



ENVIRONMENTAL INTEGRATION AND THE CAP

A REPORT TO THE EUROPEAN COMMISSION, DG AGRICULTURE

EXECUTIVE SUMMARY

Objectives of the Study

The study was based on both a literature survey and consultation with stakeholders. The principal objectives were to:

- identify the principal environmental concerns related to agriculture in Europe and consider the main factors and driving forces giving rise to these concerns
- develop an informed understanding of the distinction between CAP driven environmental issues in agriculture and those relating to other factors, such as technical, economic and structural developments, and changes in other policies;
- use this understanding to explore the scope and means for further integrating the environment into the CAP;
- thus identify and evaluate the main options for integration within the CAP, particularly ‘add-on-instrument’ approaches (such as agri-environmental measures), and ‘add-on-objective’ approaches (such as cross-compliance); and
- assess the compatibility and complementarity of integration approaches within the CAP with environmental policies and
- briefly assess the budgetary implications of different integration strategies.

1.1 Environmental Concerns

It is clear from the study that environmental concerns arise in relation to a significant proportion of agricultural production in Europe. Agriculture both creates pressures on the environment and plays an important role in maintaining many cultural landscapes and semi-natural habitats.

The most severe pressures tend to arise in the more intensively managed farmland, for example in horticulture and arable production, lowland dairying and other livestock housed indoors. Conversely, low input systems, such as extensive grazing of cattle, sheep and other livestock as well as traditionally managed, long-established orchards and olive plantations are closely associated with valued cultural landscapes and high nature value farmland. Some pressures, such as greenhouse gas emissions from farming, have clearly declined in recent years. However, others have increased, such as the over exploitation of aquifers from increased use of water for irrigation. Awareness of the importance of certain issues, such as diffuse pollution of freshwater, is increasing.

Most stakeholders are reluctant to rank the environmental issues arising from farming in terms of their importance. However, the most prominent issues include the loss of biodiversity and decline in important habitats and species, loss of landscape diversity and quality, water pollution and excessive abstraction levels, soil erosion, air pollution by ammonia and greenhouse gases and the use of toxic substances. These impacts are apparent both in agricultural sectors subject to the CAP and those that are not.

1.2 Driving Forces

Environmental impacts arise as a result of farming activities of many kinds. The effects of both the withdrawal of past practices and the introduction of new ones need to be considered alongside the evaluation of current systems. There is a variety of driving forces which underlie farmers' management decisions, of which policy is only one. Other important driving forces include changes in market conditions, technological development, changes in the wider economy, particularly the rising relative cost of labour, and a range of structural changes. Amongst policy drivers, the CAP has a central place. However, the role of other policies including those covering land ownership and tax, food safety and hygiene, social security and interest rates, and other issues should not be overlooked. In practice it is often difficult to ascertain the precise role of different driving forces, especially in the absence of clear counterfactual information. Many claims that CAP policies are the primary driving force in relation to substantive environmental impacts of agriculture are difficult to verify. The scientific literature on this topic is limited.

2.1 CAP Effects: Stakeholder Views

The views of a range of farming and stakeholders active at a European level were considered in some detail in the preparation of this report. A process of literature review, interviews with individuals and two seminars held in Brussels formed a central part of the study. The cooperation of stakeholders was much appreciated.

It was found that much of the policy and research literature addressing the integration of the environment into the CAP takes rather a general approach. There are relatively few studies presenting a more detailed, rigorous analysis.

Many environmental critiques of the CAP highlight the pressures arising from intensive agriculture, underline the relatively high support levels offered under the

principal CAP regimes, and present these as the principal driver of intensification. At the same time it is noted that many low input farming systems, generally more benign environmentally, receive a relatively low share of support under these regimes. This approach may encourage environmental stakeholders to have inflated expectations of the potential benefits of reducing CAP support levels. At the same time they may overlook other, underlying trends in the sector and the role of different drivers in influencing environmental impacts on the ground.

A shortage of more detailed analysis – for example, on the effects of specific instruments in individual regimes, supported by case studies or other empirical evidence, - has proved a significant limitation on this study. However, it must be noted that many NGOs appreciate this problem and were in the process of undertaking new analysis at the time of writing.

2.2 CAP Effects: Evaluation of the Literature

The empirical information available on the environmental effects of specific CAP measures is extremely limited, particularly for the purpose of isolating these effects from those of other drivers. In this study, attention was focused on a selection of CAP measures which illustrate the variety of instruments, sectoral characteristics and different policy and non-policy interactions concerned.

This approach utilises specific evidence of the often significant impacts of agricultural systems on the environment and provides the foundation for a rational analysis of the relative influence of CAP measures. In several sectors there is evidence that general CAP support policies and/or specific instruments have stimulated increased production with direct environmental consequences. These stem either from intensification and specialisation, an expansion in the cropped area, an overall rise in livestock numbers or a combination of the above. Certain environmental changes can arise directly from policy measures, arable set-aside being one example. However, the evidence of specific, strong CAP effects is often inconclusive, because of the role of other factors and the highly variable conditions within Europe. The dairy regime is a case in point. Here, the relationship between guaranteed prices for dairy products, the quota system and trends in water pollution is not clear and there is evidence that similar environmental pressures have arisen in countries where the sector has been much less supported. In other cases, there is more evidence to suggest that policies have had a more easily identified impact; for example, in relation to the headage payments and stocking densities under the beef and veal regime, and the output-related payments in the olive regime.

In many cases where it appears that a policy measure may have contributed to environmental pressures in a particular way, this relationship is not consistent throughout the Community because different farming systems will respond in different ways to common instruments. Decisions made at Member State level, affecting the implementation of various aspects of the common policy (eg to determine base areas and reference yields in the arable regimes, and the application of Community national envelopes in the beef regime) also are a significant factor.

A number of changes in the CAP over the past decade have, in principle, addressed certain environmental concerns. For example, incentives to plough up permanent grassland and other valuable habitat in order to claim arable area payments should have been eliminated following the 1992 reform, when base areas were fixed. However, other developments such as the new support for forage maize after 1992 have introduced fresh pressures. It is particularly difficult to assess the impact of some of the more recent changes in the Agenda 2000 package because little monitoring or evaluation work has been completed. The environmental consequences of the shift from headage to area payments for the LFA compensatory system, for example, are not yet apparent.

It is clear that some of the new options made available to Member States under Agenda 2000 have potential to support environmental goals but that these have not yet been widely used for that purpose. For example, national envelopes in the beef regime offer Member States considerable flexibility and scope for targeting support, but do not appear to have been used to target specific environmental concerns or experiment with more decoupled payments. Few countries seem to have introduced new environmental standards under Article 3 of Regulation 1259/1999 through cross-compliance for example. Only two Member States have chosen significantly to expand expenditure on agri-environment and other accompanying measures, through the use of modulation. However there are also examples of a more integrated approach, such as the application of various measures under Regulation 1257/1999 to support the implementation of Natura 2000 in some countries.

3.1 Towards an Integration Strategy

An integration strategy should seek coherence and complementarity between policies intended to pursue different objectives. Both agriculture and environmental policy have their own separate and legitimate objectives; integration implies the active pursuit of complementarity and synergies between them. This requires clarity about the respective roles of the two policies and the ways in which they can support each other. At a European level a strategy needs to focus on Community policies and instruments, while taking into account the approach to implementation at Member State level. The appropriate degree of subsidiarity in different areas will be one of the issues to be addressed.

The specific concern here is the integration of environmental concerns into the CAP and the selection of the most effective and efficient instruments for this purpose. The evidence collected in this study emphasises the importance of seeking to address the broad range of agricultural production, not just individual sectors.

Environmental Policy

Environmental policy rests on broad aims and principles, established in the Treaty and elsewhere. At a Community level these are developed into more concrete objectives; the Sixth Environmental Action Programme sets a binding framework for the period up to 2010. Individual measures specify more concrete objectives and standards to be reached. A significant number of Community environmental measures affect

agricultural production and so establish standards which farmers need to meet; national and regional measures supplement and elaborate EU instruments. These standards are established almost wholly outside the CAP and are changing over time. They represent a pre-condition for an integration strategy and a starting point for considering how agricultural policy can help to deliver the desired environmental outcome. It is not the role of the CAP to set these standards but it can contribute significantly to their enforcement and the adjustment of the farm sector to society's changing expectations and requirements on the environment.

An integration strategy must respect fundamental principles, such as the Polluter Pays and recognise the challenge set by environmental standards - such as those which will arise from the implementation of the Water Framework Directive 2000/60. It should identify means within the CAP of supporting the attainment of these goals. For example possible mechanisms include cross-compliance and the verifiable environmental standards currently required for certain measures under the second pillar. Approaches can be taken in parallel, at Member State and EU level. Water policy should be a key concern over the coming decade. Enhanced agricultural performance in this area will be a priority and an integration strategy should clarify the ways in which CAP policies can be developed and implemented to support the goals established in the Water Framework Directive and elsewhere.

At present there is a severe shortfall in the implementation of many EU measures which relate to the farmed environment, including the Nitrates, Birds and Habitats Directives. Full and effective implementation of these measures would be an important starting point for a successful integration strategy. A clear reference level for agriculture is essential.

CAP Policies: selecting appropriate measures

There is no simple way of achieving environmentally appropriate farm management decisions by means of conventional support policies, such as the main commodity regimes. At any given level of basic support, there are many farms operating management practices which are not environmentally desirable. For these farms, the incentives established by the support system clearly do not promote, and may work against, environmental goals. At the same time, there are others that are creating fewer pressures or actively maintaining environmental goods through environmentally benign management. Some of these farms may be marginal in economic terms and the same level of support may thus be inadequate, on its own, to sustain them. This implies the use of more targeted policy interventions, in order to focus on promoting appropriate management at farm level. Five approaches are particularly relevant:

- agri-environment payments, above the reference level of “good farming practice”, applied at a sufficient scale and intensity and targeted at locally appropriate farm management;
- enhanced and more effective environmental application of other second pillar measures, particularly Less Favoured Areas (LFA) and Article 16 payments where required. There is scope for an enhanced environmental dimension in support for local product marketing and processing, sustainable farm diversification,

agricultural investment, training to address environmental priorities and sensitive forestry measures. These instruments can be used together to encourage long term sustainability through balanced development which takes full account of environmental needs.

- more targeted measures within the first pillar, such as the use of ‘national envelopes’ to vary the normal rules within a market regime and target support towards more environmentally beneficial management systems;
- a more substantive use of Article 3 of the Common Rules Regulation, including cross-compliance. This is a means of strengthening the implementation or level of environmental standards in particular sectors, making these conditions sensitive to variations between farming systems and environmental situations;
- the elimination of measures within the CAP which provide a direct incentive for environmentally damaging policies.

Targetted and selective instruments of this kind need to play a central role in an integration strategy. They are more easily attuned to environmental objectives than broad brush changes in overall support levels. Priority would be given to “add-on-instruments”, particularly agri-environment schemes, but a strategy would also include “add-on-objective” approaches such as cross-compliance. It would be internally consistent and would require a substantial shift in resources from the first to the second pillar of the CAP.

Second Pillar Measures

A primary requirement for an integration strategy would be to significantly enlarge the budget for the second pillar. This would be essential to permit sufficient funding for the full range of potential measures in the agriculture sector, in addition to the broader needs of rural development and forestry. The requirement is mainly to expand the use of existing measures and to make relatively minor modifications rather than to add significant new instruments to the Rural Development Regulation.

Agri-environment schemes have the potential to address a large number of the environmental concerns identified in the course of this study. They are particularly suited to the encouragement of appropriate land management, having the flexibility to respond to the great variability in local conditions. Their effectiveness could be further enhanced if they were supported by complementary investment aid of the kind in principle available to farms under other RDR measures but not always readily integrated into management payment schemes. Take up of agri-environment schemes is highly variable between Member States and there is considerable potential for expanding their deployment both geographically and to address a wider range of environmental issues. They are likely to be needed on an increasing scale to meet landscape and biodiversity objectives, for example those set out in the Community’s Biodiversity Action Plan for Agriculture.

Continuous improvement in the design and implementation of schemes is needed to achieve the intended environmental outcome and to reduce transaction costs. This

underlines the importance of thorough monitoring and evaluation to a degree not envisaged in CAP measures in the past.

Some changes in the current basis for calculating agri-environment payments to farmers is likely to be necessary in certain conditions, to account for the full costs of maintaining management where revenues from farming are very low. Taking full account of fixed as well as variable costs in calculating the costs of complying with management agreements would be appropriate in these cases. There are also concerns about the level of Community co-funding, which is considered too low in some regions.

Agri-environment should become a central plank of the CAP rather than an accompanying measure. However, there remain limits to the extent to which schemes can support adequate environmental management on farms since they must be based on measures above the reference level of “good farming practice”. This points to the need to focus on increasing the environmental performance of other forms of support under the CAP, reflecting the aspiration of the EU Sustainable Development Strategy. Several instruments are available in both first and second pillars of the CAP.

Greater use of other second pillar measures should form a further element in the strategy. The most important of these include:

- Article 33, which contains several sub-measures which have the potential to support improved environmental standards on farms and the associated rural infrastructure
- Article 4, which provides for farm investment aid, particularly relevant to meeting standards which in future may become mandatory under EU water policy and to complement management payments in agri-environment schemes
- Support for sustainable farming in Less Favoured Areas, which should be adjusted to reflect local carrying capacity, particularly for livestock, as well as to compensate for agronomic disadvantage
- The new Article 16, which allows compensation to be paid to farmers facing a range of mandatory environmental standards. While a balance with the Polluter Pays Principle is necessary this measure has the potential to support the improved implementation of EU environmental policy. This may be increasingly relevant if the burden of compliance on certain farmers increases
- Measures concerned with training, marketing and processing all of which provide support for different aspects of sustainable land management and food production

There is also the option of adding or strengthening environmental conditions on these and other rural development measures. This could reinforce the strategic goals of the RDR to support sustainable development by ensuring that certain aids – particularly those targeting investment in rural activities, farms and infrastructure – are deployed in environmentally acceptable ways.

First Pillar Measures

In the first pillar a variety of changes can be made to support an integration strategy.

One priority is to amend those market regimes which provide incentives for environmentally damaging forms of production and other environmental pressures at a level which otherwise would not occur. These appear to include support for forage maize under the arable regime, and aids for tobacco, cotton, sugar and dried forage. In the light of available evidence for the environmental damage associated with these regimes, significant policy changes need to be made.

In several market regimes, there remains a direct link between the volume of output or number of livestock held on a farm and the extent of support. Further progress towards decoupling would be appropriate in environmental terms. This could include conversion of headage to area payments in the beef and veal and sheep regimes, and a move to area payments for olives. However the precise environmental implications of such a transition, particularly for beef, are difficult to forecast and would require careful monitoring to enable refinement and modification to the new system, as it is implemented.

There are opportunities to target certain forms of CMO support more precisely or modify specific rules with environmental benefit. At present there is no regional differentiation in stocking rate ceilings to reflect local carrying capacity for example. Organic farmers are exempted from compulsory set-aside but other forms of high nature value farming are not. One means of introducing a more targeted, regionally adapted approach reflecting environmental priorities is through the appropriate use of 'national envelopes'. These are now included in the sheep and goat as well as the beef regime. There are limitations on the deployment and reach of this approach and it is likely to become less relevant if there is further decoupling of support. However, there is scope for making more use of the present envelopes and adding others, in the dairy regime for example.

In parallel, steps should be taken to build on the existing common rules Regulation and particularly the provisions for cross-compliance under Article 3. Much of the responsibility to use this option currently lies with the Member States. It is important that they address the issues fully. In addition, at EU level motivation for complying with environmental standards could be strengthened under this measure, for example by the introduction of an environmental audit requirement for all farmers receiving significant levels of direct payments.

Separately from the CAP, it is clear that changes in the market and new consumer perceptions are an important driving force for the whole agriculture sector. More steps to include environmental considerations in marketing and food labelling policy associated with the CAP market regimes would be a useful complement to changes in support measures. These could have a potentially valuable role in reducing incentives for environmentally damaging technological change in certain traditional and more extensive production systems.

Budgetary and Broader Considerations

Individual measures to promote environmental integration under the CAP cannot be considered in isolation. They must be compatible with realistic budgetary constraints and the wider objectives of the CAP, concerning food supply, farm incomes etc. The value and potential effectiveness of several proposals here will depend partly on broader changes in the CAP, particularly those which would shift the balance of resources between different regimes and between the two pillars. A clear distinction must be made between an approach which relies on changes to first pillar measures, with little accompanying growth in the second pillar budget, and one which depends primarily on expansion of the second pillar. The latter approach is seen as being of major importance. It would almost certainly necessitate some reduction in first pillar expenditure, for budgetary reasons. However, an overall increase in FEOGA expenditure is not envisaged within the strategy outlined. Many of the measures would be budget neutral

This study suggests that a strategy for effective integration within the CAP should incorporate a significant expansion of second pillar measures, alongside changes to both first and second pillar elements in order to enhance their environmental performance.

Growth in the second pillar budget could be achieved by various means, including:

- a system of compulsory modulation, requiring Member States to transfer resources from the first to the second pillar
- an expansion of the RDR budget allocations for individual Member States by agreement at Community level, accompanied by savings in overall first pillar expenditure.

Growth in second pillar measures at the expense of support under market regimes will have impacts on farm incomes. Consequently, there may be a need to balance the growth in second pillar measures with a form of decoupled farm income support to prevent an unacceptable contraction in overall farm income.

Conclusions on an Overall Strategy

A strategy would include both a range of agricultural policy elements in an integrated way. Overall budgetary impacts are difficult to predict within the constraints of the study but it appears likely that adjustments can be made to the expenditure in the first pillar, in order to finance a significant shift in overall expenditure in the second.

Such a strategy needs to be considered within the context of the wider reform process and to deploy individual measures in a coherent way. Thus, these instruments should be combined and phased in over a period of time. Bearing in mind their potential effects upon the CAP budget and upon farm incomes, favoured options for the shorter term might include:

- compulsory modulation or degressivity of direct payments specifically to enable an expansion of agri-environmental and other environmental second pillar measures throughout the Community – a target could be set for the second pillar to represent a minimum proportion of total CAP expenditure at national level.

- a transition from headage to area payments for the beef and sheep sectors and the adoption of area payments in the olive oil sector
- greater use of national envelopes in the livestock sector, not in general terms but specifically for environmental purposes e.g. for extensification incentives.
- a reform of the sugar regime, involving significant price cuts
- a removal of forage maize from eligibility for arable area aids and some obligation to address any unintended environmental consequences of differentiation arising from the use of irrigation/regional yield differentials
- removal or significant reform of aid for tobacco and dried fodder to eliminate their adverse environmental impacts
- appropriate application of Article 3 of the Common Rules Regulation, including cross-compliance by all Member States following widespread scrutiny and debate of their April 2002 reports to the Commission
- the introduction of a Community-level requirement for farm environmental auditing for those receiving direct payments. This would be designed to help ensure that farms meet environmental standards, particularly those under EU legislation;
- review of the environmental impacts of the wine and fruit and vegetable regimes with a view to introducing further enhancements in due course.
- detailed study of the environmental implications of removing milk quotas

In the medium to longer term these could be followed by:

- further, more substantial budgetary shifts from first to second pillar
- further price cuts, dismantling of quotas and introduction of a grassland premium as direct compensation, in the dairy regime, with environmental conditions
- harmonisation of direct area-based aids in livestock sectors
- development of a more clearly environmentally benign form of income support to farms, complementing the range of specific measures targeted to meet environmental needs.