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How to Finance the Common Agricultural Policy of the European Union?

Master thesis

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CONTENTS

ABBREVIATIONS

AWU	Annual Work Unit
CAP	Common Agricultural Policy
CEECs	Central and Eastern European Countries
COM	Common Organization of the Agricultural Markets
DDA	Doha Development Agenda
DEFRA	Department for Environment, Food and Rural Affairs
EAGGF	European Agriculture Guidance and Guarantee Fund
EC	European Community
EFTA	European Free Trade Association
EU	European Union
GDP	Gross Domestic Product
GNP	Gross National Product
HM	Her Majesty
MEP	Member of Parliament
NGO	Non Governmental Organization
NMS-10	New Member States-10
NMSs	New Member States
NTCs	Non Trade Concerns
OECD	Organization for Economic Cooperation and Development
PSE	Producer Support Estimate
QMV	Qualified Majority Voting
TEC	Treaty establishing the European Communities
URAA	Uruguay Round Agreement on Agriculture
WTO	World Trade Organization

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ABSTRACT

2008/9: A review of the European Union's (EU) 2007-2013 financial perspective, including the Common Agricultural Policy (CAP) – An à la carte choice

For the small pocket: Reduced spending without compensation

or

Pay the bill together: reduced spending by the EU but Member States compensating for lost aid through shared financial responsibility (co-financing)

or

Pay and choose together: a way forward towards better targeting and emphasis on the subsidiarity principle through increased spending on rural development creating a less common and more targeted "federal agricultural policy"

or

Chose, decide and pay separately: the way out through re-nationalization[1]

The CAP is a fundamental policy field of the EU, taking up around 40% of the EU budget, often being subject to substantial political tension amongst the Member States. The CAP has been radically transformed in the last 15 years, in an attempt to adapt it to the 21st century through the reduction of total farm spending, the introduction of uncoupled direct aids linked to cross-compliance and the creation of rural development measures, coined pillar 2 of the CAP. Article 33 of the Treaty establishing

[1] The author's e-mail address is moschitz@gmx.at

the European Community (TEC) lays down the objectives of the CAP, such as ensuring a fair standard of living for the agricultural community.

The EU is facing three major challenges concerning the CAP. Firstly, it is becoming increasingly difficult to *finance* the CAP as well as finding compromises amongst the 25 Member States regarding its future. Secondly, the EU is facing domestic pressure about the *usefulness* of farm subsidies in general. The CAP is often contested to be lacking sufficient targeting and being too centralized. Thirdly the EU is facing international pressure to abolish all sorts of *trade* distorting subsidies. A success of the Doha Development Agenda (DDA) is depending heavily on the EU's actions and commitments.

In December 2005, the EU agreed on the financial perspective 2007-2013 including a review taking place in 2008/9. This review explicitly includes the CAP. The EU should engage citizens, politicians and policy makers in a wide ranging debate on the future of European Agriculture and the CAP. The core question to be answered is if agriculture is different from other economic sectors, and therefore deserves and more importantly requires aid and compensation by the EU or national governments.

To tackle the above mentioned challenges the EU has various options to choose from. Firstly, the EU can decide to wait until the latest reforms take effect and therefore decide to *do nothing*. Doing nothing would not actively solve any of the problems but might still be the chosen path if a compromise can not be reached. Secondly, the EU can severely *cut agriculture spending,* without any compensation of lost aid by Member States. This would solve the EU budget crisis, contribute to a success of the DDA, not burden the Member States budgets but provoke radical structural change in European agriculture. Thirdly, the EU can opt for a reduction of agriculture spending but introduce a mechanism of compensation through *co-financing* of direct aids of pillar 1, making Member States financially responsible. Fourthly the EU may choose a further shift of financial means from market and income support (pillar 1) to rural development measures (pillar 2), called *modulation*. If measurements of pillar 2 remain subject to compulsory co-financing by National Governments, as they are now, the EU could disburden its budget and create a more targeted, legitimated and sustainable type of CAP. Implementation powers and financial responsibility would be shifted back to the Member States, leaving them more choice of which policies to choose and how to implement them, enabling them to best meet their local needs. As a last option the EU can agree on a partial *re-nationalization* of decision-making and implementation power, meaning a shift of competences back to the Member States. Such a scenario would highly disburden the EU budget but might endanger the common market, lead to a certain degree of disintegration and leave the Member States with a task they might not be able to deal with or they might be less effective in solving.

Politically every form of change and reform will be difficult knowing that national interests are diverse and often heavily perused. A co-financing of direct aids might be heavily contested by Central and Eastern European Countries (CEECs), having recently joined the EU. Only if exceptions and transition periods are granted to these countries does a political compromise seem likely. An increase of modulation seems politically most feasible because it makes the CAP more targeted, reduces financial pressure on the EU budget and gets Member States involved by offering them the power to choose and implement policies. The Commission would have to continue drafting a clear framework and administer the CAP. A re-nationalization of the CAP does not seem likely or wise, as it would be in opposition to the treaties and having a disintegrative effect.

If a majority of the EU citizens agree firstly that agriculture is different, and therefore deserves and needs special care and governmental aid, and secondly that farmers should be compensated for the provision of non-commodity outputs being, beneficial for everybody, politicians and EU policy makers should use the review in 2008/9 to foster change: creating modalities to finance the CAP in the future, increasing legitimacy and acceptance and making it more targeted and long term beneficial for farmers and rural areas. For the CAP to have a future, Member States will have to be involved, according to federal and subsidiarity principles, by granting them more implementation power and making them financially responsible. More financial means should be transferred to rural development measures. This will promote structural change and ensure a fair standard of living for the agricultural community in the long run, through endorsing the strengths of European agriculture which are a wide product range of safe high quality food, produced in a multi-functional and environmentally friendly way providing non-commodity outputs for all citizens.

INTRODUCTION

MANY QUESTIONS CONCERNING THE UPCOMING REVIEW

What might the future of European Agriculture look like, and how will the CAP be designed? But most importantly, how will a policy currently taking up around 40% of the EU budget be financed? Is it likely that agricultural aid will be dramatically reduced by the EU, and if so will it be compensated by Member States through co-financing mechanisms? Is the EU likely to shift considerable amounts of its money from pillar 1 to pillar 2? Is it probable that the EU gradually re-nationalizes the CAP? And what would these different scenarios mean politically? Which compromise can be found to enable continued financing of the CAP and meet the diverse needs of the Member States? And what do the EU citizens think of farm subsidies and the CAP? Do they believe that agriculture is different from other economic sectors, justifying governmental protection and aid?

All these questions will be addressed in the present work. There will be no simple answers but there will be a detailed discussion leading to helpful suggestions. This thesis will evaluate different options for the future financing of the CAP especially in the light of the review clause 2008/9, agreed upon in December 2005 in the "Final Comprehensive Proposal from the UK Presidency on the Financial Perspective 2007-2013". What will happen to the CAP and how can it be financed? Which solution would be desirable for the EU, its citizens, farmers, consumers and rural communities and which solution is likely to be reached through a compromise between 25 Member States?

IS FARMING DIFFERENT FROM OTHER ECONOMIC SECTORS?

Agriculture provides a variety of things. Most obviously food, but there is a lot more that farming offers to society. "Multi-functionality refers to the concept that, besides producing food and fibre, agriculture creates non-food joint or spillover – multifunctional – benefits such as open space, wildlife habitat, biodiversity, flood prevention, cultural heritage, viable rural communities, and food security".[2] The EU embraces this core principle for its agricultural policy. It considers all these functions; therefore it does not come as a surprise that the CAP is a special and highly complicated policy field.

Farming creates different feelings and emotions. For some people it is connected to a nostalgic and romantic feeling to others farming is something simple, basic and low profile, contributing little to growth and gross national product and employing few people. Nevertheless most of us have some sort of link to farming. Our parents might have grown up on a farm, our grandparents may still run one and a friend might take one over. But the majority of the population in so called developed countries has only a vague idea of agricultural life and work. Commissioner Fischler stated: "Agriculture is different; it is different because despite all the innovation of recent years, agricultural production (except in specialized sectors) does not take place in a controlled environment; it does not take place at a controlled pace; it does shape our countryside and, even more important does hold a special place in human imagination and affection."[3] The aim of this paper is to evaluate possibilities for the EU concerning the implementation *and* financing of policies creating a framework for the survival and wellbeing of European agriculture and farmers, *if* its citizens want such a policy in place. "Europe must begin a broad public debate on the future of its agriculture. Many issues need to be addressed, including what role governments should play in farming, the type of countryside

[2] Swinbank, A., (2001, November 29th) Multifunctionality: A European Euphemism for Protection? The University of Reading, FWAG Conference, National Agricultural Centre, Stoneleigh
[3] Fischler, F., (2000, October 11th) Speech/00/371, The CAP and WTO Agriculture Negotiations, Banff

that Europeans want, and the role of agriculture in the European and international economy"[4]. Citizens and politicians have to reflect if agriculture is actually different from other economic sectors and thus deserves aid. According to The Economist of London, the CAP is hard to justify on any "European" grounds. It does not contribute to economic growth. The CAP today offers almost nothing towards the goal of an ever closer union.[5] Only if Europeans and the EU know what they want from agriculture and how they want their countryside to look, can they formulate goals. Once these goals have been formulated it needs to be decided how they can be reached. That has to be achieved with the help of academics, think tanks and expert groups, by evaluating if and what intensity of governmental intervention is necessary to reach these objectives. If the conclusion of the questions above is, that the EU does need some sort of governmental intervention and that the framework should be laid down by the EU, a compromise on its financing and final implementation has to be reached amongst all Member States. This is not an easy task, but this rigid procedure seems necessary to ensure that a policy is only in place if it is really desired and if so performed by the entity that is most efficient in doing so. If there is any agricultural policy in place it will have to have a strong federal taste. If not it will not be accepted, supported and properly implemented by Member States, regions, communities, farmers or citizens.

DIVERSITY CALLS FOR A WELL TARGETED FEDERAL TYPE AGRICULTURE POLICY

The EU is a Union of diversity; the same is true for its agriculture. There are a great many differences among the agricultural sectors of the

[4] Wolf, J., (2002) The future of European Agriculture, CER, p 3
[5] The Economist (2005,December 17th) Charlemagne: A modest proposal

Member States, i.e. natural and climatic conditions, farm structure, productivity and profitability, allocation and levels of CAP support, and the overall significance of agriculture to rural regions and national economies and the significance of the rural, mainly agricultural, regions to society and economy at large.[6] Throughout this work it will be emphasize that no matter what sort of policy is in place it needs to meet the different needs of the Member States and its regions. A one size fits all approach is doomed to failure. Only a strong feeling of responsibility, solidarity and burden sharing will reach the objective agreed upon. If the EU has common interests it needs to express them and find a way to implement them satisfactorily for all Member States.

A SHORT OUTLOOK OVER THE CHAPTERS

CHAPTER 1 COVERS THE EUROPEAN MODEL OF AGRICULTURE.

In Chapter 1.1 some general features of farming in the EU will be discussed. The diverse character of European agriculture and the obstacles it is facing nowadays will be highlighted. The question if today farmers are simply a "group of aging idealists" will be raised at the end of this chapter.

Chapter 1.2 introduces the CAP. It will start off with a very short historic overview to provide the essential groundwork for understanding later discussions on its financing and possible reforms and modifications. Part of this chapter also discuses what EU citizens think about the CAP and how this should influence policy makers. At the end of this chapter the term "multi-functionality" will be introduced and the multi-functional character of European agriculture will be discussed.

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[6] Kola, J. (2003, July 1st-4th), Non-common agricultural policy of the EU: implications for the present and future member states and policies; In: Niemeläinen, O. & Topi-Hulmi, M. (eds): Proceedings of the NJF's 22nd Congress "Nordic Agriculture in Global Perspective", Turku Finland (409 p.): 167-168.

CHAPTER 2 IS DEDICATED TO THE CHALLENGES EUROPEAN AGRICULTURE AND ITS CAP ARE FACING.

Chapter 2.1 will talk about the strained EU budget and the financing of the CAP will be introduced as the first major challenge the CAP and its beneficiaries are encountering.

Chapter 2.2 highlights the ongoing discussion about the usefulness of farm subsidies, if they could be severely reduced or abandoned at all.

Chapter 2.3 looks at the CAP and the WTO negotiations. The EU is facing constant pressure in the Doha Round because of its still highly protectionist agricultural policy.

CHAPTER 3 COVERS POSSIBLE SCENARIOS TO SOLVE THE ABOVE MENTIONED OBSTACLES.

This chapter discusses in great detail the different options examined by academics and discussed amongst policy makers.

Chapter 3.1 talks about the "we are all happy, everything is fine" option of not reforming anything.

Chapter 3.2 deals with the possibility of reduced CAP spending by the EU. It begins with the concept of subsidiarity and its implication for the decision making process concerning the CAP which is supposed to serve a highly diverse agricultural landscape all over Europe. In this chapter it is being argued why the subsidiarity principle might stress the need for an increased share of Member State power concerning design, decision making and implementation of the CAP. Less spending by the EU could lead to a simple reduction in agricultural aids if the Member States would not compensate. The chapter takes this theory further and discusses the option of an increased shared financial responsibility (co-financing) for reasons of financial pressure concerning the EU budget but also on subsidiarity grounds, if farm aids are not supposed to drop dramatically. To solve the financial crises the option of a co-financing mechanism of direct aids in pillar 1 is discussed. A further increase in modulation, meaning the gradual transfer of means from pillar 1 to pillar 2 of the CAP is being evaluated. This option might lead to a more targeted CAP, providing for sustainable, environmentally friendly production and the long term improvement or farms and rural communities. It would also lead to less financial pressure and responsibilities for the EU since measures of pillar 2 co-financed (from 20 to 50 % depending on the program) by Member States.

Chapter 3.3 introduces the concept of a possible re-nationalization of the CAP. This is a shift of decision making and implementation power back to the Member States.

CHAPTER 4 CONSIDERS THE POLITICAL DIMENSION OF ALL THE SCENARIOS DISCUSSED IN THE PRECEDING CHAPTER.

Chapter 4.1 starts of to examine possible risks for the common market of the reform solutions discussed.

The CAP comprises a real foundation of the EU, being the only entirely common policy. It was and might to a certain extent be still important for European Integration. Therefore Chapter 4.2 has a closer look at what effect a possible co-financing mechanism or re-nationalization of the CAP might have on European solidarity, cohesion and on further integration.

Chapter 4.3 is dedicated to examine the willingness of Nation States to conform to change. More importantly it attempts to evaluate the probability of change knowing that 25 (27) countries have to reach a compromise in order to substantially change the financing mode of pillar 1, advance modulation or reform the CAP altogether.

CHAPTER 5 CONCLUDES AND GIVES SOLUTIONS AND SUGGESTIONS.
It will do so specially in the light of the upcoming review of the financial perspective 2007-2013 in 2008/9.

1 The European Model of Agriculture

1.1 Farming in the European Union

1.1.1Diversity

9.9 MILLION FARM HOLDINGS
The European Union is made up of 25 diverse countries. In 2007 or at the latest 2008 Bulgaria and Romania will join the EU leading to an EU of 27 Members. Travelling through Europe one can enjoy a variety of landscapes and cultures realizing that farming in the EU is very different amongst the member countries. Data from 2003 shows, that there are around 9.9 million farm holdings in the EU. The average farm size was 15.8 ha. The share of employment in agriculture, forestry, hunting and fishing was 5% of the employed civilian working population whereas the share of agriculture in GDP was only 1.6 %. The average farm size in the UK is 57.4 ha, in Austria 18.7 ha and in Italy 6.7 ha. In Poland 17.6 % are employed in agriculture, in France 4.0 % and in the UK 1.3 %.[7] Eurostat data from 2003 indicates that the majority of European holdings (EU-25) are still relatively small in size, with 45% of all holdings using less than 5 ha of agricultural area. The highest shares of holdings smaller than 5 ha can be found in Malta (97%) and in Cyprus (80%), followed by Greece

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[7]European Union web site; Agricultural Statistics
http://europa.eu.int/comm/agriculture/agrista/2005/table_en/2012.pdf (downloaded 06.05.05)

(70%), Italy and Portugal (both 69%) whereas the highest shares of holdings above 100 ha can be found in the United Kingdom (22% of all holdings), Czech Republic (17%), Denmark (16%), France, Luxembourg and Slovakia (15% in each), and in Sweden (13%). In the NMS-10 (New Member States), the importance of the mixed holdings (specialised in mixed cropping, mixed livestock or mixed crop-livestock) is relatively high: 58%, whilst in the EU-15 it is only 16%. Across Member States, the highest share of arable land can be found in Finland (99%), followed by Denmark (93%), Malta (87%) and Sweden (85%); on the opposite side of the scale, the smallest shares of arable land were in Ireland (27%) and in Slovenia (37%).[8] The growing season is about 140 days in Finland but over 300 days in many Member States. The average dairy herd size ranged between 9 and 18 cows in Portugal, Greece, Austria, Spain and Finland but was 65 in Denmark and 72 in the UK (EU-15, 26 cows) in 2000.[9]

UN-COMMON AGRICULTURAL POLLICY

These figures are of high importance because they prove that European farmers do not face the same production conditions. Therefore they face different obstacles. Any Common Agricultural Policy has to be "un-common enough" to be supported by its farmers, citizens and politicians. If it fails to do so it will not only miss its objectives but might also face a gloomy future. European Agriculture has a variety of common purposes and roles to fulfil but is clearly diverse in many ways; be aware!

[8] Eurostat, European Commission, Agricultural Statistics, Quarterly Bulletin, Farm Structure Survey 2003, http://epp.eurostat.cec.eu.int/cache/ITY_OFFPUB/KS-NT-05-S01/EN/KS-NT-05-S01-EN.PDF p 22, (downloaded 12.05.05)

[9] Kola, J. (2003, July 1st-4th). Non-common agricultural policy of the EU: implications for the present and future member states and policies. In: Niemeläinen, O. & Topi-Hulmi, M. (eds): Proceedings of the NJF's 22nd Congress "Nordic Agriculture in Global Perspective", Turku Finland (409 p.): 167-168.

1.1.2 Is Farming in a crisis?

DOES A FARM PROBLEM EXIST?

Mr. Fischler, former Commissioner for Agriculture and Rural Development is confident and says: "I have no doubt that we should be optimistic about our rural areas".[10] Andreosso-O'Callaghan in contrary talks, in her book on "The Economics of European Agriculture", about a problem: "The interplay of demand and supply characteristics explains why producer prices and incomes have declined over the last decades; this situation epitomizes what is known as the farm problem".[11] Is the statement by Mr. Fischler a typically visionary-positive and political one and the statement by Andreosso-O'Callaghan a more academic-rational description of farming?

HALF A MILLION FARMS CLOSED IN 5 YEARS

Looking at the facts, this so called "farm problem" can genuinely be observed all over Europe. Scores of farms close down every year. "In Austria, 18.5 farms have been closed daily over the last four years"[12] One can use this very alarming figure to make some telling calculations. In 2003, there were 174,000 farm holdings in Austria. Every year 6,750 farms are being closed down. If this trend continued, Austria would not have a single farm remaining in around 30 years. Of course, this is unlikely to happen because the small farms which are given up are cultivated and run by expanding, "land hungry", bigger farms and

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[10] Fischler, F. (2003, November 12th-14th), Europe's rural areas – an invaluable asset for us all, Second European Conference on Rural Development, Planting seeds for rural futures, Salzburg, European Commission, DG Agriculture, p40

[11] Andreosso-O'Callaghan, B., (2005), The Economics of European Agriculture, Palgrave MacMillan, p. 66

[12] Wohlmeyer, H., (6/2005) Wider die Zukunftskriminellen, Agrarische Rundschau; p18; I highly recommend this excellent article by a visionary and holistic thinker at the "Universität für Bodenkultur Wien"

therefore there will be always a few big farms remaining. Nevertheless the countryside would be deserted, left with a few industrial-type farms, in favoured regions where this type of growth would be possible. Within the EU-15 the number of farm holdings has decreased by almost half a million (8%) between 1999 and 2003 which is a continuation of the trend already observed over the previous decade.[13] Is Mr. Fischler wrong or overly optimistic, and should he not also be a bit more pessimistic or let's say realistic? The question is how poor are farmers really and how much do they struggle for survival? The Observer claimed that "most farmers who receive subsidies earn above the average for their country. The average French farmer earns 60 per cent more than a non-farmer"[14]. Is he so optimistic about the rural areas because he believes farmers are so wealthy? More likely is that he was a politician by the time he put forward this quote, and his responsibility as Commissioner for agriculture was to find solutions to the problems and challenges faced by farmers and rural areas. He is probably aware of the importance food producers have and will have in the future for providing city people with foodstuffs and a clean and friendly country side. By pushing through the 2003 reform of the CAP he certainly did try to find solutions for rural areas and farmers and throughout the next year we shall see what effect the new system of uncoupled direct aids, cross-compliance and modulation has on rural areas and farmers.

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[13] [13] Eurostat, European Commission, Agricultural Statistics, Quaterly Bulletin, Farm Structure Survey 2003, http://epp.eurostat.cec.eu.int/cache/ITY_OFFPUB/KS-NT-05-S01/EN/KS-NT-05-S01-EN.PDF, p18, (downloaded 12.05.05)

[14] The Observer (2005, June 19th) How Europe Cheats Africa http://observer.guardian.co.uk/business/story/0,6903,1509560,00.html (visited 25.05.2006)

EUROPEANS PLEASE DECIDE!

Europeans have to decide if they are happy with this sort of structural change. If they do not mind fewer but bigger farms they have to say so and the elected politicians have to find policies to promote this process. If the EU wants to keep its family sized farming the policy will have to be adapted to these small farm holdings. The question is if the latest CAP reform had a clear aim and if so if the modifications made will prove to be sufficient? If citizens of the EU want to keep family sized farms in business they have to reflect and debate what can be done to prevent the decline of the number of farm holdings and more importantly what are they prepared to pay for it, either through their tax money used for governmental aid or through paying higher prices for locally produced high quality food?

CREATIVE FORCES ARE NEEDED

What would have to be changed? Mr. Fischler has got an answer: "A European farming culture that clings to tradition would soon degenerate into some sort of vast agri-museum. It is only when creative forces are still at work, and when those involved in agriculture continue to search for new answers to the changes taking place around the world, that agriculture will stay economically vital and keep on making a valuable social contribution".[15] Mr. Fischler is talking about creative forces to find answers for the current problems. These creative forces can come from farmers, communities, governments or the EU. "A cornerstone of Europe's new drive to reform its agrarian system has to be a general acceptance by society of the economic value and achievements of the farm sector."[16] After WWII one of the main objectives of EU intervention was to provide people

[15] Fischler,F. (2006, Spring) Why CAP reform is on track, Europe's World, p 118
[16] Fischler,F.(2006, Spring) Why CAP reform is on track, Europe's World, p 119

with enough food at a low price. Nowadays the EU produces enough food to provide for its people. What the public needs is a broad discussion about what they expect from farmers in the EU and how much the National Governments and the EU should intervene in agriculture. At the end of the day it is the taxpayer providing the means for State intervention, and it is the consumers suffering from too high food prices, lacking supply or low quality.

1.1.3 Farmers in the 21st century - An aging group of idealists?

WHERE ARE THE YOUNG AND DOES SIZE MATTER?

55 per cent of farmers in the EU-15 are over 55 years old.[17] Nearly half of the holders (46%) in the EU-25 were older than 55 years.[18] Is farming dying out? In the future farms might be run by a few wealthy and skilled businessmen, hiring managers to do the administration tasks and cheap labour to do the manual work.

Europe's farms are run by retired folk or people close to retirement. There is substantial variation across Europe concerning its agricultural workforce. The labour input of the holder and his family make up over 90% of the total annual work unit (AWU) in Poland, Austria, Ireland and Slovenia, whereas it was of much less importance in the Czech Republic and Slovakia (17% and 14%, respectively). One AWU corresponds to the work performed by a person undertaking fulltime agricultural work on the holding over a 12 month period. The yearly working time of such a

[17] Wolf, J., (2002) The Future of European Agriculture, CER, p22

[18] Eurostat, European Commission, Agricultural Statistics, Quarterly Bulletin, Farm Structure Survey 2003, p 25

worker is 1,800 hours (225 working days of 8 hours per day).[19] Eurostat has shown that in both the old and the new Member States the age structure of the holders, according to the farm size, was similar: the share of holders older than 65 decreasing with an increase in the economic size of the holdings.[20] What will happen if the trend continues that young people are not willing to take over and continue farms? A bunch of highly motivated youngsters might rent as much farm land and quota as they can and run industrial style farms; already today 15 per cent of farms produce 70 per cent of the EU's agricultural output.[21] But would it be so bad if this trend continues and only a small percentage of today's farms produced all the food needed? The countryside and social environment in rural areas would change dramatically. But maybe this sort of structural change is necessary! Growth and expansion might be the way forward for the few young farmers running profitable farms and staying in business. Often structural change in the countryside is being talked about. But what is it we desire? To some extend this sort of transformation is inevitable and fruitful. But will these bigger farms continue producing safe food and protecting the environment? There is no clear cut dogma proving that smaller farms produce in general more environmentally friendly and safer food. Rural Studies at Germany's Federal Agricultural Research Centre showed that farm size was not the most important factor in the environmental impact of agriculture.[22] What, on the other hand will happen with the labour force set free during such a process? During this transformation and beyond it, the EU can have a guiding function. What role does and should the EU play? First of all, the citizens have to reflect

[19] Eurostat, European Commission, Agricultural Statistics, Quarterly Bulletin, Farm Structure Survey 2003, p 25
[20] Eurostat, European Commission, Agricultural Statistics, Quarterly Bulletin, Farm Structure Survey 2003, p 26
[21] See Wolf, J. for details
[22] See Wolf, J. p 27

what type of European agriculture they want and if they are prepared to pay for it. If Europeans want family sized farms, producing also in less favoured areas, then these farms might only stay in business if they are supported. Young farmers might not merely need aid as incentives to stay on their home farms but also require aid for their survival due to the less favourable and harsh working conditions they have to put up with. Young farmers might need more guidance and positive signals to continue such businesses. On the other hand, Europeans might want structural change towards bigger farms, needing less aid or no governmental protection at all. These farms might even do better without regulations and limitations, i.e. quotas, enforced on them by the CAP. But a "bigger and fewer" type of structural change would have its drawbacks concerning unemployment, rural character, landscape and production methods. But as Ms Wolf puts it in her book on "The Future of European Agriculture": "there is a need to look beyond the big is bad, small is good view when devising policies"[23]

AVAILABILITY OF SUPPLY AT REASONABLE PRICE

Whatever politicians consider during the review 2008/9 it will have to coincide with a public debate. The officials in Brussels should only design a policy that can and will be supported by the European citizens. Policy makers have to be aware that the CAP is financed by tax money and not only designed for farmers benefit, i.e. Article 33 of the TEC lays down availability of supplies and reasonable prices for consumers as two objectives of the CAP. It has been created to be beneficial for farmers and consumers. If Europeans want to support family sized farms, they should say so and stick to it. No matter which policy will be in place, young people will be the key to a viable and functioning European agriculture.

[23] See Wolf, J., p 26

Politicians, policy makers, officials, citizens and farmers should keep that in mind. The young are not to be forgotten!

1.2 The Common Agricultural Policy (CAP)

1.2.1Historic overview

THE MAKING OF

The Treaty of Rome defined the general objectives of a Common Agricultural Policy. The principles of the CAP were set out at the Stresa Conference in July 1958. It is often said that the CAP was part of a pact between Germany and France. This is important, because this argument is still often used in various political debates concerning the CAP, but Ms Rieger argues in the book, The Policy-Making in the European Union, that: "The much repeated assertion that there was a political bargain between the industrial interests of Germany and the agricultural interests of France should be laid to rest. The record provides no evidence for this …".[24] In 1960, the CAP mechanisms were adopted by the six founding Member States and two years later, in 1962, the CAP came into force. The legal basis of an agricultural policy for the whole Community is defined in Articles 32 to 38 in Title II of the TEC.[25] The CAP regulates the production, trade and processing of agricultural products in the EU, with attention being focused increasingly on rural development. "The Common Agricultural Policy has always been of central importance to the functioning of the EU. This is so whether it is viewed from a political, economic, administrative, or legal perspective"[26] The objectives of the CAP are: (a) increase in agricultural productivity by promoting technical

[24] Rieger, E. (1996), The Common Agricultural Policy: External and Internal Dimensions. P. 97-123 in: Helen Wallace, William Wallace (Eds.) Policy-Making in the European Union. Oxford
[25] EU web site, Agriculture, Common agricultural policy: from the beginnings to the present day, http://europa.eu.int/scadplus/leg/en/lvb/l04000.htm (downloaded 10.05.06)
[26] Cardwell, M., (2004) The European Model of Agriculture, Oxford University Press, Preface

progress and by ensuring the rational development of agricultural production and the optimum utilization of the factors of production, in particular labour; (b) thus to ensure a fair standard of living for the agricultural community, in particular by increasing the individual earnings of persons engaged in agriculture; (c) to stabilize markets; (d) to assure the availability of supplies; (e) to ensure that supplies reach consumers at reasonable prices.[27] Article 34 of the EC Treaty provides for the creation of the common organization of the agriculture markets (COM). The CAP is financed from the European Agricultural Guidance and Guarantee Fund (EAGGF).

SEVERAL REFORMS

The CAP was reformed various times; it underwent a major reform in 1992. The so called MacSharry Reform included a major cutback of agricultural prices, the compensation of farmers for loss of income, as well as other measures relating to market mechanisms and the protection of the environment. The Agenda 2000 was the most radical reform of the CAP; it included amongst many other things the formation of a new policy for rural development, which became the second pillar of the CAP and the integration of more environmental and structural considerations into the CAP. The June 2003 reform included the decoupling of single farm payments from production, compliance with certain food safety and environmental standards (cross-compliance) and the gradual reduction of direct payments (modulation) to finance the rural development policy. The CAP nowadays consists of two pillars. Pillar 1 comprising market and income support covering direct payments to farmers and continuing market-related subsidies. Funding for Pillar 1 measures comes from the

[27] European Union, EuroLex, Consolidated Version of the Treaty establishing the European Union, Article 33, http://europa.eu.int/eur-lex/en/treaties/dat/C_2002325EN.003301.html (visited 29.04.06)

EAGGF Guarantee section. The second Pillar is dedicated toward rural development aiming at encouraging environmental services, providing assistance to difficult farming areas and promoting food quality, higher standards and animal welfare. These measures are jointly funded (co-financed) by the EU and by Member States.

1.2.2 The EU citizens and the CAP

WHAT DO CIZENS EXPECT?

Do farmers and citizens benefit from the CAP? What do citizens expect from the CAP? In a recent Eurobarometer survey 37% of people asked agreed that the CAP ensures the food that consumers purchase is safe, 32% agreed that it ensures that the food they eat is of good quality and 23% thought that it ensures that the food they buy is reasonably priced. Citizens in the 25 EU Member States were asked for their opinion on which should be the three main priorities of the EU in terms of agricultural policy. 32% of the people said that it should ensure stable and adequate incomes for farmers, 26% said that it should ensure that agricultural products are healthy and safe and 23% that it should promote the respect of the environment.

People were told that the European Union is subsidising agricultural products less and less. However, it is granting more funds for the protection and development of the overall rural economy and for direct support to farmers and asked what they think of that development. A majority of 60% of EU citizens of the EU 25 believe that these developments are a good thing and remain therefore positive about the latest CAP reform.[28]

The shift to uncoupled direct income support seems to meet the public priority for adequate income for farmers (32% of people asked), but whether direct aids are the best form of help for farmers in the long run is uncertain and contested. The recent CAP reform puts an emphasis on cross-compliance meaning that as a result of the June 2003 agreement farmers will have their subsidies reduced if they do not follow EU rules on protection of the environment, animal welfare, and public, animal and plant health. Cross-compliance is now compulsory and all farmers receiving direct payments will be subject to cross-compliance.[29] The compulsory introduction of cross-compliance meets the prioritised food safety and quality issue (26% of people asked) as well as environment protection (23%). In the future the public opinion will and should greatly determine what will become of the CAP.

1.2.3Multifunctional Agriculture

FUNDAMENTAL DIFFERENCE

The EU Commission proclaimed in 1998: "The fundamental difference between the European model and that of our major competitors lies in the multifunctional nature of Europe's agriculture and the part it plays in the economy and the environment, in society and in preserving the landscape, hence the need to maintain farming throughout Europe and to safeguard farmer's incomes"[30] "Behind multi-functionality is the idea that agriculture, in addition to producing food and fibre, produces a range of

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[28] European Commission, Special Europarometer: Europeans and the Common Agricultural Policy, January 2006

[29] European Commission, DG Agriculture, The common agricultural policy – A policy evolving with the times, http://ec.europa.eu/comm/agriculture/publi/capleaflet/cap_en.htm

[30] Commission of the European Communities (1998), Proposals for Council regulations (EC) concerning reform of the common agricultural policy, COM(1998)158 CEC: Brussels

other non-commodity outputs such as environmental and rural amenities, and food security and contributes to rural viability"[31]. Within the World Trade Organization (WTO) the term Non-Trade Concerns (NTCs) is used as a synonym for multi-functionality.

The question arises if these non-commodity products have a price and if farmers should be rewarded for them? If yes who should pay for them? Ms Fischer Boel, Commissioner for Agriculture, announced that: "The EU has a strong rural flavour. Rural areas cover more than 90% of our territory and are home to more than 50% of the population. When they are in poor health, the Union as a whole is in poor health"[32] These figures highlight that it is simply not possible to diminish the importance of farming to figures concerning employment in agriculture and share in gross national product (GNP). At the first International Conference on Non-Trade Concerns in Agriculture held at Ullensvang in Norway, the European Commission put forward the four main non-trade concerns associated with agriculture: (a) conservation of biological diversity, (b) maintenance of farmed landscape, (c) preservation of cultural features and (d) protection against disasters.[33] The value of non-commodity outputs as a by-product of multi-functional agriculture is difficult to evaluate as multi-functionality is a complicated concept, difficult to grasp and impossible to put into a simple scheme. However, agriculture might have negative effects as well. "Agricultural nutrients, pesticides, pathogens, salts, and eroded soils are leading causes of water quality

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[31] OECD, Directorate for Agriculture, Fisheries, http://www.oecd.org/department/0,2688,en_2649_33779_1_1_1_1_1,00.html (visited 29.04.2006)
[32] Fischer Boel, M. (2006, March 6th) Speech /06/142, European agricultural policy in a changing environment, Wellington, http://europa.eu.int/rapid/pressReleasesAction.do?reference=SPEECH/06/142&type=HTML&aged=0&language=EN&guiLanguage=en
[33] Swinbank, A. (2001, November 29th) Multifunctionality: A European Euphemism for Protection?, The University of Reading, FWAG Conference, Multifunctional Agriculture – A European Model. Stoneleigh, p 8

problems in many countries. Water used for irrigation in agriculture is water unavailable to nonagricultural sectors or ecosystems. There is concern about the negative effects of livestock production on animal welfare"[34] Farming can be done in a multi-functional, sustainable and environmentally friendly way or just the contrary. The choice of the farmer will depend on norms and laws as well as policy incentives and morals. Expecting farmers to automatically follow the "good" way is utopic. The citizens of the EU and its representative politicians have to decide if they leave the choice entierly up to the farmers or if they give them incentives to follow enironmentally friendly and sustainable production methods. Non commodity outputs might have been free of charge in the past, but farmers will not always be willing or able to provide these for free. To oblige farmers to produce in an environmentally friendly way through norms and regulations might be an option but politically it is hard to persue and discouraging for the farming coummunity, only accelarating the trend of ever more farms closing down.

2 Challenges

Today, the EU and its CAP face three big challenges:

- The financing of the CAP is becoming increasingly difficult
- The usefulness of farm subsidies is increasingly questioned in general
- The EU faces enormous pressure in the WTO negotiations towards abolishing all sorts of trade distorting subsidies

[34] Abler, D. (2004, April) Multifunctionality, Agricultural Policy, and Environmental Policy, Agricultural and Resource Economics Review

IS CHANGE LIKELY?

According to Jack Thurston: "The prospects for radical CAP reform look bleak"[35] There is strong resistance to change; especially the French-led coalition is more united than the group that favours reform. "In theory, EU ministers decide on agriculture issues by qualified majority voting (QMV). In practise, however, consensus is the general rule"[36] This behaviour leads us back to the year 1966. France decided not to take part in Council proceedings. This led to the "empty chair crisis". The Luxembourg compromise, signed on 30 January 1966, ended the crisis by providing that: "Where, in the case of decisions which may be taken by majority vote on a proposal of the Commission, very important interests of one or more partners are at stake, the Members of the Council will endeavour, within a reasonable time, to reach solutions which can be adopted by all the Members of the Council while respecting their mutual interests and those of the Community"[37] This has no legal force, in that it does not modify the Treaty but the resulting tendency to seek unanimity has considerably slowed down decision-making.[38] Decision making is slow and the Members of the Council are simply much less inclined to work towards a compromise knowing that they can claim that "very important interests" are at stake and veto decisions. If Members of the Council feared being overruled they would be more likely to bargain and accept a compromise. As long as the European Union stands by the Luxembourg compromise of 1966, major reforms will be difficult especially within the CAP where interests are often very diverging. Observing the negotiations

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[35] Thruston, J. (2005, December) Why Europe deserves a better farm policy, Center for European Reform, policy brief, p 1
[36] Thruston, J. (2005, December) Why Europe deserves a better farm policy, Center for European Reform, policy brief, p 1
[37] European Union, Europe Glossary, http://europa.eu.int/scadplus/glossary/luxembourg_compromise_en.htm (visited 01.05.06)
[38] European Parliament, Fact sheet, Council, http://www.europarl.europa.eu/factsheets/1_3_6_en.htm (visited 12.05.05)

over the financial perspectives 2007 – 2013 has made clear how complicated it was to reach a compromise. Only if all Member States accept the existence and use of QMV to its full extend as agreed upon in the treaties, will the EU have a real prospect for progress. Unanimous decision taking among 25 Member States is a "nightmare". The EU will clearly not be able to face the challenges of the 21st century if it continues to respect the 1966 Luxembourg compromise. Adjustment is needed!

BE PREPARED FOR THE REVIEW

The CAP will be reviewed in 2008 and everybody should be prepared for another long lasting and intense debate. The problems encountered in 2005 did not disappear and were largely unsolved. They will be faced again in 2008 and real solutions should be found. The review should be used wisely to get necessary reforms done; still under this financial period. But this review ought to be also used to consider necessary reforms and change for the next financial perspective and the EU should start drafting and designing new policies so that they can be in place by 2014. The CAP has been explicitly included in this review. It is imperative that the EU listens to its citizens, engages in a debate on the CAP with experts and puts down clear objectives. It then has to agree on a financing mechanism that all Member States can live with and afford.

SUBSIDIES CAPITALIZE ON LAND VALUE

Subsidies have been in place for a long time, and radical change is unlikely. Mr. Greenspan gives the main reason for that in a speech held at a conference on rural policy on March 25th and 26th 2004 at Airlie Center near Washington D.C.: "It is very important to remember, that once subsidies have been implemented and continue to exist on an ongoing basis the value of land begins to capitalize on the subsidies. And ones subsidies begin to capitalize on the land you begin to create a distortion in the structure of the use of land and it then becomes exceptionally difficult to unwind the subsidies"[39] He than argues that the "introduction of farm subsidies should be carefully considered as the long-term implications are exceptionally negative". Since subsidies are already in place in the EU it might be difficult and also unwanted to withdraw them altogether. Although what can be done is change the way the government subsidizes, guaranteeing that tax payers get most value for money and farmers are actually helped in the long term. Any reform, especially radical change has immense implications for farmers. They take subsidies into account when they calculate and plan their investments for the future. It is not a desirable or fair task to reform a policy every few years. But this has been happening over the last two decades.

FAIR AND FLEXIBLE CAP

What is necessary, fair and efficient is to create a policy that is designed in a flexible way so that Member States, regions and even farmers have room for manoeuvre. "The role of policy makers is to design a policy that accommodates the varying circumstances across rural areas, avoiding a one size fits all approach for development"[40]. The EU is facing a far reaching crisis concerning the financing of its agricultural policy. When it comes to paying, Member States are less enthusiastic about solidarity and cohesion than they are rhetorically or in principle. Creating a fair and functional system of CAP financing is crucial for its acceptance, survival and effectiveness. In 2008/9 this will be the hot topic and answers are to be found.

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[39] OECD (2005), New approaches to rural policy, Alan Greenspan, Think Regionally in a Globalizing Economy

[40] OECD (2005), New approaches to rural policy

2.1 Challenge Nr. 1: Financing of the CAP

FINANCIAL SOLIDARITY

In article 34 of the TEC the three main principles of the Common Organisation of Agricultural Markets were laid down. The third of these principle is financial solidarity, implying that all expenses and spending which result from the application of the CAP are borne by the Community budget.[41] In order to enable the common organisation to attain its objective one or more agricultural guidance fund may be set up.[42] In 2004 the EU allocated € 92 billion to the Member States. Agriculture and rural development allocations to Member States constituted 47.5 % (€ 43.6 billion) of the total allocated expenditure in 2004.[43] "Yet the share of the budget devoted to CAP spending has fallen sharply: 20 years ago, it was 70%"[44] Britain, who gets few farm subsidies wants them cut even further, France as a big net recipient is determined to preserve them. During the negotiations for the financial perspective 2007-2013 it was evident that the EU budget was in a critical state if not to say in a crisis. France insisted on the October 2002 EU summit deal to keep spending on the CAP unchanged until 2013. Great Britain insisted on keeping its rebate. But Britain will give up around one-fifth of its budget rebate which is attributable to the cost of EU enlargement to the East. On the other hand France accepted the proposal for a review of the entire budget in 2008. The EU budget is still in a critical state and the review will bring up problems that have been pushed aside in 2005.

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[41] Altomonte, C., Nava, M., (2005) Economics and Policies of an Enlarged European Union, Edgar Allan Publisher, p 239

[42] Treaty establishing the European Community, Article 34

[43] European Commission, Press Room, First budget of enlarged EU benefits all Member States. Main beneficiaries remain the same, Brussels, 22 September 2005, http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/05/1175&format=HTML&aged=0&language=EN&guiLanguage=en (visited 12.05.05)

[44] The Economist (2005, December 8th) Europe's farm follies

COMMON INTERESTS

It was remarkable how much time and effort it took to draft the latest financial perspective. The Economist is very clear about it: "This budget was a characteristic exercise in national self-interest and splitting differences"[45] The constant battle over the CAP is notorioius and it grows with ever more Member States. European agriculture is not the same, not even similar amongst its Members, but it is dealt with through a common policy. Naturally this creates tensions and conflicts of interest. A way out of the dilemma without disovling the EU is difficult to find. When it comes to paying, the Member States are more concerned about their own benefit and interests than about a genuine solution. The EU is built on the belief of common interests and that certain things can be dealt with more efficiently at a supra-national level. The EU Member States have to be certain about their common interests, define them and persue them in a co-operative fashion. If there would be no common interests the EU would not be needed. And if these common interests are not definable or simply not being defined and if co-operation is not possible the EU can not function and European Integration will be reduced to a rhetoric concept.

CHIRAC-SCHROEDER DEAL IN 2002 MADE THINGS DIFFICULT

In this thesis possible ways out of the current financial crisis will be evaluated. The Economist goes straight to the point in its article about the EU budget compromise: "The biggest failing remains the CAP"[46]. The Commission is aware of the problem and has experts at hand. A 2003 report by a group of experts led by André Sapir, a Belgian economist, called it an "historical relic". The Sapir report suggested a rethink,

[45] The Economist (2005, December 20th) The European Union summit, Cries and gestures
[46] The Economist (2005, December 20th) Brussels fudge

including scrapping CAP spending[47]. Of course the biggest obstacle during the 2005 negotiations was the famous deal of 2002. France's president, Jacques Chirac, persuaded the German chancellor, Gerhard Schröder, to agree to keep CAP spending unchanged until 2013.[48] An EU summit unanimously endorsed this deal, so the Commission had to stick to it in its financial perspective. As the CAP takes up around 40 % of the EU budget, little room was left for real negotiations. A financial perspective was agreed upon in December 2005 but the debate about the CAP and its future financing has just been posponed until 2008 when the financial perspective including the CAP will be reviewed. Interesting times lie ahead of us. It is not only about less or more CAP spending. The CAP is the only enitre common policy of the EU and therefore what its future looks like is crucial

REVIEWING THE EU

The review in 2008/9 might lead to much more than just a debate on financing issues. This review will be most likely be a debate, on the EU itself. Topics like subsidiarity, legitamcy, transperency and efficiency will certainly be discussed. The CAP creates emotions because Member States have been giving up power to the EU and still have difficulties accepting its implications. Once power is transferred to a higher level of governance it leaves the lower entities in a weaker and sometimes vulnuralbe state, leaving a bitter after taste.

[47] The Economist (2005, March 3rd) The battle of the budget

[48] The overall expenditure in nominal terms for market-related expenditure and direct payments for each year in the period 2007-2013 shall be kept below this 2006 figure increased by 1% per year. http://ue.eu.int/ueDocs/cms_Data/docs/pressData/en/ec/72968.pdf (visited 01.05.2006)

REVIEW WISELY

Farming might contribute little to econimic growth and GNP, but it provides food for around 450 million Europeans and the EU spends a vast amount of money on the CAP and a lot of time on legislation relating to agriculture. Farming might not be important in simple statistical terms but it certainly plays a crucial role in any society. The financing of the CAP will determine the future of European farmers, rural areas and consumers. The EU should use this review wisely and every Member State is advised co-operate, prioritizing common interest!.

2.2 Challenge Nr. 2: Farm subsidies – what for?

ECONOMIC VALUE OF THE ENVIRONMENT?

John Maynard Keynes[49] heavily critisised the narrow thinking of economists and politicians of his time, leading to the disastrous events in the inter-war period[50]: "We have until recently conceived it a moral duty to ruin the tillers of the soil and destroy the age-long human traditions attendant on husbandry, if we could get a loaf of bread thereby a tenth of a penny cheaper. There was nothing which it was not our duty to sacrifice to this Moloch and Mammon in one; for we faithfully believed that the worship of these monsters would overcome the evil of poverty and lead the next generation safely and comfortably, on the back of compound interest,

[49] John Maynard Keynes is doubtlessly one the most important figures in the entire history of economics. He revolutionized economics with his classic book, The General Theory of Employment, Interest and Money (1936). This is generally regarded as probably the most influential social science treatise of the 20th Century, in that it quickly and permanently changed the way the world looked at the economy and the role of government in society. No other single book, before or since, has had quite such an impact http://cepa.newschool.edu/het/profiles/keynes.htm (visited 13.05.05)

[50] Wohlmeyer, H., (2005) Die gegenwärtige Gesellschaft-, Wirtschafts und Agrarpoliitk im Lichte des Rückblickes aus der Zukunft, Zukunftskriminalität oder Blindheit?!, in Land in Gefahr, Leopold Stocker Verlag, Graz-Stuttgart, p 123

into economic peace"[51] We find similar types of arguments nowadays made by high-ranking officials like Mr. Fischler. He believes that nobody should be fooled into thinking that the deserting of rural areas will have no consequential costs.[52] Keynes also reflected very interestingly on the phenomenon of multi-functionality which as a concept arose in the 1990s and has been heavily debated ever since: "…The same rule of self-destructive financial calculation governs every walk of life. We destroy the beauty of the countryside because the unappropriated splendors of nature have no economic value". National self-sufficiency, in short, though it has a cost, may be becoming a luxury which we can afford, if want it.

FARM SUBSIDIES HAVE BEEN DECLINING

"Farm subsidies, measured as a percentage of the value of farm output, have been declining in most places since the late 1980s. But they are still enormous. The EU spent $121 billion suporting agriculture in 2003, while America spend $39 billion on its farmers. Japan, Norway and Switzerland all provide farm subsidies that are worth well over half of national output"[53] Producer Support Estimate (PSE) in the EU decreased from 41% in 1986-88 to 34% in 2002-04 compared to an OECD average of 30%. Support decreased in 2004 to 33% for the EU25.[54] These figures highlight that farm subsidies are not an EU phenomenon even though the EU aids its farmers with 33% PSE slightly more than the OECD average of 30% PSE. They are widespread amongst many countries and have been in place for several decades.

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[51] Keynes, J.M. (1933, June) "National Self-Sufficiency," The Yale Review, Vol. 22, no. 4 , pp. 755-769, http://www.mtholyoke.edu/acad/intrel/interwar/keynes.htm (visited 04.05.06)
[52] Fischler, F., (2005) Land in Gefahr: Damit wir Zukunft haben, in Land in Gefahr, Leopold Stocker Verlag
[53] The Economist (2004, July 1st) Agricultural subsidies
[54] OECD, (2005) Agricultural Policies in OECD countries: Monitoring and evaluation 2005, p126

HOW TO VALUE NON-COMMODITY OUTPUTS

There are constant discussions about why agriculture is still so highly protected and if it should continue this way. There is no clear cut answer to this question. Evaluating the quote by John Maynard Keynes written in his book on "National Self-Sufficiency" shows that disputes and misunderstandings concerning agricultural subsidies arise because the "splendors of nature have no economic value". The EU committed itself to promoting and subsiding multi-functional agriculture providing and sustaining this "splendor of beauty". The problem policy makers and politicians are facing is excactly what Keynes said. Multi-funcional non-commodity outputs seem to have no economic value and if so this value is higly difficult to calculate. Many are aware that non-commodity outputs provided by farmers have their value and are favouring governmental aid. An additional argument for subsidies is, that States and the EU are aware of the strategic importance of farming and self-sufficiency in food production. Remaining self-sufficient has its price which countries are often willing to pay. A rather personal and emotional argument for subsidies is that many people still have links to agriculture through their parents or grantparents. They see governmental intervention in agriculture not as lost money but conect it with real people and real places benefiting from these aids. There is also a strong attachment to nature and rural nostalgia, causing some people favoure aid.

SPECIFIC ECONOMIC NATURE

Agricultural economists, like Andreosso-O'Callaghan, give a very technical but explainatory answer as to why subsidies are in place: "The rationale for government intervention in agriculture stems from the specific economic nature of the agricultural sector. Supply is highly unpredictable, because of natural phenomena, and demand is not very responsive to price and income changes. It is also expained by socio-political and strategic considerations"[55] Governmental intervention in agriculture has reasons and objectives. The EU objectives are laid down in Article 33 of the TEC. All Member States who have joined the EU have signed this treaty, therfore accepted its content. It is important to note that the CAP did not create governmental intervention in Europe. National governments were highly intervening in farming prior to the establishment of the CAP. If farm subsidies promote a viable country-side and a clean environment then people living in cities might be inclined to favour them. Citizens might be willing to pay for the "splendors of beauty"[56] if they were aware of the fact that farmers provide it and if they genuinly believed that this is not a service free of charge. The economic value of multi-funcional, non-commodity outputs might be difficult to put into exact figers but if policy makers and citizens are convinced that these values exist, farm subsidies are to a certain extent justified. Some might even believe that a clean environment and healty food is priceless or invaluable. If these multi-functional, non-commodity outputs are invaluable, the EU should grant aid to farmers and rural communities to an extent that will secure their future existance. And in a certain way this approach has been taken in the TEC by stating in Article 33 that one objective of the common agricultural policy shall be to ensure a fair standard of living for the agricultural community, in pariturlar by increasing the individual earnings of persons engaged in agriculture.[57]

[55] Andreosso-O'Callaghan, B., (2005) The Economics of European Agriculture, Palgrave MacMillan, p 86
[56] See Keynes (1933)
[57] TEC, Article 33

HELPING TO HARM THE EVIRONMENT?!

But what if farm subsidies are harmful to the environment? If this is so, they would not ensure a clean countryside and healthy food, but would promote the opposite which can not be anybody's intention. The EU has to make sure that its aid does actually favour environmentally friendly farming and that farmers receiving aid, produce food of high quality and put high empahsis on environmental protection and animal wellfare. The OECD developed a list of obstacles standing in the way of reform of environmentally harmful subsidies. One of them is the "establishment of a culture of "entitelment" to subsidies"[58] These subsidies become capitalised into the value of land and are therefore hard to break. The EU has taken a great step forward in its 2003 reform. It has not taken away subsidies but it has made them subject to cross-compliance, meaning that only farmers obeying strict rules concerning the environment, food saftey and animal welfare are entitled to receive them. But, these environmentally friendly subsidies are now twice as hard to get rid of. Firstly, they created a feeling of "entitlement", and secondly they are "good for the environment".

ARE SUBSIDIES REALLY NECESSARY?

The sort of subsidies currently in place could only be removed by proofing that farmers do not actually need or deserve them. Brian Gardner, editorial director of Food Policy International, argues that "agriculture is no different from any other industry. Subsidies are not needed to protect the enviornment, encourage good animal welfare or maintain food standards. Like other businessmen farmers will perform these functions unaided by the State to fulfil their normal undertakings to their

[58] OECD (2005) Environmentally Harmful Subsidies: Challenges for Reform, p 10

customers"[59] Can farmers be expected to fullfil all these roles without governmantal intervention and help, or can States or the EU "force" farmers to deliver a clean environment and healty food by creating the necessary norms and juridical framework? Might farmers deliver these non-commodity outputs anyway even if non-subsidised? In business it is often not a question of what is desirable or not; it is about profit making. If farming is like other businesses it would logically follow the same laws guiding "ordinary" businesses. Farmers opting for profit maximisation would obey the law to the minimal extent necessary, might sometimes bend it, but byond that they would do everything possible and necessary in order to maximise profit. The question arises if this would be in harmony with food safety, environmental protection and sustainabiltiy. Responsible farm holders are likley to choose a sustainable production way because they are usually inclined to pass on a viable, functioning and intact farm to their offspring. Farms in Europe are mainly passed on from generation to generation because the majority of farmers are the owners of their land. This is a clear difference to "ordinary" businesses. They are often also passed on, but in many cases they are sold, merged with other companies or split amongst various family members. This is not common practise in agriculture and there are good reasons for it. Industries are obliged to fullfil certain environmental norms. Why should farmers not be obliged to do the same without any aid? The question is, if this sort of pressure can be applied to farmers?

[59] Gardner, B. (2006, Spring) On track maybe but far from over, Europe's World, p 123

CITIZENS ARE PAYING!

The EU and its decision making are overwhelmingly burdened by the CAP since the share of the CAP of all decisions of the EU is still 40 %[60]. What is important to keep in mind is that subsidies might in general not be as useful as they seem. The OECD estimates that for every $4 spent on subsidies, farm incomes go up by only $1[61] This figure means that farm subsidies do not only distort trade they are also not very effective in helping farmers. Any sort of agricultural policy and farm aid is being fincanced by the EU tax payer. A recent paper by the HM Treasury of Great Britain calculated that the CAP costs an EU family of four around €950 a year, with only around €20 of this spent as EU money on targeted environmental programme. Furthermore the CAP has been estimated to be equivalent to a value added tax on food of around 15 per cent".[62] These figures are for the taxpayer of course much more demonstrative than the billions of Euro discussed during budget negotiations. What do the consumers get for all this money? That is a legitimate question they ask themselves; and they should. It is important that any farm policy and aid is designed in a way that it is beneficial for everybody; for farmers and consumers. A tax of 15 % on food caused by the CAP has to be justifiable. If the EU wants to help its farmers *and* consumers it has to make sure that consumers get value for their money. The EU citizens are the ones paying for the CAP in any case, either through the EU or the National Governemnts' budgets. Policy makers have to find the best solutions to help farmers so that they can engage in multi-funcional, sustainable and enironmentally friendly farming and make a decent living. And any policy in place has to be benifical to consumers!

[60] Alesina, A., Angeloni, I. & Schuknecht, L. (2002). What does the European Union do? CEPR Discussion Paper 3115.
[61] Wolf, J., (2002) The Future of European Agriculture, CER, p23
[62] HM Treasury, DEFRA (2005, December) A vision for the Common Agricultural Policy

LET'S GET THE JOB DONE!

The EU has recently shifted to uncoupled direct aids, or in other words direct income support. This sort of aid goes straight to the farmer and through compulsory cross-compliance this money is meant to recompense farmers for the services they grant to society. Cititzens have to ask themselves if this is wanted and if the EU should continue in this way. The CAP will be reviewed in 2008/9 providing a chance for reform and consolitation. If the current CAP is what the EU citizens want, politicians should already engage in debates and discussions on how to finance it in the future and how to modify it to meet the diverse needs of its Member States.

2.3 Challenge Nr. 3: WTO negotiations

FREE TRADE

A study has shown that 50 per cent reduction in agricultural trade protection would provide a $27 billion boost to the world economy.[63] The developed world, and especially the European Union, would enjoy around two-thirds of this gain. But, Tim Lang of Thames Valley University is against removal of trade barriers. He argues that liberalisation and free market capitalism damages the environment. "Our vision is for less trade and, where it happens, for trade to be more local, more equitable and to meet higher standards"[64]

The EU has currently shifted to uncoupled direct aids, belonging to the so called green box in WTO jargon. Green box measures comprise of domestic support which is deemed to be minimally trade-distorting and

[63] Francois, J., (2001) The next WTO round: North-South stakes in new market access negotiations, Adelaide University
[64] Lang, T., Hines, C., (1993), The new protectionism: protecting the future against free trade, Earthscan Publications

that is excluded from reduction commitments under the URAA.[65] Only if the EU manages to abolish all of its trade distorting export subsidies, import tariffs and direct aids does a full success of the Doha Round seem possible. The EU has gone a long way with the last three major CAP reforms. But more work must be done to contribute to a full success of the WTO trade negotiations.

3 Scenarios and Outlook

REVIEW COMING UP – USE IT WISELY!

Where is the CAP heading? There are a variety of possibilities. The EU can accept the current situation and wait for the full implementation of the reform of 2003. It will take years before it takes full effect. Accepting the status quo means that the troubles of financing the CAP are just being ignored and they will reappear in 2008/9. A financial perspective for 2007-2013 was agreed upon by the Council of the European Union on 19th December 2005 and contained a review clause stating the following: "The European Council invites the Commission to undertake a full, wide ranging review covering all aspects of EU spending, *including the CAP*, and of resources, including the UK rebate, to report in 2008/9. On the basis of such a review, the European Council can take decisions on all the subjects covered by the review. The review will also be taken into account in the preparatory work on the following Financial Perspective"[66]

[65] European Commission, DG Agriculture and Rural Development, EU Agriculture and the WTO
[66] The Council of the European Union (2005, December 19th) Financial Perspective 2007-2013 http://ue.eu.int/ueDocs/cms_Data/docs/pressData/en/misc/87677.pdf, p 32

BATTLE POSPONED

The battle about the CAP is on hold until 2008/9. The CAP takes up a huge chunk of the EU budget and the member countries have completely different opinions about how much the EU should spend on agriculture. Roeder-Rynning writes in one of her papers: "The CAP is no longer an impregnable citadel. The "iron pacts" that enabled it to weather political storms over the years have increasingly been put to test".[67] In 2003 an expert group led by André Sapir even called the EU budget "an historical relic"[68] This report suggested that the EU should reduce the portion of the EU budget it spends on agricultural support to just 15 per cent. A recent report by the HM Treasury goes even further: "The challenge for the EU is to remove current distortions so that by the second half of the next decade EU agriculture is treated no differently from other sectors of the economy".[69] If this path is chosen, assuming that farmers would mange on their own, the budgetary problems would be solved automatically. Even if farmers might be capable of doing good business on their own, as argued in the HM Treasury report, the political path towards treating agriculture like any other economic sector would be a "long and bumpy road". And a genuine "equal status" might never be reached.

DIGRESSIVE MODEL OF AID

Because of the tremendous financial pressure it is likely that there will be a step by step process towards less and less aid. Mr. Baldwin puts forward a way out of the financial crisis, being well aware of its dreamful nature. He estimated that the EU's CAP budget could be cut by €7 billion without touching CAP payments to 90% of EU farms (these €7 billion, went to less

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[67] Roeder-Rynning, C. (2003, Winter-Spring) Impregnable Citadel or Leaning Tower? Europe's Common Agricultural Policy at Forty, SAIS Review vol. XXIII, no. 1

[68] Saphir, A. et al., (2003, July) An agenda for a growing Europe: Making the EU system deliver

[69] See HM Treasury (2005) for details

than 2% of EU farm owners who are among the richest). This one reform could settle the whole budget issue – the new members could keep their structural funds, the Brits could keep their rebate and the vast majority of French farmers could keep their CAP payments.[70] The discussion about rich land owners getting a lot of CAP money has been around for a while and it would make sense to finally introduce a model that would grant less money to big farms. Some sort of digressive model of direct aids with a clearly defined plafond is desirable. Achieved could such a policy be only after a long and painful battle against strong and powerful lobby groups defending their "rights".

3.1 A question of subsidiarity

AN EFFICIENT AND TARGETTED CAP

"Subsidiarity is the concept that government power should be exercised at the lowest efficient level"[71] In line with this principle, Mr. Delors stated at a conference on subsidiarity in 1991: "Logically, currency and defence would be transferred to the Community and would cease to be national affairs, while agricultural policy would again become national"[72] This statement somehow reflects some of the discussions currently underway. European agriculture is highly diverse and might need special treatment in each country or region. In the early 1990's the Commission asked Mr Larsen to put together an expert group in order to evaluate different reform possibilities for the CAP. The Larsen report included the following

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[70] Baldwin, R. (2005, December) Who finances the Queen's CAP payments? The CAP as a dooH niboR Scheme, CEPS Policy Brief, No. 88, p 4

[71] Rabinowicz, E., Thomson, K., Nalin, E., (2001) Subsidiarity, the CAP and EU Enlargement, Swedish Institute for Food and Agricultural Economics, SLI Report 2001:3, p3 http://www.sli.lu.se/pdf/SLI_rapport_20013.pdf (visited 30.04.06)

[72] Delors, J. (1991) Subsidiarity: The Challenge of Change, Proceedings of the Colloquium, European Institute of Public Administration, Maastricht, p 27

recommendation: "In line with the subsidiarity principle, the responsibility for direct income support, should be allocated to the Member States ..."[73] Guyomar and Le Bris concluded in their work on multi-functionality that NTCs associated with agriculture are likely to be country specific, reflecting differences in preferences amongst countries. They would be best addressed through specific, i.e. targeted instruments.[74]

THE FUTURE OF DIRECT UNCOUPLED INCOME SUPPORT

The EU promotes the multi-functional character of its agriculture and its importance for society. But the Member States judge the importance and substance of this "phenomenon" differently; they attribute different values to it and they have different expectations and preferences. The negotiations for the 2007-2013 financial perspective gave evidence for this. The CAP shifted from price support to income support and recently to decoupled direct income support mechanisms. Decoupled direct aids to farmers represent in some way a policy of interpersonal income redistribution which might be dealt with more efficiently at the National level.[75] Direct aids are considered as minimally trade distorting.[76] One could therefore argue that these direct aids could also be paid out by the Member States. Since they are only minimally trade distorting they would not endanger the established common market. But politicians often oppose co-financing or re-nationalisation of the CAP in order not to

[73] European Commission, (1994) EC Agricultural Policy for the 21st Century (the Larsen report), Economy Reports and Studies no. 4. Brussels.
[74] Guyomard, H., Le Bris, K. (2003, December) Multifunctionality, Agricultural Trade and WTO Negotiations, ENARPRI, Working Paper No. 4, p10
[75] See Altmonte and Nava for more detail
[76] European Commission, DG Agriculture (2003, September) EU Agriculture and the WTO, Doha Development Agenda, Cancún, http://ec.europa.eu/comm/agriculture/external/wto/backgrou/cancun_en.pdf (downloaded 08.05.2006), p16

disintegrate or damage the functioning of the common market. If every member country would have its own little agricultural policy it would distort the common market and disintegrate the EU, they argue. But if direct aids are really only minimally trade distorting this argument would loose ground.

THE ABUSE OF SUBSIDIARITY FOR NATIONAL INTERESTS

Proponents for a re-nationalisation often agree that the EU would have to lay down basic rules and frameworks to secure the common market. Member States could then decide on how much interpersonal redistribution of wealth they want and need. Interpersonal redistribution is not among the specific EU competences.[77] But as long as there are certain countries profiting from this sort of arrangement it would be highly unlikely that co-financing would come into existence. Redistribution of wealth through the CAP is of course favoured by countries such as France, who greatly benefit from it. In the future, Poland might lead the CEECs defending this sort of EU-competence. Countries or entities unfortunately often only call for the subsidiarity-principle if it is in their National interest. If they have something to lose financially they are quite happy to leave competences at a higher level of governance. Countries benefiting from the CAP are always finding arguments why direct aids have to be designed, implemented, supervised and financed by a supra-national organisation like the EU and they are defending their arguments heavily. Whereas countries "loosing" through the principle of financial solidarity will put forward subsidiarity related arguments for more national power *and* responsibility.

[77] See Altmonte and Nava

MUTUAL RESPONSIBILITY

It should be remembered that in Article 34 of the TEC all Members agreed upon the principle of financial solidarity regarding the funding of the CAP. Solidarity means mutual responsibility[78], one entity might gain more, another less, but everybody is meant to profit from this sort of agreement in general and in the long run. Calls for co-financing are in some way in contrary to the principle laid down in Article 34. These principles were defined in 1962, and of course a lot has changed since then; agriculture is not the same, nor is the CAP what it was back then. Defending the solidarity principle in Article 34 is therefore surely not enough to justify the current financing of the CAP. Europe is growing and changing and has set itself new goals. Treaties have been signed and principles have been laid down, and the parties are expected to abide by these agreements. But it is sensible to revise principles and adapt them to reality if needed. The EU officials and the EU citizens should engage in a frank debate on financial solidarity. Is direct uncoupled aid, or direct income support as it can also be seen, still something they want to be centrally designed and implemented or should it be handled by Member States or even regions? Another debate has to be held about the significance of the CAP as the only entirely common policy. Would the EU really go a step backwards if the CAP were no longer common? Can the CAP be still a foundation for a knowledge based Europe? Was the CAP important back in the 60s and 70s but did it lose its importance both for society and European Integration in the 21st century? It is not enough to call for subsidiarity, co-financing, re-nationalisation, dismantling of the CAP or multi-functionality without knowing what the citizens want. Citizens, officials and think-tanks must reflect on whether the EU or the Member States themselves are more capable of dealing with

[78] Online etymology dictionary, www.etymonline.com

compensating and aiding the agricultural community. Few people contest common norms on food security and animal welfare, but uncoupled direct aids are a completely different matter; a clever mutual decision is needed, and it is required fast!

MEMBER STATES HAVE AN INFORMATION ADVANTAGE

The EU functions and is necessary because there are certain issues and obstacles that can only or at least more efficiently be dealt with at a supra-national level. The EU should do what it has been created for and what it can do best. It should deal with tasks that Member States are not capable or are less capable of handling. It is crucial to evaluate if nowadays the EU deals with the CAP to such an extent because it would undermine its purpose by giving power back to the Member States, or because there are genuine reasons why the EU can better deal with the current challenges in agriculture. Once any institution has acquired power it is reluctant to give it up. If certain countries or the EU itself are opposed to change regarding pillar 1 of the CAP solely because of egoistic reasons and self-interest, change has to come sooner rather than later. The CAP has been created for everybody, for consumers by providing them with foodstuffs of high quality and low price, and for farmers by granting them a decent living. Certain issues will have to be left at the EU level but more involvement of Member States and regions seems likely. Brussels often has an information disadvantage and bureaucratic hurdles often hinder process. The EU is made for is citizens who must reflect on what they want from agriculture and which policy will satisfy their needs. Policy makers have to then decide how and at which level these can be dealt with best. This has to go along with a wide debate engaging as many people as possible and politicians should try to inform and try to convince citizens one way or the other with well founded and honest arguments. Any EU policy can only function with a legitimacy base being provided by supportive citizens. Such a base can be reached by debate, arguing, reflection and shared responsibility and honesty. The EU lives off citizen's tax money and is created to increase the standard of living amongst its members. The CAP is no exception to that.

BASIC NEEDS

Food is a basic need and it has to be of good quality and safe. Supply must be reliable in good times and in crisis. States or institutions like the EU have to take care that such basic needs are satisfied by creating frameworks and norms that will ensure the survival of its citizens and of the State itself. Living in a telecommunication and knowledge based society perception of reality is sometimes distorted. Internet, mobile phones and all sorts of services are only of value if members of society can satisfy first their basic needs by having enough to eat. Food supply has become something of normality nowadays even though this was not the case just a few decades ago. It still is far from being normality in the developing world. Whenever discussing the CAP it is crucial to remember that it is about a policy regarding one of the basic needs people have, it is not a policy dealing with, i.e. internet security or industrial norms, which can hardly be considered as basic needs. In a post-materialistic society policies like the CAP have lost their appeal but are nevertheless of high importance for individuals, societies, States and International Relations. Farmers are the owners of the land and supply cities with food, thus they have an underlying importance; or hidden power. This is often underestimated by policy makers and citizens. The only profession being capable of providing foodstuffs to society are land owners, farm holders and farmers. This role is always crucial but more so in times of crisis. Farmers are to a great extent the owners of the land and have the knowledge and skill to cultivate it. Even thought agriculture contributes little to economic growth, and GNP, this small minority surely is to a great extent responsible for nourishing the people.

CALLING FOR THE MOST EFFICIENT LEVEL

The subsidiarity principle is of crucial importance in the CAP context. Only a policy that is dealt with at the lowest most efficient level is a legitimate policy that will be supported by the taxpayers and only such a policy will ensure that future generations living in cities all around Europe will feel secure and will be supplied with high quality food. And only such a policy can ensure a decent income for farmers and viable rural areas.

3.2 No further reform

RADICAL OR STEP-BY STEP REFORM?

How often can and should the EU reform its CAP? The CAP has been reformed in 1992 in 2000 and in 2003, and perhaps it will be reformed again in 2008. Reform is in principle vital in order to adapt to change. We are living in a fast changing environment and an increasingly dynamic and interdependent world. But how many reforms are healthy? Each reform is connected to huge administrative burdens and difficulties in implementation. With each reform farmers face new subsidizing models and plutocratic procedures.

Farmers calculate their investments for 10 to 25 years. Subsidies are part of these calculations and often determine the outcome. This sort of uncertainty makes it difficult for farmers to run their businesses.

Radical reforms are often politically not feasible, leaving only the "step-by-step approach". It always takes time until the implementation of a policy bears fruits, and if the upcoming reform is already underway before one can evaluate the old one it gets particularly complicated.

POLITICALLY DIFFICULT

There is a great risk for misperception if different reforms are overlapping each other. Cause and effect relations are difficult to identify is such a case. But reality is calling for change. The EU is under constant pressure during WTO negotiations, and has gone through a heavy battle over the financial perspective 2007-2013. Problems were not solved during the last negotiations over the EU budget. They have to a great extent only been pushed aside. In 2008 they will reappear and cause the same if not more severe disputes than in 2005. The CAP will surely be under attack. The most urgent question will surely be the future financing of the CAP. It might not undergo a substantial reform itself but the financing modalities might change significantly. Even so it will be politically very difficult to reach a compromise shared by all Member States. The concept of decoupled direct aids is unlikely to change since it was introduced only recently. It will take tremendous effort by everybody to reach a compromise. The following chapters offer solution to solve the CAP financing crisis.

3.3 Reduced CAP spending by the EU

3.3.1.1 No compensation by Nation States

A LOSS FOR FARMERS

CAP spending could be reduced by the EU without any compensation by Nation States. The EU has a tight budget and the Member States face budgetary deficits, therefore such a scenario seems probable. If it is decided that the EU spends less on the CAP, some member countries might not compensate all of the money lost in agricultural spending or even nothing at all. Countries which are traditionally pro-farm minded, i.e. France, would probably go ahead and aid farmers from their National budget. In countries, where farming-lobbies are powerful and influential, a scenario with no or little compensation seems unlikely. But other countries, i.e. Great Britain, now campaigning for a substantial reduction in CAP spending, might compensate only marginally. The EU would in any case continue designing the framework of the CAP but leave more implementation power up to its members. They would have to decide how much they want to aid their farmers. The EU would share financial responsibility with the Member States. The Commission would of course have to set strict guidelines and frameworks for agricultural aid. Some countries might grant the maximum aid allowed within the EU framework whereas others might compensate farmers only marginally and, in the most unlikely case, not at all. If this scenario becomes reality, European countryside would change noticeably. The countries opting for no or little compensation would force their farmers into expansion and diversification. This would have advantages if these farms would go on to be profitable on a free market without much aid. They would either be large enough or smart enough to survive without governmental protection. Agriculture in these countries would undergo substantial structural change. Countries opting for governmental intervention would keep businesses alive that would in principle not be viable without aid. This would prolong the situation as we know it in the EU today.

TARGETED AGRICLUTURAL POLICY

The 27 Member State of the EU getting together in 2008/09 for the review of the financial perspective might decide to reduce CAP spending by the EU but leave Member States the possibility to compensate their farmers within a certain framework laid down by the Commission. As mentioned before, some Member States might opt for the lowest possible compensation either because it is in their National interest, i.e. Great Britain, or they just might not have the necessary financial means, i.e. Poland. Differences amongst Member States would be the result. But this sort of development would not be entirely new. Already today the help granted within the second pillar is co-financed by Member States, and not equally implemented, leading to differences in farm aid amongst countries. Even the newly introduced concept of modulation is applied differently amongst countries; therefore the possibility of compensation by Member States would be a continuation towards a more federal type of agricultural policy. The Common Agricultural Policy, which is already non-common, would develop into a “Targeted Agricultural Policy” or “Federal Agricultural Policy”, bearing in mind the needs of its entities. If national governments would not compensate aid because it is in their citizens interests, it would be completely justifiable on federal and subsidiarity principles. If governments would not compensate simply because they would not have the financial means it would contradict the principle of solidarity. A cut in farm subsidies by the EU would in any case bear a risk since it could lead to a decrease of cohesion amongst the Member States. It might lead to a certain degree of disintegration.

SHIFTING IS NOT ENEOUGH

Member States might realize that it is not enough to take money from policy fields in order to finance new ones. It might be smart to accept that new common interests, need not just new common norms and rules but also common financing. If Member States are not prepared to pay more into the EU budget or if they are incapable of agreeing on some sort of EU tax they also have to accept that European Integration is slowing down and might come to a deadlock.

3.3.1.2 Compensation by Nation States through co-financing

3.3.1.2.1 Co-financing of direct payments of pillar 1

SHARED FINANCIAL RESPONSIBILITY

"It is important to note, that partial national financing (known in EU speak as co-financing) does not mean the re-nationalisation of agricultural policy"[79] Nevertheless co-financing can be seen as re-nationalisation of financial responsibility, however clearly does not mean the re-nationalisation of decision-making and implementation[80]. In this work the distinction between co-financing, meaning the partly re-nationalisation of financial responsibility, and re-nationalisation, referring to a transfer of decision making and implementation back to the national level, will be made and investigated.

JUST DO IT

John Peet, the Europe editor of The Economist, argues that "moving the CAP to co-financing is long overdue in any case"[81] The Committee on Budgets in the European Parliament concludes: "The purpose of co-

[79] Peet, J. (2005, July) The EU budget: A way forward, Centre for European Reform, policy brief
[80] Kjeldahl, R., (1994) Introduction, Reforming the Reform? – The CAP at a Watershed, in Kjeldhal, R., Tracy. M. (eds) (1994) Renationalsiation of the Common Agricultural Policy? Copenhagen: Institute of Agricultural Economics and Agricultural Policy Studies
[81] Peet, J. (July 2005) The EU budget: A way forward, Centre for European Reform, policy brief, p 6

financing is to add value to programmes through additional activity that would not otherwise have been funded, as well as to simplify processes and reduce bureaucracy"[82] What does co-financing mean in actual figures? According to the financial perspective 2007-2013 the EU committed around €41 billion towards agriculture marked related expenditure and direct payments in the year 2007. If member countries were to co-finance 25 % of it, the EU would only have to spend around €30 billion. This would liberate €10 billion per year and could be redirected to other policy fields. It is important to stress that a part of the €10 billion would have to be raised by National budgets. It is very unlikely that the Member States are very cheerful about this extra burden. During the heated debate about the financial perspective and replying to the Böge report[83], Fischer Boel put forward calculations of a possible co-financing scenario. She stressed that there would be a considerable redistribution of financial resources. A 10%-co-financing would save Germany €1.3 billion, Italy €0.55 billion, The Netherlands €0.48 and Great Britain €0.48 billion in the period 2007-2013. France would loose €1.40 billion, Spain €1.32 billion, Greece €1.12 billion and Ireland €0.53 billion. She also highlighted that the financial part of the CAP would need re-negotiating. Because of the severe redistribution it is difficult to imagine that a political majority could be reached.[84]

[82] European Parliament, Committee on Budget (2004, November 17th) Annual Meeting with National Governments, Rapporteur: Salvador Garriga Polledo, http://www.europarl.eu.int/meetdocs/2004_2009/documents/dt/547/547581/547581en.pdf (visited 04.05.2006)

[83] Böge, R., rapporteur, Temporary Committee on Policy Challenges and Budgetary Means of the enlarged Union 2007-2013, http://www.europarl.eu.int/meetdocs/2004_2009/documents/pr/561/561325/561325en.pdf (downloaded 08.05.2006)

[84] DBV-Wochenbericht Brüssel, Woche 19 / 09.-13.05.2005, http://tbv-erfurt.de/download/DBV-News/2005/DBV-News_19_KW.pdf (visited 08.05.06)

CO-FINANCING: COMPROMISE AHEAD!

Co-financing represents some sort of compromise. The EU would spend less on agriculture in total but the farmers in certain Member States would receive nearly the same aid as before. Some countries might be less capable of providing the means for co-financing than others. This would create some inequality, but all countries would be *offered* the same help from the EU *if they contribute* according to the co-financing rate. This sort of arrangement would strengthen federal aspects of the CAP but weaken solidarity. Nevertheless it might be the only way out of the budgetary and legitimacy crisis. The advantages of more participation rights, shared financial responsibility and less battling over the CAP financing will go hand in hand with the disadvantage of a certain loss of cohesion.

WHAT ABOUT THE NEWCOMERS?

Nevertheless it seems unlikely that the newly joined Member States would be receptive to this change so soon after their accession only five or ten years ago. A lot of old members have profited heavily from the concept of financial solidarity whereas the CEECs might only have benefited for a few years. Any change will have to go through the institutions and will take time and effort. Radical change is unlikely knowing that 27 Member States with diverging interests have to find a compromise. The only way to convince the CEECs to vote for a co-financing mechanism is to grant them transition periods, lower co-financing rates or some sort of other "special" treatment. The "Ökosozalies Forum Österreich" declared in a press text that co-financing would have to be implemented in a way that there are now losers and winners[85]. Politically this would be difficult to push through. However a co-financing mechanism that would create a

[85] Ökosoziales Forum Österreich (2001, January 25th)Europäische Agrarpolitik – Grenzen des Neo-Liberalismus, Pressetext, Wien

"looser group" and a "winner group" would be equally difficult to implement. A long debate will have to precede the implementation of such a mechanism and the EU Member States should adhere to a certain level of solidarity, even if it would mean that richer countries would have to pay more or receive a little bit less. The EFTA-enlargement went along with a certain degree of re-nationalisation of the CAP and an increased emphasis on the subsidiarity principle. "It will inevitably be the future direction of the CAP"[86]. Austria, Finland and Sweden were allowed to keep some of their policies, but they are also the ones paying for them. The European Parliament stated in a resolution on "Policy Challenges and Budgetary Means of the enlarged Union 2007-2013" the possibility of a phasing-in process of compulsory co-financing which should be initiated within EU-15 if the needs exceed the forecasts.[87] Mr. Böge, an MEP, sees potential for savings in the agricultural policy: "We have to begin with co-financing"[88] Fischer Boel, Commissioner for agriculture is against a co-financing arguing that this would mean the end of the CAP. Commission President Barroso, would be prepared to accept it as a last way out.[89] The European Parliament is very well aware of the distinction between co-financing mechanisms and re-nationalization by rejecting any attempt to renationalize the CAP in its resolution. Co-financing of pillar 1 will clearly not solve all the problems. Co-financing stands for a shift in spending behaviour. The National Farmers' Union Vice President Mr.

[86] Kola, J. (2004) Can the CAP cope with the enlarged European Union?, Maataloustieteen Päivat, p3, http://www.smts.fi/MTP%20julkaisu%202004/posterit04/mp04.pdf (visited 01.05.06)
[87] European Parliament (2005, June 8th) Resolution on Policy Challenges and Budgetary Means of the enlarged Union 2007-2013 (2004/2209(INI)) http://www.europarl.eu.int/omk/sipade3?SAME_LEVEL=1&LEVEL=5&NAV=X&DETAIL=&PUBREF=-//EP//TEXT+TA+P6-TA-2005-0224+0+DOC+XML+V0//EN (visited 02.05.06)
[88] Böge, R., http://www.epp-ed.org/Press/showPR.asp?PRControlDocTypeID=1&PRControlID=3639&PRContentID=6786&PRContentLg=de
[89] Lippert, C., (2005) Agrar- und Fischereipolitik in Weidenfeld, W., Wessels, W. (Hsg), (2005) Jahrbuch der Europäsichen Integration, Institut für Europäische Politik, Nomos, p132

Raymond speaks of a "change in spending classification (from EU to national)".[90] Mr. Popp argues that a co-financing mechanism would lead to less bureaucracy, more real federalism (subsidiarity principle) and higher political acceptance. Regional self-responsibility would increase and countries could decide themselves which agriculture they wanted.[91] Co-financing would release some EU money and could be the first step of reform, but only if the Member States do not cut down their overall contribution towards the EU budget. In principle some sort of co-financing already exists for the CEECs who joined in 2004. They are allowed to contribute to the EU direct aids by national funding.[92] For them co-financing would be nothing new in principle but would create a huge financial burden. CEECs have been allowed to top up EU direct aid because they will not receive full direct payments until 2013. Co-financing goes way beyond financial burden sharing. It involves all entities concerned and creates the feeling of shared responsibility. Mr. Tracy, concluded in 1994, in one of the major publications on re-nationalisation of the CAP: "…better targeting of assistance can best be achieved by involvement of those concerned at all levels … this may call for more national financing: but too much national financing could be contrary to the spirit of solidarity and could threaten the cohesion of the EU".[93] Too much national financing could lead to disintegration. But where is the borderline? This is a difficult but highly important question. If disintegration or a step backwards in European integration should be avoided whilst reforming the CAP proceeds, it is of crucial importance to

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[90] Raymond, M. (2005, April 13th) CAP Future Finance, National Farmers' Union (NFU)

[91] Popp, H., (2005) Agrarpolitik der EU und International: Schlüsselrolle für den ländlichen Raum, in Land in Gefahr, Leopold Stocker Verlag, Graz-Stuttgart, p 82

[92] Weidefeld, W., Wessels, W. (Hrsg.), (2006) Europa von A bis Z, Institut für Europäische Politik, 9. Auflage, Nomos, p 57

[93] Tracy, M., Summary in Kjeldhal, R., Tracy. M. (eds) (1994) Renationalsiation of the Common Agricultural Policy? Copenhagen: Institute of Agricultural Economics and Agricultural Policy Studies

find modalities of co-financing that would not substantially weaken the cohesion of the EU. A certain level of co-financing might be perceived positively as it involves the entities concerned and leaves them some choice. Too high co-financing rates could be seen as a real burden for National governments and might even increase scepticism and criticism towards the EU. Many countries already struggle with huge budget deficits. It is unlikely that policy makers, official, politicians and citizens are very excited about directly paying for a policy field they did not have to worry about in the past. Already in 1994 Mr. Tracy pledged for a co-financing mechanism, showing that this proposal has been around for quite a while. What seems certain is that other modifications will have to follow!

THE UNDERLYING TRUTH

The debate about the CAP and its financing clearly goes deeper in principle and touches topics like the EU own resources. If the EU wants to take up new policy fields, i.e. research, security and education, it needs more financial means to do so. Where can this money come from? Firstly, a co-financing mechanism of pillar 1 would release considerable amounts of money. The same is true for a simple reduction of CAP expenditure. Secondly, an increase of the EU budget dedicated to new "modern" policy fields could be a way forward. It is important to modify and reform the CAP, but it should not be forgotten that there have been 3 major reforms in the last 15 years. In principle it seems necessary that the EU reforms its budget in general. It is worth debating its own resources and the overall annual EU budget allowance. If the EU takes up new policy fields it is not feasible to only take money from other policy areas. This can be an additional mechanism but the introduction of new policy fields should go along with an increase in the overall EU budget dedicated to these new policies!

WHAT ABOUT THE TREATIES

Mr. Seidel, a German lawyer, puts forward a very interesting argument against the co-financing of direct aids, on legal terms. According to him, the treaties would not allow co-financing of direct aids.[94] But he argues that a financial contribution by the EU directed towards national systems of direct aid would be in accordance with the treaties. It is important to consider these legal aspects when discussing co-financing and re-nationalisation since a change in the treaties would require unanimity and would be extremely difficult to pursue amongst 25 Member States.

GET INVOLVED

Co-financing is a way to involve Member States and to apply more and more federal principles to a Union of countries that are not (yet) a Federation. Co-financing has the advantage of introducing shared responsibility and might even create higher acceptance of the CAP. But financial solidarity will weaken the less the EU finances the CAP from its common budget. Co-financing means in simple terms a shift from a "common centralized policy and a system of solidarity" to a system emphasising "partial self-help and local authority". Direct aids are now being entirely financed by the EU budget, meaning that some countries gain more than others. If direct aids are co-financed this sort of "win and loose situation" would be "watered down". This is an advantage when it comes to the battles over who gets what and who pays how much. The last negotiations over the financial perspective showed how difficult it was to

[94] Seidl, M. (2000) Rückführung der Landwirtschaftspolitik in die Verantwortung der Mitgliedsstaaten? – Rechts- und Verfassungsfragen des Gemeinschaftsrechts", Agrarrecht 2000, 381, Deutsche Gesellschaft für Agrarrecht (DGAR)

reach a compromise. Co-financing does not simply mean more involvement by Member States and a release of EU money. At its core it means that the EU has reached a point where (financial) solidarity is weakening. Member States are more aware of what they might gain and go along with their national interest rather than the common interest. It is of high importance to stress that co-financing is not only relating to the financing of the CAP. It is a sign of how the EU works and how the Member States treat each other when it comes to financial matters. It concerns solidarity and shows how much solidarity the Member States want. The members of the EU might agree on a lot of principles and have a lot of common interests but are they also willing to pay for them from a *common* budget? Co-financing means a step towards weaker cohesion and less solidarity; however that might be just what the EU needs at the moment. Maybe the EU works better if it only lays down principles whereas the Member States would do the rest. If the EU agrees on 10 % co-financing, what would be the next step? Is co-financing not some sort of creeping disintegration? It can be also seen as a creeping way towards a more federal Europe. The core question is how much solidarity the Member States want to show? How much are they willing to share? These questions need to be considered carefully and hasty or foolish decisions have to be avoided!

CONTINUATION OF A SUCCESS STORY

Co-financing, well administered and planned can be beneficial for the EU. It might create a feeling of having more of a say. If the members of the EU have to co-finance they might feel involved and their citizens might feel less commanded by Brussels. The legitimacy problem of the EU might be partly solved, if lower entities have more power.

Co-financing in pillar 2 has been a big success so far and the same might become true for direct aids of pillar 1. Especially now that these direct aids are uncoupled from production and therefore resemble some sort of direct income aid embedded in a system of income redistribution, the time might be right for more National involvement. Why should the EU deal with "redistribution of wealth"? Direct aids are aimed to reimburse for non-commodity outputs. Hence, the EU will still be the most efficient entity to lay down the rules and the framework for a sustainable multifunctional model of European agriculture, providing these services.

THE GOLDEN MIDDLE

A certain degree of co-financing would liberate money from the EU budget for research and development and it would get Member States involved. A certain loss of cohesion might be worth the price to pay for a more functional EU. Only if financial matters are out of the way can the EU focus again on its substance and pursue common interests.

If only those Member States who can afford or want to subsidize will do so, and others not, the result could be a "two class society of farmers" and with it two "contradicting models of agriculture" amongst the Member States. The CAP is financed by the common EU budget because differences do exist amongst Member States, and if the EU wants a common policy it has to be financed mutually under the principle of financial solidarity. A move away from this solidarity principle would relieve the EU budget but might lead to a decrease in cohesion amongst the Members of the EU.

Member States should acknowledge, that co-financing does not necessarily mean that they pay less into the EU budget. It could simply mean that they pay the same into the EU budget, where it is used for new policy fields. And for some countries it will not mean that they spend less on farm aid. Some Member States will make extensive use of co-financed aid programs. They will allocate financial means towards farm aid from their national budgets. In total, these countries will have to raise more money. If that's their goal then co-financing is the way forward. It will give countries the possibility to choose how much they want to spend on agriculture. And it would finally lead to *more money for the new policy fields*!

A CONCRETE PROPOSAL FOR CO-FINANCING TO BE CONSIDERED DURING THE REVIEW 2008/9

CO-FINANCING IN 2008

The EU-15 should commence with compulsory co-financing of direct aids in 2010, starting with a co-financing rate of 10%. The rate should be increased by 5% per year reaching 50% in 2018. The NMS-10 could start with a 10% co-financing in 2014, increasing it 5% per year reaching 50% in 2022. This will grant them a transition period of 4 years. Romania and Bulgaria should start with co-financing in 2017, reaching 50% in 2025.

The money liberated through this mechanism should go towards new policy fields, i.e. security, research and education. As a sign of solidarity and fairness a bigger share of this money should be dedicated towards NMSs for a certain transition period. This would strengthen cohesion and would be necessary to reach a compromise.

3.3.1.2.2 Modulation: Transfer of financial means from pillar 1 to pillar 2

MORE MEANS FOR RURAL DEVELOPMENT – PROVIDING LONG TERM HELP!

Mr Fischler[95] made a clear statement at the second European conference on Rural Development held in Salzburg, Austria: "Rural Development concerns us all, whether farmer, rural community or city-dweller"[96] Rural Development measurements of the EU are embedded within the second pillar of the CAP. Modulation means the reduction of spending on pillar 1 measures and transferring the funds to be spent on pillar 2 measures. In order to finance additional rural development measures agreed in the latest reform, all direct payments will be reduced, by 3 % in 2005, 4 % in 2006 and 5 % from 2007 onwards until 2012[97]. The OECD calculated that modulation is expected to yield €1.2 billion per year from 2006. "At their discretion, Member States may transfer additional sums from within the ceiling of pillar 1 to rural development programmes up to a maximum of 20% of the amounts that accrue to them"[98] Unfortunately the Member States have agreed upon a non co-financing clause as follows: "Sums transferred to support rural development measures pursuant to such arrangements shall not be subject to the national co-financing and minimum spending per axes rules set out in the Rural Development Regulation".

[95] Franz Fischler grew up on a hill side farm in Tyrol, Austria and helped his grandparents on their farm age 14. He studied agriculture in Vienna and served two terms, from 1995 until 2004 as Commissioner for agriculture implementing the Agenda2000 and 2003 reforms.

[96] Fischler, F. (2003, November 12th-14th) Europe's rural areas – an invaluable asset for us all, Second European Conference on Rural Development, Planting seeds for rural futures, Salzburg, European Commission, DG Agriculture, p 193

[97] European Commission, http://europa.eu.int/comm/agriculture/capreform/infosheets/modul_en.pdf (visited 01.05.06)

[98] Council of The European Union (2005, December 19th) Financial Perspective 2007-2013, Brussels, p23

THREE IN ONE: MODULATION CAN SOVLE THREE OBSTACLES

TEACH THEM TO FISH

Direct payments to farmers are now decoupled, meaning not linked to production. To prepare farmers for the new challenges of the 21st century this might not be the best approach. "Give a man a fish, and you've given him a meal. Teach him to fish, and he'll have food for a lifetime". The same might be true for farmers. They need to undergo structural change. Farmers have to expand, be very creative, i.e. by finding niche markets, or in the best case should do both. The rural development measures of pillar 2 of the CAP are more likely to give incentives for adaptation whereas the direct payments of pillar 1 are unlikely to provide the right signals. In pillar 2, the EU provides financial assistance for investments in farm businesses, young farmers and early retirement. It also covers the financing of training programs, investments to improve the processing and marketing of agricultural products and support for sustainable forestry. Moreover it even goes further by promoting and developing rural areas, food quality measures and animal welfare.[99] Rural development programs have long term goals and often show holistic approaches. They finance support that leads to structural change. Farmers and rural areas have to adapt in order to be able to keep rural areas attractive. Farms are often not profitable because they are still functioning exactly the way they did after World War II. Although many things have changed: countries are negotiating on the reduction and abolishment of farm subsidies in the Doha Round; eating habits have change as well as quality expectations, productivity increased dramatically and farmers are an aging group of individuals. It is wise to strive for structural change rather than just

[99] European Commission, Agriculture, The CAP, A policy evolving over time, http://europa.eu.int/comm/agriculture/publi/capleaflet/cap_en.htm#rurdev (visited 01.05.06)

support farms the way they are by giving way direct payment. In the long run only the "big and/or smart" will continue doing profitable business. All the other farms scattered around Europe will disappear forever. With them will go jobs, stories, homes, cultural institutions, local food providers and family roots! The European landscape will look very different in any case. But if the CAP provides more financial aid for rural development, things will change constructively and rural communities will prosper. A shift from financial means from pillar 1 towards pillar 2 is urgent and was unfortunately not taken account of enough in the 2003 reform. There is hope that during the review in 2008/9 things will change, and more money will be allocated to pillar 2.

COMPULSORY CO-FINANCING

The second big advantage of modulation is that pillar 2 expenditures are subject to compulsory co-financing. The more money can be transferred from pillar 1 to pillar 2 the more money the EU can "save" on CAP expenditure. National governments will be able to co-finance measures they desire. But the EU can only liberate money if it will not introduce exceptions to the rule of compulsory co-financing in pillar 2; even if means were transferred through modulation. Unfortunately, such an exception has been part of the deal on the financial perspective 2007-2013, concerning the voluntary increase of modulation up to 20%. Whatever the modalities of modulation, the EU will have to continue creating the framework for the agricultural policy and will survey Member States. Therefore there is little threat of significant disintegration of the EU. More financial means for pillar 2 will change things rather than prolong the status quo whereas it is certainly not a remedy against everything. Farmers and National governments will have to be willing to accept EU aid programs. In order to reform, they will have to accept structural change. Modulation will not alter increasing competition, growing occurrences of natural catastrophes or the lack of young farmers. But it will promote and enable change and make farming more competitive and appealing. A paper published by a group of various NGOs including Bird Life, Oxfam and WWF concludes that shifting funds from pillar 1 pillar 2 will deliver a wide range of public benefits.[100] In the financial perspective 2007-2013, the vast amount of €301.1 billion has been foreseen for pillar 1, only €88.8 billion has been reallocated towards pillar 2.[101] Rural development can offer much to the future of the European periphery. "If one were to draw five imaginary lines between London, Paris, Milan, Munich and Hamburg, the resulting pentagon is the heart of the union. This area contains 20 % of the surface, 40 % of the population, and 50% of the GDP and includes all the global functions of the EU-15"[102] Rural development issues address therefore large areas, with low population density and low GDP. "Farmers are an original, culturally and symbolically important component of the rural world but no longer hold the keys to its viability or its sustainability in the future"[103] The second pillar of the CAP is therefore not only about "cows, wheat and sugar" it is about the lives of everybody in these regions. The pillar 2 instruments should be reinforced and strengthened as rural areas are important to all

[100] Make Trade Farer, Part of Global Call to Action against Poverty, Re-thinking the CAP, A major CAP reform is needed by 2008 to redirect spending at the provision of public goods and to ensure an end to dumping**.** http://www.maketradefair.com/en/assets/english/rethinking_cap.pdf (visited 01.05.06)

[101] The United Kingdom Parliament, House of Lords (2005, June) European Union – Second report, The Future Financing of the CAP, http://www.parliament.the-stationery-office.co.uk/pa/ld200506/ldselect/ldeucom/007/702.htm (visited 01.05.06)

[102] Sotte, F., (2005) From CAP to CARPE: the state of the question; published in Assessing rural development policies of the Common Agricultural Policy, Selection of paper from the 87th Seminar of the European Association of Agricultural Economists (EAAE), Edited by Karl Michael Ortner, Wissenschaftsverlag, Vauk Kiel KG,

[103] Saraceno, E. (2005). Rural Development policies and the Second Pillar of the Common Agricultural
Policy: the way ahead, In Ortner, K.M. (ed.), Assessing rural development policies of the Common Agricultural Policy, selection of papers from the 87th Seminar of the European Association of Agricultural Economists (EAAE). 21-23 April 2005. Wien, 25-47.

the non-farmers in these regions but also to everybody living in urban areas. Marianne Fischer Boel, Commissioner for Agriculture and Rural Development, said in her press statement at the "Grüne Woche, Berlin 2006": "I have to confess that I am disappointed by the amount of money available for Rural Development".[104] Knowing, that the Commission has the right of initiative in the EU, there is still hope for an increase of means for Rural Development in the future.

TARGETED AND FEDERAL

Thirdly the layout of pillar 2 goes along with the subsidiarity principle. Member States have more room to manoeuvre, shared responsibility and the possibility to adapt the policies to their specific needs and interests. The rural development policy consists of three thematic axes, including a range of pre-defined support measures, and a methodological axis with no pre-defined measures. Mr. Ahner, Deputy Director General DG Agriculture and Rural Development, says that "Member States or regions should select those measures which are most suited for their purpose of their national or regional rural development strategy and combine them in a way that mobilises a maximum of synergies".[105] By getting the Member States to choose from different options and even design their own projects they are involved and responsible and can form a policy that fits best for their regions. The problem of pillar 1 and its financial solidarity principles is twofold. Firstly, Member States divert in their interests and heavily debate how much to spend on what and secondly it is often seen as a big "honey pot", and everybody wants to get as much as possible. Co-financing could increase legitimacy and acceptance of CAP spending by

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[104] Fischer Boel, M. (2006, January 12th) Speech/06/03, Challenges for EU Agriculture Policy in 2006, Grüne Woche, Berlin

[105] Ahner, D. (2005, March 15th) Deputy Director General, European Commission, DG Agriculture and Rural Development, Brussels, Speech/05025

involving the Member States as well as promoting their financially responsibly.

PROMOTING INTELLIGENT AND SUSTAINABLE CHANGE

Pillar 2 is a way to promote slow and sustainable structural change. The direct aids of pillar 1 are useful only if their recipients, the farmers, invest them in a way that one day their farms will be more likely to make higher profit, being less dependent on State and EU aid. The nice thing about pillar 2 measurements is that they are dedicated to development; they grant help to farmers in order that they help themselves. As an example they offer money for investments in farms; investments for expansion, diversification or increase in quality.

In principle, farmers in the EU have three paths to choose from: (a) expand and increase production, (b) diversify or/and increase quality or find niches (c) quit. Obviously option "a" and option "c" are linked since those getting bigger will rend or buy the land and production facilities of those quitting. Option "b" is the only possible, way ahead if governments and the EU want to keep as many family sized farms alive as possible without constantly granting them direct income support (uncoupled from production). Option "b", the quality option, is the only feasible option in the light of globalisation. One day the Doha Round will be completed and agriculture tariffs and export subsidies will be a thing of the past. Agricultural products such as milk, meat and wheat are being produced much cheaper in countries like New Zealand, Argentina and the USA. If the EU boarders are open these products will compete with EU products by being sold for lower prices. Only if Europe opts for high quality cheese, fine wine, meat specialities etc., will European consumers choose these products and contribute to the survival of local agriculture without having to see a share of their tax money go towards farm aid. If Europe opts for multi-functional and sustainable agriculture it will opt for a clean and liveable environment. Change towards this type of agriculture has to be fostered now and this can be done most efficiently through rural development aid. The EU is on the right track by having chosen for a modulation mechanism, but if the future of European farmers and a clean environment is to be assured the EU has to continue this road and shift much more financial means from direct aids towards rural development. Means shifted through modulation to pillar 2 have to remain subject to compulsory co-financing. Through this mechanism the EU will solve its biggest financial obstacle, the financing of the CAP. Only if the EU abides by the principle of compulsory co-financing in pillar 2 can it take a big step towards solving its problem of CAP financing. Modulation would not necessarily mean less money for farmers. Some sort of direct income support might still be necessary but it could be granted to a much lesser extent. The more the EU does now to promote sustainable change leading towards Europe producing environmentally friendly and high quality products, the less direct aids it will need to grant its farmers in the future. The consumers will have a choice daily of which products they want to buy and eat. A certain percentage of Europeans will go for quality products from local producers paying them a fair price. In such a case their tax money can go towards new policy fields and challenges, i.e. research and technology, security and education. If farmers are given incentives to change structurally and to change their production methods they will not always need or want direct aids. As long as they can convince consumers with honest arguments that their products are superior in quality their income will come directly from their customers. Not all farmers will be able to go this way, and some might not even want or need to. Farms in favoured areas, i.e. Northern Germany, Denmark, Holland, France and Poland could expand and compete with the products imported into the EU. They could do so without having to expect a gloomy future: transport might be cheap now, but could be much more expensive "tomorrow", increasing the price of imported goods. Nowadays environmental costs of transport are not supplemented to the price of products but they might be in future.

DO WHAT YOU CAN BEST OR, NEVER CHANGE A WINNING TEAM

The EU has an important role in presenting the right signals. Politicians must have the strength and courage to counteract farm lobbies and to do what they believe is best for European farming and the EU in the long run. Direct income support might seem the first choice for farming lobbies and farmers today, but they are certainly not the best option for the future. More money for rural development can do much good for European agriculture in the long run and can involve Member States in policy implementation. The EU would be able to share the burden of financing the CAP with its members, and could also share implementation duties. Member countries have a huge information advantage concerning their local needs. European agriculture has a future even in the age of globalisation and trade liberalization if it does what it does best: work multi-functionally, provide non-commodity outputs and produce high quality food in environmentally friendly manners with special concern on food safety and animal health. Quality and diversity in agricultural products is one of Europe's strengths and will enable it to compete on the world market without constantly being granted direct income aids. European farmers and their policy makers should improve their skills. Farms in less favoured areas should stay and take advantage of their strengths, find niche markets, produce high quality food and keep rural areas viable or provide tourism services. Farms in favoured areas, i.e. flat lands, should expand and run the farms without successors.

Europe will not need and can not want a “one size fits all approach”. Europe is diverse and so is its agricultural structure. The rural development program of the EU should be reinforced to promote local strengths reaching the highest levels possible. The EU will not be able to finance all the necessary measures alone but through compulsory co-financing of pillar 2, Member States will share financial responsibilities with the EU. The House of Lords published a report on “The Future Financing of the CAP” and suggests that “richer Member States should fund a higher proportion of their own rural development programmes”.[106] Such measures would promote cohesion through solidarity. In The House of Lords paper, it is also being argued that “The first test that is always applied to rural development measures must be that they are effective and value-for-money. Only if this test is met could we recommend a straightforward fiscal transfer into a rural development budgetary heading, without linking the funds to agricultural objectives“. They conclude that “there is a need to build on the rural development work already undertaken by the Commission”. The House of Lords Committee on the European Union clearly sees the importance of the rural development programme and wants them to be taken further. A recent paper published by the HM Treasury, Department for Environment, Food and Rural Affairs (DEFRA) proposes that in 10 to 15 years “EU spending on agriculture would be based on the current pillar 2 and would support these objectives as appropriate, allowing a considerable reduction in total spending by the EU on agriculture” They argue that “the rural economy could benefit significantly from shifts away from general agricultural

[106] House of Lords, European Union Committee (2005, June 6th) The Future Financing of the Common Agricultural Policy, Volume I: Report

support towards more targeted rural development"[107] Especially CEECs face far deeper socio-economic problems than most regions in the EU. "It is estimated that "hidden" unemployment in the CEECs is very widespread, affecting at least half of those in agricultural employment – about 5 million people"[108]. Only a small fraction of these "excess labour" can be absorbed through new jobs linked to the farm sector. The scale of the challenge in these countries is enormous and a lot of effort will have to be undertaken by the EU, Member States, regions and individuals to create new opportunities and a good life in the country side.

More means for pillar 2 will create a targeted and modern CAP. Through the principle of compulsory co-financing it can help to ensure the future financing of the CAP. Modulation should be embraced and promoted!

3.4 Re-nationalisation of the CAP

A SHIFT IN COMPETENCES

"Re-nationalisation implies a shift of competences back from EU institutions to National ones"[109] The CAP is a core element of European Integration and it is the only entire common policy of the EU. It is a master piece of European integration. Would a partial re-nationalisation of the CAP mean a disintegration of Europe? "The EU institutions would have to be given sufficient powers to ensure that basic principles of the

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[107] HM Treasury, Department for Environment, Food and Rural Affairs (DEFRA) (2005, December) A vision for the Common Agricultural Policy, www.hm-treasury.gov.uk

[108] European Environment Agency, (2004) Agriculture and the environment in the EU accession countries, Environmental issue report No. 37, Luxembourg, p42

[109] Niemi, J., Kola, J., (2004), Gradual renationalsation of the Common Agricultural Polciy – away forward?, Maataloustieteen Päivät, p 1

CAP are not put at risk"[110] Kjeldahl and Tracy already dealt with the question of re-nationalisation in the early 90s and concluded that the Commission should be able to survey – and enforce – that national assistance targeting environmental or social objectives do not give rise to unfair competition.[111] The discussion about re-nationalisation has certainly re-appeared during the embarrassing battle over the financial perspective 2007-2013. For example, Ms. Van Velzen, a SP Member of Parliament expressed in September 2005 that she is going to ask farm minister Cees Veerman of the Netherlands, to bring pressure to bear in Europe for a re-nationalisation of agricultural subsidies.[112] Ms Berkhout and Ms Meester present three arguments for a limited "re-nationalisation": (a) better targeting, (b) reduction of bureaucracy (c) relief of pressure on the EU budget.[113] On the other hand, the Committee on Environment, Agriculture and Local and Regional Affairs concluded in its assembly debate on 23 June 2003 (17th sitting): "It is important that changes to the CAP do not undermine the principle of financial solidarity (ruling out the possibility of a re-nationalisation of CAP financing)".[114] The Sapir report concludes that a policy that is more and more about social welfare through the redistribution of wealth would be much better taken care of by national governments. One of the key figures being responsible for the implementation of decoupled direct aids is Mr. Fischler. He believes that "demands for a re-nationalisation of the CAP

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[110] Niemi, J., Kola, J., (2004), Gradual renationalsation of the Common Agricultural Policy – away forward?, Maataloustieteen Päivät, p 3

[111] Kjeldhal, R., Tracy. M. (eds) (1994) Renationalsiation of the Common Agricultural Policy? Copenhagen: Institute of Agricultural Economics and Agricultural Policy Studies. 105 p.

[112] SP International news, EU Common Agricultural Policy must be scrapped, September 23rd, 2005, http://international.sp.nl/bericht/050923-eu_common_agricultural_policy_must_be_scrapped.html

[113] Berkhout, P., Meester, G., in Kjeldhal, R., Tracy. M. (eds) (1994) Renationalsiation of the Common Agricultural Policy? Copenhagen: Institute of Agricultural Economics and Agricultural Policy Studies

[114] Parliamentary Assembly, Resolution 1330 (2003), Agriculture and the enlargement of the European Union, http://assembly.coe.int/Documents/AdoptedText/TA03/ERES1330.htm (visited 30.04.2006)

are pointless and risky".[115] Mr Wilkinson suggests that "targeting" should be used as a term replacing re-nationalisation, arguing that terminology is crucial; "Discrimination" is negative; "differentiation" or "targeting" are positive.[116]

The EU does not need to re-nationalise its CAP entirely; it only needs to adapt to reality. It has a problem with its financing and it faces a crisis of legitimacy. Europe still has certain common interests concerning agriculture being best dealt with at EU level. Therefore there is no need to dissolve the CAP. A diverse EU will need a federal distribution of power and responsibilities. Even though the EU is not a federation its Members have forfeited power related to agriculture to the EU. The CAP does promote certain common values and interests like multi-functional agriculture, food safety, environmental protection and animal welfare. A re-nationalisation would not lead to a situation where these common interests are promoted more efficiently.

What is necessary is to accept that local entities have an information advantage. Different regions and States have diverse needs concerning local agriculture. The EU has to agree on the main principles it wants to foster but share financial responsibility and implementation power with its members. A complete re-nationalisation of the CAP would be foolish and not achieve anything but disintegration and frustration. Europeans do have certain values and showed common interests in the Eurobarometer surveys.[117] The CAP is the most efficient way to promote common values of the European citizens but since agriculture varies

[115] Fischer, F. (2005, February 8th) The Week in Europe, The European Commission, http://europa.eu.int/rapid/pressReleasesAction.do?reference=SPEECH/02/48&format=HTML&aged=1&language=EN&guiLanguage=en

[116] Wilkinson, A., (1994) Renationalisation: An Evolving Debate in Kjeldhal, R., Tracy. M. (eds) (1994) Renationalsiation of the Common Agricultural Policy? Copenhagen: Institute of Agricultural Economics and Agricultural Policy Studies. 105 p

[117] See European Commission, Eurobarometer, Europeans and the CAP

across Europe it will be increasingly necessary to transfer certain aspects, i.e. financial responsibility and decision making power back to lower entities. Better targeting of policies, especially in pillar 2, can only be achieve through participation and co-operation of all entities involved: EU, States, regions, communities and farmers. It should not be about a complete re-nationalisation of the CAP but about devolution of power and responsibility; not only towards States but also towards regions. A recent paper by Niemi and Kola concludes that "…the CAP does not currently meet the different needs of diverse agricultural conditions and that the EU does not need the CAP as such to promote the economic integration and balanced development of the Member States"[118] What the EU should not do is re-nationalise the CAP in its entirety, but it should introduce co-financing of pillar 1 which can also be seen as re-nationalisation of financial responsibility. The EU should also allow Member States more of a choice of which policies they want to implement and how, meaning that the EU has to re-nationalise a certain share of implementation power and give Member States more of a choice. The CAP should nevertheless remain a policy field of the EU. It should be "less common and more targeted". The EU has to draft, implement and survey a framework. Member States should be allowed to act within this framework, preventing any distortion of the common market.

Only if the EU continues to be the main institution drafting the CAP can it be assured that Europe pursues its common interest in promoting multi-functional, environmental and sustainable agriculture. Only if the EU creates a clear and intelligent framework can it assure that the common market does not fall apart and furthermore it can contribute to a

[118] Niemi, J., Kola, J., (2005) Renationalization of the Common Agricultural Policy: Mission Impossible?, International Food and Agribusiness Management Review Volume 8, Issue 4

success of the DDA. The EU should keep only as much power as necessary to ensure the promotion of its common interests; all other competences should be transferred back to the Member States. This will lead to better targeting of the CAP, positive long term effects on rural areas and farmers, the feeling of shared responsibility and will disburden the EU budget considerably.

4 Political dimension

FAIR STANDARD OF LIVING

"Food production is about social harmony"[119] Subsidies were originally implemented to secure food supply. No economy can really function if basic needs are not taken care of. The EU and many other countries succeeded in this goal; the CAP has been crucial for this success. Mr. Brouwer describes a three-tier model of farming: (a) farmers producing for the world market, (b) farmers facing natural handicaps and (c) farmers providing countryside services.[120] The first group might be able to survive without any governmental intervention or in some cases might this group even be better off without it. The second and third group would go out of business and disappear if they were to suddenly face a situation without governmental aid of any kind. All of the above discussed options for reform are directly linked to political questions. The EU is now made up of 25 Member States and decisions are taken by qualified majority vote or even unanimous if vital interests are at stake. The EU is therefore constantly threatened by countries willing to make us of their "veto right", defending their "vital interests". Any shift of competences would have to

[119] The Economist (2003, December 11th) Filling the world's belly

[120] Brouwer, F. (2005) Sustaining Agriculture and the Rural Environment: Governance, Policy and Multifunctionality (Advances in Ecological Economics), Edward Elgar Pub

go through a major debate and political bargaining process, especially in the case of a shift in financial responsibility (co-financing) or in the case of a shift in decision-making competences (re-nationalisation). The gap between, what would theoretically be desirable, and what can be pushed through politically, is enormous. France and Great Britain show completely opposing positions when it comes to the usefulness and future of the CAP. Countries with low vegetation periods or a vast amount of mountainous regions again have completely different interests. Article 33 of the TEC states that "… the CAP should ensure a fair standard of living of the agricultural community, in particular by increasing the individual earning of persons engaged in agriculture" All 25 Member countries have signed and ratified this treaty and have therefore agreed on its legal text. It is therefore about "*how*" the individual earnings of the afore mentioned should be increased, and it is also a question of to "*what*" these aids should be linked to. By introducing the system of "cross-compliance" the EU has already linked payments to "the respect of environmental, food safety, animal and plant health and animal welfare standards, as well as the requirement to keep all farmland in good agricultural and environmental condition"[121] This was a decisive and important step, but the EU needs to go further. The EU Members either stick to the legal text, including Article 33 or they have to agree on radical change, meaning a change in the treaties. If the treaties are unchanged, the EU is challenged to find the best way to reach its treaty objectives. The review in 2008/9 will give citizens, politicians and policy makers a chance for discussion and consideration. It will hopefully lead to compromises, shared by *everyone*. The task will be on how a "fair standard of living of the agricultural community can be ensured in the future". Most importantly

[121] European Commission, Agriculture, CAP reform - a long-term perspective for sustainable agriculture, http://europa.eu.int/comm/agriculture/capreform/index_en.htm (visited 03.05.2006)

they have to agree on a way to finance this sort of governmental intervention. Whatever decisions will be taken, they should aim to reach the objectives in the treaties, not jeopardize the common market, avoid disintegration and contribute to a success of the DDA. This is clearly not an easy task; but common efforts will promote common interests!

4.1 Danger for the common market

BE AWARE

In Article 34 of the TEC it has been agreed upon that a common organisation of agricultural markets (COM) shall be established. Any measure that would go against this principle of a COM would be against the treaty. Member States should not start drafting their own agricultural policies. This would lead to a chaotic and worrying development. It seem virtually impossible that something like this would happen since any reform contradicting the treaties is unlikely to be championed by the Commission. Any reform of the pillar 1 or the system of financing would by necessity have to go along with the treaties and therefore not endanger the common market. The EU has to continue being the core body of the agricultural policy. It should continue creating and surveying the framework of the CAP. The common market is not to be distorted at any price.

4.2 Disintegration

COHESION IS CRUCIAL

The CAP is one of the core policies of the EU. Moving away from the principle of financial solidarity might lead to a certain decrease of cohesion. If co-financing of direct aids is introduced cohesion might weaken substantially. Increases of pillar 2 spending which is also a subject of national co-financing might not necessarily decrease cohesion. It would make Member States financially more responsible but this would be counterbalanced by an increase in implementation power. Any sort of re-nationalisation regarding decision making is likely to disintegrate the EU. It would be wise to opt for a solution that unburdens the EU budget but does not lead to too much of a loss in cohesion or to disintegration. Anything leading to better targeting and to more subsidiarity should be embraced by the EU. An increase in modulation and the introduction of co-financing would weaken cohesion but would be clearly beneficial for the functioning and acceptance of the EU on the whole. The EU will need to compromise and only if Nation States are willing to co-operate will the EU have a chance to promote common interests of a united Europe. The review 2008 will be a test of solidarity, co-operation and morals. The EU member states should think holistic and see the EU as a whole rather than perusing purely their national interests. The EU countries will come closer only if everyone will work towards a fair and intelligent compromise.

4.3 Trade liberalization

DO NOT DISTORT AND OPEN UP

Mr Tangermann, head of the agricultural division of the OECD stated: “Europe’s farmers are reasonably competitive”.[122] Is he right? The EU is engaged in WTO trade negotiations and is facing constant pressure to abolish all sorts of trade distorting subsidies. If the EU chooses wisely, it can reform the CAP in a way that it solves two of its main challenges.

[122] Tagermann, S., (2005, October 22nd-23rd), Harald Tribune, In trade fight, France stands up for „terroir“

Firstly the problem of its financing and secondly the obstacles concerning the negotiations for trade liberalization. Market and income support pillar 1 will aid farmers only as long as they are granted for, whereas rural development measures are aimed towards structural change making farmers less dependent on governmental help. Transferring financial means, through modulation, from pillar 1 to pillar 2 will create a CAP which is much less trade distorting and it will also fund measures that are beneficial in the long run. Europe can benefit hugely from free trade and it can prepare its farmers for a free market by further improving their strengths. The EU should do everything possible to make the DDA a success; nevertheless it should continue to aid farmers to become and stay competitive and to compensate rural areas and the farming community for its non-commodity outputs. Some farmers are surely already competitive but many more still have to prepare themselves. The EU can provide a good deal of help; and it should!

4.4 Willingness of nation states

CHANGING ATTIDUDE OF FRANCE?

No CAP talk can proceed without keeping France in mind, as it is the biggest proponent and beneficiary of the CAP. It seems very unlikely that France would agree on a co-financing mechanism before 2012/13. Mr Heinemann and Mr Lefebvre argue that due to the enlargement, France will not be a beneficiary of the CAP in the long term and might therefore be in favour of a co-financing mechanism after 2013. Nevertheless France might ask for a tough attitude in the WTO negotiations in exchange for a compromise on co-financing.[123] After the enlargement France lost its

[123] Heinemann, F., Lefebvre, M. (2004, November) Deutsch-französische Überlegungen zur Zukunft des EU-Haushalts, DGAP-Analyse, Nr.31

privileged role in the EU. "They no longer feel the commission is representing their interest and they feel like they need to make more noise to be heard"[124] To push through any sort of change, France will have to be convinced. This will not be easy, but absolutely necessary to keep the EU running.

AND GERMANY?

In a speech in June 2006 Angela Merkel, implicitly demanded France to make the decisive step towards the co-financing of the agricultural policy, but in October, after having become Chancellor of Germany, she assured in an interview in the "Handelsblatt" that she will stick to the CAP compromise already reached, being against re-negotiations.[125] This clearly shows that the topic of co-financing is off the agenda until the review of the financial perspective in 2008/9, but will most likely be heavily debated at this time. Germany will play a crucial role in the 2008 review. It might once more be the country being a negotiator, promoting a compromise. Germany should act as a mediator amongst countries with heavily diverting interests. Germany can do much to help cure the EU budget; please do!

MIGHT NEW MEMBERS FEEL BETRAYED?

"One of the major drawbacks of the re-nationalization would be related to the NMSs, since most of the them cannot afford to allocate the same kind of resources to their agricultural sectors as what could be the case in the current Member States"[126] Peter Becker, argues that a co-financing would

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[124] Swinnen, J. (2005, October 22nd-23rd), Harald Tribune, In trade fight, France stands up for "terroir"
[125] Marhold, H. (1/2005) Deutsche Europapolitik nach dem Regierungswechsel 2005, integration, p10
[126] Niemi, J., Kola, J., (2005) Renationalization of the Common Agricultural Policy: Mission Impossible?, International Food and Agribusiness Management Review Volume 8, Issue 4, p 38

reduce the existing imbalance of the EU budget and believes that the introduction of co-financing in 2013 will be highly difficult because the NMSs will be the new beneficiaries of the CAP and they will certainly want to keep it that way.[127] Nevertheless, Niemi and Kola argue in their recent paper on re-nationalisation that tensions could be avoided if the EU implements more targeted structural funds and regional policies. The NMSs, who joined the EU in 2004, will need many more years to restructure their agriculture. They will not be particularly happy if they soon have to start financing a major share of agricultural aid. A major incentive especially for CEECs to join the EU was its CAP. They might feel betrayed if they would soon have to co-finance measures from pillar 1. It is very likely that a coalition of CEECs, led by Poland, will make negotiations on co-financing long and difficult. A compromise might nevertheless be reached if these countries are granted generous exceptions.

Any sort of co-financing is unlikely to be in place until the next financial period 2014 – 2020, and if there will be an agreement, it probably will take off with very low co-financing rates and numerous exceptions for NMSs. An increase in modulation will also be heavily debated but seems more likely because it can create a better targeted CAP, shifting power and responsibility back to Nation States. Member States should think more about how farmers and rural areas can be helped in the long run. They should "wake up" and realize that the EU *can* solve problems together, helping rural areas and farmers to become competitive for free trade on a world stage. They can design an intelligent and useful policy if they find the right mixture concerning power sharing

[127] Becker, P. (2005, November) Der EU-Finanzrahmen 2007-2013, SWP Studie, Berlin, p 27-29

and financial responsibility. Overall it is crucial that the CAP itself is promoting the objectives laid down in the treaties.

5 Conclusion

European agriculture and its CAP are facing three main challenges.

GRUELLING FINANCING

Firstly, the financing of the CAP is becoming increasingly difficult. The negotiations over the financial perspective 2007-2013 have clearly demonstrated this. Around 40% of the total EU budget is committed towards the CAP, the only entirely common policy of the EU. Member States have distinct opinions on how much should be spent on the CAP in the future. France and other beneficiaries of the CAP insist on high CAP spending whereas countries like Great Britain have little interest to spend large proportions of the EU budget on agriculture.

USEFULNESS IS QUESTIONED

Secondly, citizens of the EU, policy makers, politicians and academics are increasingly questioning the effectiveness of the CAP or the necessity off farms subsidies in general. Certain academics argue that farm subsidies should disappear all together whereas others believe that they should be substantially reduced. A third group promotes a different kind of governmental intervention; they argue that direct aids should be dramatically reduced and aid for rural development should to be fostered.

FREE WORLD TRADE

Thirdly, the EU is engaged in WTO negotiations facing pressure to reduce trade distorting farm subsidies. For a success, the EU will have to dispose of all trade distorting subsidies.

REVIEW IN 2008

In 2008/9 the financial perspective 2007-2013, including the CAP, will be reviewed. The main part of this work has been dedicated to evaluate possible solutions that could be considered or agreed upon during this review in order to tackle the challenges the CAP is facing. Especially the problem of financing the CAP has been pushed aside during the 2005 budget negotiations and thus serious considerations or agreements should be made during the review in 2008/9.

SUBSIDIARITY IS IMPERATIVE

Every change in the way the CAP works and how it is financed will touch the issue of subsidiarity. The 25 Member States (27 by the time the review will take place) have highly diverging agricultural sectors and diverting National interests. Farm size, land ownership, climate, productivity and product range vary considerably amongst the Member States. All this calls for more implementation power and choice by the Member States of which policy to use. Member States and regions have an information advantage, and only a well targeted policy can achieved the objectives of the CAP.

MANY OPTIONS

The financing of the CAP becomes increasingly difficult; certain Member States aspiring to spend bigger shares on the CAP than others. This situation suggests shared financial responsibility. If the EU wants to continue administering the CAP but can not agree on a mutual financing, financial responsibility will have to be transferred back to National Governments. The EU has various options to solve the contemporary challenges and all of these should be considered in the light of the above mentioned subsidiartiy issue. The EU has to accept that it should only be involved where its Members have common interests and are less efficient in dealing with them or where they are simply not capable of perusing these interests.

HOW TO FINANCE THE CAP IN THE FUTURE?

NR. 1. THE WORST OPTION: DO NOTHING

The first, and worst, option would be to do nothing. The EU has reformed its CAP several times in the last two decades and might come to the conclusion that now there should be a time for these reforms to take effect. It seems likely that the EU is not going to substantially change the CAP and its financing during the review, but it will certainly consider changes for the upcoming financial perspective; and it should. Change will only be possible if all Member States can agree on a compromise. Knowing that 27 countries with diverse interests and very different agricultural landscapes will sit around the negotiation table, it will not be an easy task. Nevertheless the EU should use this review wisely and not just postpone solving these urgent problems. The "no reform" option seems likely, since the Members will have difficulties agreeing on a compromise, thus they might take the easy way out by postponing any substantial reform agreeing to deal with it whilst negotiating the next financial perspective 2014-2020. This would not be very helpful or wise but might politically be the easiest choice.

The second option is that the EU opts for less CAP spending. This option can be further divided into three possibilities.

NR. 2. A BETTER OPTION: LESS SPENDING AND NO COMPENSATION

The EU might reduce CAP spending and Member States might not compensate for the money lost by their farmers and rural communities. The EU faces extreme budgetary pressure; therefore this option seems likely, freeing up financial means for "modern policy fields", i.e. research, education and security. Most National Governments on the other hand face huge budgetary deficits and may not be able or willing to compensate their farmers and rural areas for the loss of EU aid. In this case farmers and rural areas would receive less aid and face disadvantages. Many countries will not agree on such a scenario which makes the following option politically more feasible.

NR. 3. A MUCH BETTER OPTION: CO-FINANCING

A co-financing mechanism of direct aids granted within pillar 1 seems an overall wise and feasible approach. All measurements of pillar 1 are currently financed entirely by the EU budget. To further reduce the money the EU spends on the CAP it could introduce a co-financing mechanism, making Member States financially responsible. The beneficiaries of the CAP would be clearly opposed whereas countries now "loosing" through the CAP are more likely to be in favour of such a financing model. The biggest opponents would probably be the CEECs who recently joined the EU. Whereas old Member States will have benefited from the CAP for decades, they would have not have profited much from it. CEECs will not even receive the full direct payments until 2013 and might feel betrayed if they soon have to start co-financing them, leaving them only with the option of blocking such a development. The only way to get CEECs on board would be a generous offer of exceptions, granting them transition periods and lower co-financing rates to start with. Co-financing of direct aids would surely relieve the EU budget but would not grant the Members more decision making and implementation power, therefore not making the CAP more targeted or "federal". To achieve these goals the following solution seems most appropriate and intelligent.

NR. 4. THE BEST OPTION: MORE MEANS FOR RURAL DEVELOPMENT THROUGH MODULATION

The EU has introduced recently the concept of modulation, meaning a shift of financial means from market and income support (1st pillar) to rural development measures (2nd pillar). The rural development measurements are subject to compulsory co-financing. If the EU can shift financial means towards pillar 2, and not allow any exceptions to this compulsory co-financing, it can unburden its budget hugely and dedicate it to new policy fields. Within pillar 2, Member States have a certain freedom to choose measures and an increased implementation power. By shifting means to pillar 2 the EU can achieve a variety of things.

Firstly it can ease the burden on its budget and secure the financing of the CAP. Secondly it can make the CAP more "federal" and in accordance with the subsidiarity principle by granting the countries more power concerning which policies they choose and how they implement them. Thirdly, the CAP would be much better targeted because National Administrations have an information advantage, knowing what their farmers' needs and circumstances are. The means of pillar 2 are dedicated towards measures such as farm investment, training, processing and marketing. They are much more appropriate to promote sustainable structural change making rural areas and farmers more competitive in the future. Direct aids are not giving enough incentives for change and might not be justifiable in the future. In the 2003 reform they have been uncoupled from production and now represent a direct income support. The EU should continue to transfer means to pillar 2. Thus the review in 2008 should once again be used to decrease direct aids and to substantially increase means for rural development. Member countries can than continue to choose policies that best fits to their needs, sharing financial responsibility through co-financing.

A further increase in modulation will relieve the EU budget, improve the targeting of the CAP, increase subsidiarity, legitimacy and acceptance of the CAP and lead to an agricultural policy that is less common but will ensure a descent living for farmers and viable rural areas, making them competitive on a free world market for agricultural goods. Not all countries might be immediately happy with more modulation, but a fair compromise and wisely designed model, accentuating a certain level of solidarity, can reduce the burden on the EU budget and preserve cohesion amongst the Member States.

NR. 5. HANDS OFF OPTION: RE-NATIONALIZATION

The third and most radical option, for the EU would be to partially re-nationalise the CAP. Re-nationalisation means a shift of decision-making and implementation competences back to the National Governments. The EU does have common interests concerning the CAP, i.e. food safety and quality, environment and animal welfare. The CAP has made huge progress in promoting these common interests by introducing compulsory cross-compliance, modulation and a variety of rural development measures, all aiming towards a multi-functional European agriculture. A re-nationalisation of the CAP would lead to a certain degree of disintegration and would leave States with tasks they may be less effective in dealing with. The CAP has been a highly successful policy; nevertheless it has created a variety of problems. Thus it has constantly experienced change over the last two decades in order to adapt. A re-nationalisation of the CAP would certainly unburden the EU budget but it would also mean that the EU gives up its only entire common policy. Agriculture is certainly very diverse across Europe, but many common interests remain. Hence the EU should strive to design a policy that creates a clear framework. Within this framework, National Administrations should be able to choose from certain policies. They should have the necessary room to manoeuvre concerning its implementation in order to best meet their countries needs. National Governments need to be involved and responsible. They will be granted implementation power and will have to share financial responsibility.

THREE FOLD APPROCAH FOR THE EU CONCERNING THE FINANCING OF THE CAP

1. CO-FINANCING

The EU should already introduce a co-financing of direct aids in 2008, starting with a low co-financing rate of 10%, increasing it year by year up to 50%. NMSs should be granted a transition period and start co-financing at a later point, i.e. at the beginning of the new financial perspective in 2014. The money untied should be directed towards new policy fields of the EU, especially research, education and security. Special care should be taken of the NMSs by granting them bigger shares of these means in the first years, creating cohesion, since a co-financing of direct aids would severely stress their especially tight budgets.

2. INCREASE MODULATION

The EU has to continue to increase its share of modulation, meaning it should continue to shift means from pillar 1 to pillar 2. The money transferred should remain subject to compulsory co-financing. Rural development measures will ensure and foster a multi-functional European model of agriculture. They will give incentives for structural change, making European farmers competitive on a free market.

3. NO MORE DISTORTION

The EU should abolish all trade distorting subsidies in order to contribute to the full success of the DDA. A well designed, intelligently implemented and mutually financed rural development policy will promote multi-functional agriculture being competitive on a world market not entirely through size and quantity but through innovation, diversity, niche-markets and safe quality food of local origin. The Members of the EU have common interests and should continue to promote them together by having an agricultural policy that is becoming "decreasingly common and increasingly targeted, accepted and legitimate". The financing of the CAP can be secured through shared financial responsibility. The usefulness of governmental intervention is justified if trade is not distorted and aid linked to obligations concerning environmentally friendly production of safe high quality food. Only if aid compensates farmers for providing non-commodity outputs (beneficial for everyone) through being engaged in a multi-functional type of agriculture, will it be accepted and financed by the EU citizens.

CORE QUESTIONS TO BE ADDRESSED TO EU CITIZENS AND TO BE TAKEN INTO ACCOUNT BY POLICY MAKERS AND POLITICIANS:

- Is agriculture different from other economic sector and does it therefore deserve and need governmental intervention?
- Should the EU continue to embrace a multi-functional, environmentally friendly and sustainable model of agriculture?
- Farmers are providing non-commodity outputs, i.e. clean environment, safe food, and viable countryside. Are EU citizens willing to compensate farmers for providing these services? Or should farmers be expected to provide these services automatically and if not, should and can they be obliged to do so by norms?

WHAT SHOULD BE DONE *IF* A MAJORITY WANTS THE EU TO CONTINUE PROMOTING A MULTI-FUNCTIONAL EUROPEAN MODEL OF AGRICULTURE AND *IF* A MAJORITY BELIEVES THAT FARMING IS DIFFERENT, THEREFORE DESERVING COMPENSATION THROUGH AID?

- The EU can not and should not entirely give up its CAP
- The EU has to abolish all trade distorting subsidies, opting for minimally trade distorting aids
- Co-financing of direct aids should be introduced by 2008, starting at 10% increasing up to 50% for EU-15 and 2014 for CEECs; this would enormously unburden the EU budget
- The EU should continue shifting financial means to pillar 2 (modulation), promoting rural development; it should do so substantially
- Compulsory co-financing of pillar 2 should be continued so that an increase of modulation can unburden the EU budget considerably

- The aid programs of pillar 2 are the only way to help rural areas and farmers in the long run, promoting structural change and improving the strengths of European agriculture.
- Member States should be able to choose policies and have the power to implement them, making the CAP more targeted, shifting it from a common agricultural policy to a targeted agricultural policy with a strong federal essence.

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