Reducing Waste In Public Expenditure - The Potential Within The Common Agricultural Policy

Berkeley Hill [1]

Emeritus Professor, University of London (Imperial College London)

Paper prepared for presentation at the 87th Annual Conference of the Agricultural Economics Society, University of Warwick, United Kingdom

8 - 10 April 2013

Abstract

The current and prospective direct public expenditures on agricultural support are set against estimates of the costs of alternative ways of providing the outcomes (economic, environmental and social) generated by instruments proposed for the Common Agricultural Policy for the period 2014-20. Central in the discussion are the objectives that the CAP is attempting to achieve and the identification of the net impacts that it has currently. Ways of making estimates of generating the outcomes and their determining factors are considered. A conclusion is that a large potential exists for reducing public spending or of diverting it from the CAP to other policy areas. How this might be achieved in the face of rent-protection, organisational self-interest and national politics are outlined.

]

Keywords Common Agricultural Policy, Public Expenditure, Evaluation

JEL code: H4, Q1

[1] Berkeley Hill, 1 Brockhill Road, Hythe, Kent CT21 4AB b.hill@imperial.ac.uk

1 **Introduction**

Within the specialist branch of economics called policy evaluation a regular part of the practitioner's toolbox (mandatory in certain areas)[2] is the consideration of alternative ways to achieve given objectives; these alternatives include the option of not intervening at all, or doing so in a *de minimis* manner (such as running out existing schemes), This discussion paper focuses on how some core objectives of the present system of CAP support could be achieved in a more direct manner, with the potential to use fewer public resources. The implication is that the present ways of using of public funds may turn out to be wasteful.

Identification of waste in public spending seems particularly appropriate in a time of financial austerity when national governments of EU Member States are keen to reduce public expenditure. In the UK new projects (such as the HS2 rail line) are politically contentious where they are seen as in conflict with continuing support of social or environmental programmes. Similarly, the EU is needing funds to bail out countries in deficit and to provide support to financial institution, the failure of which could carry major consequences for the European economy. Under such circumstances all existing policies must expect close scrutiny for evidence of waste in the use of public resources and remedies sought.

So far, the EU's Common Agricultural Policy (CAP) appears to have escaped serious attention for waste elimination. Explanations must include the long-period nature of commitments under the Financial Perspectives (now the Multiannual Financial Framework) and the political sensitivity that proposed cuts would engender in some countries. However, evaluators of rural development programmes in the EU are told by the European Commission to demonstrate that the chosen instruments are the most cost-effective (or if not, to justify their choice). It seems not unreasonable to apply this principle to the broader CAP. If the same outcomes could be achieved with fewer resources using alternative instruments, then there is prima facie evidence for the waste of public funds. Of course, there may be structural and political impediments to change, but at least the direction of desired adjustment would be clear.

This short paper attempts to go through the steps necessary to identify and, in broad term, indicate the potential for reducing public expenditure under the CAP by the use of alternative instruments to achieve the policy outcomes of the present system. Even with many unknowns it is clear that potential savings are large.

2 The budgetary cost of the CAP

The first, and easiest, step is to quantify the current spending on the CAP. It and related policies directed at 'natural resources' (agriculture, forestry, fishing etc.) currently absorb almost half of the spending on all activities from the EU budget – some €396 billion (at 2004 prices) over the period 2007–13, or 45% of total EU spending. Planned expenditure for the period 2014–20 is €383 billion (at 2011 prices), or more than double the amount used for the second Greek bail-out.

Most of the current CAP spend – €293 billion in 2007-13 – goes on 'Pillar 1' support, more than fourth-fifths (84% in 2011) of which consisted of direct income payments to farm operators under the Single Payment Scheme, the remaining 16% being about equally divided into other forms of

[2]Such as Strategic Environmental Assessments – SEAs - in the European Union

direct payments and the cost of intervening in commodity markets to support farmers' incomes. In 2011 €36.2 billion was spent on SPS payments. In the UK alone, the Single Payment Scheme in 2010 cost €2.5 billion. Planned spending on direct income payments (and the remaining market related expenditures) to farmers for 2014-20 is €278 billion[3] for the EU as a whole; it is among these payments that the case for cutting is strongest and the opportunity for making savings in the CAP is greatest.

3 The policy aims of the CAP

A second, but much more contentious step, is to identify the purposes for which spending under the CAP takes place, and hence the intended policy outcomes for which alternative delivery mechanisms might be sought. If there are no policy aims behind interventions, the resources they absorb are, by definition, wasted. The key to these are the CAP's objectives, stated or implied. Of course there may be other, higher-level aims, such as building a cohesive Community (in which the CAP could be said to have played an important early role) and, now, contributing to the Europe 2020 Strategy for smart, inclusive and sustainable growth. But at the level where alternative ways of implementation come into sharpest focus, it is the aims of the CAP that are most relevant.

Here there is a dilemma. On the one hand, the legislation that permits the use of EU resources within the CAP is quite clear on objectives. The current legal base is the 2010 Consolidated Version of the Treaty on the Functioning of the European Union (*Official Journal of the European Union, C83, March* 2010), the new name given by 2007 Treaty of Lisbon to the Rome EEC Treaty of 1957. There the original wording of the 1957 Treaty of Rome are carried over, with its reference to inter alia 'ensuring a fair standard of living for the agricultural community' (see Box 1). The *Agenda 2000* agreement, while not having the same legal authority of a Treaty, nevertheless includes a restatement of CAP aims that was agreed (in 1997) by all the (then) Member States (both their agricultural ministers and the Heads of State meeting as the European Council). The assurance given to the fair standard of living of the agricultural community was carried over, word for word, from the 1957 Treaty of Rome. The added mention in *Agenda 2000* of stability registers the Commission's concern with one of the fundamental problems facing agriculture. Perhaps surprisingly, the Regulations that put the CAP into operation are also clear on the importance of the 'fair standard of living' Even the 2007 'Single CMO Regulation' (Council Regulation (EC) No 1234/2007) mentions this aim for support under the rump of market regulation (paras. 10, 24 and 29). The February 2013 MFF agreement by the European Council again cites the Treaty's 'fair standard of living' words when commenting on the objectives of the CAP (European Council, 2013, para 61). Many non-governmental commentators (reviewed in Hill 2012a) have concluded that CAP reform has been opposed principally on the grounds of the implications for farmers' incomes (though without much distinction being drawn between the rewards from agricultural activity and the resources available to farmers' households). Thus there can be little dispute about the relevance of the 'standard of living' as a core aim in the CAP's legislation, though several authors point out that the EU institutions have never defined what is meant by a 'fair standard of living' in this context, or who comprise the 'agricultural community' (including Court of Auditors 2003, Hill 2012a, EEIG AGROSYNERGIE 2011).

[3] European Council Multiannual Financial Fremework agreement of 7/8 February 2013

Box 1 Official statements in legislation of CAP objectives

Consolidated Version of the Treaty on the Functioning of the European Union (2010)

Article 39

(ex Article 33 TEC)

1. The objectives of the common agricultural policy shall be:

(a) to increase agricultural productivity by promoting technical progress and by ensuring the rational development of agricultural production and the optimum utilisation 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 stabilise markets;

(d) to assure the availability of supplies;

(e) to ensure that supplies reach consumers at reasonable prices.

EN C 83/62 Official Journal of the European Union 30.3.2010

Box 2 The 'new' objectives for the CAP were, as set out in *Agenda 2000*:

- [To] 'increase competitiveness internally and externally in order to ensure that Union producers take full advantage of positive world market developments;
- Food safety and food quality, which are both fundamental obligations towards consumers;
- *Ensuring a fair standard of living for the agricultural community and contributing to the stability of farm incomes* [emphasis added];
- The integration of environmental goals into the CAP;
- Promotion of sustainable agriculture;
- *The creation of alternative job and income opportunities for farmers and their families* [emphasis added];
- simplification of Union legislation'.

The second part of the dilemma is that the Commission in **implementing** the CAP has almost totally ignored the issue of the fair standard of living of the agricultural community. Its instruments have never been directed at the agricultural household (the unit most appropriate for the assessment of standards of living and the target for interventions to make it 'fair'), and the EU's official statistics has no working system for measuring standards of living in agriculture or the income indicators that would be reasonable proxies (a situation criticised by the Court of Auditors (2004)). Recent Commission articulations of concerns about incomes in agriculture are largely concerned with the impact that inadequacy in rewards would imply for food supplies and the provision of pubic goods (implied by the term 'sustainable agriculture' and how income instability can be coped with by the sector. In Commission documentation describing the CAP towards 2020 (Commission 2010) and the related publicity material on the website, there is no mention of the objective of achieving a 'fair standard of living' for the agricultural community.

Nevertheless, the Commission tries to imply that farmers are a hard-done-by group   In the lead up to making proposals for the CAP in the period beyond 2014, it asserted in several documents that incomes in agriculture compare unfavourably with those in the rest of the economy. To take only one example, the Commission's *Impact Analysis* of its CAP reform proposals (October 2011) comments on the relatively low level of income in the agricultural sector; "For the period 2008–2010, the average agricultural income in the EU-27 was slightly less than 40 per cent of the average wage in the total economy'' (European Commission, 2011a, pp. 17–18). Of course, such figures, based on earnings from agricultural labour inputs, ignore the fact that farmers and their household members often have non-farm jobs and other forms of income, found among all sizes of farm but particularly prevalent among the operators of small farms. where incomes from agriculture are lowest on average.

However misleading the Commission's figures are when viewed in a welfare context, the myth they create helps to legitimise continued spending under the CAP's Pillar 1 and to protect the size of the budget controlled by the Directorate-General for Agriculture and Rural Development. Such assertions are convenient for governments wishing to broadly maintain the Single Payment Scheme arrangements. For example, in a discussion paper on CAP reform and the role of SPS, the Welsh Government claims that, in addition to compensating farmers for their provision of public goods, 'Paying farmers income support is important in itself as the agricultural sector is a low income sector in the economy' (Welsh Government, 2013). The Commission has been noticeably unenthusiastic about developing comprehensive statistics on the disposable income of farm households in the EU; to do so would clearly undermine its position and the myth it tries to perpetuate.

What evidence that exists does not support the view that personal or household incomes in agriculture under the present CAP are anything like as low as the Commission implies. What is known from a handful of EU Member States with suitable microeconomic data sources (see Hill 2012a, 2012b) suggests that household income (disposable income in some cases) in most countries for which data are available is more likely to be at approximate parity with all-households averages, substantially above the level suggested by the Commission (using an inappropriate indicator). For example, for the UK, Defra has estimated that the average household income of people it regards as 'principal' farmers in England was £45,400 in 2007–08, as against the equivalent of £31,700 for English households overall. In France in 2003 farm households had average disposable incomes 5% higher than the national average, though their larger household sizes gave them an income per person some 15% lower. In addition (though usually ignored), farm households are typically far wealthier than the average; claimants of support for the cost of accommodation in care homes in England would probably see this as extremely unfair. Of course, averages tell us little that is relevant to whether there is a problem of 'fairness' in incomes; this is more concerned with distributions and the incidence of low incomes. Disparate information sources tend to point to the characteristic of a greater share of farmers as having low incomes in a particular year than does the general population, something which is returned to later (OECD, 2004).

Thus, in summary, there is a major disjunction between the objectives stated in the legislation that validates spending under the CAP and the way in which it is implemented, a situation that should open up the possibility of legal challenge. Furthermore, the Commission seems intent to give and impression about relative living standards that are not borne out by evidence (as shown by household incomes). While both the Court of Auditors (2004) and the evaluators of CAP direct income payments (EEIG AGROSYNERGIE, 2011) – among others - make recommendations about improving statistics on agricultural household incomes, the Commission has not placed any priority in filling this gap. With governments and the EU claiming commitment to 'evidence-based' policy, the CAP sticks out as being characterised by a failure to provide data by which its core objective can be justified and monitored. It seems that there is much self-interest in maintaining a state of ignorance (this line of explanation is developed in Hill (2012a) and UN (2005/2007) and FAO (2011)).

This paper proceeds on the assumption that the living standards of farmers is central to the aims of the CAP, even if these do not form part of the Commission's articulation. Certainly, many commentators have regarded the impact on them as a brake on reform.

4 The policy outcomes of the CAP

The next step is to identify the impact that the current CAP is having in furthering the objectives set for it (or implied), as a precursor to considering alternative ways of achieving these outputs. The Commission's 2011 'A Budget for Europe 2020' states that the CAP 'is designed to deliver a sustainable agricultural sector in Europe by enhancing its competitiveness, ensuring an adequate and secure food supply, preserving the environment and countryside while providing a fair standard of living for the agricultural community'(Commission 2011c, p15). The inclusion of the last phrase may reflect the closer attention of DG Budget to the legal basis of CAP expenditure than of DG Agriculture and Rural Development.

It seems unlikely that spending on Pillar 1 helps with most of these aims, though Pillar 2 spending may, especially with regard to the environment. In terms of enhancing competitiveness, Pillar 1 payments are more likely to slow down the exit by relatively inefficient producers and the transfer of their land to ones who are, or have the potential to be, internationally competitive. It could be argued the security of our food supply could be better achieved by a modernised and competitive industry than one dependent on the cushion of direct payments, and that their removal would not pose a threat to agricultural production.

The history of direct payments is too well known to need repeating here, though it should be noted that their original rationale as 'compensatory payments' for the changes made in market support in the 1992 MacSharry reforms was dropped some time ago. Because payments were originally linked to the volume of production, the largest farms still receive the biggest sums. These payments are now mostly 'decoupled', in that they are given without any requirement on the part of farmers to produce anything marketable. There are conditions ('cross-compliance'), such that the land has to be kept in so-called 'good agricultural and environmental condition' and statutory obligations respected. So there may be some incidental environmental benefits from Pillar 1 , but the SPS payments are a highly costly way to achieve them. What we have at the moment is rather like arguing for the entire spending on our armed forces to be maintained because of the artistic benefits to society coming from the professional musicians employed in military bands; these may be real, but hardly justify the purchase of Trident.

Under the proposals for the CAP from 2014, these direct payments will be made under the Basic Payment Scheme. The draft legislation is virtually dumb on what these are for (Commission 2011b). But according to the Commission website, 'Direct payments ensure a safety net for farmers in the form of a basic income support, decoupled from production, stabilizing their income stemming from sales on the markets, which are subject to volatility'. Certainly there is no mention of the standard of living of the agricultural community and the role that the Basic Payment is expected to play in securing them.

Nevertheless, as pointed out above, this 'fair standard of living' remains in the legal basis for making such payments, and here we will focus on the impact of direct payments on household income, a common proxy. One approach is to estimate the impact withdrawing them, with special attention given to households likely to suffer poverty. Of course, such an exercise should take into account that (a) farm household have multiple sources of income, and that a given fall in their income from farming will often represent a smaller change in their total income; and (b) withdrawal is unlikely to be unannounced and instantaneous, so that farm households would exercise opportunities to adjust (such as by changing their on-farm activities, diversifying both on and off the farm, and changing farm size). Even if were withdrawal sudden, many farm households will have other resources that can be utilized during this adjustment period (other assets, finance borrowed against farming assets etc.). The ability of farmers to make adjustments is often underestimated but has been demonstrated countless times (see Blandford and Hill, 2006) and in the longer term structural change would inevitably help maintain the incomes of those left in agriculture.

The evaluation for the Commission of income effects of direct support (EEIG AGROSYNERGIE, 2011) found that it was not possible to evaluate their role in farm household total income 'in spite of noticeable interest in this matter'. Instead, it attempted to answer the question 'To what extent have the direct payments contributed to achieving a fair standard of living for the agricultural community, by stabilising and enhancing the income of farmers?', something rather different. Its conclusion was that calculations made by deducting direct payments from the weighted average of the farm income for the period 2004-2007 indicated that the removal of direct payments would have led to a 27% fall in farm income value, though more in the case of some farming types (such as grazing livestock) and less in others (such as horticulture). Of course, this crude approach ignores the adjustments that farmers would make and is therefore an over-estimate of the impact on the income from faring. Its implications for change in household income would be further diluted by income from other sources (which is found across the size range but is particularly important among the smaller farms).

A major problem in attempting to assess the impact of direct payments, and their removal, on farmers' living standards is that no reliable data exist for farm household incomes at EU level (see Hill, 2012a; FAO, 2011). Such data would enable the numbers of EU farm families currently in poverty to be established and models created to estimate the impact of removing direct payments[4].

[4] An example of an attempt to use household budget surveys to identify poverty was the general micro-based research study of poverty published by Eurostat in 1994 (Hagenaars *et al.*, 1994). Both income and expenditure approaches to assessing poverty were considered, using poverty lines set at various national levels. However, the usefulness in a CAP context is reduced, firstly, by the amalgamation of the households headed by farmers with those headed by agricultural workers. Secondly, the authors conceded that the quality of the survey-based income data was frequently poor; in that self-employed people typically understate their incomes, the degree of poverty will be overestimated. For farmers, data on expenditure might also be highly misleading as to real consumption and standards of living. The percentage of the households of agricultural workers and farmers shown to be in poverty in each of the EU-12 countries was typically higher than that of other economically active household groups but lower than the unemployed and of a similar order to the retired. By way of example, in France 25% of the agricultural group were in poverty (below half the arithmetic

In 2010 the England's Rural Advocate claimed that a quarter of farm households were in (relative) poverty, with incomes that were less than £20,000 per year (the official poverty line was about £18,000 for a household of two adults and two dependent children at the time). However, the validity of the Advocate's assertion is hard to judge in the absence of reliable data on a household basis for the UK. Nevertheless, a survey of literature over a long period on the incidence of poverty in OECD agriculture (in Hill, 2012a), though patchy in terms of countries covered (including Austria, Australia, Canada, France[5], Ireland, USA) and using data sources that are far from ideal and focusing on income rather than consumption poverty, often comes up with a figure of about 20% of farm households falling below the official poverty line in a given year. In what follows this is taken as a working assumption.

Thus, in the present state of knowledge it is not possible to obtain a reasonable estimate of the extent to which removal of direct payments would impact on farm household incomes and change the incidence of income poverty there. In the face of this information gap another approach is necessary.

5 Approximations of alternative delivery systems

Discontinuing the system of direct payments was once a serious option. In 2007 the then Commissioner for Agriculture (Mariann Fischer Boel) indicated that the Single Payment Scheme would be unlikely to survive. This produced a predictably angry response from farmers' representative. Since then, the Commission's position has changed, and even Defra's enthusiasm under the former Labour government for dismantling the system of direct payments has cooled; it is clear that direct payments will continue up to at least 2020. The Commission's focus has shifted to how a relabeled set of payments (the Basic Payment Scheme) can be made to appear 'greener' and the distribution of benefit shifted. These 'policy innovations' seem to be designed to increase the political acceptability of these payments but will, in all likelihood, result in even greater negative impacts on efficiency.

Though radical change has been put off until at least 2021, it still makes sense to ask 'What sum has to be reserved to achieve the economic, social and environmental outcomes of present direct payments?'

It is probably easiest to start with the environmental benefits that flow from direct payments. Funds would be required for agri-environment schemes to deliver, more effectively, the rather modest environmental benefits accruing currently from cross-compliance applied to direct income payments. A rough estimate, based on applying England's entry-level agri-environmental scheme to

---

mean national household expenditure, corrected using a modified OECD equivalence scale), compared with 11% of private sector manual workers, 8% of other self-employed, 22% of retired households and 35% of the unemployed. However the problem of data quality, and some surprising internal inconsistencies, suggest that study's figures should be treated with great caution.

[5] in France in 2003 some 38% of farmers had (disposable) income per consumer unit below the official minimum wage, though it should be borne in mind that incomes from farming can vary widely between years, and that for many (evidence from Norway suggests a majority) a low income in a particular year does not indicate a permanently low income, so the French figure is likely to be an over-estimate of those suffering income poverty.

the whole EU farmed area, suggests some €7–8 billion per year would need to be spent (though some of this may already be covered in agri-environment spending under Pillar 2), which compares with the current annual spend on direct income payments of €44 billion (2012). An advantage of such a scheme is that it would lead to a far clearer link between payments and delivery of public goods than exists under the present system. Allowing for double counting leaves some €40 billion annually.

What about delivering the relief from poverty that would result from terminating direct payments? In modern EU societies it seems more equitable (and economic) to tackle poverty among farmers by society-wide welfare nets rather than as part of agricultural policy. Some public resources would need to be ear-marked for this purpose; this issue is how much and how would that cost compare with spending under the present system that channels most of the benefits to large farms whose operators are both high-income and asset-rich.

Several steps are involved estimating the cost of a direct approach:

- Define the circumstances (income concept and level) that would correspond to the lowest standard of living that would be considered 'fair';
- Identify the policy need exposed by terminating the present system of support (specifically the numbers of farm households with incomes falling below this level);
- Estimate the costs of making welfare payments necessary to bring each household's income up to the minimum under the new implementation system;
- Explore the knock-on effects (such as impact on innovation, which might be positive or negative), administrative feasibility and implementation cost.

Estimates in the US have been made of the cost and distributional effects of making support policy a welfare-based programme (Gundersen et al., 2000), providing safety nets to bring the incomes of farm households to various levels (including up to the official poverty line and to the median regional household income). Most scenarios produced a lower total cost than the existing programs, but with a marked redistribution towards smaller farms and away from the larger commercial producers. About one fifth of US farm households in the 1984 FCRS fell below the official poverty line, a proportion that seemed quite consistent across sizes of farms; negative incomes were less frequently encountered among small farms than among larger ones (where 17-18% had negative total incomes), reflecting more off-farm income in the household's mix.

No such calculations are possible for the EU because of a lack of basic data, so any progress needs rather heroic assumptions and simplifications. Let us start with England. The Defra website states that direct payments currently cost £1.5 billion and are paid to over 100,000 farmers. Let us assume that;

- only these 100,000 would be eligible for the alternative support system (as beneficiaries of the present system);
- 20,000 fall below the poverty line in any year (in line with the Rural Advocate's claim and international experience), and that payments would be triggered on a year-by-year basis
- initially, that the change in support system of this 20% reduces their household income from farming to zero, and there are no other income sources
- that welfare payments would be made to bring them up to the poverty threshold of £18,000

- the total cost of payments to these farmers would therefore be £360 million, less than a quarter of the current budgetary cost.

How many additional farmers would fall into poverty on the removal of the Single Payment Scheme? Because of the ability of farmers to generate incomes above the Poverty Level from market returns, to adapt and to take incomes from other sources, this is difficult to assess. But in England only when assumptions are made that almost ***every*** household that currently receives CAP direct payments must be paid the full poverty level income does the cost of welfare payments exceed the current level of direct payments expenditure, clearly an extreme and unrealistic position. The implication that the alternative is far cheaper than the present support system, and the conclusion that public funds could be saved by adopting a welfare approach is clear.

In Wales, there are some 17,000 recipients of Single Payments Scheme benefits, which in recent years have been of the order of £260 million annually (averaging just over £15,000) (Welsh Government, 2013). Assuming one fifth of these were in single-year poverty (3,400), and the same poverty threshold is applied as in England above, gives an annual welfare payment bill of £61 million, or less than a quarter of the current SPS spending. Only when the assumption is made that more than 85% of the present cohort of farmers would be plunged into poverty by the cessation of SPS payments does the cost of welfare payments match the budgetary cost of the SPS support.

At EU level calculations are more difficult. Making estimates as for England requires information on national poverty lines, which vary with the levels of earnings in each country. Eurostat's SILC statistics contain the poverty thresholds of all EU-27 Member States, corresponding with 60% of the national median disposable incomes for groups of two adults and two children under 14; these are available for years 2006 to 2011, though the last is the most comprehensive (though missing for Romania). It also publishes the numbers of recipients of direct payments (SPS and other direct payments) for each country (and by band of payment), and the sums involved. These enable some order of magnitude to be established of the likely costs of welfare payments to those deemed to be in poverty in each Member State and to compare these with the known costs of direct income payments. This is done in Table 1.

EU statistics showed that in 2010 there were 11.1 million people working in agriculture, 13.7 million holdings of which 9.6 were below 5 ha (2007), 13.4 million holders who were a natural person, and (in 2009) 7.9 million beneficiaries of direct income payments (totaling €39.1 billion in 2009). The second column of the Table shows the numbers of beneficiaries of direct payments in each Member State and, in the third, the number to which welfare payments would be made assuming that in each country 20% of farm holdings receiving direct payments are in poverty in any one year. If it is assumed that payment corresponds to the full national poverty threshold (that is, any income households may have from farming after the direct payments are withdrawn and any other income is ignored), then the cost in each country can be easily calculated.

Table 1: Estimates of Welfare Costs and Comparison with Direct Payments

	Direct payment recipients (2009) *(000)*	One fifth in poverty (000)	Poverty threshold € (2011)	Estimated welfare payments (€mio)	Direct payments (€mio)	Percent	X percent
Belgium	38.24	7.648	22673	173	574	30	66
Bulgaria	80.35	16.07	4731	76	210	36	55
Czech Republic	23.40	4.68	9628	45	474	10	210
Denmark	56.87	11.37	19976	227	977	23	86
Germany	352.87	70.57	19720	1392	5535	25	80
Estonia	17.23	3.45	5957	21	51.4	40	50
Ireland	124.50	24.90	19000	473	1278	37	54
Greece	872.57	174.51	13546	2364	2499	95	21
Spain	909.80	181.96	14685	2672	8134	33	61
France	389.58	77.92	18274	1424	8165	17	115
Italy	1254.15	250.83	17237	4324	4120	105	19
Cyprus	38.35	7.67	18618	143	24.9	573	3
Latvia	70.46	14.09	4948	70	76.3	91	22
Lithuania	182.32	36.46	4847	177	196	90	22
Luxembourg	1.84	0.37	34730	13	34.5	37	54
Hungary	185.14	37.03	7007	259	683	38	53
Malta	4.78	0.96	14792	14	2.7	524	4
Netherlands	62.82	12.56	20185	254	823	31	65
Austria	122.57	24.51	21961	538	712	76	26
Poland	1406.18	281.24	5996	1686	1562	108	19
Portugal	194.20	38.84	10378	403	602	67	30
Romania	1078.55	215.71	*4731	1021	531	192	10
Slovenia	60.02	12.00	14587	175	70	250	8
Slovakia	15.73	3.15	5027	16	201	8	254
Finland	64.87	12.97	17794	231	545	42	47
Sweden	79.67	15.93	18162	289	713	41	49
United Kingdom	181.30	36.26	21287	772	3317	23	86
EU27	7868.57	1573.60		19251	39109	49	

* in the absence of national data, assumed to be the same as for Bulgaria

The important relationship is between the cost of these hypothetical welfare payments to combat poverty and the current cost of direct payments under the CAP. This is shown in euros and in percentages. Comparison between the relevant columns shows that in 21 Member States the costs of welfare payments would be less than the present direct payments under the CAP. In Germany, France and Spain (the three with highest direct payment expenditures) the welfare approach appears to cost only a third or less of the present system. The UK picture is essentially the same as already described. For Greece, Italy and Poland the costs work out to be broadly the same. There are some outliers. For both Cyprus and Malta the costs of welfare payments would greatly exceed the present system; the explanation would need to take into account their farm structure and the country's entitlements under the Single Payment Scheme. The other outliers are the Czech Republic and Slovakia, where a welfare payments approach is far less expensive.

The final column in the table shows the percentage of all beneficiaries under the present CAP system who would need to be paid under a welfare approach for the cost of the two systems to be the same. This avoids the assumption of a 20% incidence of poverty among farm households, though it poses another interpretive challenge; what is the reasonable bounds of estimates of the proportion of farm households who might be placed in poverty by the withdrawal of direct payments?. Looking at the final column indicates that for the Czech Republic and Slovakia welfare payments would need to go to more than double the total number of present beneficiaries (an impossibility) before the costs would be greater than under the present system – paying all beneficiary holdings the poverty threshold sum would be far less costly than the current direct payments. In sharp contrast, in Cyprus, Malta and Slovenia less than 10 percent would need to be paid for the welfare costs to equal the present level of expenditure.

Of course, much refinement is needed in these calculations, including;

- justification of the assumption that a figure of 20% of agricultural households in poverty is reasonable;
- using actual household income data to measure the degree of income poverty;
- querying the use of general poverty thresholds as being appropriate to farm households whose opportunities to consume from production is unusual (own-produced food, fuel, vehicle expenses etc.);
- modeling the impact of removing CAP direct payments on total and disposable income levels, and estimating the degree to which welfare payments might act as a top-up towards the poverty threshold or to other yardsticks, such as median household incomes.

Overall, it appears that, with the assumptions adopted, payments of sums to the 20% of EU farmers deemed to be poor would sum to only to about half the present costs of direct income payments, of the order of €20 billion per year.

Of course, even if environmental and farmer household income issues were adequately dealt with by agri-environmental and welfare payments, there would be a residue of issues that might be exposed by the removal of direct payments. These may need specific attention and require financing, probably by strengthening further Pillar 2. Despite such factors, the present degree of inefficiency and inequity in the CAP's Pillar 1 suggests that a substantial proportion of the €302 billion provisionally allocated for direct income payments to farmers over 2014–20 need not be spent or could be used in other policy directions. This would also improve the overall productivity of the EU agricultural sector, at a time when the world needs to make better use of its agricultural resources.

6 Getting from here to there

If CAP direct income payments are primarily a residual from a past policy change that can no longer stand close scrutiny and should be replaced by a less costly welfare-based system, how best to remove them? Though examples of transitional aids to facilitate policy revisions can be found (such as assistance to farmers who wish to exit the industry, buying of production entitlement, special welfare payments or limited-term income supplements), a review of such mechanisms for Defra (Hill 2009) concluded that a preferable approach would be simply to announce their termination after a period sufficient to allow farmers to adjust, perhaps five years. This delay would minimise any claim that farmers had been induced to take investment decisions on the assumption that direct payments would continue and thus would encounter capital losses unfairly.

Of course, the UK cannot decide to cut Pillar 1 spending unilaterally, as the shape of the CAP is determined at EU level. At an early point in the discussion on the shape the CAP should take from 2014, phasing out of direct payments to farmers seemed probable. However, it is clear that the next opportunity will not now occur until 2020. In the run up to then any case for using direct income payments for supporting living standards among the agricultural population should be accompanied by solid evidence and for close examination of alternative approaches. Simply continuing payments because they have existed for three decades should not be a sufficient rationale.

References

Agra CEAS (2007), *Feasibility study on the implementation of agricultural households sector (IAHS)statistics,* Final Report for the European Commission submitted by Agra CEAS Consulting, March 2007.

Blandford, D. and Hill, B. (eds) (2006), *Policy Reform and Adjustment in the Agricultural Sectors of Developed Countries,* CAB International.

Commission (2010), *The CAP towards 2020. Meeting the food, natural resources and territorial challenges of the future,* Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, COM(2010)672 Final, The Commission, Brussels.

Commission (2011a), *Commission Staff Working Paper: Impact Assessment Common Agricultural Policy towards 2020,* Brussels, 20.10.2011 SEC(2011) 1153 final/2

Commission (2011b), Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL establishing rules for direct payments to farmers under support schemes within the framework of the common agricultural policy Brussels, 19.10.2011 COM(2011) 625 final/2 2011/0280 (COD)

Commission (2011c), 'A Budget for Europe 2020 – Part II, Policy fiches', COM(2011) 500 final, The Commission, Brussels.

Court of Auditors (2004), *Special Report No 14/2003 on the measurement of farm incomes by the Commission Article 33(1)(b) of the EC Treaty, together with the Commission's replies,* (2004/C45/01), Official Journal of the European union.

EEIG AGROSYNERGIE (2011), *Evaluation of income effects of direct support,* Final Report for the European Commission, May 2011.

European Council (2013), *European Council 7/8 February 2013, Conclusions (Multianual Financial Framework)*, Secretariat to the Council, Brussels.

Eurostat (2002), *Income of the agricultural household sector, 2001 Report,* Theme 5 (CD contains information on methodology, special studies, analysis and tables), Eurostat, Luxembourg.

FAO (2011), *Handbook on Rural Statistics and Agricultural Household Income, Second Edition*. See FAO website. (For first edition, see UNECE (2005/2007 below).

Gundersen, C., Morehart, M. Whitener, L., Ghelfi, L., Johnson, J., Kassel, K., Kuhn, B., Mishra, A., Offutt, S., and Tiehen, L.. (2000), *A Safety Net for Farm Households***.** Economic Research Service, U.S. Department of Agriculture. Agricultural Economic Report No. 788.

Hagenaars, A. J. M., de Vos, K. and Zaidi, M. A. (1994), *Poverty Statistics in the Late 1980s: Research Based on Micro-data*, Theme 3 Series C, Eurostat, Luxembourg.

Hill, B. (2009), *Review of Transitional Arrangements to Facilitate Policy Reform and Their Possible Relevance to Dismantling of the Single Payment Scheme,* Policy Review Paper for Department for Environment, Food and Rural Affairs, London.

Hill, B. (2012a), *Farm Incomes, Wealth and Agricultural Policy – Filling the CAP's Core Information Gap,* CABI, Wallingford. ISBN 978-1-84593-847-5.

Hill, B. (2012b), 'How Do Incomes in Agriculture Compare with Those in the Rest of the Economy? point de vue', *EuroChoices*, 11(3), 2012, pp16-19.

OECD (2004), *Policy Brief: Farm Household Incomes – towards better informed policies,* Organisation for Economic Cooperation and Development, Paris.

UNECE (2005/2007) (ed. Karlsson J. and Hill B.). *Handbook on Rural Household Livelihood and Wellbeing: Statistics on Rural Development and Agricultural Household Income,* United Nations Economic Commission for Europe, Geneva, on behalf of the Intersecretariat Working Group on Agricultural Statistics and Rural Indicators (IWG.AgRI) (UNECE, Eurostat, FAO, OECD, World Bank).

Welsh Government (2013), *The Common Agricultural Policy Reform: Direct Payments to Farmers: Next Steps,* Common Agricultural Policy Reform Conversation, Welsh Government

Scottish Government (2010), *The Road Ahead for Scotland* **-** *Final Report of the Inquiry Into Future Support for Agriculture in Scotland* (Chairman Brian Pack OBE) – The Pack Report, Scottish Government, Edinburgh.