

# The Role of Post-2013 Common Agricultural Policy on the Sustainability of Italian Beef Production

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## Summary

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A seminal objective of the Common Agricultural Policy (CAP) is to ensure a fair standard of living in agriculture. Since 1992, the CAP has moved most of its policy towards direct payments (DPs) that have been decoupled from production under the Mid-Term Review (MTR) in 2003. The shift towards decoupled payments highlights the asymmetry of the support among farmers and countries and the need such a payment to be connected with specific commitments towards European citizens. In the final stages of institutional negotiation for the new CAP Post-2013, agriculture is facing a new challenge within a general economic context of uncertainty. This article discusses the expected impact of the EC legal proposal for the CAP post-2013 with a specific focus on specialist beef fatteners in Italy.

## Key words

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beef, feedlots, CAP, sustainability, economic viability

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## Introduction

The chronic uncertainty of farm income has been among the main reasons for the adoption of policies supporting the agricultural market (Gardner, 1992). A seminal objective of the Common Agricultural Policy (CAP) is “to ensure a fair standard of living for the agricultural community, in particular by increasing the individual earnings of persons engaged in agriculture” (Article 39 of the Treaty of Rome). In accord with international agreements, since 1992, the CAP has moved most of its policy from market support measures toward annual direct payments (DPs). European Union (EU) agricultural policy underwent significant changes under the Mid-Term Review of the Common Agricultural Policy (CAP) in 2003. Concern for the World Trade Organisation (WTO) deal has been central in shaping this reform. Member States agreed to implement a system of single farm payments (SFP) decoupled from production (Swinbank and Daugbjerg, 2006). However, some exceptions to full decoupling were allowed for specific sectors and regions to limit the potential of negative effects from the immediate transition to full decoupling; e.g., preserving agricultural production in specific vulnerable regions and providing environmental benefits through a continuation of a specific agricultural production.

The choice to introduce decoupled support has been motivated by the need to increase the market orientation of EU farmers and to fulfil WTO requirements to reduce the market distortions caused by coupled payments (OECD, 2011). Currently, approximately 85% of direct payments granted in the EU can be considered decoupled (European Commission, 2011a). Direct payments are directed at goals other than productivity, including remuneration for environmental services provided by farmers who fulfil a set of compliance rules relating to basic environmental standards, food safety, animal health and welfare, and good agricultural and environmental conditions (Art. 3 of Regulation (CE) n. 1782/2003). In addition, the shift to decoupled payments, which generally has been made on the basis of farmers’ historical payments, has made the incoherence of such an asymmetric distribution evident. Regarding the new post-2013 CAP, one of the main issues to solve is the distribution problem for farm support (Severini and Tantari, 2013).

The optimistic approach, based on the development of free trade within the agricultural sector, has not been able to produce the expected results. In fact, the anticipated positive effects of the Marrakech agreement, including an improvement in food availability, a reduction in commodity prices, and the improvement of economic conditions and income distribution in developing countries, have not been substantially met.

The above expectation has been negatively affected by i) the unexpected growth of the global economy and the related increase in food demand in some geographical areas/countries; ii) the rise in energy and other input prices; iii) the climate changes observed in the last decade; iv) the increase in price volatility; and v) growing concerns about food quality, food safety and the impact of production methods on the environment (De Castro, 2010).

Within this economic context, the EU is again facing the problem of assuring the availability of food to European citizens at a fair price. This objective, ignored during years of over-production, has again become a priority in the policy agenda.

Additionally, issues such as food quality, rural space management, environmental and climate impact mitigation and natural resource access have become new priorities.

Beef production is a sector deeply involved in the above-mentioned concerns of EU citizens. In addition, the sector plays an important role from an economic perspective and has taken advantage of a relevant budget allocation before MTR reform equal to 14.7% of the entire agricultural budget (European Parliament, 2005). The reform of CAP is a critical issue for the specialised Italian beef sector. The production model is different from mainland Europe’s beef rearing system. Farms specialise in fattening young cattle, which are imported mainly from France, reared in indoor feedlots, and fed with locally produced feed, until they reach final weight. Most of these farms are located in the northern area of the country, where 83% of beef carcass production takes place (ISTAT, 2010). In this area, specialised producers account for 82% of whole beef production. In northern Italy, the Veneto Region is the main producer, accounting for 25% of Italian beef production.

The objective of this article is to discuss the implications of the EC Proposal on post-2013 CAP and to highlight the risks and opportunities for the Italian beef sector under the forthcoming policy.

## The post-2013 CAP proposal

Looking toward the new programme period 2014-2020, the EU has identified a model for sustainable development strategies that answer all the above concerns. In this manner, the development of European society should be assured from an economic, environmental and social perspective. At the same time, this developing model should be able to face competition in the global market. The guideline for this strategic plan has been defined in the European Commission (EC) document called Europe 2020 Strategy. The economic growth should be i) smart, through more effective investments in education, research and innovation; ii) sustainable, as a result of a decisive move toward a low-carbon economy; and iii) inclusive, with a strong emphasis on job creation and poverty reduction. The strategy is focused on five goals: employment, innovation, education, poverty reduction and climate/energy (European Commission, 2010a).

In this context, the agricultural policy should be able to promote a sustainable model of agriculture, satisfying the goal of income maximisation for farms; e.g. by promoting production processes that use lower amounts of non-renewable resources or produce a lower amount of greenhouse gases. This model of production should be able to assure, despite the lack of immediate economic advantage, a higher and enduring benefit in the long run (Ruttan, 1997). However, under actual market conditions this choice could be disadvantageous both in the short and long term. In the short term, sustainable farms will suffer higher cost and lower revenue compared with standard farms. In the long run, the standard producer will take advantage of the benefits created by sustainable producers, without paying the related costs (Daly, 1974 and 1991). These considerations lead to the conclusion that a sustainable model cannot be supported only by market rules. This justifies the need for public support in favour of the sustainable production model.

The strategy for the development of agriculture and rural areas has been outlined in the EC Communication “The CAP towards 2020” (European Commission, 2010b). The EC stressed the idea that the new CAP should remain a common policy structured around two pillars. The CAP should pursue these strategic aims: i) to preserve food production potential on a sustainable basis while guaranteeing long-term food security; ii) to support farming communities that provide sustainable food production to European citizens with quality, value and diversity; and iii) to maintain viable rural communities in which farming is an important economic activity and creates local employment.

Within this framework, the EC proposal for the new CAP is characterised by radical reform of the first pillar, moving in the direction of a system of DPs able to respond to the issue of green growth and improve better distribution and targeted support.

The EC has proposed that a single scheme across the EU (the Basic Payment Scheme) should replace the Single Payment Scheme (SPS) (European Commission, 2011b). This scheme operates on the basis of payment entitlements allocated at a national or regional level to all farmers according to their eligible hectares in the first year of application. The use of the regional model, which was optional in the current period, will be generalised, bringing all agricultural land into the system. Member States are asked to define the regions in which the new scheme should be applied in accordance with criteria such as their institutional, administrative or geographical structure, among others. The unit value of payment entitlements per hectare is calculated by dividing the national or regional ceiling by the number of hectares allocated at the national or regional level. This means that, by using the regional model for those Member States opting for the historical model of SPS implementation, the payment per hectare at a national or regional level will progressively converge toward a uniform value (Severini and Tantari, 2013). In addition, to enhance the overall environmental performance of the CAP, a relevant part of the regionalised payments (30% in the Proposal of the EC) is submitted to the respect of certain agricultural practices beneficial to the climate and the environment; this is referred to as the “greening” of direct payments.

Concerning the second Pillar, the proposal for a Regulation of the EC substantially confirms the structure of a Rural Development Programme. One of the main innovations arising from a first reading is the abolition of the Axis and the introduction of six Priorities (art. 5 of the legal proposal).

The six Priorities for rural development are as follows: i) fostering knowledge transfer and innovation in agriculture, forestry; ii) enhancing competitiveness in all types of agriculture and enhancing farm viability; iii) promoting food chain organisation and risk management in agriculture; iv) restoring, preserving and enhancing ecosystems that are dependent upon agriculture and forestry; v) promoting resource efficiency and supporting the shift toward a low carbon, climate-resilient economy in agriculture, food and forestry sectors; and vi) promoting social inclusion, poverty reduction and economic development in rural areas.

Another innovation concerns strengthening the level of integration among all structural policies, defined at the local, national and EU level.

The EC proposal has introduced some interesting innovations within these priorities: i) an explicit role given to the support of knowledge transfer in Priority 1; ii) higher importance for policies regarding the integration of the agri-food supply chain (Priority 3); iii) inclusion of a policy for the management of risk in agriculture in the rural development program (Priority 3); and iv) the implementation of numerous instruments to promote the transition toward a low carbon economy (Priorities 4 and 5).

Within this new policy framework, understanding the impact of this new CAP on different farm types has been delegated to the impact assessment reports published by the EC (European Commission, 2011c). The report cites concerns regarding the impact of the new CAP proposal on the beef sector, but in our view, the analysis should consider the additional aspects discussed in the next section.

### The role of the new CAP proposal on the sustainability of Italian beef production

Decoupled DPs, introduced by MTR reform, have been placed into the WTO’s ‘green box’ of agriculture-related subsidies and must therefore adhere to the fundamental requirement that the policy has no, or at most minimal, trade-distorting effects. The assignment of such payments to farmers has been made on the basis of historical subsidies received by them during a reference period prior to the reform. The choice to distribute the DPs based on the historical subsidies is justified by the goal of reducing the impact on farm income and giving the farms enough time to adapt their production choices to market signals. Because the amount of the DPs bears no relation with any counterpart given to the community, the system is still open to criticism on the imbalance of payments among farms and across countries (Howley et al, 2010).

With respect to the beef sector, Severini and Tantari (2013) report that for a large share of beneficiary farms in Italy, DPs are still essential to ensure positive economic results. In fact, among beneficiaries, 25.5% of farms show a negative market income compared with 5.5% in the case of non-beneficiaries. Thus, the introduction of the regional model, shifting the resources provided from beneficiary to non-beneficiary farms, will likely exert a negative effect on the income of the former. In fact, the main concern of farmers is understanding whether the new CAP will undermine the viability of their farms. In our knowledge, except for the analysis of the redistribution effect of the reform, few studies have examined the impact of the reform on specialist beef fatteners.

The EC impact assessment for CAP reform proposal assumes that in the context of decoupled payment support, the impact to the beef sector is limited to the abolishment of residual coupled payments. Such payments are still applied, e.g., for suckler cows in France, but have a marginal role on specialist beef fatteners in Italy (Annex 6 of European Commission, 2011c). Additionally, despite the fact that WTO associates the decoupled payment with the ‘green box’ of agriculture-related subsidies, there is some uncertainty as to whether these payments are truly production neutral (Adams et al., 2001; Goodwin and Mishra, 2005; Hennessy and Thorne, 2005). With respect to the beef sector in Ireland, Howley et al. (2011) argue that cross-compliance obli-

gations can have, the effect of at least partially re-coupling decoupled payments, among others. Their results are based on the comparison of cattle herds observed after MTR Reform with the projection under two hypotheses on farmers' reactions to DPs: i) truly decoupled payments or ii) coupled payments. The observed dynamics in cattle herd lies between the two projections, suggesting that decoupled payments affect production as a non-perfect decoupled payment.

In fact, the availability of such payments provides a variety of non-market factors that can influence farmers' activities (Kantelhardt, 2006). Decoupled payments can influence farmers' behaviour by increasing overall wealth, decreasing risk aversion, or making credit more accessible (Bhaskar and Beghin, 2009). In addition, as reported by Howley et al. (2011), farmers may initially be reluctant to make significant changes to their production levels in case future payments are reassessed on the basis of their levels of agricultural activity during a more recent base period.

The results of the above research suggest that the movement from the historical distribution of direct payments to the regional model could significantly affect Italian specialist beef production, as a consequence of the expected strong reduction on DPs for this type of farm. The Italian specialist beef production model is characterised by very limited pasture use. Most of the animals are reared in feedlots while the land is used for feed cultivation. As a result of high land productivity and the potential to buy feed on the open market, the concentration in terms of head per hectare could be very high (Sturaro et al., 2012). As a consequence, the application of MTR reform on this type of farm has led to a value of decoupled DPs significantly above the average (Table 1). Reform in the direction of regionalisation of payments could dramatically penalise this type of cattle rearing, due to the important reduction in the value of DPs per hectare.

**Table 1.** Average decoupled payments per type of farm in the region of Veneto (Italy) in 2008 (€)

	DPs per farm	DPs per hectare
Specialist field crops	24,027	455
Specialist horticulture	1,672	262
Specialist permanent crops	3,423	164
Specialist grazing livestock	28,045	1,495
Specialist granivore	7,566	344
Mixed cropping	15,906	344
Mixed livestock	14,056	431
Mixed crops-livestock	41,028	679

Source: Farm Data Accountancy Network (2008)

In addition, the economic sustainability of specialist beef fatteners depends on the economics of live animals that are imported mainly from French pastures. In fact, French suckler cows benefit from a coupled premium in the current CAP. The EC impact assessment reports that by suppressing coupled payments, the percentage of French breeder farms operating on negative gross margins would increase from 7% to 29.5%. As a consequence, the risk of a reduction in the supply of live animals will most likely impact the economics of fatteners due to the lower availability and higher price of live animals.

Some opportunities to mitigate the impact of CAP Reform are related to the possibility to dedicate part of the budget to coupled payments that have to be negotiated among all other agricultural sectors at a national level.

Despite the uncertainty related to the reform on DPs, several new opportunities could result from the new Rural Development Programme:

- Establishment of producer groups (art. 28), especially concerning (a) the adaptation of production and output to market requirements; (b) the joint placement of goods on the market and the centralisation of sales; (c) the establishment of common rules on production information; and (d) the development of business and marketing skills and the organisation and facilitation of innovation processes. This priority seems to offer an important opportunity to promote, similar to the French meat sector, the development of an inter-professional agreement among all the agents in the supply chain.
- Agri-environment-climate (art. 29) measure. These payments could be granted both to the traditional environmental commitments and climate commitments. In addition to the proposal of the EC that grants these payments to land-managers, the proposal of the European Parliament extends climate payments for the improvement of the climate performance of the entire agricultural holding or farm system. This solution would also allow feedlot rearing systems to obtain access to specific compensation under climate commitments.
- Income stabilisation tool (art. 40). This measure aims to support farmers when the drop in income exceeds 30% of the average annual income of the individual farmer during a prior defined period. The heavy reduction of direct payments to Italian fatteners will most likely increase the uncertainty of farm income and the risk of financial loss. This type of tool, among others established by art. 37 to 39, could most likely improve the ability of this type of farm to manage higher risk.

## Conclusions

The proposal of regulations by the EC is currently under negotiation by the European Commission, Parliament and Council. This negotiation is occurring in a context of unresolved debate on the EU budget for 2014-2020. This aspect could undermine the ability of European institutions to have a new CAP in place in 2014. In this context, even if it seems very hard to quantify the level of impact of alternative choices, the direction of the new CAP will most likely be confirmed. In this potential scenario, the Italian beef sector is facing important changes in the level of support, which could undermine the economic viability of their production. Alternatively, the new rural development programme could provide new opportunities if the sector can take advantage. Among the different measures, there are some that may be able to improve the viability of the sector and lead farmers toward a more sustainable model.

With respect to the improvement of farm viability, a key challenge could be the measures aimed at improving the level of organisation and integration of the supply chain toward a more competitive model.

Concerning the environmental impact of beef production, an interesting measure is the payments for climate commitments. If Parliament's proposal is adopted, feedlot rearing systems would also be able to obtain support by improving their climate performance.

Finally, the development of a risk management tool, especially concerning income stabilisation, should be able to mitigate increased exposure to financial risk and improve the ability of farms to invest in innovative production models.

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