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On the future of CAP Direct Payments…

a proposal for addressing their joint economic and environmental output complementarity

ELO event on The Future of Direct Payments
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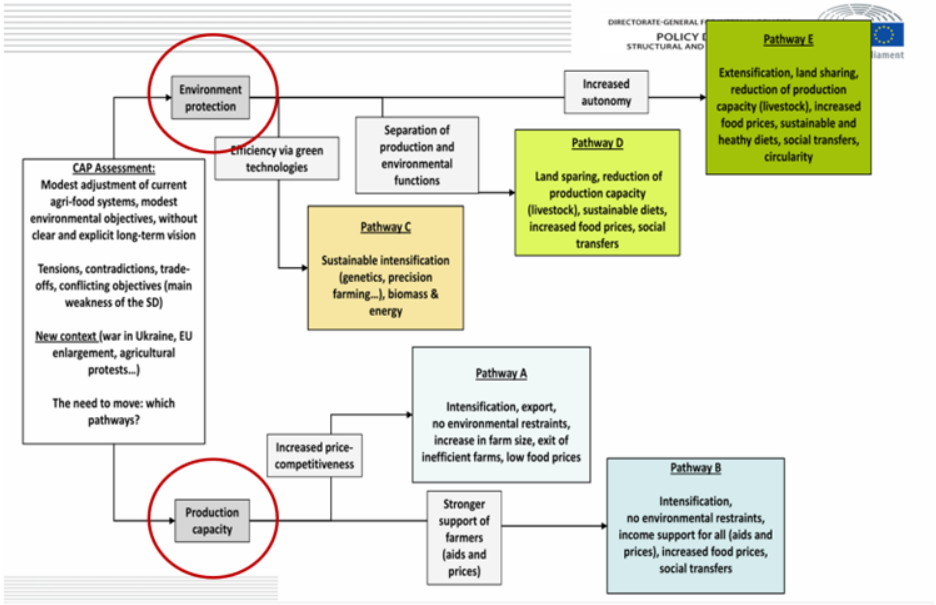
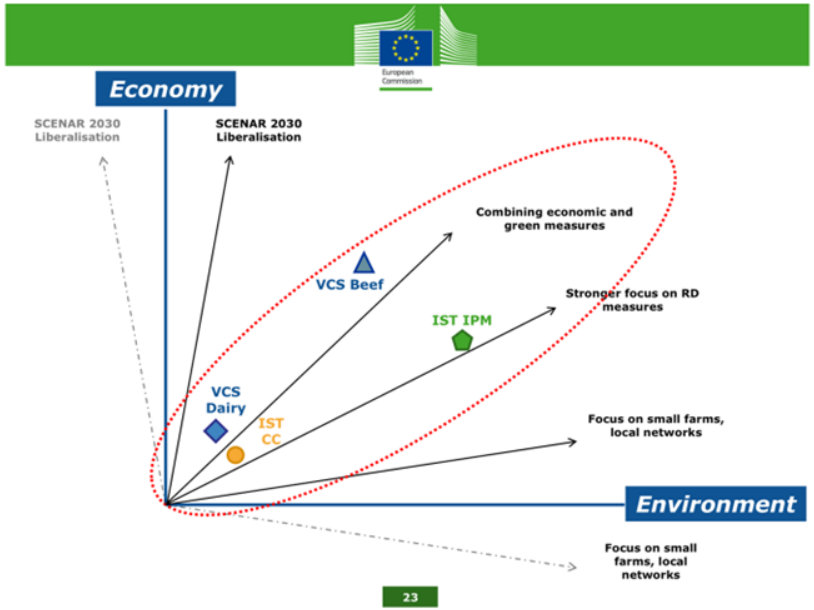
Forum for the Future

Lest we forget…

INRAE/IDDRI Study "The next reform of the CAP: The variables in the equation". January 2025



DG AGRI Scenarios, CAP Impact Assessment, January 2017.



What this is all about!

❑ Jointness of economic and environmental output

- Splitting farm income from environmental obligations comes at a measurable cost, **addressing farm economic and environmental output together** taps on existing but underutilised opportunities

❑ Sustainable productivity

- The **polarisation** of the policy debate **around climate change action and food security** distorts fact-based global needs and **leads to inefficient policy choices**

❑ Simplification in enhancing policy performance

- **CAP simplification** is a **prerequisite for** policy performance only if it does not lead into lowering policy ambition but enhancing performance by **exploiting synergies** in policy measures with similar impacts

The markets, they were a-changin' (even before T)...

❑ The production landscape (according to OECD-FAO)

- ✓ Next decade prospects - **strong growth** in **fuel and feed**, **lower growth** in **food**, **stagnation** in **fibre** production
- ✓ Many players in food commodities, fewer players in feed and soybeans - **trade increasingly covers deficits**
- ✓ **Livestock and feed driven by income** growth, while **population** growth **drives wheat and rice** prospects

❑ The consumption landscape (according to OECD-FAO)

- ✓ **Asia and Africa** now account for **50%** (in meats) **up to 75%** (in cereals) **of global consumption**
- ✓ **China**'s demand **slows down** in the future, but **India, Southeast Asia and Africa increase** demand strongly
- ✓ OECD is losing consumption share everywhere, the result of slow population growth and shifts in dietary patterns

❑ The trade landscape

- ✓ **Global tensions** disturb trade, with the impact of the Russian invasion in Ukraine especially marked in grains
- ✓ **Food-security risks and the role of trade are often underestimated**, thus distorting farm policy priorities
- ✓ **Polarisation treats climate change action and food security as substitutes instead of complements**

...confronting the CAP with untested waters

❑ Food inflation

- ✓ **Food inflation** turned into a **global problem**, but expressed more acutely in the EU than elsewhere
- ✓ The **huge gap between EU producer and consumer prices** requires clear assessments of its root cause
- ✓ **Distorted price transmission signals** act as a major **disincentive for green transition** at the consumer level

❑ EU energy price uncertainty

- ✓ It is not crude oil but **natural gas** availability and prices that **complicates the EU's green transition**
- ✓ **Higher fertilizer prices** due to gas prices act both as incentive for efficiency gains and burden on competitiveness
- ✓ The potential **impact** on nitrogen fertilizer prices **complicates choices on best practices and precision farming**

❑ Impact from geostrategic tensions could be globally huge and needs to be accounted for

- ✓ The **war** in Ukraine impacts long-term prospects for grains, potentially **differentiating wheat importer sourcing**
- ✓ **Tensions Sub-Saharan Africa** link security risks to food security due to demographics and slow productivity
- ✓ The **energy and raw material dependence** turns geostrategic tensions especially acute for the EU

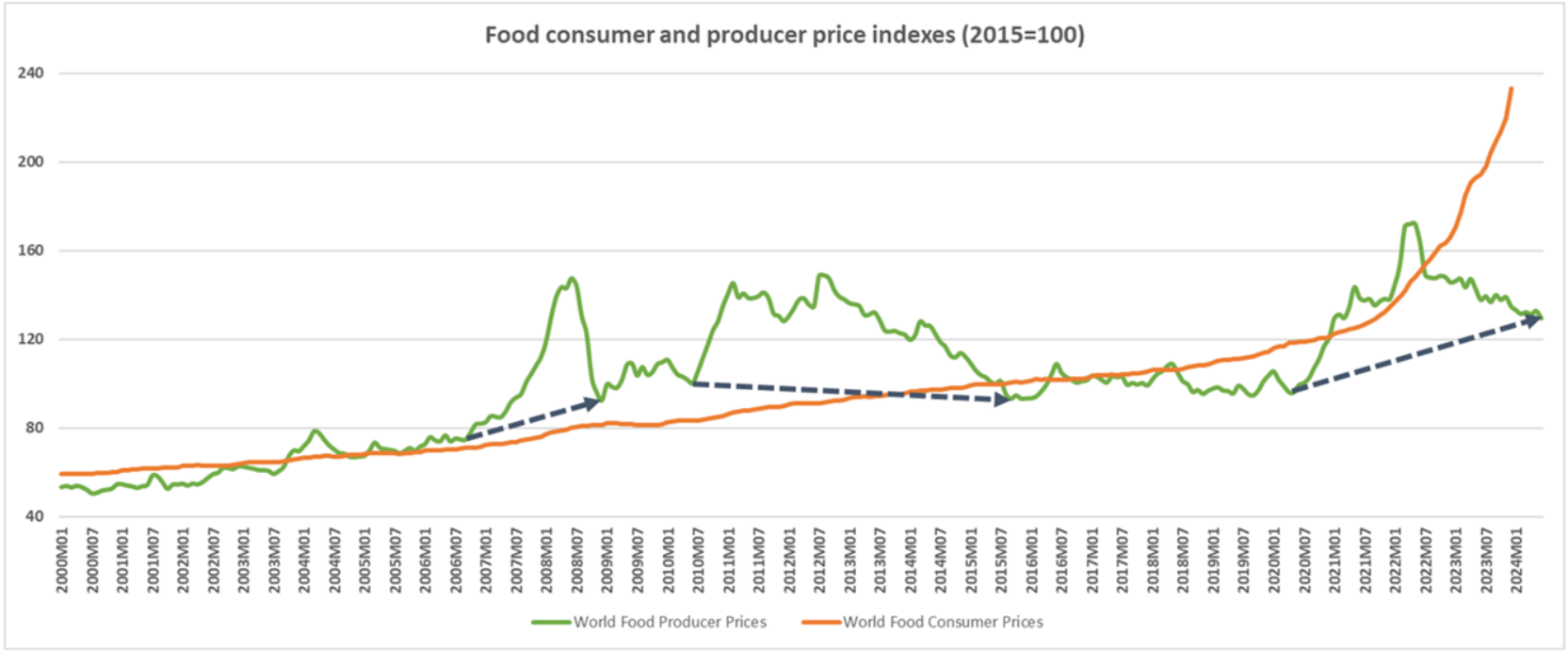
Deterioration of long-run Terms-of-Trade for agriculture

	Price Indexes in real terms				Price Indexes in nominal terms			
Period	Food	Fertilisers	Energy	Metals & Minerals	Food	Fertilisers	Energy	Metals & Minerals
2024/1985	**24%**	**81%**	**46%**	**96%**	**138%**	**249%**	**181%**	**278%**
1994/1985	**-15%**	**-30%**	**-56%**	**-3%**	**20%**	**-2%**	**-38%**	**37%**
2004/1995	**9%**	**40%**	**142%**	**13%**	**1%**	**30%**	**124%**	**5%**
2014/2005	**38%**	**39%**	**29%**	**14%**	**70%**	**72%**	**60%**	**41%**
2024/2015	**11%**	**2%**	**31%**	**36%**	**31%**	**20%**	**54%**	**59%**

Source: Own calculation based on World Bank. Prices are in real terms.

Note: Food excludes cotton, rubber and tobacco from the WB agriculture price index.

The recent food inflation path is unique

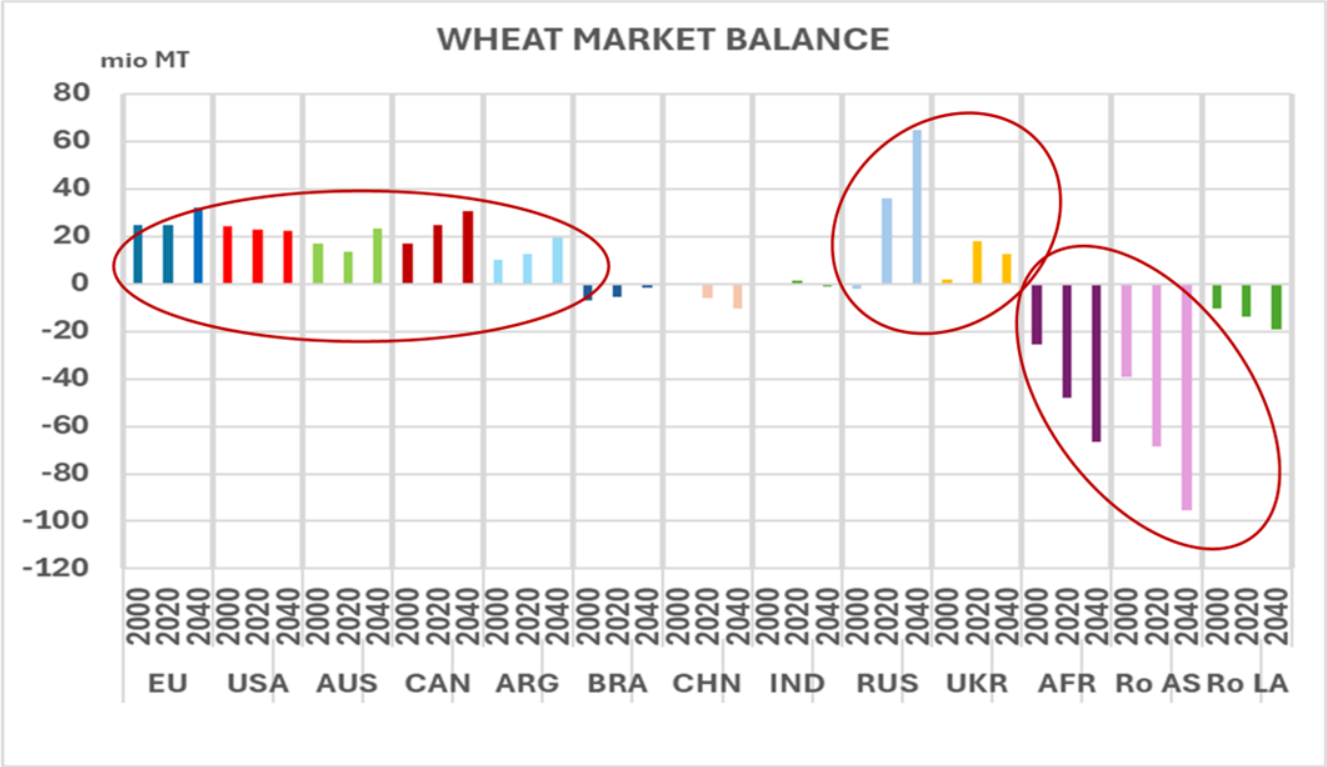


Source: J. Baffes (World Bank). Global Food Price Inflation: Trends, Channels, and Insights, AAEA Annual Meetings, Jul 31-Aug 1, 2024.

Wheat outlook reflects major shifts of past trends

Change 2020/2000 (mio MT)		
EU	-0,31	-1,88
US	-1,57	
AUS	-3,25	7,56
CAN	8,03	
ARG	2,78	
BRA	1,37	-3,22
CHN	-5,90	
IND	1,31	
RUS	37,74	53,77
UKR	16,03	
AFR	-22,09	-48,66
RoLA	-3,66	
RoAS	-26,57	

Change 2040/2020 (mio MT)		
EU	7,53	7,05
US	-0,48	
AUS	9,60	22,08
CAN	6,02	
ARG	6,46	
BRA	3,73	-2,80
CHN	-4,26	
IND	-2,27	
RUS	29,05	24,00
UKR	-5,05	
AFR	-18,75	-46,68
RoLA	-5,31	
RoAS	-27,93	



Source: Own calculations based on 2024 OECD-FAO Outlook.

In a changing world, has the policy debate adapted?

- **Who is afraid of productivity?**
  - What prospects for **sustainable productivity growth**, and how to address **competing land use demands**?
  - What are the long-term prospects for **price developments**, both at producer and at consumer level?
  - EU agricultural **inputs** heavily **depend on energy and science**; in the EU, both currently act as constraints
- **What is afraid of science?**
  - How to address the **long-term deterioration of the terms of trade for agriculture** with new knowledge?
  - How to resolve the **paradox of different attitudes on biotech** for human, animal and plant health?
  - How to limit the ways, yet expand the scope and efficiency of **measuring carbon footprint**?
- **Who is afraid of trade?**
  - **Trump's election** brutally **challenges** the very **foundations of global rules** on borders, science and trade…
  - **…yet trade complements actions addressing food insecurity**, and thus broader security considerations
  - **EU agriculture** clearly **gains from trade**, but addressing potential **loser concerns** has been weak

Treating an asset as a liability

- **The EU's food system is anything but broken, but is still treated as such**
  - **EU agri-food competitiveness** is high, but the Draghi report chose to omit the sector
  - **Productivity** growth based on high **food safety standards** turn **EU** food into **a world leader**
  - **Innovation potential** is high, especially **in earth observation** where EU is world leader
- **Major aspects of CAP performance are systematically ignored**
  - EU's is the only major global agriculture that **reduces emissions while increasing output** volume and value
  - CAP **major contributor to** measurable reform impact in terms of **reducing trade distortions** (OECD **PSE**)
  - **Decoupled income safety net results** factually **better than any alternative**, price-linked policies
- **The CAP between a rock and a hard place**
  - The CAP continues to be a **big part of a small budget**, generating "subsidy envy" among other EU policies…
  - …with **disproportionate focus on weaknesses** due to agriculture's dual role as carbon emitter and sink…
  - …and the **weak focus on facts** relating to the asymmetric impact of existing best practices and experiences

Back to the CAP's future…

- **The inevitable, yet less prone to change, issues in the EU's farm policy debate**
  - **Total income of farm households** – national tax systems already address this, and it should stay like that
  - **Convergence of direct payments** – opportunity costs of land and labour hugely differ among MS
  - **Reverse the downward trend of farmers** – this will continue, driven by the broader economy in rural areas
- **The inevitable, and very relevant for change, issues in the EU's farm policy debate**
  - **How to better target support** – more focus on better land management to help income and environment
  - **How to measure CAP impact** – big picture matters, but which indicators best reflect performance?
  - **How to balance national and EU interests** – flexibility is possible, but CAP legitimacy requires transparency
- **The difficult questions that we rarely ask and even more rarely try to answer**
  - ***Do we want to stop structural change in agriculture?*** Farm numbers will decline, rural areas can still thrive
  - ***Is it focus on area that is the problem?*** Focus on individual farmer more problematic and uncontrollable
  - ***Do we cover part or all farm area? Do we keep conditioning annually?*** Choice linked to redistribution

...and its link to global agriculture

- **What's next for the suspended step of the Farm to Fork?**
  - ✓ Is the "Strategic Dialogue" a prelude of new vision and strategy or opportunistic tactics focusing on process?
- **What to expect from the "Fork" side of the F2F?**
  - ✓ The farming sector needs to know which directions policy (and consumers) will actually follow
- **What are the long-term prospects for price developments?**
  - ✓ Farm prices can resume their long-term downward trend in terms-of-trade; but what about food prices?
- **What impact on EU agriculture from the energy transition?**
  - ✓ The EU fertiliser industry heavily depends on prospects of natural gas and nitrogen markets
- **What impact on global agriculture from the global realignment of forces?**
  - ✓ Food security is linked to broader security considerations (including in Africa)
- **How does the CAP policy debate adapt to a dramatically changed world environment?**
  - ✓ Narrative still reflects Paris Agreement collaborative ideas in a world where common rules are under attack

The policy dilemma: whither direct payments?

❑ Dilemma No 1: public money (only) for public goods?

- ✓ A slogan more than a policy proposals, it **fails to see** that there are **also failures in** the **markets of private goods**
- ✓ **Agri-environmental measures** are actually **compensating *maximum* marginal cost** instead of "cost incurred"…
- ✓ …**resulting in overcompensation** of existing practices, unfavourable **distribution issues**, and **poor efficiency**

❑ Dilemma No 2: how to address jointness in economic and environmental outputs?

- ✓ The manner by which **farming activity** generates **outputs** is **inseparable** – photosynthesis reminds us of this
- ✓ Optimising output while minimising environmental footprint **requires policy measures** that act **as compliments**
- ✓ **Covering all land** with such policy measures rather than splitting nature-friendly islands from the rest is key

❑ Dilemma No 3: how gradual should the path of adjusting/abolishing direct payments be?

- ✓ The **pressing target** on direct payments should be **redistribution** – based on opportunity cost of land and labour
- ✓ **Gradual targeted convergence path** should create space for generational renewal by benefiting farm transfers
- ✓ "**End point**" should reflect economic realities to **avoid a debt crisis** in a sector whose asset values are land-linked

Why old habits die hard…

❑ The strengths of decoupled payments

- ✓ Provided a **valuable and proven income safety net** at times of high commodity market volatility
- ✓ Established a **solid administrative basis** for policy implementation (but also for vested interests…)
- ✓ **Linked** support based on **economic criteria with broader food safety/environmental dimensions**

❑ The strengths of coupled payments

- ✓ **Sustained economically an environmentally invaluable sector** (grassland-based extensive livestock)
- ✓ **Constrained budgetary outlays** to stay within clear predefined limits
- ✓ **Allowed** targeted **product-specific support** where and **when social economic or criteria justify it**

❑ The strengths of agri-environmental payments

- ✓ Constitute the **targeted support par-excellence**, linking specific measures to actual environmental needs
- ✓ **Reflect the diversified nature of agriculture**, overcoming the “one-size-fits-all” approach
- ✓ **Promote innovative, bottom-up approaches** linking multiple actors to common actions and objectives

…often masking implementation challenges

❑ The weaknesses of decoupled payments

- ✓ Their present **(re)distribution lacks reference to pertinent criteria**, becoming an accounting exercise
- ✓ Conditionality/cross-compliance is based on **prescriptive measures** rather than actual needs
- ✓ **Red-tape** undermines the very logic of their market orientation under conditionality constraints

❑ The weaknesses of coupled payments

- ✓ Availability in sectors lacking evidenced-based need to preserve production **hampers structural adjustment**
- ✓ Control requirements and annual nature of payments remain a significant **administrative burden**
- ✓ **Compete with agri-environmental measures** addressing same needs (e.g. extensive livestock, protein crops)

❑ The weaknesses of agri-environmental payments

- ✓ They require a farm-based approach, yet they are **aggregating across farms with different characteristics**
- ✓ Selection of **criteria often arbitrary**, based on best-practice experimental results rather than actual farm needs
- ✓ **Administrative burden heavy**, especially for farms where farm advice and knowledge transfer is weak

What future payments could do – an option

❑ Put the horse in front of the cart on timing and targeting of support measures

- ✓ **Focusing on adaptation measures** rather than mitigation is essential to make tangible existing solutions
- ✓ **Prioritising soil** simultaneously helps water, air and biodiversity – the opposite is not true
- ✓ Every farmer has basic knowledge of their soil – **support should be based on trying to improve soil health**

❑ Cover all agricultural area with payments conditioned on improvement of soil health

- ✓ **Use available data** (soil maps, Lucas surveys…) **to define regions based on agronomic criteria** (this exists!!!)
- ✓ **Redistribute** all area payments **based on land rents and PPP-adjusted wages** (data exist at MS/regional level)
- ✓ Provide a **smooth transition** to new support level recognising economic/social realities of EU agriculture

❑ Accept that land management practices provide results slowly and variably

- ✓ **Measure** regional 3-year average **soil health at beginning and end of transition** (incentivise farm level data)
- ✓ **Further redistribute payments at the end of transition based on** measurable results of **soil improvement**
- ✓ **Benchmark redistribution** based on deviation from average performance (with regional discounts/premia)

What such an option could offer, and its risks

❑ Simplification and harmonisation

- ✓ **Merge all direct payments into one, multiannual system** with a **common conditionality** targeted on soil
- ✓ **Recognise** in policy design the economic and environmental **jointness of agricultural production**
- ✓ **"Repurpose" support** based **on** a limited number of **measurable indicators reflecting real farm conditions**

❑ Commonality in challenges with alternative approaches

- ✓ All potential **implementation challenges** are **identical to "public money for public goods" approaches**
- ✓ The need to establish **carbon-linked policy measures** (taxes, tariffs, subsidies, incentives) **pass from the soil**
- ✓ **Enhancing** the quality of the **most valuable farm asset** – land – increases **attraction of private investments**

❑ What could go wrong

- ✓ **Vested interests in current system** – actors of the 2 pillars are accustomed to enjoy their splendid isolation
- ✓ **Bureaucratic inertia** – resistance to soil health monitoring despite existing data in public and private domain
- ✓ **The irresistible charm of endless objectives and indicators** – to discover ex-post the failure in outcomes

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Thank you!

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