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The Common Agricultural Policy Beyond 2020: Commission's initiative on CAP co-financing points into a promising direction

*Friedrich Heinemann**

55 years after the establishment of the Common Agricultural Policy (CAP) it still absorbs a substantial share of the EU budget. Over the 2014-2020 Multiannual Financial Framework (MFF), the total CAP envelope amounts to over EUR 400 billion. Direct income support to farmers (the CAP's "first pillar") accounts for roughly 70% of total CAP spending and almost one-third of total European Union (EU) spending. Most of the remaining CAP spending falls under the "second pillar," which is used to finance development measures in rural areas. A key feature of CAP financing is that its first pillar is fully financed from the EU budget, with not a single euro funded by Member States' budgets. This is a striking contrast to other major spending items in the budget. For cohesion spending, for example, Member States co-finance substantial shares of all investment projects from national or sub-national budgets.

Restructuring the EU budget to boost added value

In this context, the European Commission recently tried to kick-off an important debate. Its reflection paper on the future of EU finances features a remarkable sentence that has attracted far too little attention to date: "One option to explore is the introduction of a degree of national co-financing for direct payments in order to sustain the overall levels of current support" (European Commission, 2017, p. 24). This cautiously and diplomatically worded initiative is hugely important to the future of the EU budget. If successful, it will open a window of opportunity for restructuring the European budget to create more European added value.

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A recent study by the ZEW Mannheim and the Bertelsmann Stiftung (Heinemann, 2017) provides strong support for reform in this direction and stresses the high and rising opportunity costs of CAP. Given tight EU budget constraints, the high share of the budget swallowed up by CAP is preventing the EU from financing policies that would generate far more added value for Europe than farming subsidies currently do. Spending priorities within the European budget are obviously way out of line with the relative European importance of policies. The spending ratio for CAP relative to EU spending on the Asylum, Migration and Integration Fund in 2015, for instance, was 134 to 1. Alternatively a mere 15 to 20% of the annual CAP budget would be sufficient to compensate for the loss of the UK's net contribution to the EU budget after Brexit.

Scaling back income support for farmers

A particularly obvious case for substantial cuts can be made with respect to the direct payments under CAP's first pillar. Direct payments were introduced to protect the income of farmers who lost out from the liberalisation of agricultural markets. While this argument may have had some plausibility decades ago, it no longer offers convincing justification for continuing with the spending. The ZEW-Bertelsmann study analysed the extent to which first pillar spending provides well-targeted income protection for needy farmers. Its results indicate that CAP is imprecise and, to a large extent, benefits farmers who earn market incomes far above the national minimum income levels as defined by their respective welfare states.

CAP's defendants point out that, today, this policy aims to achieve far more than merely protecting farmers' income support. Examples of its goals include animal protection, climate protection, the preservation of clean soil and water, the provision of public goods like well-kept landscapes and the preservation of cultural heritage. According to the study's findings, however, these objectives do not convincingly legitimize continued CAP spending at current levels. Cultural heritage and well-preserved landscapes are a local or national public good for which European funding is not appropriate. Other targets like environmental protection or animal welfare can be achieved more effectively via straightforward regulation. It is simply astonishing that the agricultural sector expects to be compensated for adopting environmentally-friendly production methods. Hardly any other sector in the European economy receives this kind of generous treatment.

CAP in general, and its first pillar in particular, are probably the clearest candidates for cuts if the EU budget is to be rebalanced towards true European public goods; a step that urgently needs to be taken. In line with the recent Commission proposal, the study recommends a strategy of gradually shifting part of farmers' income support back to the Member States. Given the considerable power wielded by agricultural lobbies and their allies in national governments, national parliaments and the

European Parliament, an immediate cutback of direct payments is hardly feasible. A gradual phasing-in of national co-financing could be more acceptable since it would avoid immediate losses for farmers. From a European perspective, CAP co-financing would nevertheless allow for a substantial reduction of agricultural spending in the EU budget.

The frequent claim that a "renationalization" of CAP via co-financing would trigger a destructive race towards national subsidies is misleading and alarmist. Co-financing does not constitute a renationalization of CAP. Subsidy and internal market rules would continue to be defined at the European level. Co-financing is a mere financing tool and does not imply any changes that would endanger the level playing field for agricultural production.

Co-financing would not only free up substantial resources in the EU budget for truly European policies. There would be a second valuable effect: if farmers' income support were to be reflected in a salient financial burden at the national level, these transfers would start to compete against other national spending items. This, in turn, would fuel a better informed democratic debate over the costly special treatment of EU farmers.

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EconPol Europe

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3) capital markets and the regulation of the financial sector and

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