might be agreed by the European Council in March 2019, but as previously noted large differences between the views of member states would have to be bridged before that date.

Brexit in March 2019 does not have a direct influence on the scheduling of the CAP negotiations (its indirect effect on the MFF negotiations through the loss of the second largest net contributor to the EU budget has already been noted). If the negotiations on a withdrawal agreement break down, or the draft text of this agreement is rejected either by the UK Parliament or the EU side, then in the absence of an agreement to extend the negotiating period which would be politically difficult for both sides, the consequences will be a disorderly withdrawal for which neither side has prepared. One can imagine that the full focus of EU decision-makers in the months

after a disorderly Brexit would be on managing the fall-out from that event, leaving limited capacity to progress the “normal” business of the Union.

Finally, even without these disruptions, the European Parliament elections in May 2019 leave little time for both the Council and Parliament first to reach agreement on their respective positions and then to negotiate a compromise text on which both parties can agree prior to the election. The probability must be that the negotiations will not be completed before that date, in which case the reform dossier will be an issue for a newly-appointed Commission and a newly-elected Parliament. As the new Parliament will not meet until October 2019 and may well want to form its own views on the CAP legislation rather than adopt those ‘inherited’ from the previous Parliament, it is a moot point whether the legislation can be in place to allow the new CAP rules to come into effect from 1 January 2021 as planned. There may well be a need for a transitional period in which the current CAP rules are extended for a period of time.

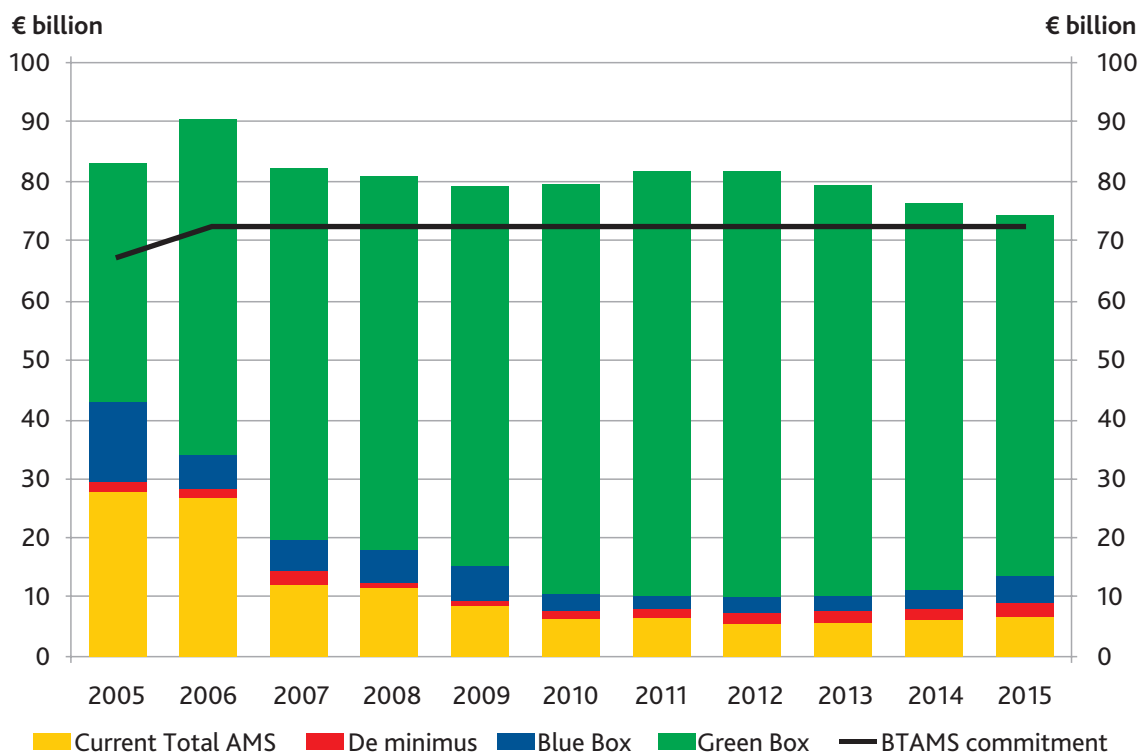
4. WTO IMPLICATIONS OF THE COMMISSION PROPOSAL

One way to assess the potential impact of the CAP post 2020 proposal is to examine the way it might alter the EU's notification of domestic support to the WTO and, in particular, the balance between trade-distorting and non- or minimally trade-distorting support.

Trend in overall domestic support. The EU submitted its latest domestic support notification to the WTO for the 2015/16 marketing year on 23 August 2018. This notification was the first to cover the first full year of operation of the 2014-2020 CAP in 2015, as the new direct payments architecture was first implemented in that year.

The broad trends in domestic support provided to EU agriculture according to the WTO classification are shown in Figure 3. Total EU domestic support is decomposed into four components (a) Amber Box support (Current Total Aggregate Measurement of Support, CTAMS), (b) *de minimis* trade-distorting support (c) Blue Box support and (d) Green Box support. In addition, it shows the EU's Bound Total Aggregate Measurement of Support (BTAMS) commitment. This has increased slightly with successive enlargements of the EU as the EU has added the BTAMS commitment of new member states to its own BTAMS.

Figure 3. EU domestic support notifications 2005-2015



Source: Own presentation based on EU WTO notifications. Figures refer to marketing years, so that 2005 refers to the 2005/06 marketing year.

Overall EU domestic support (measured using the metrics set out in the Agreement on Agriculture) has averaged around €80 billion per annum with a slight reduction in recent years. Most of this is notified as Green Box support. The EU's notified Amber Box support is well below its committed ceiling. Further, EU trade-distorting support (the sum of its Amber Box,

de minimis and Blue Box support) has steadily fallen since 2005, although there is some evidence that it started to increase again in the last two years of notification. This reflects the reduction and elimination of market price support for individual products as part of the move towards greater market orientation during this period (Matthews 2018b).

Green Box. The EU notifies around €60-70 billion as support that is exempted from the WTO disciplines on trade-distorting support on the basis that it meets the criteria set out in Annex 2 to the WTO Agreement on Agriculture (Green Box) (Table 4). The single biggest item is decoupled income support notified under Paragraph 6 of Annex 2. This item first

appeared in the 2005 notification when the Single Farm Payment was paid to farmers mainly in the older member states following the 2003 Mid-Term Review CAP reform. Some member states delayed its introduction for administrative reasons so the total notified increased again in 2006 and has remained stable since then.

Table 4. EU Green Box support 2005-2015

€ million	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
General services	5,671	6,801	6,781	6,983	7,394	8,504	9,183	8,807	9,526	9,150	6,852
Public stock-holding and food aid	387	789	479	641	652	755	972	942	745	871	920
Decoupled income support	14,734	30,672	31,346	31,894	31,482	32,913	32,756	32,780	31,845	31,564	29,985
Income insurance and income safety-net programmes	8	13	14	17	17	22	31	38	39	45	33
Payments for relief from natural disasters	399	1,157	968	1,165	1,298	803	841	775	638	967	617
Producer retirement programmes	772	676	944	886	957	779	743	720	656	513	352
Resource retirement programmes	112	362	452	303	307	350	331	401	399	375	163
Investment aids	7,305	4,534	7,594	7,772	6,153	7,134	7,339	6,642	5,964	5,502	3,683
Environmental programmes	5,558	5,491	6,345	5,694	6,553	7,238	8,302	8,869	7,882	5,885	8,122
Regional assistance programmes	3,397	3,755	4,508	3,720	4,505	4,452	4,511	4,452	3,581	2,418	2,289
Other direct payments	1,937	2,280	3,182	3,752	4,482	5,102	5,968	6,713	7,422	7,967	7,812
Total GREEN BOX	40,280	56,530	62,610	62,825	63,798	68,052	70,977	71,140	68,698	65,257	60,829

Source: Own tabulation based on EU WTO notifications. The figures refer to marketing years where 2005 is the 2005/2006 marketing year.

Amber Box. The EU's Amber Box support (Table 5) derives mainly from market price support due to administrative support prices set for mandatory public intervention for three products—common wheat, skimmed milk powder and butter. Non-product-specific AMS has always been reported as zero under the *de minimis* rule. The 2015 notification also includes over €1 billion provided as extraordinary support measures (to milk, beef, sheep, pig meat and fruits and vegetables)

but in all cases this support is not counted in the Amber Box as it is also excluded under the *de minimis* rule. Under the Agreement on Agriculture, the *de minimis* provision allows developed countries to provide up to 5 percent of the value of production in product-specific trade-distorting support and 5 percent of the value of production in non-product-specific trade-distorting support without counting this as part of their Current Total Aggregate Measurement of Support.

Table 5. EU Amber Box support 2010-2015

€ million	2010	2011	2012	2013	2014	2015
Common wheat	1,886	1,930	1,865	2,016	2,214	2,274
Skimmed milk powder	977	1,111	1,145	1,135	1,476	1,559
Butter	2,729	2,799	2,743	2,709	2,853	2,986
Other product-specific support	910	1,019	146	111	99	284
Non-product-specific support	0	0	0	0	0	0
Current Total AMS	6,502	6,859	5,899	5,972	6,642	7,102

Source: Own tabulation based on EU WTO notifications. The figures refer to marketing years where 2010 is the 2010/2011 marketing year.

Blue Box. The EU also notifies Blue Box payments under Article 6.5 of the Agreement on Agriculture (Table 6). This Article exempts payments under production-limiting programmes from reduction commitments provided either (a) such payments are based on fixed areas and yields, or (b) such payments are made on 85 per cent or less of the base level of production, or (c) livestock payments are made on a fixed

number of head. Until now, the EU has notified its coupled support beyond *de minimis* levels in the Blue Box. Notified Blue Box support reached a low point in 2013/14 when the limitations on coupled supports introduced in the 2008 Health Check were most effective. There was a significant jump in Blue Box payments in 2015 reflecting the changes to coupled support in the 2014-2020 CAP (discussed above).

Table 6. EU Blue Box payments, 2010-2015

€ million	2010	2011	2012	2013	2014	2015
Payments based on fixed areas and yields	1,136	977	833	771	832	1,516
Payments based on 85% or less of the base level of production	0	0	0	0	0	0
Livestock payments based on a fixed number of head	2,006	2,004	1,921	1,893	2,047	2,815
Total BLUE BOX	3,142	2,981	2,754	2,664	2,879	4,331

Source: Own tabulation based on EU notifications. The figures refer to marketing years where 2010 is the 2010/2011 marketing year.

Impact of Commission's legislative proposal for CAP post 2020. The draft Regulation on CAP Strategic Plans makes explicit reference to the EU's WTO obligations. To ensure that the proposed new architecture of direct payments continues to be notified as Green Box support which has no, or at most minimal, trade-distorting effects or effects on production, the framework definition for 'agricultural activity' provides for both the production of agricultural products or the maintenance of the agricultural area without production. An entire Article (Article 10 of the draft CAP Strategic Plan Regulation) is devoted to ensuring that member states show how the interventions they include in their Strategic Plans are consistent with the relevant provisions of Annex 2 (Green Box) to the Agreement on Agriculture.

The Commission expects that the various direct payment schemes intended to provide income support will continue to be notified under Paragraphs 5 (direct payments to producers) and 6 (decoupled income support), depending on whether member states choose to make use of entitlements in the implementation of these payments or move to the area-based payment model currently used in the Single Area Payment Scheme. Questions have been raised whether the EU schemes, and particularly the area-based payment model, meet the criterion in Annex 2 that "The amount of such payments in any given year shall not be related to, or based on, the factors of production employed in any year after the base period." The Commission's response to this criticism has been that, because no production is required to receive payments, they are compliant.

Payments under the eco-scheme funded within Pillar 1 will also be notified under these paragraphs except for payments granted to farmers not eligible for the basic income support for sustainability, in which case they will be notified under Paragraph 12 Environmental Programmes. What is novel about the eco-scheme is that it opens the possibility that member states can grant

support in the form of hectare top-ups to genuine farmers for environmental or climate practices that go beyond compensation for all or part of the additional costs incurred and income foregone as a result of the commitments undertaken. Where compensation takes the form of the income top-up, it cannot be notified under Paragraph 12. Instead, the Commission proposes to notify it under Paragraph 5 or 6.

Here, a problem may arise if eco-payments are linked to specific forms of production (e.g., payments to maintain permanent grassland). The Commission takes the view that no WTO member is likely to challenge the scheme.

It should be noted that the purpose of eco-schemes is not to enhance production but to enhance delivery on environmental objectives. The effect of these schemes is therefore most likely to provide a production constraint or to have a certain influence on the type of production chosen rather than an overall production stimulating effect (European Commission 2018d).

It further notes that payments to maintain permanent grassland at the expense of cropland would still fall under the eligibility criteria of WTO Green Box to the extent that no production is required to receive the support.

The most significant change in monetary terms will be the reclassification of some coupled supports from Blue Box to Amber Box. Until now, the EU has notified its coupled support as production-limited payments in the Blue Box because it was granted within defined quantitative limits and based on fixed areas and yields or on a fixed number of animals. As these requirements are eliminated in the proposed legislation, it will not be possible to notify coupled payments as exempt under Article 6.5 of Annex 2.

Because coupled support to some commodities may be notified as *de minimis*, not all the Blue Box support currently notified will become Amber Box support. The Commission

estimates that between €2-4 billion may be added to the EU's notified Amber Box support in future as coupled support. Some additional amounts may also be added if member states make greater use of the risk management toolkit in future as the risk management instruments will no longer be compliant with the Annex 2 criteria. The new eco-scheme will continue to be classified as a Green Box measure, albeit as compliant income support rather than as an environmental programme.

In summary, it is plausible to suppose that the Commission's legislative proposal will lead

to an increase in the EU's use of Amber Box support (Current Total Aggregate Measurement of Support). The two main reasons are the mandatory support for risk management (which will no longer qualify for the Green Box), and the more liberal rules for coupled support (which will no longer qualify for the Blue Box). The size of any increase in the EU's CTAMS will depend on how much of the expenditure on these items will fall under the *de minimis* provisions and thus not be counted as part of the EU's CTAMS. Regardless of the use made of this exemption, the EU's CTAMS will remain well below its bound BTAMS commitment.

5. MARKET AND TRADE EFFECTS OF THE NEXT CAP REFORM

It is not possible to be definitive about the market and trade effects of the next CAP reform, for two reasons. One is that the Commission's legislative proposal published in June 2018 is just that, a proposal, that may well be altered, even quite radically, before the new CAP regulations are agreed. The other is that, under the Commission's proposal, member states are given significantly more flexibility than they have at present to craft their own agricultural policy interventions in the context of their CAP Strategic Plans. Until these plans are approved, it is not possible to predict, *inter alia*, the level of environmental and climate ambition that EU farmers will be asked to meet after 2020, the extent of targeting and redistribution of Pillar 1 direct payments, or the use that will be made of coupled payments.

Nonetheless, some guidance on the likely scale and direction of the market and trade effects is available from the impact assessment (IA) that accompanied the Commission's legislative proposals (European Commission 2018d). The IA examined the potential impact of different choices that member states might make by simulating the outcomes of a range of scenario options using several statistical models. The market and trade effects were estimated using the Common Agricultural Policy Regionalised Impact (CAPRI) model which is a publicly available and well-documented model, although the interpretations in the IA are those of the Commission itself.

Impact Assessment scenarios. Five different options for the future CAP were assessed in addition to a baseline scenario (see Box 1). The same CAP budget was assumed in each of

the five scenarios; this was set at 8.9 percent below the current budget to reflect the impact of Brexit on the CAP budget. It was assumed that expenditure for market management will be held constant, so this budget assumption translated into a 10 percent reduction in Pillar 1 direct payments. The post-Brexit baseline was based on this budget reduction but assumed a continuation of the CAP 2013 into the future.

The purpose of the five options was to explore the impact of different decisions with respect to (a) the level of ambition with respect to environmental and climate objectives and (b) the targeting and redistribution of direct payments. Some options put greater emphasis on environmental objectives than on economic sustainability (with a greater share of the CAP budget devoted to agri-environment-climate schemes and a lower share allocated to direct income support). Some options put greater emphasis on redistribution where direct payments were focused on small and medium size farms to keep jobs in rural areas. Some options take money from basic income support to fund new risk management instruments. These different scenarios were then translated into more detailed schemes and payment levels for modelling purposes.

These dimensions were chosen to reflect the areas where member states would have greater discretion to decide how to achieve the CAP specific objectives in their CAP Strategic Plans. The new conditionality applied across all five options. The IA underlined that, because of this design, no option was intended as a preferred option and that options were not mutually exclusive.

Box 1: Scenarios in the impact assessment

Each scenario is made up of many elements, where the weightings given to each element differ across scenarios. The main differences between scenarios that drive the market and trade results are highlighted here. Option 2 was originally proposed as a “No-CAP” option in which all support was removed, but this option was not pursued in the IA. Option 1 is the business-as-usual baseline. All options, including option 1, assume an overall reduction of 8.9 percent in the CAP budget (10 percent in Pillar 1 direct payments) due to the exit of the United Kingdom from the EU. However, the potential impact of Brexit on markets and trade has not been considered in simulating the various options. None of the simulated options correspond exactly with the Commission’s legislative proposal.

Option 1. The post-Brexit baseline. This option assumes the continuation of the CAP2013 reform to 2030 but with the smaller post-Brexit budget also common to the other options.

Option 3a. Ambitious environmental focus, limited basic income support. What drives the results in this scenario is that 60 percent of the direct payment ceiling is allocated to the eco-scheme, 10 percent to risk management and 5 percent to assistance to young farmers, leaving just 25 percent for basic income support. Coupled support is eliminated.

Option 3b. More conservative environmental ambition than Option 3a and more emphasis on redistribution of payments. In this scenario, 30 percent of direct payments are allocated to the eco-scheme, 5 percent to risk management, 2 percent to young farmers, and 12 percent to coupled support (reflecting the status quo). The remaining 50 percent of direct payments is used for basic income support, including 15 percent for the redistributive payment.

Option 4. Balance between environmental and income objectives. Option 4 does not make use of the eco-scheme, so apart from some allocation to risk management (5 percent) and to coupled support and young farmers (5 percent), the balance is available for basic income support. However, the basic payment is adjusted according to land type (arable land, permanent grassland, permanent crops) with redistribution to permanent grassland at the expense of permanent crops. Coupled support is limited to extensive livestock production. Within this option, two sub-options are modelled.

Option 4a. Strong income support with high environmental ambition. In addition to the general characteristics just described, this option aims to achieve equally ambitious environmental outcomes as Option 3a, but to do this through mandatory measures by implementing higher requirements exceeding basic conditionality.

Option 4b. Strong income support with limited environmental ambition. This option has no requirements beyond basic conditionality.

Option 5. Strong focus on small farms and the environment. This option shifts the focus to small and medium size farmers to keep jobs in rural areas. The basic income support payment is modulated by size and a low maximum payment per farm is introduced through capping. Coupled support and young farmers account for 15 percent of direct payment envelopes. member states would be obliged to allocate 30 percent of pillar I payments to provide top-ups for four schemes that would be voluntary for farmers, organic farming, permanent grassland, Areas with Natural Constraints and linear landscape elements such as terraces, hedges and ditches to promote biodiversity. This ring-fencing obligation would further encourage climate action and sustainable management of natural resources.

Box 1. *Continued*

It is not possible to rank these options *a priori* in terms of market and trade effects because of the many differences between them, e.g. an option with high environmental ambition (which will lead to stronger market and trade effects) may also include coupled payments (which will mitigate these effects). On *a priori* grounds, we might expect the largest impacts in Option 3a where basic income support is cut back the most and coupled support is eliminated, and more limited effects in Option 4b which has a strong focus on income support and limited environmental ambition. However, empirical modelling is required to assess these market and trade impacts in detail.

Baseline scenario. The baseline option assumed the continuation of the 2013 CAP reform and a market environment to 2030 as described in the 2017 EU agricultural markets outlook (European Commission 2017a). In the baseline, production is assumed to increase by 2 percent per annum in nominal terms (thus almost stagnating in real terms and with risks of output variability).

Actual and projected changes in self-sufficiency rates to 2030 by product, which

also take account of changes in consumption within the EU, are shown in Table 7. These projections are based on a continuation of the 2014-2020 CAP in the EU-28 and do not take either budget or market effects of Brexit into account. Changes in self-sufficiency are equivalent to changes in the EU's net trade position. Figures are only available for selected commodities and are not provided for some commodities of potential interest to some developing countries, such as fruits and vegetables and nuts. The EU's net trade

Table 7. Actual and projected agricultural self-sufficiency based on continuation of 2014-2020 CAP, EU-28 (%)

	2015	2016	2017	2020	2025	2030
Wheat	124	112	119	122	123	125
Barley	124	118	116	119	120	120
Maize	78	83	82	88	87	86
Rice	67	67	64	63	61	61
Oilseeds	63	62	66	66	66	65
Oilseed meal	56	57	54	54	54	54
Vegetable oils	65	66	66	67	69	69
Sugar	81	91	111	107	107	108
Tomatoes	97	98	99	98	99	99
Wine	106	105	95	108	106	107
Olive oil	141	121	129	134	138	142
Cheese	107	107	108	109	110	111
Butter	109	109	105	108	109	110
Skimmed milk powder	208	203	187	179	192	193
Whole milk powder	223	206	200	193	191	192
Beef and veal	101	102	103	102	101	101
Sheep and goat meat	86	88	91	87	86	86
Pig meat	110	113	112	112	112	113
Poultry meat	104	104	105	104	105	105

Source: Own calculations based on EU Agricultural Outlook 2017 (European Commission 2017a).

position remains rather stable to 2030 under the business-as-usual scenario. The main exception is sugar, where the removal of sugar quotas in 2015 has allowed production to expand and turned the EU into a net sugar exporter. There is also an expectation that maize self-sufficiency will increase, but that self-sufficiency in rice will drop somewhat. But, overall, no major changes in the EU's net trade position are expected over the coming decade.

Impact assessment of the modelled options.

In assessing the possible impacts of the Commission's proposal on markets and trade, the following insights from the scenario modelling in the IA are relevant, even though none of the options simulated correspond exactly to that proposal.

- In all scenarios, farm income is reduced compared to the baseline pre-Brexit due to the cut in the CAP budget. Farm income declines even further (by up to 10 percent) even relative to the baseline post-Brexit in those scenarios where environmental objectives are given priority relative to the basic income support payment.
- Because producers of different enterprises differ in their dependence on direct payments, the differences between options in the relative budget share allocated to basic income support has strong sectoral impacts. Lowering the share of direct payments allocated to basic income support has a strong effect on cattle, crop, sheep and olive producers because direct payments represent a large share of their income. In addition, cattle and sheep sectors, where significant coupled support is currently granted, are more affected when coupled support is removed.
- The extended requirements considered under the new conditionality (e.g. obligation to dedicate more land to non-productive elements, land re-allocation to fulfil crop rotation and cover crop costs) lead to a significant decline in cereal area in favour of set aside and fallow land, and thus to a decline in market revenue of arable crop producers as well as to a deterioration of the EU trade balance.
- Redistribution of support to smaller farms would lead to a strong reduction in support for very large farms, an increase in payments for more intensive farms (smaller on average, selecting products with higher returns) and would result in a decline in support to most extensive farms. The IA points out this last outcome could be mitigated by providing coupled support to extensive livestock systems and top-ups to permanent grassland.
- The redistribution of support to smaller farms also has sectoral effects because different sized farms specialise in different production systems. Redistribution leads to higher income drops for larger farms (mostly cereal producers and extensive livestock farms), while olive growers benefit from this redistribution.
- Higher requirements to increase environmental performance have a bigger impact on crop producers; for example, a three-year rotation affects particularly sugar beet and potato producers. However, a redistribution of support to permanent grassland (for environmental reasons) would benefit extensive systems.

Market and trade impacts. The IA does not give directly the production effects in the different options but presents the impacts on net trade (Table 8). For all commodities except for oilcakes there is a deterioration in the EU trade balance in all options. There are increased imports of beef, sheep and poultry meat as well as maize in almost all options and reduced exports of mainly beef and wheat. The percentage changes need to be interpreted in the context of the initial levels of net trade. While the percentage changes are larger for beef, the overall EU beef market is very close to self-sufficiency and initial levels of both imports and exports are very small. Trade in dairy products is not affected. The EU trade balance reduces most

in option 4a and 3a, and then 3b and the lowest decline is simulated in options 4b and 5. Overall, however, the changes are small in

magnitude in most scenarios, and no radical changes in trade flows are projected for the range of scenarios considered.

Table 8. Changes in trade by main commodity (%)

	Beef		Sheep meat	Poultry meat		Pig meat	Cereals		Oilseeds	Oilcakes
	Exports	Imports	imports	Exports	Imports	Exports	Exports	Imports	Imports	Imports
3a	-13	20	8	-2	2	-3	0	1	1	-2
3b	-3	4	3	-1	1	-2	-3	6	0	0
4a	-9	13	2	-2	3	-4	-1	3	1	-1
4b	-7	9	1	-1	1	-1	0	-1	0	-1
5	-9	13	-6	-1	1	-1	-1	1	0	-1

Source: Commission Impact Assessment, simulations based on the CAPRI model (European Commission 2018d).

Notes: Option 3a: Ambitious environmental focus, limited basic income support. Option 3b: Conservative environmental ambition, focus on redistribution. Option 4a: Strong income support, high environmental ambition. Option 4b: Strong income support, limited environmental ambition. Option 5: Strong focus on small farms and the environment.

In contrast to decoupled payments, coupled support without production limitations is considered trade-distorting under WTO rules. The IA provides mixed support for this view (Table 9). While removing coupled support for beef and sugar beet would reduce supply, the IA simulation results appear to suggest that it would lead to an increase in milk supply as the yield increase is greater than the herd size reduction. This reflects an aggregation issue rather than providing evidence of a significant productivity increase due to the removal of

coupled support. In the CAPRI model the output of the dairy activity is not only milk but also young animals. Most of the action in the dairy activity is around the number and weights of young animals rather than the number of dairy cows and milk yields. There is almost no change in the raw milk balance as a result of removing coupled support. The Commission proposals, by removing any quantitative limits on this support, albeit while maintaining a financial ceiling, will possibly exacerbate these effects in future.

Table 9. Changes in price and production if coupled support were fully removed (%)

	Hectares or herd size	Yield	Supply	Price
Dairy	-0.7	1.5	0.7	1.4
Beef	-2.5	0.2	-2.4	3.2
Sugar beet	-4.9	2.2	-2.8	3.9

Source: Commission Impact Assessment, simulations based on the CAPRI model (European Commission 2018d).

6. IMPLICATIONS FOR DEVELOPING COUNTRIES

6.1 The Commission's Impact Assessment

The Commission's 2017 Communication *The Future of Food and Farming* (European Commission 2017b) which set out the direction of travel for the CAP after 2020 includes a chapter on the global dimension. This recognises that the CAP has global implications and linkages that must be considered when decisions are taken about the policy's future. It commits to ensuring coherence between agricultural policy and the 2030 Agenda for Sustainable Development and highlights its commitment to policy coherence for sustainable development.

To this regard, the CAP is and will continue to be coherent with the EU development policy, which recognises the important role sustainable agriculture plays for poverty eradication and sustainable development in developing countries and promotes also the development of agricultural markets and inclusive value chains which benefit the poor and encourage the agro-industry to generate jobs (op.cit, p. 25).

However, the Communication does not elaborate further on the meaning of coherence nor try to demonstrate how coherence is achieved despite its assertion to this effect.

The Communication also makes explicit reference to a greater role for the future CAP in the root causes of migration from outside the EU. It suggests six specific actions to this end:

- Sharing knowledge and know-how gained from CAP-supported projects to develop employment opportunities and revenue-generating activities in regions of origin and transit of migrants, including possible projects for training young farmers - with the involvement of European farmers' organisations.

- Developing EU-Africa Union exchange schemes for young farmers.
- Deepening cooperation on agricultural research and innovation through the relevant EU policies and instruments.
- Enhanced strategic policy cooperation and dialogue with the Africa Union on issues related to agriculture and rural development so as to help the region develop its agri-food economy.
- Offering opportunities for seasonal workers in agriculture.
- Using EU rural development programmes to help settle and integrate legal migrants, refugees in particular, into rural communities, building on the experience of Community-Led Local Development/ LEADER projects.

These can be valuable initiatives, but only the proposal to use CAP resources to help integrate legal migrants into rural communities would seem to fall under the specific competence of the CAP. There is no specific reference to this objective in the draft CAP legislation, though member states may be able to earmark resources for this objective in their Strategic Plans. The other projects involve areas of competence within the Commission other than agriculture, or even refer to competences reserved for member states such as the admission of non-EU nationals as seasonal workers.

A Task Force for Rural Africa has been announced to look at job-creating economic development in agriculture, agri-business and agro-industries, and to advise on priorities and next steps in cooperation with Africa. The Task Force will work in close cooperation with the African Union and will complete its work by January 2019.⁹ The intention is to move

⁹ For background on the Task Force, see https://ec.europa.eu/info/news/european-commission-launches-expert-group-strengthen-eu-africa-partnership-agriculture-2018-may-24_en.

beyond traditional forms of development co-operation to focus on “targeting policy support, fostering investments in rural areas and supporting agro-industries in Africa, with the involvement of the private sector.” The focus in future will be on ‘investments and policy dialogue’ to help address the underdevelopment in African agriculture.

In the Explanatory Memorandum to the legislative proposal, the Commission notes that “The proposal...takes into account the EU development cooperation’s objectives of poverty eradication and sustainable development in developing countries, in particular by ensuring that EU support to farmers has no or minimal trade effects.” This conclusion is based on a short analysis of Policy Coherence for Development in the accompanying Impact Assessment (European Commission 2018d).

In the IA, the Commission underlines its open trade policy towards certain developing countries (particularly LDCs and its African, Caribbean and Pacific trading partners under its Everything but Arms scheme and Economic Partnership Agreements, respectively). It highlights its role as a development donor and particularly the importance of food security and nutrition in its development co-operation programmes. With respect to the CAP specifically, it underlines the move away from coupled support to decoupled payments that do not distort trade, as well as the fact that it ceased to apply export subsidies since July 2013. It notes that market intervention measures are still permitted, but only in times of crisis, and that support for farmers is set at levels that are generally well below normal market conditions.

Among the various interventions in the CAP post 2020 tested in the IA, the Commission identifies the following five as most associated with impacts on third countries (refer back to Section 3 for a discussion of these measures).

- Decoupled direct support. The Commission notes that decoupled direct support is not considered trade or production distorting
- under WTO rules and hence any changes in this support is not expected to affect third countries.
- Coupled support. The Commission recognises that coupled support does have a positive impact on production.
- Risk management tools. The Commission acknowledges that the changes made in the Omnibus (Agricultural Provisions) Regulation in 2017 and which are confirmed in the legislative proposal can have the effect of shifting these payments from the Green to Amber Box.
- Payments for management commitments in the case of the incentive-based eco-scheme. The Commission accepts that these schemes would no longer be covered by paragraph 12 of Annex 2 of the Agreement on Agriculture that exempts payments under agri-environment schemes that fulfil certain conditions from a country’s Current Total Aggregate Measurement of Support. It goes on to note that eco-schemes are not intended to enhance production but to enhance delivery on environmental objectives. It asserts that the effect of these schemes is therefore most likely to provide a production constraint or to have a certain influence on the type of production chosen rather than an overall production stimulating effect.
- Sectorial programmes: market measures. The potential for these measures to influence markets is recognized, but the Commission notes that no changes to these measures were examined in the IA.

6.2 Developing Country Exports to the EU

Table 10 provides some essential context by presenting the structure of EU agri-food imports in 2017 (these trade statistics include the UK). Agri-food imports are defined as HS Chapters 01 through 24 plus HS 52 Cotton. They include fish (HS 03) and fish preparations (some of HS 16) which are not agricultural products affected by the CAP. Developing countries are

Table 10. Structure of EU28 agri-food imports, 2017

€ million	Developed countries	Developing countries	<i>of which: % imports under preferences or MFN zero</i>	LDCs	<i>of which: % imports under preferences or MFN zero</i>
	Total	Total	%	Total	%
01 - Live Animals	178.9	54.1	87.1	0.5	98.9
02 - Meat and edible meat offal	1,547.1	2,160.1	39.6	0.1	1.1
03 - Fish	8,839.9	10,085.8	76.9	1,250.1	99.0
04 - Dairy produce and eggs	544.2	435.2	36.3	2.1	84.8
05 - Products of animal origin not elsewhere specified	247.0	1,105.6	98.9	3.0	100.0
06 - Live trees and plants, cut flowers	192.9	1,280.6	84.1	269.7	94.6
07 - Vegetables	928.3	3,746.2	81.3	175.5	97.4
08 - Fruits and nuts	3,514.7	16,379.5	88.2	143.7	98.2
09 - Coffee, tea, spices	1,542.5	8,316.7	98.3	1,175.2	99.4
10 - Cereals	1,253.0	3,829.1	64.2	288.2	98.1
11 - Products of the milling industry	58.2	143.3	54.5	4.5	93.5
12 - Oilseeds	4,479.9	6,226.7	93.1	92.2	99.2
13 - Gums and resins	223.4	586.0	89.8	132.3	97.2
14 - Vegetable products not elsewhere specified	13.7	182.2	99.9	2.5	100.0
15 - Animal or vegetable fats and oils	755.8	8,943.8	60.2	102.6	98.4
16 - Meat or fish preparations	467.9	5,198.1	65.5	83.6	99.1
17 - Sugars and sugar confectionery	285.9	1,551.5	61.7	126.0	90.3
18 - Cocoa and cocoa confectionery	698.2	5,571.2	98.0	184.2	99.9
19 - Cereal preparations	577.1	984.9	54.5	14.2	97.7
20 - Vegetable and fruit preparations	468.8	4,758.9	58.9	37.5	95.3
21 - Miscellaneous edible preparations	1,668.4	1,557.5	52.9	3.5	72.9
22 - Beverages and spirits	3,255.4	2,746.9	76.8	20.7	96.3
23 - Animal fodder and food residues	1,426.9	8,168.0	93.8	17.1	97.3
24 - Tobacco	180.7	1,330.4	51.2	614.2	97.2
52 - Cotton	180.9	2,916.6	64.6	48.9	97.5
TOTAL	33,529.5	98,258.9		4,792.2	

Source: Own tabulation based on Eurostat COMEXT data for Statistical Regime 1 which refers to normal imports of goods for final use in the EU. LDCs are those on the UN list <http://unohrls.org/about-ldcs/>.

by far the major suppliers of agri-food imports to the EU, supplying over €98 billion of imports in 2017. Developed countries accounted for almost €34 billion while LDCs supplied agri-food imports worth almost €5 billion. Many of these imports enter the EU under either preferential arrangements or where the MFN tariff rate is zero. For several CAP products, MFN tariff rates are high enough to prevent trade from taking place.

Excluding fish, the most important developing country exports are fruits and nuts (€16 billion), vegetable oils (€9 billion), coffee, tea and spices (€8 billion), animal fodder (€8 billion), oilseeds (€6 billion) and cocoa and cocoa confectionary (€5 billion). Other important exports include meat and fish preparations, fruit and vegetable preparations, cereals, vegetables, beverages and spirits, cotton and meats. Other products with exports over €1 billion include processed foods (miscellaneous edible preparations), sugar and sugar confectionery, tobacco, cut flowers and other products of animal origin.

Exports from LDCs are on a much smaller scale and with important differences in composition. Fish is the most important LDC food export to the EU. Among agricultural products, exports are dominated by coffee and tea (€1.3 billion), followed by tobacco (€0.6 billion), cereals (€0.3 billion, mainly rice), cut flowers (€0.3 billion), cocoa (€0.2 billion), and vegetables (€0.2 billion). Striking absences from this list, as compared to developing countries, are fruits, sugar and cotton. Cotton (both as lint and carded and combed) is the largest LDC agricultural export commodity (ICTSD 2017), but sales are mainly to countries that are important textile exporters (e.g. Vietnam, India, Pakistan and Turkey) rather than to the EU despite the absence of tariff barriers and limited EU domestic production.

Despite the fact that LDCs have duty-free and quota-free access to the EU market for all originating products, LDCs have almost

zero exports in chapters such as HS 02 Meats and HS 08 Fruits and nuts where developing countries are major exporters. This points to the importance of non-tariff measures and supply-side constraints as the limits to exports. In the case of meat, for example, the EU has stringent hygiene rules to prevent the import of animal diseases and other health risks. Countries that wish to export to the EU must first be approved by the EU's veterinary authorities as having appropriate disease control and monitoring and inspection facilities in place, and then individual plants must be approved as meeting EU hygiene standards before they can export. No LDC is on the EU approved list at this point.

With regards to fruits and nuts, there are also stringent sanitary and phytosanitary controls to prevent the introduction of pests and diseases into the EU as well as to protect human health from pesticide residues and harmful fungi and bacteria. The inability to meet these standards may explain why exports of fruits and nuts from LDCs are so low. Where the inability to satisfy non-tariff measures of this kind are the explanation for low import volumes from LDCs, then changes in EU market conditions due to the Commission's legislative proposals are irrelevant from the point of view of market access. They may still be important if they result in changes in EU net trade for products where LDCs are net importers, as then they would contribute (though very slightly) to putting upward pressure on LDC import prices.

6.3 Agricultural Policy Impacts on Developing Countries

Before assessing the possible impact of the Commission legislative proposal on developing countries, and LDCs in particular, we can sketch the three main channels through which the agricultural policy of one country may impact on food production in another. These channels operate through market price effects, supply chain effects of agricultural imports and environmental spillovers.¹⁰

¹⁰ These three channels are similar but not identical to the three mechanisms identified by Rudloff and Brüntrup (2018) which they call "hinges"—the export hinge, the import hinge and the direct and indirect "climate" hinge.

The main channel of impact of agricultural policy (including agricultural trade policy) on food production in other countries is through its *impact on global market prices*. A protectionist agricultural policy will encourage domestic production, and lead either to reduced imports from or increased exports to the world market. In both cases, the effect is to depress world market prices, to reduce export opportunities for net exporters and to increase import competition for net importers. The protectionist instruments can be different—high import tariffs, disproportionate sanitary standards, subsidies paid on agricultural exports, or direct payments coupled to production—but the consequences for the level of world market prices are the same. In addition, some agricultural policy instruments designed to stabilise domestic market prices can have the effect of destabilising world market prices, adding to their damaging effects on food production in the rest of the world.

EU agricultural policy in the past was justifiably criticised for its protectionist nature. Much progress has been made in successive CAP reforms to reduce the level of protection and to align EU producer prices with world market prices (Blanco 2018; Matthews 2014; Rudloff and Brüntrup 2018). The OECD reports that the EU's average Nominal Rate of Protection (a measure of the extent to which EU agricultural producer prices are supported above world market levels, including by coupled payments) has fallen from 70 percent in 1986-88 to 5 percent in 2015-2017.¹¹ Tariff protection for some commodities remains high (WTO 2017), but many developing countries, and particularly LDCs and African signatories to Economic Partnership Agreements enjoy duty-free and quota-free access to the EU market (which also implies a margin of preference with respect to other potential exporters to the EU). Preferences for other developing countries are much more limited and EU tariffs can be prohibitively high.

The EU has eliminated the use of export subsidies since July 2013. Development NGOs report that, in some developing countries particularly in Africa, the availability of cheap EU commodity products (milk powder, poultry meat, onions) on local markets is a competitive threat to local production. These trade flows can arise because of the nature of consumer preferences on EU markets (for example, wholesome but misshapen produce may be unsaleable on the EU market but may still have some value when exported to an African market, or EU consumer preferences for white chicken meat can lead to the export of other chicken parts at relatively low prices). These trade flows are not the result of CAP support and would continue in the absence of the CAP. Developing countries faced with this import competition may decide to impose tariffs to protect the domestic sector, within the constraints of their bound tariff commitments at the WTO or in their free trade agreements with the EU. In some cases, importing countries welcome the low-cost imports as an important addition to the domestic food supply. Another response might be to increase investment in local infrastructure to make it more attractive to supply burgeoning urban markets from local producers rather than imports.

The second channel through which agricultural policy may impact on food production in third countries is through *supply chain effects of agricultural imports*. These effects arise as a result of agricultural trade flows and agricultural policy may play a limited role. Critics who highlight negative supply chain impacts of EU agricultural imports from developing countries have two different targets in mind. Some worry about the “virtual footprint” of EU imports, arguing that these imports make use of land and water resources in exporting countries which might be used for domestic food production (Friends of the Earth Europe 2016). This concern is misplaced as the use of these resources to produce crops for export markets can return a higher income

11 OECD, Producer and Consumer Support Estimates Database: EU Country File, available at <http://stats.oecd.org/wbos/fileview2.aspx?IDFile=b19a487e-0c57-4e5d-8d37-911afad77ba5>, accessed 11 November 2018.

to these farm families with positive impacts on their nutrition—a good example was the early impact of the boom in quinoa exports for poor Bolivian and Peruvian families (ITC 2016). The potentially positive impact of supplying export markets may be undermined if land rights are insecure and encourage “land-grabbing,” if there are strong gender inequalities or if export production leads to monoculture or other environmentally damaging practices. Particularly the potential for negative environmental consequences is the second major target for critics of EU import demand. There has been a particular focus on the contribution of EU demand for imported beef, animal feed, particularly soybeans, and for imported palm oil (both for food and cosmetic manufacture but also to produce biodiesel) to tropical deforestation (LMC International et al. 2018; Schulmeister 2015).

The environmental damage of export demand for agricultural commodities should be addressed. It reflects a lack of adequate environmental protection or enforcement in the exporting countries. Strengthening environmental protection in exporting countries is the first-best solution. Pressure can be brought to bear in the first instance by companies making use of imported commodities that can seek to exclude products that cause environmental damage from their supply chains. Several certification schemes are in place for specific commodities (including soybeans and palm oil) to encourage only sustainable imports, although with mixed success (one issue is the relative importance of importers that demand certified products relative to those that are indifferent). Trade policy, such as a ban on unsustainable imports, can also be an effective instrument but needs to take account of WTO rules and jurisprudence.

Agricultural policy as discussed in this paper, which is primarily focused on domestic support, is not an efficient instrument to address supply chain concerns around imports. For example, coupled support for protein crops in

the EU is partly justified on the grounds that it would reduce the negative environmental impacts of imported protein feeds. While this strategy may reduce overall EU imports of protein feeds, it does not discriminate between sustainable and unsustainable import sources. The more efficient policy is one that targets the source of problem—inadequate environmental management in the exporting country—directly.

The final channel by which agriculture may influence food production in third countries is the indirect channel of *environmental spillovers, and particularly greenhouse gas emissions that lead to global warming and climate change*. Agricultural emissions are a significant contributor to global warming. The resulting changes in climate and weather patterns (higher temperatures, less reliable rainfall, greater frequency of extreme events) will adversely affect yields particularly in developing countries where average temperatures are already above the global average. Domestic support policy can result in increased agricultural emissions (for example, by providing support to livestock production) or decreased emissions (for example, by encouraging carbon sequestration in soils or techniques to reduce emissions).

6.4 Impacts on Developing Countries of the Commission Legislative Proposal

This final section assesses the potential impact of the Commission’s proposal for the CAP after 2020 on developing countries, and particularly LDCs, paying particular attention to the market price and climate spillover channels. As argued above, domestic support policy is not an appropriate instrument to tackle the environmental impacts of agricultural imports which are more effectively addressed by other policies.

The primary channel of impact of the Commission’s CAP proposal will operate through changes in market prices. Quantifying the scale of these changes is not possible at this stage. Both the Commission’s MFF and

CAP proposals may be modified, even quite radically, before they are approved. Also, the proposal leaves a great deal of flexibility to member states with respect to the choice of instruments they include in their Strategic Plans. Until these plans are approved, it is not possible to predict the level of environmental and climate ambition that EU farmers will be asked to meet after 2020, the extent of targeting and redistribution of Pillar 1 direct payments, or the use that will be made of coupled payments. Therefore, the market and trade impacts will remain uncertain.

Despite these uncertainties, some generalisations about the likely impacts are possible. The IA simulations show that there is a trade-off, at least in the short run, between agricultural production and farm income levels, on the one hand, and environmental ambition, on the other. This trade-off is most apparent for arable producers, particularly in the case of higher conditionality requirements. This trade-off is central to the debate on the CAP post 2020. The farm unions argue that farmers cannot be asked to meet higher environmental and climate requirements at the same time as less money is available for the CAP budget. Environmental NGOs argue that these higher requirements are internalising some of the external costs of agricultural practices, and that the existing budget can be justified only to the extent that it supports farmers in the transition to a more sustainable agriculture. Whatever the merits of these arguments, the greater the environmental ambition in member state Strategic Plans, the larger the likely impact will be in reducing production.

The IA simulations also suggest that there may be a further reduction in production levels, relative to the baseline assuming a continuation of the 2014-2020 CAP, because of the slightly smaller budget and the intended redistribution of direct payments support from larger to small- and medium-sized farms. The Commission's actual budget proposal maintains member state direct payment envelopes more or less constant in nominal terms (a reduction of around 2 percent) although this translates into a larger cut in real terms. On the other

hand, member states could decide to provide a greater share of direct payments as coupled support given that previous restrictions on the use of this support have been lifted, even if the Commission's proposal does not provide greater overall scope for coupled support (see earlier discussion). Current experience is that coupled support is concentrated on three products, beef, milk and sheep and goats, which together account for three-quarters of the coupled support provided in the EU in the 2015-2020 period (DG AGRI 2017).

The greater focus on higher environmental and climate ambition in the Commission's legislative proposals translates into higher production costs within the EU relative to competitors and thus a (very slight) reduction in its exports and increase in imports, compared to a business-as-usual baseline. This will tend to raise world market prices, although the impact will be hard to detect among the multitude of other factors that will affect world market prices in the coming decade (e.g. the arrival of new technologies, the impact of climate change on yields, water stress, changes in oil prices, the frequency of extreme events, and so on).

These changes may open some new market access opportunities for developing countries, particularly those that export under preferential access arrangements. For least-developed countries that benefit from 100 percent duty and quota-free access to the EU market, an examination of existing trade statistics highlights that the inability to meet the EU's strict sanitary and phytosanitary standards on food exports may well be a barrier to taking advantage of any new opportunities that may arise.

Most LDCs are now net food importers even if many also depend on exports of specific agricultural commodities (ICTSD 2017). Depending on the extent of price transmission from world markets to domestic markets (a function of transport costs and policy interventions, among other issues), the Commission proposal might lead to some (very minor) upward pressure on domestic producer

and food prices, all else assumed unchanged. Food producers would benefit while poorer food consumers would be (very slightly) disadvantaged. LDCs can best respond by increasing their own domestic support to the agricultural sector so that it can provide remunerative employment opportunities and meet growing domestic and regional demands.

Finally, the Commission's desire for a greater level of environmental and particularly climate ambition in the CAP after 2020 may strengthen interventions to reduce net agricultural greenhouse gas emissions. This will also be welcomed by LDCs and developing countries generally, given that these countries are most at risk from global warming. The issue here is whether the Commission's ambition will be followed up by effective initiatives at the member state level. Doubts have already been expressed whether the new governance

arrangements built around the new delivery model will be sufficiently robust to deliver on the Commission's ambition (European Court of Auditors 2018).

This paper provides a preliminary assessment of the Commission's legislative proposal for the CAP after 2020. Its ultimate impacts will depend on the changes that are made to the proposal in the legislative proposal, and how it will be implemented by member states in their Strategic Plans. Although the Commission hopes that final agreement can be reached in sufficient time to allow the legislation to come into force from 1 January 2021, possible delays in reaching agreement on the MFF budget proposal as well as European Parliament elections in May 2019 could well mean that there will be a need for a transitional period in which the current CAP rules are extended for a period of time.

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