Financing the European Agriculture: A Comparative Approach across the Member States

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Abstract: - This paper aims to highlight through a comparative analysis the main trends and challenges for the Member States under the new Common Agricultural Policy financial framework. Our research will base its assumptions on the most recent statistics published by the Member States and also on the DG Agriculture& Rural Development reports. Our article will also assess, through a SWOT analysis, the opportunities and the weaknesses for the financial support granted to the Member States under the new regulations of the Common Agricultural Policy. In the final part of our paper we will present some conclusions related to the future of Common Agricultural Policy as a tool for addressing some financial gaps in the national rural development strategies of the Member States.

Keywords: - European Agriculture, Common Agricultural Policy, Member States, SWOT analysis

1 Introduction

Throughout its entire existence the Common Agricultural Policy (CAP) has constantly evolved both in terms of objectives and of main financing tools (Direct Payments, Rural Development Programmes). If in its early years CAP has supported production subsidies, presently this policy focuses on granting financial support for the European farmers, the sustainable rural development and the environmental protection. Some analyzes (EC, 2014) show that through its financial tools, the CAP has evolved gradually from the support for production to the support for producers in order to meet one of its major challenges: the growing demand for agricultural products in the context of European Union constant enlargement. Currently, some authors (Bleahu, 2005) shows that CAP has several main objectives: financial support for farmers' incomes, guaranteeing a stable and affordable food supply and promoting the sustainable development of rural space in the European Union. Moreover, some analyses consider that CAP is essential for Europe food security (Debating Europe, 2016) emphasizing that without this common policy the European Union would be dangerously dependent on fluctuating imports. Some analyzes (Ghinea, 2009) shows that although in the Member States " the agricultural policies are targeting some common European objectives", CAP is currently facing the so-called "prisoner’s dilemma[1]": although its major objectives are agreed by all Member States, during the inter-governmental negotiation process, each country is trying to support some national interests. Given this status quo, in our research we propose a comparative analysis of the financing of the agricultural sector in Member States, emphasizing both the compliance with CAP objectives and the pursuit of some distinct national goals.

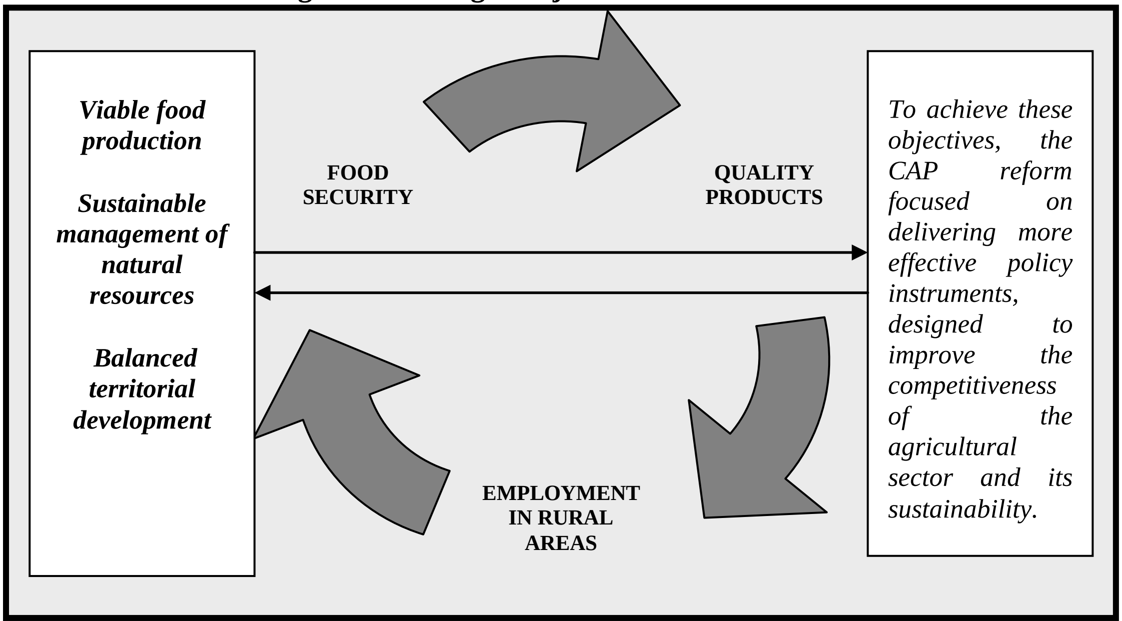
2 Financing the agricultural sector in the Member States during 2014-2020: main trends

In order to meet both the challenges of globalization and those imposed by the *Europe 2020*, the CAP has undergone through a series of reforms: the MacShary Reform (1999), which granted fixed compensatory payments to farmers; the 2001 Reform concerning the adoption of Pillar II – the rural development and the

[1] The *prisoner's dilemma* is a standard concept in game theory that shows that two or more completely "rational" individuals might not cooperate, even if it appears that it is in their best interests to do so.

most recent Reform from 2013 with its three major objectives: assuring food security, high quality agricultural products and an increase of employment in rural areas (see Figure 1).

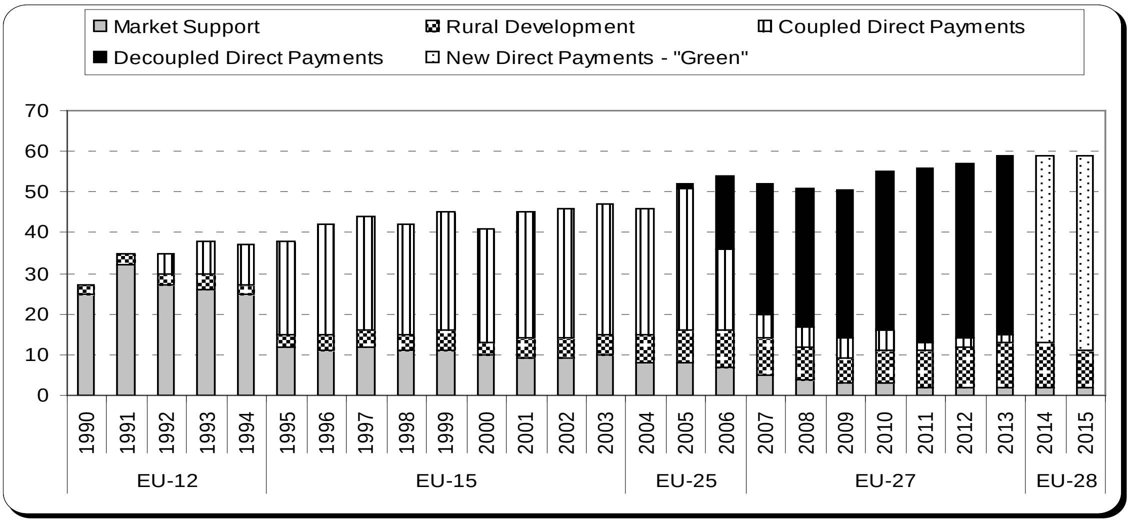
Figure 1: Strategic Objectives of CAP Reform



Source: Authors representation based on European Commission - *Overview of CAP Reform 2014-2020*

During 2014-2020 a major CAP priority is to reduce the inter-regional development disparities. In order to meet this specific objective the Member States are allowed to select measures adapted to their needs and to manage national programs addressing their specific vulnerabilities (through the co-funding process).
In this context, it should be noted that since 2014, the European Agricultural Fund for Rural Development (EAFRD) is part of the new Common Strategic Framework, as are the European Regional Development Fund (ERDF), the European Social Fund (ESF), the Cohesion Fund (CF) and the European Maritime and Fisheries Fund (EMFF). Through the co-funding process Member States may implement rural development projects in order to achieve the Europe 2020 strategic goals: sustainable, smart and inclusive growth. In the new financial framework, the budget for sustainable rural development may be used to finance agricultural activities (flexibility in the application of common mechanisms). The radical changes generated within the Common Agricultural Policy under the various reforms are illustrated by Graph 1 which shows the historical development of this common policy from its market orientation to the support for farmers and measures related to sustainable development and environment protection.

Graph 1: The path of CAP expenditure in the Member States (billion EUR)



Source: Authors, based on DG Agriculture & Rural Development data.

The last reform has outlined the strategic objectives for which Member States may grant financial support during 2014-2020, keeping the two pillars of the CAP (the support for agricultural markets – the first Pillar and for rural development – the second Pillar), but increasing the interdependence between them. Consequently, through the flexibility mechanism will be possible to transfer up to 15% of funds between the two pillars, which will enable Member States to achieve some national rural development objectives. In this respect it should be mentioned that while there is a new flexibility for Member States in the budgeting and implementation of first Pillar instruments, acknowledging the wide diversity of agriculture and of socio-economic conditions across the EU, this trend will be framed by budgetary limits in order to ensure that common objectives are met. The CAP set the framework, but it is Member States responsibility to ensure the right balance between possible benefits and the burdens of red tape for producers as well as for administration and controls.

CAP new regulations will support the Direct Payments which are becoming better targeted and more equitable. At the same time, the new CAP framework will preserve the sustainable component of financial support (through the Green Direct Payment that are becoming compulsory) also strengthening the rural safety nets (emergency support in case of market crises or external shocks[2]).

Some analyzes (Was et al., 2014) indicate the huge potential existing in the new financial framework of CAP in terms of sustainability and "greening" the agricultural practices in the Member States. In this context, it should be noted that since January 2015 the "cross-compliance" mechanism is mandatory for Member States and has become more eco-friendly by introducing a new tool: the Green Direct Payments. The Green Direct Payments are mandatory for Member States and must represent 30% of all Direct Payments. Farmers will receive Green Direct Payments if they respect some mandatory agricultural practices: maintenance of permanent grassland, ecological focus areas and crop diversification. The Green Direct Payments will enable the Member States to improve their environmental performance through financing more sustainable production methods.

Although the new rules are requiring the compliance of some mandatory objectives related to rural areas sustainable development, they still offer Member States the possibility to finance some specific national objectives, adapted to local needs. Such measures (e.g. those funded under the LEADER Axis) are supporting the "bottom-up" rural development. In order to implement this type of financial support for agriculture and rural areas, the Member States benefit from complementary tools: the Farm Advisory System, funds from the European Innovation Partnership and funding for applied research projects to support European farmers to find solutions for the specific problems they face. Moreover, presently, due to its multiple reforms, CAP became capable of responding to external challenges which may have a negative impact on the agricultural sector from the Member States (e.g. the Russian ban[3] that affected European producers of fruits, vegetables and dairy products that received compensatory funds[4]).

The Russian import ban has highlighted the strategic importance of CAP reform for the agricultural sector from the Member States. Some analyzes (Drăgoi, Bâlgăr, 2015) showed that the CAP reform allowed the funds transfer between the two pillars, providing a true "safety net" for European farmers, helping them to mitigate the negative effects produced by some external (Russian ban) or internal (natural disasters such as droughts, floods, fires) crises. The mechanisms by which reformed CAP may support European farmers include: public buying (government agencies may purchase the agricultural products which remain unsold due to some exceptional circumstances) and aid for private storage, those public policy tools aiming to stabilize markets and to prevent a drastic decrease in revenue for European farmers. All these mechanisms have been introduced as part of 2013 CAP reform, being necessary because in recent years the crises in the European agricultural sector have increased in frequency and intensity. To meet this specific challenge during 2014-2020 the Member States may request funds from the Emergency Mechanism for Market Intervention. Such financial support may include loans for European farmers, as well as insurances in case of harvest loss or inability to sell it.

[2] See the case of Russian ban.

[3] On August 2014, the Russian Federation introduced import restrictions on a variety of agricultural products from EU, notably fruit and vegetables, dairy products and meats.

[4] In response to the Russian ban, the European Commission, with the help of Member States, enforced a range of emergency measures notably for the fruit and vegetables sector, aimed at addressing market pressure, stabilising prices and finding alternative sales opportunities.

One of the fundamental changes imposed by the latest CAP reform is the increased transparency of financial support granted to rural areas in the Member States (DG Agriculture & Rural Development, 2014). The new rules aimed at increasing transparency were introduced by Regulation 1306/2013. Under the new regulations some improved management procedures concerning financial support will be enforced by a more rigorous control of the financed projects.

Some analyzes (Hogan, 2014) show that the role of new transparency requirements is crucial in supporting the European farmers from the Member States (given the fact that they are often forced to comply with stricter rules on organic farming, environmental requirements and animal welfare, compared with their global competitors). The new transparency regulations are applying both to the Direct Payments and to private investment projects. Improving transparency requires an annual publication by Member States of the beneficiaries of Direct Payments, detailing the precise amounts and destinations for which they are used, including the specific objectives covered by that funding.

Those new regulations raise the question: why were needed these additional rules in order to improve transparency in the financing of rural areas in the Member States? As previous experience shows (2007-2013), since 2010 there has been a decision of the European Court of Justice (see combined cases C-92/09 and C-93/09) stipulating that some regulations related to financing Rural Development Programmes (RDPs) violated the principle of proportionality for "individuals" (“individuals” must be interpreted in opposition to the term "legal person", which referred to the European associations and farmers' organizations), due to insufficient information on nature and objectives of financial support. In this context it must be noted that not only the direct CAP funds are subject to transparency rules. In many cases, the projects for rural areas are co-funded through the European Regional Development Fund, the Cohesion Fund, or the European Social Fund - for instance for projects related to increasing employment and regional development. Moreover, in the current financial framework (2014-2020) about 80% of the rural development funds are managed by the National Agencies under a shared management procedure with the European authorities.

The shared management procedure will require to the Member States to publish on the national authorities websites information related to: the beneficiary name, source of funding and description of each objective funded. Referring to the shared management procedure some authors (Gray, 2012) have shown that this will reduce the administrative burden for European authorities increasing at the same time the responsibility of national authorities.

3 Direct Payments – main tool for financing the agricultural sector in the Member States

The Direct Payments are the main instrument for granting financial support to the European farmers who face systemic risks due to the high volatility of agricultural prices as to the occurrence of some weather events that may adversely affect the quality and quantity of agricultural production. Some analyzes (Dewbre et al., 2001) showed, however, that the Direct Payments may have a negative effect on the European agricultural sector, due to the fact that European farmers are sometimes disadvantaged compared to their international competitors because they need to respect the environmental standards this resulting in higher production costs.

In order to respond to such challenge, the Member States may use the Green Direct Payment tool that allows them to finance agricultural activities in compliance with environmental standards. To avoid distorting the free competition within the internal market, these Direct Payments are based not on production levels, but on the type of agricultural practice.

According to DG Agriculture & Rural Development estimations during 2015-2020 around 252 EUR billions are allocated for Direct Payments at EU-28 level. The Member States that have allocated the largest funds were France (over EUR 45 million), Germany (over EUR 30 billion) and Spain (over EUR 29 billion). Regarding Romania, it occupies a middle position in the European hierarchy, with an allocation of over EUR 10 billion (see Table 1).

Table 1: Direct Payments - ceilings by Member States (EUR billion)

MEMBER STATE	2015	2016	2017	2018	2019	2020
BELGIUM	0.544	0.536	0.528	0.520	0.515	0.505
BULGARIA	0.642	0.721	0.792	0.793	0.794	0.796
CZECH REPUBLIC	0.875	0.874	0.873	0.872	0.872	0.872
DENMARK	0.926	0.916	0.907	0.897	0.889	0.880

MEMBER STATE	2015	2016	2017	2018	2019	2020
GERMANY	5.148	5.144	5.110	5.076	5.047	5.018
ESTONIA	0.110	0.121	0.133	0.145	0.157	0.169
IRELAND	1.216	1.215	1.213	1.211	1.211	1.211
GREECE	2.047	2.039	2.015	1.991	1.969	1.947
SPAIN	4.833	4.824	4.815	4.886	4.880	4.893
FRANCE	7.586	7.553	7.521	7.488	7.462	7.437
CROATIA	0.113	0.130	0.149	0.186	0.223	0.261
ITALIA	3.953	3.902	3.850	3.799	3.751	3.704
CYPRUS	0.051	0.050	0.050	0.049	0.049	0.048
LATVIA	0.168	0.195	0.222	0.249	0.275	0.302
LITHUANIA	0.393	0.417	0.442	0.467	0.492	0.517
LUXEMBOURG	0.033	0.033	0.033	0.033	0.033	0.033
HUNGARY	1.272	1.271	1.270	1.269	1.269	1.269
MALTA	0.005	0.005	0.005	0.004	0.004	0.004
THE NETHERLANDS	0.793	0.780	0.768	0.755	0.744	0.732
AUSTRIA	0.693	0.693	0.692	0.691	0.691	0.691
POLAND	2.970	2.987	3.004	3.021	3.041	3.061
PORTUGAL	0.557	0.565	0.573	0.572	0.590	0.599
ROMANIA	1.428	1.629	1.813	1.842	1.872	1.903
SLOVENIA	0.138	0.137	0.136	0.136	0.135	0.134
SLOVAKIA	0.377	0.380	0.383	0.387	0.390	0.394
FINLAND	0.523	0.523	0.523	0.523	0.524	0.524
SWEDEN	0.696	0.696	0.697	0.697	0.698	0.699
UNITED KINGDOM	3.548	3.555	3.563	3.570	3.581	3.591

Source: DG Agriculture &Rural Development (2015)

In should be noted that while the CAP reform introduced a new system for the Direct Payments allocation, providing a basic layer of fixed income support for all European farms, another important outcome is that the European farmers would be less vulnerable to fluctuations in prices and income. The new allocation of Direct Payments will enable a better production diversity also supporting agriculture in specific areas with significant spillover effects on food supply chain and rural economies.

4 Rural development programmes

The rural development programmes (RDPs) will continue to provide financing in the Member States in the period 2014–2020, for business, environmental and social projects, and the priority financing objective will be the support for the development of SMEs in rural areas. The budgets allocated by the Member States vary (see Table 2) and they illustrate the adaptation of national plans to the rural and local development priorities, focusing however on incentivising the business environment and private investment in the rural area.

Table 2: Financial allocations by Member State through rural development programmes (EUR millions)

MEMBER STATE	2014	2015	2016	2017	2018	2019	2020
BELGIUM	78	78	78	78	78	79	79
BULGARIA	335	335	334	334	333	333	332
CZECH REPUBLIC	314	312	311	310	308	307	305
DENMARK	90	90	90	89	89	89	89
GERMANY	1,178	1,177	1,175	1,174	1,172	1,170	1,168
ESTONIA	103	103	103	103	103	103	103
IRELAND	313	313	312	312	312	312	312
GREECE	601	600	600	599	598	598	597
SPAIN	1,187	1,186	1,185	1,184	1,183	1,182	1,182
FRANCE	1,404	1,408	1,411	1,415	1,418	1,422	1,427
CROATIA	332	332	332	332	332	332	332
ITALIA	1,480	1,483	1,486	1,489	1,493	1,496	1,499
CYPRUS	18	18	18	18	18	18	18

MEMBER STATE	2014	2015	2016	2017	2018	2019	2020
LATVIA	138	138	138	138	138	138	138
LITHUANIA	230	230	230	230	230	230	230
LUXEMBOURG	14	14	14	14	14	14	14
HUNGARY	495	495	494	493	492	492	491
MALTA	13	13	14	14	14	14	14
THE NETHERLANDS	87	87	86	86	86	86	86
AUSTRIA	557	559	560	562	564	565	567
POLAND	1,569	1,567	1,565	1,563	1,561	1,558	1,555
PORTUGAL	577	577	578	579	580	581	582
ROMANIA	1,149	1,148	1,146	1,145	1,143	1,141	1,139
SLOVENIA	118	119	119	119	120	120	120
SLOVAKIA	271	270	270	270	269	269	268
FINLAND	335	336	338	340	341	343	344
SWEDEN	248	249	249	249	249	249	249
UNITED KINGDOM	371	370	369	368	367	366	365

Source: DG Agriculture &Rural Development (2015)

As it can be seen in Table 2, Romania ranks very well among the Member States in terms of allocations for rural development programmes in 2015. However, in order to improve its performance, a stronger focus on environmental and climate change objectives and a gradual abandonment of income support and of most market measures would be useful. Establishing a clear financial direction regarding the environmental and climate change aspects through the framework created by the national rural development policy would encourage the development of regional strategies to guarantee the fulfilment of EU objectives. This could be achieved by means of better targeted measures which would also be easier to understand by the Romanian farmers. These measures would imply higher expense effectiveness and a more careful focusing on the added value of implemented projects. Such a direction would enable an approach of the economic, environmental and social challenges in Romania and would increase the contribution of agriculture and of the rural area to the achievement of the objective of the Europe 2020 strategy regarding smart, sustainable and inclusive growth.

5 SWOT analysis

As regards the impact of CAP reform on the new financing directions in the field implemented by the Member States, Zahrnt (2015) considers that, although in its over fifty years of existence this policy has incontestably improved its performances, there are still aspects of its regulations that may lead to distortions of free competition on the EU internal market, sometimes placing low-income farmers at a disadvantage. Some CAP critics (Brunner and Huyton, 2008) also said that this policy is still insufficiently targeted in order to provide an efficient response to the unprecedented challenges that the EU agricultural sector may be confronted with if major natural disasters occur. For example, a study from the European Court of Auditors (ECA, 2008) identified a series of structural “weaknesses” of the CAP, from the insufficient targeting of sustainable economic development objectives to the fact that from an economic point of view, the only net CAP beneficiaries continue to be the farmers and landowners who pay less in terms of contribution to the EU budget than they receive through this policy. The ECA showed in its analyses that the new CAP financing context is characterised by the beneficiary paying a single payment independent from production (a process called “decoupling”). One essential element of the new Common Agricultural Policy provides however that the due payments may be reduced if the beneficiaries do not observe certain already existing rules regarding the environment, food safety, animal and plant health and animal welfare or if they do not comply with the newly established requirement that the agricultural land be kept in good agricultural and environmental condition in its entirety.

Therefore, the full rate of the single payment is now subject to certain conditions and cross-compliance has also been extended to the payments made for certain rural development measures.

The ECA report regarding the benefits of the cross-compliance policy shows that the CAP objectives in the field have not been stated in a precise, measurable, relevant and realistic manner and that, at agricultural holding level, many obligations remain purely formal, thus having little chance of determining the expected changes, whether in terms of the reduction of payment volume or in terms of a change of agricultural practice.

Below, we propose an overview of a SWOT related to the future of CAP financing in the Member States (see Figure 2), with an important focus on the potential benefits/disadvantages of the cross-compliance policy.

Figure 2: SWOT analysis of CAP financing directions for the 2020 horizon – implications for the Member States

STRENGTHS	WEAKNESSES
Through the flexibility mechanism, the CAP became an adaptable policy that enables the transfer of funds between the two pillars, so that the Member States may achieve their specific objectives related to rural development. The CAP reform led to a change of paradigm from the direct production financing support to encouraging the observance of environmental standards (Direct Green Payments are now mandatory in all Member States). Member States have transposed the cross-compliance standards into obligations applicable at agricultural holding level. Cross-compliance represents an essential element of the Common Agricultural Policy, which may bring undisputable benefits in terms of sustainable rural development. By supporting the settlement of the young population in the rural environment (Direct Payments to young farmers), the CAP converted into a catalyser of employment increase in the rural environment.	The control of the observance of the cross-compliance obligations is deficient and, in certain cases, inexistent. One of the reasons is the fact that these controls are mainly performed during the summer months, which means that a significant number of obligations cannot be adequately performed because they refer to agricultural practices that are conducted during other seasons. The introduction of cross-compliance weakened certain key-elements of the rural development control and sanction system. Moreover, the delineation between cross-compliance and the agri-environment measures is not always clear. There are cases where the data sent by the Member States to the European Commission are not reliable, as they overestimate both the farmer control rates and the rates of compliance with the obligations. The system implemented by the Commission for monitoring these data is deficient, being affected mainly by the absence of performance indicators and reference values.
THREATS	**OPPORTUNITIES**
The limited reduction of direct payments does not observe cross-compliance because of control-related shortcomings, and because of the inappropriate structure of the sanction system. For example, the audit performed by the ECA starting in 2008 showed that the conduct of 11 633 controls pursuant to the Birds Directive and of 14 896 controls pursuant to the Habitat Directive over a period of two years in four Member States did not identify any case of breach of the cross-compliance obligations.	In order to increase the effectiveness of the CAP provisions on cross-compliance and Green Payments, the public authorities may define precise and measurable objectives, susceptible of being transposed into obligations that may be controlled at agricultural holding level. The autonomy enjoyed by the Member States in the application of RDPs allows them to simplify, clarify and prioritise the rules applicable to the financing of projects in the rural area.

As regards the difficulties related to the cross-compliance control, Brunner and Huyton (2008) point out that increased strictness is necessary in the context in which there are fears that direct green payments may be used to disguise subsidies to certain farms, rather than as an incentive for sustainable agricultural practices. It must be mentioned, in relation to these fears, that in certain Member States there are example where direct payments classified as “green” payments financed activities that effectively caused damages to the environment.

6 Conclusion

In our opinion, the future of CAP financing must focus on the “green” component of this policy, in the context in which the relation between agriculture and biodiversity is a symbolic one in Europe. For example, traditional agricultural techniques for mowing and low-intensity grazing maintained a series of semi-natural pastures in Europe and contributed to the preservation of a rich biodiversity.

In this context, we consider that the current contribution of Green Direct Payments to the support of traditional agricultural practices is vital in these conditions and that the viability of the European agricultural sector may not be improved without financial support for sustainable rural development, materialized into agri-environment measures.

Moreover, the current common policy concerning the use of agricultural land is an adequate instrument, as shown by the experience of recent years, for correcting the so-called “market failures”, as well as for concomitantly stopping the decline of biodiversity (as shown by the success of the Nature 2000 direct payments). Agri-environment schemes for European farmers enabled them to continue agricultural activities by adopting more environmentally friendly practices and techniques. Leitao (2006) and Vickery (2004) consider that these types of financing measures proved to be both an economic success and an adjuvant for habitat preservation, while other analysts (Donald and Evans, 2006) underline that these funds may create long-term benefits for environmental protection and the preservation of natural landscapes in the EU.

In the conditions in which climate change will continue to have a strong impact on the economic environment in Europe, the “green” component of the financing for the rural environment must represent a catalyser for the rural development strategies of the Member States because the quality of agricultural habitats will determine the ability of the European Union to ensure the future sustainability of quality food supply and to be competitive in the international produce trade arena. Using the Green Direct Payments, Member States may contribute to ensure viable food production in order to improve the competitiveness of the agricultural sector and increase its share in the food chain, as the agricultural sector is very fragmented compared to other segments of the food chain which are better organised and therefore have greater negotiation power. Moreover, European farmers face worldwide competition while at the same time they must comply with the high standards regarding environmental, food safety, food quality and animal welfare objectives requested by European citizens, and the “green” payments may represent a compensating incentive for them. For the 2020 horizon, the new financing framework enables Member States to encourage environmentally friendly growth through innovation, which may determine the adoption of new technologies, the development of new products, the change of production processes and the support for new demand patterns, in particular in the context of the emerging bio-economy.

The CAP reform was directly reflected in the most used agricultural financing instrument, the Direct Payments. The new conditions under which financing is granted by means of Direct Payments stress the three major objectives of the change: the redistribution, redesign and better targeting of support in order to provide added value to the expenses and make them more effective. There is considerable agreement in the literature regarding the fact that the distribution of Direct Payments should be revised and designed in a manner that would make it easier to understand by the taxpayers. The criteria should be both economic, in order for the Direct Payments to fulfil their role of offering a basic income, and environmental, in order to support the supply of public goods. The increased environmental performance of the CAP by means of the green element led to the need for a series of priority actions to be taken by the Member States. These measures may take the form of simple, generalised, non-contractual and annual environmental actions that go beyond the cross-compliance requirements and are related to agriculture (for example, permanent pasture, green cover, crop rotation and ecological set-aside,).

Through the new financing directions, Member States are able to promote the sustainable development of agriculture in areas with specific natural constraints, by offering additional support to the farmers in these areas, in the form of area payments, as a supplementation of the support granted under the second pillar.

Moreover, in order to take into account the specific problems faced by certain regions where certain types of agriculture are considered particularly important due to economic or social reasons, optional coupled aid may continue to be granted, in observance of certain clearly defined limits (support based on established elements: areas, productivity or number of animals).

Analysing the strengths and weaknesses of the new financial framework, it becomes obvious that Member States should direct their RDPs so that the environment, climate change and innovation may represent central themes, and better target their natural rural policies. For example, investments should increase the economic and environmental performance, environmental measures should be designed in order to provide a better response to the specific needs of the regions and even of the areas with high natural value (HNV), and the measures seeking to contribute to the unlocking of the potential of rural should be particularly receptive to the innovative ideas regarding the business environment and local governance.

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