

6 Towards a new policy on the public values of agriculture

6.1 Introduction

This advisory report tackles issues that touch on the foundations of our future agricultural policy. What we need is a broadly supported, future-driven agricultural policy with the associated objectives and measures, both at European and national level.

That policy should focus on an agriculture sector that makes an optimal (sustainable) contribution to public prosperity in the long term, both in the Netherlands and in Europe. It is difficult to describe precisely what such an agriculture sector should be like, of course. Moreover, what is considered optimal in one period will often not be considered so in the next. The history of the CAP makes that much clear. Changes in technology, preferences and the relevant environmental factors can also alter what we consider a socially optimal agriculture sector. A long-range policy should therefore not take the form of a blueprint, but rather promote progress in a direction that will be regarded as socially optimal even in changing external circumstances.

6.2 An optimal contribution to public prosperity

6.2.1 Introduction

Agriculture generates both marketable products and non-marketable products (services). It should receive adequate payment for its marketable products, without support. In terms of the four-cluster model, this means the enterprises that produce only “food”.

The public services (non-marketable products) must be paid for in some other way. In this case, the enterprises involved also offer services – socially relevant ones – other than “food”, or they produce in regions with a natural handicap and their survival is considered socially desirable. The payment received for such services should reflect the social benefits (appreciation) they generate. What does this mean in concrete terms?

Section 6.2.2 discusses payment for the production of marketable products. Section 6.2.3 considers the non-marketable products (public services).

6.2.2 Payment for marketable products

Two questions are important with respect to *marketable products*. To begin with: what is an adequate payment?

In a market economy that functions properly and in which the means of production basically have no restrictions on their freedom of movement, payment is “adequate”

when the production factors (capital and labour) deployed in agriculture receive the same payment as they would if deployed in some other sector of the economy. What we must also consider here is the “objective” quality of the labour and the “subjective” value that a farmer attaches to his occupation (being one’s own boss, working out of doors, working with livestock and so forth).

The second question is: under what circumstances can we expect a trend towards “adequate” payment? Awarding subsidies in order to raise payment to an adequate level would be at the expense of public prosperity: it keeps too many production factors in the sector and slows down the rate of their departure. On a global scale, it also leads to unfair competition. Leaving aside any positive externalities¹ and social considerations, there is no reason to support agriculture by intervening in the product markets. If farmers believe they are not being paid enough, they will leave the sector. If payment is adequate, few producers will leave the sector and those that do will have no trouble finding successors. If the payment for labour is considered inadequate for income distribution reasons, the best long-term remedy is to train the potential successors (children). That is what we have seen on a massive scale in the Netherlands (and other highly developed countries) in the past few decades.

In short, in an optimal situation, there is no intervention in the product markets. The exceptions to this rule are discussed below. This does not alter the fact that the primary producer partly depends for his pay on the quality of the supply and processing chains for the relevant product. The competitiveness of the agriculture and horticulture sector depends largely on innovations introduced in close coordination and cooperation in “food chains”.

Need for market regulation

Risk is inherent to being in business. That also applies to agriculture. Depending on the sector in which they operate, farmers face various different categories of risk. Weather conditions play a large role in crop farming, whereas intensive livestock farming and greenhouse horticulture are subject to price and financial risks. Livestock farming has to cope with the risk of animal disease, which can be intensified by consumer reactions (“consumer boycott”).

With respect to the most-supported products, the CAP largely covers the related price and market risks. Import tariffs on products such as grain, milk and sugar beets also offer protection on the world market (“Community preference”). This protection is, however, a topic of discussion in the WTO’s Doha Development Agenda. Market stabilisation measures now only include the fallow land and milk quota schemes (which will be

1 Negative externalities (e.g. on the natural living environment) should be corrected by charging the costs to the party causing those effects, in accordance with the principles ‘the polluter pays’ and ‘the user pays’.

phased out gradually by 2015). It is important to maintain a form of market regulation to be able to ward off crises threatening food security, if and when they occur.

6.2.3 *Payment for non-marketable products (public services)*

The following two questions are important with respect to non-marketable products. First, when is payment actually justified? And secondly, how much should be paid?

In answering these questions, we should realise that the public services provided by the agriculture sector vary enormously. One important difference is that between taking positive action and abstaining from action that has negative consequences.

Some services require farmers to perform extra activities, for example, to maintain or improve the rural landscape or preserve regional biodiversity (e.g. by mowing later in the season than customary with a view to meadow bird management). These are positive actions.

In addition, farmers may abstain from certain activities that have a negative impact on public prosperity (for example actions that are harmful to an area or the quality of the soil). The difference between taking action and abstaining from action is not always razor-sharp, as shown in the example of mowing later in the season. The difference is furthermore often a function of the technology involved, and may therefore shift over the course of time.

Essentially, only positive action should be rewarded. A large, efficient grain farm does not require extra payment because the farmer also maintains open areas. Such open areas are an automatic by-product of economic efficiency in this case. But a farmer who creates walking trails on his land or plants hedgerows between plots *should* be paid for his efforts.

There are, however, exceptions to the rule that farmers should not be paid for abstaining from negative action. It may be necessary to introduce a system of payments or compensation in order to ensure the quality of life or an attractive landscape in areas that are less suitable for agriculture. It is legitimate for the Dutch to want to see dairy cows in a moorland landscape, or for the Fins to regard reindeer in Lapland as adding to the quality of their lives. The competitiveness of the dairy farm on the moors compared to that of dairy farmers in New Zealand should naturally not play a decisive role in determining whether or not that wish can be met. The same goes for the competitiveness of the Lap who owns the reindeer compared to the Argentinean cattle farmer. But that means that the possible compensation should not be coupled to the production of marketable products, or at least as little as possible.

And then there is the second question: how much should these farmers be paid for these services? It is easier to answer this question theoretically than empirically. Theoretically,

payment should not exceed the value that society accords to the public goods/services that are maintained or produced. Because that social value (which is subjective) does not become evident in objective public behaviour (as it does in the case of marketable products), “politics” will have to decide. Payment must in any case be enough to make it attractive for farmers to produce the services the public wants.

Compensation will almost always distort competition, albeit only slightly. The agriculture sector will often be called upon to play a role in maintaining open spaces, agricultural production capacity (to combat desertification, for example), the quality of life in the countryside, landscapes of cultural and historical interest and so forth. Farmers are, after all, the current stewards of the countryside. And their public services will seldom be completely separate from their commercial activities. That means that it will not always be easy to keep this kind of payment out of the WTO discussions. If the compensation only concerns those products or services that are not traded internationally, however, the WTO basically has no bearing on them.

6.3 Which public values require which policy?

Food security

In normal circumstances, the market guarantees food security, mainly through EU production and in the form of supplementary import. Only if world market prices were exceedingly low for many years would the EU’s production capacity be affected to the extent that long-term food security could become a problem. Such a situation can be prevented by protective measures in extreme circumstances (for example the risk of large-scale bankruptcies among producers). WTO agreements do allow protection of this kind in extreme circumstances. In short, this public value will not require government intervention in normal circumstances, but it is a “remote concern”.

Food safety

Because the public has little control over food safety (people cannot determine for themselves whether their food is safe), government has an obvious role to play here. That role has two aspects to it: to determine minimum food safety requirements and to monitor compliance with those requirements. Proper monitoring encourages farmers and the foodstuffs industry to meet the requirements and to set up tracing and tracking systems (to avoid damaging their reputation). It even encourages them to set higher standards voluntarily (to help improve their reputation).

This public value does require government policy, but should not be coupled to a support payment.

Animal welfare

The main problem here is the discrepancy between public opinion and consumer behaviour. The public is confronted mainly with the benefits of animal welfare standards

(the “feel-good” factor), whereas consumers are confronted mainly with the costs (apparently identical cuts of meat are considerably more expensive).

Unilateral action by the Netherlands (i.e. setting higher standards) would not solve the problem but merely transfer it. Another possibility is that government compensates for the price difference, but this would mean that the Netherlands would have to pursue its own agricultural policy (with animal-related support). High import tariffs will also be necessary, but that is something that the rest of the world (including the EU) will probably not want to accept. In short, if the Netherlands wishes to continue trading in the international market, the agriculture sector (and therefore society) will have to conform (to some extent) to the opinions of the buyers of the products. The alternative is that the Dutch agriculture sector will have to scale back production drastically compared to the current situation.

A more obvious approach would be to attempt to reduce the discrepancy between the public and the consumer, for example by (a) raising consumer awareness in the Netherlands and abroad; (b) reaching agreements with wholesalers and the catering industry, and (c) exerting pressure within the EU and WTO to adopt stricter animal welfare standards. Except for incidental support to stimulate certain innovations, there is not much scope to support production unilaterally and structurally in the Netherlands for animal welfare reasons.

Nature and biodiversity

Under certain circumstances, land-based agriculture can provide the necessary conditions for certain forms of wildlife. Meadow birds, for example, depend on farmland to survive. Agriculture can also go hand in hand with nature management. At the same time, agriculture can have a harmful effect on the natural environment and biodiversity. Regulations attempt to limit that effect by restricting agriculture and horticulture in regions that have an impact on nature protection areas.

Positive contributions to the management and restoration of the natural environment should be rewarded. Such payment must be regarded as separate from agricultural policy. In this case, the market has failed, but correcting that failure should not be coupled to the CAP (first pillar).

If farmers are not required to make a specific effort or do not have major restrictions imposed on their operations, then the same applies to measures aiming to improve or maintain biodiversity. The boundary between a minor and a major restriction will not always be crystal clear. It will be largely political considerations that underlie any compensation for restrictions placed on operations for environmental/ecological reasons.

Man-made landscapes and the natural environment as a resource

The four-cluster model and the accompanying explanation offer a good framework for developing a payment structure that will promote an optimal agriculture sector (in broad prosperity terms). Only the areas with “serious” handicaps would qualify for long-term compensation, without active performance being required (except that farms in these areas would have to comply with various prohibitions).

The size of the compensation should (theoretically) correspond with the handicaps present in each area/hectare. However, this is simply impossible in practical terms (excessive transaction costs, large risk of government failure). It would therefore be better to have a flat rate compensation per hectare for large, homogenous areas.

Payment should also be made for specific services such as creating walking trails, planting saplings and so forth. In that case, the payment would be coupled directly to the service provided.

Environment and climate

Agricultural practices have both positive and negative effects on the environment and the climate (CO₂ and other greenhouse gases). Rules and regulations determine the extent to which agriculture may make use of the natural environment. It would not be obvious to use financial instruments (payments and fines) in this case. There are two exceptions, however: (i) when extra services are being provided (e.g. payment for planting trees as compensation for the carbon footprint); and (ii) when standards are exceeded (e.g. fines for exceeding the phosphates emissions standards).

Blue services

When farmers provide “blue” services to the rest of society, for example by allowing water to be stored temporarily on their land, then it is reasonable for them to receive payment or compensation.

Quality of life in the countryside

The Dutch countryside is no longer dominated by agriculture. Its vitality depends only to a limited extent on trends in the agriculture and horticulture sector. The situation is otherwise in some other Member States of the European Union. There, a decline in the agriculture sector often leads to the depopulation of the countryside. That is no reason to support inefficient agricultural production, however. It would be more obvious to remove the unilateral dependency on agriculture by promoting economic diversification. The second pillar of the CAP (the rural development fund) offers the necessary instruments.

6.4 From old policy to new

National level

There are three reasons for allowing the Member States to take responsibility for developing the support schemes compensating for natural handicaps (including setting the size of the compensation) and the payments for green services:

- 1 It is not always possible to determine in detail the size of the payment and the scale of the services required “objectively”. The “closer to home” the product/service is, the easier to work out the payment/compensation scheme.
- 2 Payment is context-dependent. The “right” payment depends in part on the average income in a region.
- 3 To prevent “free rider” behaviour with respect to the EU budget (bearing the first two items in mind).

In the Netherlands, the national, regional and local authorities must join forces in investing in agricultural nature and landscape management (green and blue services) by entering into a long-term commitment and setting aside the necessary financial means to support it. Chapter 5 uses the four-cluster model to describe the various options for articulating that commitment via compensation for serious natural handicaps and payment for public services. The chapter also indicates the various problems that will arise. In addition, sufficient money will need to be set aside in the national budget – whether or not co-financing is provided by the EU – in order to promote innovation and the transition to sustainable agriculture. It is important to avoid a huge administrative burden when devising the new policy. The administrative burden associated with payments for green services and compensation for natural handicaps should be in proportion to the social benefits derived from these schemes.

European level

The financial resources needed for such compensation and payment systems and innovation incentives can be made available by gradually lowering the current single farm payment. The pace at which this takes place should depend on four factors:

- 1 the speed at which the international agricultural markets are liberalised (reductions in support elsewhere can be expected to lead to higher prices on the world market);
- 2 the speed at which satisfactory compensation for extra non-marketable services can be introduced (i.e. compensation that actually corrects market failure);
- 3 the overall asset position of the enterprises (at EU level). Large-scale bankruptcies must naturally be avoided;
- 4 the degree to which the European frameworks (new CAP, co-financing, state-aid policy) actually combat unacceptable distortions of competition (as it would otherwise be possible to fall back on a form of per-hectare support for regions without a handicap).

Ultimately, cross-compliance will disappear along with the single farm payment. What will not disappear, however, is the obligation to comply with applicable laws and rules concerning the environment, working conditions, animal welfare, and so forth.

The proposed review of the division of responsibilities between the EU and the Member States by no means entails dispensing with the CAP. The EU will continue to play an important role, for example:

- 1 by combating distortions of competition in the internal agricultural market (including those brought about by payments or compensation);
- 2 in international trade policy (WTO negotiations);
- 3 by intervening in and stabilising markets in extreme circumstances (for example large-scale outbreaks of animal disease);
- 4 by harmonising legislation in such areas as the environment, food quality, animal welfare, animal disease, etc.;
- 5 by encouraging innovation in order to promote efficient and sustainable agricultural production.