

# THE IMPLEMENTATION OF SINGLE PAYMENT SCHEMES IN EUROPEAN UNION COUNTRIES

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## Abstract

The reform of the CAP in 1999, with extensive revisions in 2003 (Council regulation 1782/2003), was constructed around three central ideas: decoupling, cross-compliance of payments, and modulation.

Decoupling, which is specifically analysed in this article, is intended to eliminate all aid linked in one way or another to production, in favour of aid which is completely independent of the production activity. It is encapsulated in the new 2003 regulation by the introduction of the right to a single farm payment (SFP) proportional to farm area, independent of production activities.

These new arrangements have been accompanied by much variation in the application of the reform, and the member states have taken great advantage of the extensive room for manoeuvre inherent in the new regulation. This is revealed in the extreme diversity of choices made, both in the degree of decoupling (total or partial) and in the methods of calculating the SFPs (historical or regionalised references).

In order to better understand the reasons for and practical details of the differing national choices, this article presents a synthesis of the results of a comparative study of how the SFPs are managed in four large EU 15 countries (Germany, the UK, Spain and Italy), chosen because of the diversity in their approaches to decoupling and the calculation and trade of the SFPs. Objective economic data specific to each country and national political context are combined to explain the evolution of production systems and explain the observations, taking into account both the implications of how agricultural holdings, production systems and land are categorised, and the expected effects structures.

**Keywords:** CAP, Fischler Reform, Implementation. SFP.

**JEL Code:** Q10, Q18

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<sup>1</sup> JP BOINON, JC KROLL, D LEPICIER, A LESEIGNEUR, JB VIALLOIN : The implementation of SFPs and of article 69 in the member states of the European Union, study convention MAP –ENESAD, led by JC KROLL, October 2006

- fascicule 1 : Summary, 46 p + appendices

- fascicule 2 : A study of four European countries : Germany, Spain, Italy, United Kingdom (England), 109 p.

<sup>2</sup> JP BOINON, JC KROLL, D LEPICIER, A LESEIGNEUR, JB VIALLOIN 2008

La mise en œuvre des DPU dans les Etats membres de l'Union Européenne, Notes et Etudes Economiques n° 31, Service de la statistique et de la prospective, Ministère de l'Agriculture et de la Pêche, juillet 2008

<sup>3</sup>The authors wish to express their particular gratitude to Philippe Balny, Bernard Bourget, François Cloud, Gérard Cravero, Jean-Baptiste Danel and Emmanuel de Longeaux of the CGAAER, with whom they jointly carried out the studies in four European countries, as well as the agriculture attachés at the Economic Missions in

## **Introduction**

Since 1993 the pace of reforms to the Common Agricultural Policy has accelerated. Intended to last seven years, the reform of 1999 was thoroughly revised in 2003, to such an extent that what was originally intended as a mid-term revision became a full-blown reform, in the hope of clearly defining prospects for European farmers until 2013.

One of the strong points of this new reform was the setting up of a system of single payments, the modalities of which vary enormously between countries. This new situation raises the question of how agriculture may evolve differently across Europe. It is particularly interesting for a heavily agricultural country such as France to understand what is happening in the other EU countries, especially those which used to make up the EU 15, and are subject to the same rules for the application of the reform.

After discussing in the first section the issues raised by the reform concerning the management of direct aids to agriculture under the first pillar of the CAP, in the second section we draw up an inventory of the diverse modalities used to organise the single payments in the EU 15 countries, in particular in Germany, Italy, Spain and Great Britain, which were the object of a study and deeper analysis.

Using this inventory as our starting point, we will attempt a first analysis of the differing impacts of the new arrangements with two themes: how the aid is shared out (third section) and the impact on the production systems (fourth section).

These initial observations will lead us to a last, concluding section in which we discuss the prospects for the CAP and reflect on the directions it may take.

## **A new “Pick and Choose” Agricultural Policy: Understanding the Different National Choices**

### ***Greater variety***

The adoption of this latest reform was complicated because a certain number of member states, notably France, considered that there was no need to shake up the calendar fixed in 1999. It was finally made possible thanks to the budgetary agreement reached at the European summit of October 2002, which fixed the framework for financing the CAP with a budget for the first pillar funded until 2013. When the 2003 agreement runs out, this budget will be shared between the old and new member states in such a way that each EU 15 country will obtain, in exchange for consenting to the new reform, the guarantee of keeping until 2013 the rights to Community support previously accorded them under the Common Agricultural Policy. Further, the negotiations led to this new reform containing multiple opportunities to

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each country studied - Mrs. Françoise Moreau-Lalanne, agriculture attaché in Germany, Mrs. Cécile Bigot, agriculture attaché in Spain, Caroline Cognault, assistant agriculture attaché/veterinary attaché in the United Kingdom, and Thibault Lemaitre, assistant agriculture attaché in Italy, for their availability and involvement in the carrying out of this study.

‘pick and choose’ the modalities for applying the new common arrangements, which was a major factor in reaching consensus.

***A new step towards complete decoupling, and a new scheme: the SFP***

The 2003 reform was ambivalent. It was the latest step in the movement begun in 1992 and continued in 1999 with the Berlin agreement, featuring a reduction in prices and the establishment of partially decoupled payments, because unconnected to the volumes produced. It represents a further step towards decoupling, where part or all of the payments have become independent of the production activity. As in the previous reforms, it was justified by the Commission and by the Council of Ministers by the need to respond to the concerns of European citizens regarding food safety, product quality and the protection of the environment, by the need to stabilise agricultural expenses during a pivotal period of EU enlargement to include 10 and soon after 12 or 13 new member states, and lastly by the need to consolidate the European position at the WTO, during the Doha negotiating round<sup>4</sup>.

These multiple objectives are linked to a fundamental economic idea, that of decoupling, which aims to eliminate any aid connected in one way or another to production, which is considered to create imbalances in competition, in favour of aid which is completely independent of the production activity. In this sense, the 2003 reform represents an important turning point in the allocation of aid, in introducing several new principles. From 2007 at the latest, the payments to large scale farming, cattle, sheep and dairy farming (introduced between 2004 and 2006), as well as certain other payments will be totally or partly<sup>5</sup> replaced by a single payment per holding. The setting up of the new decoupled payment scheme is based on aid which is proportional to the farm area. The right to payment is therefore no longer linked to the activity, but to the possession of ‘eligible’ land. In the spirit of the reform, many uses of the land are acceptable, including simple upkeep involving no production. It is in this sense that the payment is definitively decoupled from the production, in as far as it is linked neither to the type of production nor even to the existence of agricultural production. But the creation of these new rights raises a new question, concerning their transfer, which has resulted in a series of arrangements governing the setting up and functioning of reserved rights and the creation and supervision of the trade in rights, with, once again, significant room for adaptation between countries. Lastly, the reform makes the allocation of aid (decoupled or otherwise) subject to new, imperative conditions, in order to respect 19 directives and regulations concerning the environment, the identification of animals, public health and food safety and animal health and well-being, as well as respecting the agricultural and environmental conditions laid down by each state.

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<sup>4</sup> This round is once again deadlocked, following the failure of the ministerial conference of July 2006, so it is difficult to assess the validity of this argument.

<sup>5</sup> Amongst other national arrangements for adapting the reform which allowed consensus, member states may decide to maintain a partial coupling of payments for certain produce, according to modalities given in the Community regulations.

### *National modalities for applying the reform: new issues*

These different innovations are all liable to significantly alter the behaviour of agricultural producers and land owners, with potentially major macro-economic effects, which economists' simulations can only predict very approximately, given the numerous assumptions required to build their models. The many possible adaptations of the modalities of implementing the reforms across countries and regions make the effects of the reform even less certain, particularly because the socio-economic characteristics of farming activities vary widely from one country to another, and within each country, from one region to another.

To better evaluate the expected impact of the reform and understand the way in which each country has dealt with it and plans to proceed, a comparative study of countries was carried out based on a bibliographical synthesis of available administrative documents and research documents, as well as direct surveys of the main public and private figures involved in the conception and application of the reform<sup>6</sup>. This study, from which the present article has derived some key results, covers the four large EU 15 countries which made different choices to France in the management of the SFPs and the application of article 69 – Germany, the UK, Spain and Italy. Without wishing to minimise the contributions of countries such as Holland, Denmark or Belgium, it should be remembered that these four large countries, with France, are responsible for the greater part of European agricultural production, as well as of Community aid, as shown in the following table:

**Table 1 - Shares by country for production and direct CAP aid**

	<b>EU 15</b>	<b>France</b>	<b>Spain</b>	<b>Germany</b>	<b>Italy</b>	<b>UK</b>	<b>Total 5</b>
Production 2004	100	21.6	14.6	14.7	15.3	8.2	74.4
Direct CAP aid 2002	100	25.3	13.2	18.1	12.6	10.3	79.5
Direct CAP aid 2007[*]	100	26.5	11.2	17.8	9.4	12.6	77.5

Source : L'agriculture dans l'UE. Informations statistiques et économiques 2005. OPOCE 2006

\* The amounts used are those of the budgets given in annexe VIII of regulation CE 1782/2003. We have checked that these amounts are very close to the direct aid payments for 2002, increased by the new decoupled dairy payments, complete from 2007 onward (national dairy quota x 35.5 €).

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<sup>6</sup> For further details of the study method, consult the summary referenced at the end of the article.

## **The Implementation Of The Sfps<sup>7</sup>: Through The Maze Of National Choices**

### ***Overview of the countries' choices***

The member states have made great use of the room for adaptation in the Community arrangements authorised by the Council's regulation 1782/2003, which is revealed by the great diversity of choices, as much with regard to decoupling as to the modalities for calculating the SFPs (historical references or regionalisation).

**As far as decoupling is concerned**, the 2003 regulation maintains some payments coupled to specific produce. For the other produce, it allows part of the payments for crops linked to cultivated fields to be maintained, and likewise for a part of the livestock payments linked to animals kept according to different possible combinations detailed in the regulations. Only the UK, Ireland and Luxembourg apply maximum decoupling to the totality of produce. Greece, Italy and Germany have retained coupled payments (total or partial) on a few limited crops (tobacco, hops, olives and seeds). Austria, Belgium, Denmark, Finland and Holland have all chosen to protect their cattle produce, while Spain, France and Portugal have opted to retain the maximum number of coupled payments authorised, for both animal and vegetable produce.

**With regard to the implementation of the SFPs**, the 2003 regulation allows two different ways of calculating the rights - using individual historical references, for the farming areas that had allocations in the past, or by mutualisation over a region, in which case the regional aid is based on the total area used for crops and livestock. This regionalisation is in itself a complex issue, given the regions' alternative modalities and differing ways of calculating the rights authorised in the regulations. The UK is the only member state to have varied the implementation of the reform according to region, by opting for different calculation methods for the SFPs (either historical references or regionalised ones) in different regions. All the other countries, including the very decentralised federal ones such as Germany, have chosen a unified implementation across the nation. Five member states and two of the UK's regions have opted for total (England, Denmark, Finland, Germany and Sweden) or partial (Northern Ireland and Luxembourg) regionalisation when calculating the SFPs, with diversified regional references varying from the administrative region in Germany's case to England's *ad hoc* zoning system based on the agricultural potential of the land. The others (Scotland, Wales and the remaining member states) have based their SFP calculations on historical references.

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<sup>7</sup> The study referenced at the end of the article also includes an analysis of the implementation of article 69 in Italy and Spain, which is not given here. Briefly, one can say that the effects of article 69 are limited because of the restricted possibilities for redistribution payments it allows; either the payments are very precisely targeted and only concern a small number of recipients, in very specific systems, or else, as in Italy, the allocation conditions for the payments of article 69 are hardly selective at all, leading to derisory levels of support per hectare or per animal without much impact, given how diluted the support becomes among a large number of recipients.

### *Six main configurations*

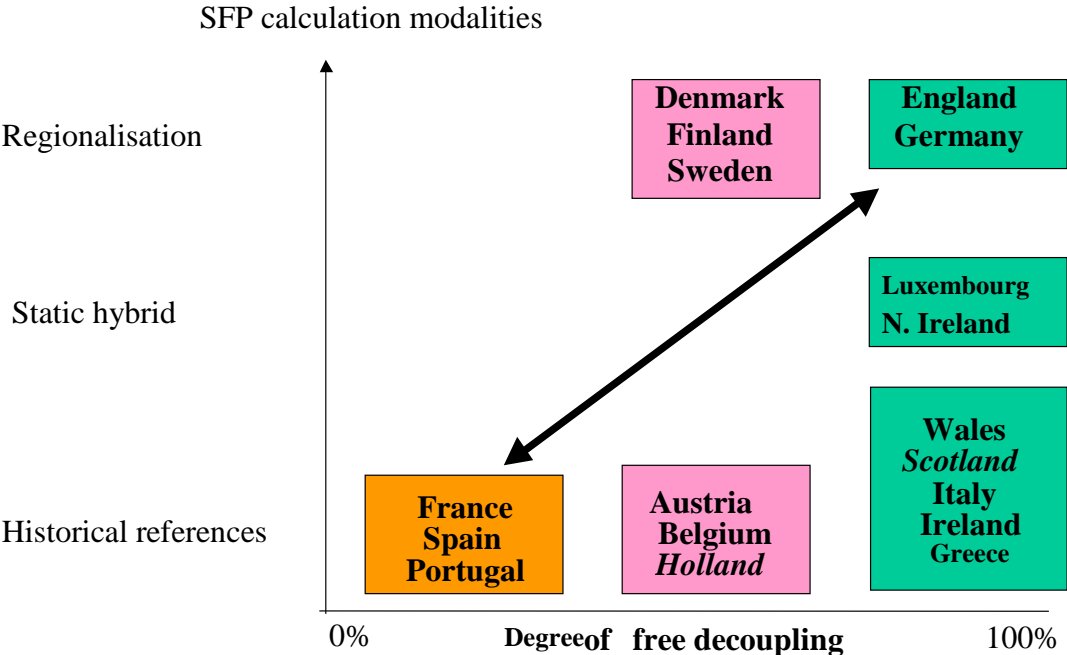
Studying the degree of decoupling and the degree of regionalisation in the calculation of the SFPs (historical or regionalised references, mixed references or according to a 'hybrid static' model) allows one to identify six main modality configurations for the application of the reform, which are displayed on the two axes of Figure 1.

This method of representing the different modalities for implementing the reform reveals certain constant features. The implementation of regionalisation is generally combined, in those member states where it has been chosen, with the maximum possible (or almost) decoupling of payments. Conversely, the retention of significant coupled aid goes hand in hand with the choice of historical references. We therefore perceive two types of strategy: that of regions or states like England or Germany, which have taken fullest advantage of the innovations introduced in the 2003 regulation, and that of states such as France, Spain or Portugal, which seem on the contrary to have chosen the minimal possible application of the regulation, in order to limit the reorientation of production (by maintaining coupled aid when possible) or by redistributing payments (historical references). These choices can in part be explained by the socio-economic and socio-structural conditions particular to each country. For example, among the five large countries under study, those which have maintained the maximum possible coupling and historical references (France and Spain) are both net exporters of agricultural products, no doubt motivated by the concern to maintain their production potential. Conversely, the three net importers of agricultural products (Germany, the UK and Italy) have opted for total decoupling, which certainly allows them to justify the aid more easily to their public. But the great diversity in choice can also be explained by the socio-political contexts prevailing in the member states at the time of the reform, and by the differing political clout in each country of, on the one hand, the professional agricultural organisations, and on the other, environmental interest groups<sup>8</sup>.

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<sup>8</sup> The study referenced at the end of the paper, and in its annexe devoted to detailed studies by country, give a deep analysis of the socio-political conditions which explain the choices made in each of the countries under study.

**Fig 1- Implementation choices for the CAP reform by EU member state**



***Managing the transition: an important part of the choice***

The order in which the new SFPs were implemented was also an important choice for the member states; the Figure above only gives a static view of the diverse national choices, after their full application (and supposing therefore that all that was planned will be applied, with no modifications along the way). Indeed, Germany and England have chosen an eventual uniformity for their SFPs by region, but with a gradual change (dynamic hybridisation). During the transition period, which will last ten years in both countries, there will therefore be juxtaposed a double system of individualised payments calculated on a historical basis and shared payments calculated regionally. In England, the changeover is being made by a progressive regional mutualisation of the historical payments covering 10% per year. The German ‘combined-model’ is much more complex, since it first defines ‘crop’ SFPs and ‘meadow’ SFPs, where each of these SFPs is made up of a shared part at the *Land* level, and an individualised part drawn from the historical references. To these are added ‘fallow land’ SFPs calculated at the regional level, ‘fruit, vegetable and potato’ SFPs based on the ‘crop’ SFPs with a quota of eligible area, and landless SFPs for certain specific categories of holding. It will only be at the end of the transition, between 2009 and 2012, that the SFPs will converge to a uniform SFP at the regional level, across all entitled farming areas.

It is therefore clear that the reform’s stated objective of simplifying the management of the payments is unlikely to be achieved soon, apart perhaps from in Italy where the decoupling is total and combined with historical references, which should result in stabilised

payments as from 2007, once the CMO ‘sugar’, ‘tobacco’, ‘milk’ and ‘olive oil’ reforms have been taken into account.

### ***Regionalisation : a multi-faceted concept***

‘Regionalisation’ as defined in the reform is explained in the regulation CE n°1782/2003 under Title III, Chapter 5 (Optional regional implementation, section 1). Article 58 gives member states the possibility of implementing the single payment scheme at a regional level. The text allows the member states to define what they mean by a ‘region’, but this must be justified ‘according to objective criteria’. The notion of ‘region’ here is therefore independent of that of European regions, and the member states are given considerable leeway in choosing their own definition.

In the regulation, regionalisation has two objectives. The first is to allow the national aid to be distributed among the chosen regions according to objective criteria defined by the member state (article 58). The second is to allow member states to harmonise the unitary value of the SFPs at the regional level (article 59). To achieve this, several arrangements are proposed:

- the distribution of the total regional aid over the totality of the hectares entitled to the aid,
- the distribution of a part of the total regional aid over the totality of the region’s hectares which are eligible to receive the aid extended to fruit (except permanent crops) and full fields of vegetables, the rest of the aid being divided up according to historical references,
- the possibility, for a farmer with historical references, to have concurrently regional rights calculated on the basis of part of the total regional aid plus historical rights calculated using the remaining regional aid,
- the possibility of differentiating the unit value of the regional rights for grazing land (or permanent grazing land) from the other eligible land (article 61),
- the possibility of setting the unitary value of the regional rights according to progressive modifications following pre-defined stages and according to objective criteria (article 63).

### ***The different forms of ‘regionalisation’ in the calculation of the SFPs***

After all is said and done, the regulation allows member states great leeway over both their very definition of regionalisation and the modalities and pace of regional harmonisation of the SFP unitary value. As a result the modalities of the implementation of the arrangement vary greatly across the countries which have chosen this option.

Germany has chosen a harmonised application of the ‘combined-model’ over all its administrative regions (the *Länder*). The distribution of the national aid among the *Länder* involves an adjustment because of the desire on the part of the federal government to introduce solidarity between the regions. The calculation method for the unitary value of the rights uses most of the arrangements allowed under the regulation (differentiation of the

unitary value between meadows and crops, concurrent regional and historical rights, and the progressive harmonisation of the unitary value of SFP). In the final analysis the German choice is a centralisation of the implementation of the agricultural policy, functioning at the regional level. Justified by the desire for adjustments between the *Länder*, this choice reveals a regionalisation concept based on territorial fairness, with a tendency towards equalising the SFPs to which each hectare provides rights.

Conversely, the UK has left the choice opened by Chapter 5 of the regulation to its four regions, both regarding the nature of the decoupling and the method of calculating the SFP unitary value. Scotland and Wales have opted for rights based on historical records, whereas England has chosen a regionalisation of the single payment scheme, based on the fertility and productivity of the agricultural areas (drawing on the European less-favoured zones) and corresponding to no existing administrative boundaries. Northern Ireland has chosen a system which combines a regional flat rate with a part based on historical rights. Across the whole UK, two strands of regionalisation combine: the first is that of the decentralisation of the implementation decision-making process for the CAP reform to the regions, while the second is implemented in England, with the introduction of zoning which differentiates the level of support according to the agronomic potential of the land.

The last possibility open to member states is to not implement these regionalisation arrangements. The SFP unitary value is then defined at the holding level according to its historical references. An economic interpretation of the concept of regionalisation leads one to conclude that it is in the countries which have made this choice (Spain, Italy and France) that regional differences in the level of direct support for agriculture are most pronounced. From the moment that the level of aid per hectare is positively correlated with productivity level, the implementation of the reform in Spain, Italy and France will tend to strongly support the agricultural areas with great agronomic and economic potential, to the detriment of the less productive areas and more challenged regions<sup>9</sup>.

In the final analysis, depending on the options chosen, regionalisation can mean:

- a uniform level of unitary aid for all farmers in the same administrative region;
- a uniform level of unitary aid for all the farmers in the same 'natural' region defined according to its agronomic potential (with specified zoning);
- unitary aid levels based on historical references which reflect more or less directly the regional and local levels of agricultural productivity.

To conclude, the economic decisions of the member states regarding the reform appear consistent with the stakes involved for their agricultures. The objective of maintaining the agricultural production potential in Spain and France, but also in Italy, has led them to retain the historical references which in effect correspond to a desire for efficiency (strengthened in France and Spain by the retention of as many coupled payments as possible). In Germany, by

putting the issue of justifying agricultural support centre stage, the objective is more obviously to share out the aid. England, meanwhile, has attempted to reconcile the two approaches, by ‘playing’ with the boundaries used to calculate the regionalised payments.

***National reserve: two schemes for its use***

The modalities for transferring the SFPs between recipients play an important role in the distribution of the payments among the different categories of farmers. The regulations for the application of the reform authorise transfer modalities and national reserve management, which vary greatly across member states.

All the member states have constituted a national reserve with the same short term objective of dealing with special cases, for the initialisation of the arrangement (the initial grant of the SFPs). The longer term prospects for its use lead, however, to operational modalities for the reserve which differ according to the country (see Table 2).

With regard to the four cases studied here, two broad approaches to the use of the reserve are apparent - one which sees the reserve as a temporary device to smooth the transition to the new system (in England and Germany), and the other as a permanent device for intervening in the SFP transfers.

**Table 2: Planned modalities for using the national reserve<sup>10</sup> in each country**

Country	France	Germany	England	Italy	Spain
Initial deduction	3%	1%	4.2%	3%(1)	3%
Deductions from transfers					
sale of SFP without land	50%(2)	0%	0%	50%(2)	50%(2)
sale of SFP with land	10%(3)	0%	0%	10%(3)	10%(3)
Prospects	Maintain	Close <sup>11</sup>	Close	Maintain	Maintain

(1) Approximation based on global data including the reserve, article 69, additional deductions for increased area, etc.

(2) During the first three years, then 30%

(3) Except: transfer of an entire holding: 5%; transfer to have new facilities or inheritance: 0%

In the first case, the temporary nature of the reserve is due to England and Germany’s liberal attitude towards the regulation of the market in SFPs. There is no further need for public control after the initial SFP payment to farmers. In these countries, no deductions from

<sup>9</sup> The payments specifically intended for the less-favoured regions as planned in the framework of the second pillar can in part reduce this geographical disparity in support, without however completely compensating for it.

<sup>10</sup> These are the rates planned in June 2006. In France the initial deduction rate was in the end only 2.2%.

<sup>11</sup> In May 2006, 75% of the budget was used. As an illustration, in the German region of Hesse, 1.7 M€ of the national reserve were awarded to about 800 farm holdings, which is a little more than 3% of the holdings and on average 2,125€ of additional rights per recipientholding.

transfers are planned and they are now wondering about the modalities for closing the reserve; in Germany's case, the proposition is to share the remaining funds among all the SFPs<sup>12</sup>. In Germany, the low level of the initial deduction is partly explained by the restricted criteria defining special and exceptional cases, and partly by the fact that the regionalisation of the great majority of the crop and cattle slaughter premiums, calculated using the 2005 database, removes most of the problems linked to the anteriority of the reference period 2000-2002. In the English system, the use of historical references from 2000-2002 and a fairly broad interpretation of exceptional situations, have led to numerous requests for supplementary SFPs from the national reserve, which justifies the high initial deduction of 4.2%.

The SFP operational modalities in Italy and Spain are similar to those in France. In these countries, in addition to the management of special cases for awarding the initial SFPs, the reserve has the implicit purpose of controlling the market in payment entitlements. This objective justifies the permanent deductions applied according to the regulation, though none of these member states has explicitly defined the criteria for awarding the SFPs beyond the initial rights allocation stage. This situation raises the question of what arbitration this arrangement will require in the transferring of SFPs, which will involve either paying for titles in an SFP market, or else receiving them freely through the reserve.

### ***The market in SFPs: limited prospects***

Article 46 of regulation **1782/2003** allows for the possible setting up of a market in SFPs, but lays down the modalities of their transfer very precisely:

- *'Transfers of payment entitlement can only be made to a farmer in the same member state, apart from the case of inheritance or brought forward inheritance...*
- *A member state may decide that the payment rights can only be transferred or used within the same region...*
- *Transfers of payment rights, with or without land, can be made by sale or any other definitive transfer. However, the lease or any similar transaction is only allowed when the transfer of payment rights is accompanied by the transfer of an equivalent number of hectares eligible for aid...*
- *In the case of the sale of payment rights, with or without land, the member states may decide that a part of payment rights sold should be paid into the national reserve, or that their unitary value should be reduced to the benefit of the national reserve...'*

In those countries that have applied regionalisation (Germany and England), the potential for a market in SFP exchanges is low because all their areas have SFPs at their

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<sup>12</sup> Negotiations with the Commission are under way on this matter, which European regulations do not provide for. Such an eventuality will also require a new look at the modalities for those SFPs unused for three years,

disposal, and eventually, the SFPs per hectare will be constant. Moreover, England and Germany have decided to reduce the market in SFPs to within the same region, which limits the transfer possibilities. Further, particularly in Germany, the regional area devoted to agricultural is reduced each year, to such an extent that there will soon be an excess of SFPs relative to the eligible areas.

In the countries which did not choose regionalisation, the risks of speculative transfers are higher, but there is a will to limit the scale of these transfers by making large deductions on transfers without land. In all the countries studied, the total amount of trade in SFP transfers was low, or even non-existent, at least at the time of our investigation, in May 2006. One of the major reasons for the lack of such a market is that definitive entitlements were only, at best, awarded at the end of 2005, and in May 2006 this was not yet finished. However, a market in SFPs can only be set up for definitive entitlements<sup>13</sup>.

**In Italy**, the transfer of entitlements has so far been very rare. The payment agency (the AGEA) counted 8,500 transactions between November 2005 and February 2006, including by inheritance. As only definitive rights can be traded, the market began late in December 2005 after the definitive notification of the payment rights, and was once more suspended in 2006 while awaiting the new definitive rights for 2006. A rights exchange to facilitate trades is planned. In addition, the market in rights remains restricted and regionalised, which limits the risks of geographical transfers, particularly that of desertification in the poor southern and mountainous regions. Further, in certain Italian regions, there are more rights available than eligible areas, because of the rigid land market, with very high prices; the access to eligible areas is another limiting factor.

All these elements lead to the conclusion that the market in rights will never be very significant in Italy, which seems to be confirmed by the visible indifference of the professionals working in this sector to the issue. Indeed, the face value of the rights is on average 300€ for large crop farming, compared to a land price of the order of 30,000€, a ratio of 1 to 100, which puts the issue of entitlements into perspective. The trade in SFPs will thus principally occur when passing on holdings, which will not be the object of significant speculation.

**In Germany**, it is likely that fruit, vegetables and potatoes for consumption will be the object of speculation in the trade of SFPs. This is because the regionalisation system has opened the right to payments for these produce, which did not use to be covered. According to the representatives at the Chamber of Agriculture in Lower Saxony, the trade in fruit and vegetable SFPs is running at about 700€ for an SFP which gives the right to a premium of 455€. This relatively low trading value is probably due to the quota in fruit and vegetable

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which are automatically returned to the reserve.

<sup>13</sup>In England, it is only possible to make a temporary land transfer (for entitlements equivalent to the land transferred), with an adjustment once the definitive entitlements are known.

production, imposed under regulation 1782/2003, which strictly controls the allocations of production permits (76,347 hectares in Lower Saxony).

There is no official exchange for SFPs, either at the federal level or at that of the *Länder*. Local grants can be set up according to needs. This was notably the case in Lower Saxony to trade unused SFPs before the submission of aid declarations in 2006, and to share the supplementary payment resulting from the implementation of the new sugar CMO among the existing SFP recipients.

To date, no accurate assessment can be made in Germany concerning the amount of trade and the market price of the SFPs. So far mainly beetroot farms have been involved in SFP trading for the 2006 season, in a rather unusual context which does not allow a reliable estimate of their trade value.

**In Spain**, by June 2006 there was still no organised SFP market. There are few indicators to show what this market could be, but there is a large surplus in eligible agricultural land without SFPs, which could generate a demand for rights. But these eligible areas without rights are generally situated in very poor regions, where the land has a poor yield, which limits the possibilities for upping the SFP price. It is therefore too early to estimate the impact of the land situation in Spain on the SFP price.

**In England**, the rights only began to be definitively established at the time of the first payments, i.e. in March 2006. A market in rights seems to have started up from June 2006, for rights which could only be activated in 2007. There are no exchanges as such, but the trade takes place through brokerage agencies. Some brokers (and in particular those with great experience in the brokerage of milk quotas) offer to sell rights. The price asked, when given, seems quite low<sup>14</sup>. Some brokers advise charging roughly twice the 2005 premium as the trade value for rights, but this is only a guide, because one must also take into account how much of the rights are historical, and therefore destined to be reduced, and how much are fixed regional rights, which will be increased<sup>15</sup>.

Given these diverse observations, one can expect the market to be generally limited because of the important connection between the SFPs and the land, and in those countries having applied regionalisation, one can expect little potential for speculation on the market in SFPs without land, because of their homogenisation and their generalisation to all areas. It is possible that the market will become more active in the future because of the trade in fallow land SFPs, as it may prove economical to concentrate them on the least productive agricultural land. In the countries which have retained historical references, the transfer of 'normal' SFPs assigned to this less productive land for which the unitary value is relatively

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<sup>14</sup> For brokers selling SFPs without land, in 15 cases out of 16 the asking price is less than the annual premium.

<sup>15</sup> A broker proposes for example a calculation method for the value of rights as a function of the 2005 premium, its composition in historical and fixed parts and the expected profitability. In the simulation of the expected income for the period 2007-2012, the calculation takes into account an adjustment of 15% and a reduction in the value of the premium for the financial discipline mechanism varying from 1.5% in 2007 to 9.8% in 2012.

low, towards land with high agricultural potential, could increase the trading value of these rights. Nevertheless, this process has not been observed during the investigations in the countries under study.

## **A First Approach To The Effect Of The New Sfp Arrangement On The Reallocation Of Direct Aid**

### ***Definitions and principles for the reallocation of aid***

The principle of the agricultural policy is to define a set of allocation rules for agricultural support, leading to a redistribution of the payments given to farmers, as a function of the economical orientation and size of the holdings, or the destinations for their products (food or otherwise). The modification of the allocation rules could potentially involve a modification in the way the aid is shared among farmers. The redistribution (or transfer) effect thus represents the amount (or share, when the amount is compared to the total aid paid) of aid having changed recipient between the situation before the reform, and that after the reform. This strictly arithmetical definition of the redistributive effect (the change in the distribution of aid) excludes here any value judgement about the fairness or justness of this reallocation.

The 2003 CAP reform introduced three potential sources of aid transfer :

- The modification of the CMOs and the levels of support of products constitute the first source of transfers.

Although the great majority of the supports for different produce have been carried over, the reform has introduced some modifications in the level of support for certain produce. It is the case for the hard wheat supplement in non-traditional zones, which disappeared from 2006. It was also the case for the direct dairy payments put in place progressively from 2004 to 2006, amounting to 35.5€/metric ton (in 2006), which were supposed to more or less compensate the drop in the price of milk (25% reduction in the intervention price for butter over 4 years and 15% for powdered milk over 3 years). Lastly, as from 2006, the reform of the sugar CMO has introduced some new decoupled aid. These modifications, which correspond to the suppression or introduction of new supports, do not generate immediate transfers, in as far as they reduce or increase the total aid budget to be allocated, without affecting other payments. They do however modify the relative shares of the aid allocated to each sector. They can also indirectly open into new transfers, through the financial discipline mechanism, which allows for a reduction in the set of payments if the financing of new aid results in an overrun of the budget limit set for financing the first pillar of the CAP.

- The decoupling of aid

The decoupling of aid can constitute a second source of transfers, notably because of discrepancies between the reference and application periods of the new CAP. By referring the unitary value of the aid per hectare for each agricultural holding to the average aid level

received between 2000 and 2002, the decoupling potentially results in aid transfers between producers. Those producers who modified their crop rotation in order to achieve more extensive production (particularly for pastureland) after the reference period, will find their aid level per hectare increase during the decoupling process, to the detriment of those who adopted more intensive crop rotations during the same period. The reallocation is then achieved indirectly through article 41 of the regulation, which stipulates a percentage of linear reduction in the aid when the total demand exceeds the national budget allotted to each member state. Nevertheless, the redistribution effects of the decoupling remain limited in size and smaller yet in the countries which have limited the decoupling, in proportion to the coupled aid level.

- The calculation method for the decoupled aid

The regionalisation of the calculation of the unitary value of the direct payments attached to the SFPs is without doubt the mechanism which introduces the greatest redistribution effects, in comparison to individual historical references. The levelling out of the SFP amount per hectare for farmers from the same zone leads to transfers resulting from two main mechanisms: (i) the structural effect – in a given sector, regionalisation generates redistribution effects from holdings which use the land intensively (with regard to the yield grown or raised per hectare) to more extensive ones, and (ii) the sectorial effect – with regionalisation, the differentiation of initial levels of support according to the produce and the systems of production<sup>16</sup>, results in transfers between holdings according to the different production types. This has happened in Germany, with transfers in favour of extensive livestock farming systems, and to an even greater extent in fruit and vegetables, which benefited from no aid before the reform but now obtain aid per hectare under regionalisation. This arrangement has led to a cap on the areas being given the right to this new aid (new quotas), in order to limit the unintended effects of these new transfers. In practice, these different redistribution effects combine in complex interactions, making it difficult to isolate their influence.

***Variable redistribution effects according to the choice of implementation***

Simulations carried out in several European countries have been based on varying scenarios with the aim of comparing the impact of a reform based on historical references with that resulting from the implementation of regionalisation.

The redistribution effects introduced by the reform in the countries which kept the historical references are marginal, and even more so where the payments are only partially decoupled. The implementation choices made in France and Spain had the explicit objective of limiting the impact of the reform on the amount received by each holding. However, the

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<sup>16</sup> The APCA simulations (based on ROSACE/livestock farming networks) of the amount of the SFPs per hectare for several holdings of the French type vary from 83€/hectare for young grazing livestock without

payments are not set in stone: the progressive application of the modulation of aid for holdings receiving over 5000€ and the probability in the medium term that financial discipline will be applied, mean there is a risk that payments will be reduced before 2013 (but these reductions will be applied in the same way in the countries which have chosen regionalisation). In the countries which have applied regionalisation, the redistribution effects on the payments were an important factor taken into account when defining the practical application of article 59. The management of the transition period was the second major concern, in Germany as much as in England, in order to give the farmers the time to adapt their production systems to the new aid distribution rules.

The term 'hybrid model' which is commonly used to refer to the regionalisation implementation modalities actually covers several different approaches to regionalisation, regarding the control of the redistribution effects. The differences can be pinpointed using two main criteria: (i) the type of zone chosen for the application of regionalisation is the main factor influencing the redistribution effects at the end of the implementation of the reform (i.e. at the end of the transition period), and (ii) the modalities for managing the transition phase influence the pace at which the transfers will take place.

### ***Two contrasting cases: Germany and England***

In both these respects, the regionalisation model selected in Germany differs significantly from that applied in England.

- The type of region selected:

In Germany, the regional area used is the *Land*. In administrative terms, it brings together a relatively varied range of produce and types of production structure. FAL (Federal Agricultural Research Centre) simulations have found a variation in the amounts of SFPs across the *Länder* going from 260€ per hectare in Saarland to 370€ in North Rhine-Westphalia, which is explained by the structural differences in agricultural holdings between the *Länder*. Within each *Land*, the redistribution effects between holdings are significant as much in terms of structural effects as in sectorial ones.

England, on the other hand, has chosen to define three zones according to their agricultural potential, which correspond to different types of agriculture: moor land in less favoured regions, which feature extensive cattle and sheep farming, the other less favoured zones featuring livestock and mixed farming, and zones not classified as less favoured with large scale crop farming and the most intensive livestock farming. This zoning approach, specifically developed for the implementation of the reform, more clearly keeps the old distribution of payments than in Germany. In consequence, the less favoured zones receive very little aid, whereas the zones not classified as less favoured enjoy eight times greater support per hectare, which allows the redistribution effect between regions (and indirectly

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premiums to 505€/hectare for livestock feeding and large crop production and 258€/hectare for holdings

between holdings and production systems) of the 'regionalisation' in the calculation of direct payments to be severely limited.

- The management of the transition phase:

The great majority of the member states or regions that are implementing regionalisation are doing it progressively, and have accordingly developed a hybrid model which allows the gradual transition towards a new system of aid distribution. In England, the transition system is linear, allowing them to change progressively from exclusively historical references in 2004 to completely regionalised payments by 2012. The transition system does not introduce further redistribution effects, but rather staggers their appearance over time.

In the German case, the implementation of regionalisation fits into a strong tradition of redistribution. The first stage of redistribution occurs when the national aid budget is shared out among the *Länder*: 65% is proportional to the aid given in the previous year in each *Land* and 35% is given according to the respective eligible areas in each *Land*.

The transition arrangement chosen in Germany stipulates, from 2005, two regionalised payments: (i) one for 'large scale crop' areas, based for the most part on the previous payments made for these crops (apart from the payments for sugar, tobacco and fodder which are still paid according to historical references), and (ii) one for meadows, made up of the slaughter premium for large cattle, the national supplement and half of the extension supplement. This premium, which is paid to all holdings featuring meadows, is supplemented by the other animal premiums (amongst which, the dairy premium) on the basis of individual historical references<sup>17</sup>.

The regionalisation of the 'large scale crop' payments and of part of the animal payments in 2005 generated some redistribution effects as from the first year of the reform's application. In addition, the German transition system allows the *Länder*, if they so wish, to apply adjustment rules between the 'large scale crop' regional aid and the 'meadow' regional aid, by reducing the former to the benefit of the latter, which strengthens the redistribution effects in favour of the more extensive *Länder* which have implemented the arrangement. In Hesse, for example, the 'meadows' premium was thus increased by between 45 and 62€ per hectare. This first redistribution will remain in place until 2009, and in 2010 the regional and individual payments will be progressively harmonised to converge towards a sole premium per *Land* by 2013. It will therefore not be until the end of the process, from 2010, that the strongest redistribution effects will be felt.

In summary, we note that the regionalisation application mode influences the scale of the redistribution effects. According to the results of a study, carried out for the English Ministry of Agriculture, 13% of total decoupled aid will be transferred from holdings in dairy and granivorous livestock, cereals and mixed production to extensive livestock farms in less

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specialising in large crop production in zones of limited potential (*Chambres d'Agriculture*, n°930, p.29).

<sup>17</sup> For a more detailed presentation of the German combined-model, which is particularly complicated to implement, see fascicule 2 of the study given in the references.

favoured zones. Quite logically, it is in the zones where alternative productions are the most straightforward (those not categorised as less favoured and to a lesser extent, less favoured zones apart from moor land) that the transfers are most intensive, while the more extensive livestock holdings are the only ones to be found in moor land, with very low support levels (barely more than 30€/hectare at the end of the reform). The German choices are explicitly part of a redistribution policy in favour of less intensive agriculture. Estimates produced by the FAL (Federal Agricultural Research Centre) put the share of transferred aid (apart from sugar) at over 20% by the end of the reform. From the economic point of view, the idea of promoting fairness by having the same support level for all eligible areas is debatable; it attaches equal importance to mountainous zones as to very fertile plains. Compared to the English situation, this egalitarian reasoning can be seen as a deliberate policy to help less favoured zones.

## **A First Approach To The Effect Of The New Sfp Arrangement On Production Systems**

### ***Several overlapping schemes***

The effects of the reform are difficult to assess in as much as they result from different schemes, which can work either in synergy or against one another:

- an administrative redistribution scheme, involving the reallocation of aid, in particular through regionalisation in those member states that have implemented it, and to a lesser extent by decoupling, but also by modulation and the financial discipline mechanism<sup>18</sup>,
- An economic adjustment and production system reorientation scheme to respond to market signals, which depends on much more varied parameters internal to the EU, but also external ones (particularly international trade negotiations),
- A patrimonial scheme involving the accumulation of land and investments, resulting from the previous schemes but which in the medium term contributes to its change in nature, by altering the share of public aid between the different types of holdings.

The first effects, which were completely predictable, are quite easy to simulate. On the other hand, the economic and patrimonial effects are much more difficult to assess, because they depend on numerous parameters which are external to the CAP (the opening up to imports for example, being negotiated at the WTO), and their simulation depends on numerous hypotheses (elastic supply and demand in relation to product and input prices, substitution of productions as a function of relative prices, comparative yield rates for different locations, etc.).

In spite of these difficulties, a certain number of simulations of the impacts of the reform on agriculture have been carried out in various member states, to give some pointers to certain likely developments. After only one year of implementation of the reform in three of

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<sup>18</sup> In these two latter domains, in countries like Italy and Spain, where the number of farmers concerned is significant, the exemption of recipients of less than 5000 € may have a considerable redistribution effect.

the four countries visited and the implementation still under way in Spain and in the sectors benefiting from the second wave of the reform (olive oil, tobacco, cotton and sugar) it was still too early, at the time of the investigation, to verify these predictions through observations on the ground of the first practical results brought about by the reform.

Nevertheless we can anticipate the main probable impacts of the reform, by using available provisional simulations commented on by experts from the four countries under study.

### ***Expected impacts on vegetable production***

**In the cereal-producing sector**, it is probably hard wheat production that will feel the most immediate and largest effects because of the suppression of the support for non-traditional zones. In Italy, the reduction in production, sought by a number of economists and policy makers who consider that some of the hard wheat grown is of poor quality and produced in inappropriate agronomic conditions, seems to be on a greater scale than that predicted by the models, notably because the cushioning effect expected from article 69 has not worked as intended. The statistical data from the payment agency (AGEA) estimates the drop in sown hard wheat between 2004 and 2006 at up to 45%<sup>19</sup>, leading to the possibility that the land which is thus no longer used may be withdrawn from agricultural use.

For **the other cereal crops**, it seems, paradoxically, that it is in Spain that the production of dry cereals is likely to be most affected, despite the partial decoupling of payments, because of the low yields. This reduction will be amplified in the zones where the traditional fallow system is already widely spread, as in Castilla la Mancha, and especially in Castilla and Leon<sup>20</sup>. Economists consider that the replacement of this unpredictable and barely profitable internal production by low cost imports will increase the competitiveness of the pork, poultry and cattle feeding sectors. However, policy makers are concerned about the impact of such developments on rural zones in the process of desertification. In England and Germany, the expected drops in cereal planting are still low (-4.2% in England according to an annual study of 13,500 holdings and -8% in Germany, according to modelling).

As far as **fruit and vegetables** are concerned, the extension of CAP support to this hitherto ineligible sector in countries having chosen regionalisation, has been a real godsend for producers, who will now receive SFPs (300€ per hectare in Germany at the end of the reform). Even if this amount is relatively low compared to the turnover these produce can generate, first observations of the trading prices of these SFPs, at twice their face value in Germany in Denmark, reveal their value for the producers. This income reinforces (within the limits of the old areas) the boom in fruit and vegetable production in the southern German *Länder* such as Baden-Württemberg, where the competitiveness is already high thanks to the

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<sup>19</sup> The drops in production to be expected are smaller, in as far as it is the low yield areas which are converted first.

<sup>20</sup> In these regions, cereal growing is included in crop rotations involving several traditional fallow years.

cheap Polish labour force. In Denmark, where production costs are higher, it seems that these SFPs will make the fruit and vegetable production more competitive. Regionalisation can therefore introduce imbalances in competition in the fruit and vegetable sector, between the countries which implement it and the others.

### ***Expected impacts on animal production***

**In the beef sector**, most predictions indicate significant drops in production, largely due to the expectation of a drop in the price of meat and 8-day-old calves. In Germany, the most alarming predictions of the FAL (Federal Agricultural Research Centre) point to a 60% drop in the number of suckling cows by 2012, which is twice the expected figure under the hypothesis of the continuation of the old CAP (Luxembourg 1999). The difference would be -15% for young cattle.

Nevertheless, these predictions point to a smaller negative impact on meat production, in as far as the reform will improve the productivity of holdings, thus mitigating the expansion effects. Overall, if the current high meat price is maintained, future prospects are good, at least in the short term. The reduction in the dairy herd does seem to have begun however in England (-6.1% between December 2004 and December 2005 according to the annual study of holdings). In Spain, there are serious concerns about the livestock feeding centres. The drop in the number of suckling cows (and also dairy ones), already underway for several years, raises the possibility of supply problems in calves and grazing cattle. It is not sure that the implementation of article 69 will be sufficient to reverse the trend. In Italy, too, livestock feeders are having difficulties finding supplies of thin young animals, and the attempts to diversify the supply by looking to central and eastern European countries have not so far been conclusive, because of animal health problems in these new markets. In the short term, the Italian livestock feeders are tending to maintain their profitability by lengthening the feeding cycles.

**In the dairy sector**, it is expected that in most of the countries affected by the reform, there will be an acceleration in the restructuring, which could be accompanied in some countries by a regional concentration of production. This is particularly the case for Spain, where the milk CMO is accompanied by an implementation of article 69 which should accelerate the restructuring through the disappearance of small centres, in favour of larger, more productive herds, with up to 500,000 kg of milk per holding. German predictions also point to increasing herd size, especially in the southern *Länder*, but to a halt in the growth in productivity. In this context of adjustment, Germany has called for the removal of milk quotas. In England, the milk herd size dropped -4.9% between 2004 and 2005.

**In the sheep and goat-farming sector**, small herds will be most affected in Spain, despite the recoupling of aid. The trend will be towards reduced production and the spread of large, extensive herds.

Overall, however, the regionalisation of the unitary SFP calculation does not have a major impact on the evolution of production systems. The comparison of the different implementation scenarios for the reform in Germany (the calculation of the SFPs based on historical references as opposed to regionalisation) seems to point, paradoxically, to regionalisation having a small impact on production evolution, despite the extent of the resulting transfers. Most of the impacts identified can be attributed to the decoupling of payments. The strong reduction forecast in the number of suckling cows, in a context where regionalisation, in Germany, is particularly advantageous for meadows, reinforces these results, and reveals the imbalance in competition linked to the non-harmonisation of the decoupling of aid. The fact that some countries have maintained coupled payments for certain produce while some have not, has thus modified the competition between the different European regions, and led to a rearrangement of the distribution of production within the European space.

### **Some Prospects To Conclude**

At the time of our investigations, during the first half of 2006, the policy makers and managers in charge of agriculture in the member states visited were preoccupied with the implementation of the reform, and so had little time to reflect on the future prospects of the CAP. Much important work remained to be done to inform farmers about the reform. In Italy, according to a survey of farmers, at the start of 2006 only 40% of producers had a good understanding of the reform, 20% had partial understanding and 30% knew nothing about it, whereas the great majority of farmers - particularly in livestock - were still unaware of the constraints inherent in cross-compliance. The majority of those interviewed did not expect any significant upheavals in 2009, but thought that major changes could occur in 2013.

In Italy, most of the trade unions remain attached to the principle of regionalisation implemented according to regional criteria and agronomic type (the differentiation of mountainous zones, piedmont plain and plains). In Spain, the decoupling is considered inevitable in the long term for the supported sectors, but the choices made in 2006 should allow the reform to be applied progressively in order to let the agricultural sector make the necessary adaptations gradually. Further, Spain is keeping a close eye on the two thirds of agricultural activities not covered by CAP aid and to the development of the common market organisations: the value represented by the opening up of European markets to low cost supplies (particularly in animal feed, to strengthen the competitiveness of landless holdings) is counter-balanced by the risk posed to Spain's Mediterranean produce by the opening up to international trade.

In Germany, where the policy makers are convinced of the wisdom of applying the principles of the reform as fully as possible, the preoccupation has been with defending a minimum level of support for agriculture, justified by the high production standards that Europe needs to have recognised during the next round of WTO talks. It is not sure that this

strategy will be supported by the UK, where the progressive transfer of credits from the first to the second pillar remains a priority.

Two years after the implementation of the new reform, it would be dangerous to draw any definitive conclusions, especially given that the future of the CAP is still uncertain. The year 2013 looks like being a watershed, which should bring new, far-reaching modifications. Without it ever being explicitly stated, the directions mapped out by the Commission, involving a general movement towards the maximum decoupling possible, uniform premiums per hectare and the promotion of transfers to the second pillar, appear inevitable for the great majority of our foreign interviewees. In this respect, for many of the analysts we met, the German model seems to best anticipate coming developments.

One of the key elements which can explain agricultural professionals' desire for, or resignation about, this evolution, is a kind of shame, regarding how best to justify the agricultural aid to the other members of society, with a clear awareness that the production activity can no longer suffice. Therefore, faced with the risk of significant cuts in the Community's agricultural budget, historical rights seem much more difficult to defend than a 'regional' premium, with a fixed rate per hectare; likewise, payments under the first pillar appear much harder to justify than those under the second pillar.

Looking beyond these tactics for justifying the payments, calling into question the productive function as a justification for agricultural activity, in favour of environmental or territorial aspects linked to the activity, actually involves calling into question a fundamental principle of the CAP, that of giving preference to the Community. Why should Italy, Germany or the UK, showing a shortfall in agricultural and food produce, support French production, when Brazil, Argentina or New Zealand can supply them at a lower price? Even in a net exporter country like Spain, many economists take this view, as Spain exports produce which for the most part is not subsidised, and imports produce for which the historical subsidies justify much of the new payment rights.

Nevertheless, this reasoning has its limitations. Most of those interviewed, and particularly in Germany, are well aware that maintaining direct payments is essential to maintaining the agricultural activity. Yet, if one takes the reasoning to its logical conclusion, with direct aid of about 330€ per hectare as in England or Germany simply for the upkeep of the land, this represents an exorbitant cost with no economic justification. Further, once the payments are decoupled from any productive activity, and are justified by the provision of specific amenities, one must immediately wonder about the readjustment of the SFPs between countries and regions: it is indeed difficult to claim that environmental or landscape amenities produced by farmers in East Anglia deserve higher payments than those produced by the farmers of Tuscany, the Peloponnese or Andalusia. Today's certainties pave the way for tomorrow's doubts. In today's world riven by instability and conflicts, they may also pave the way for future food crises. But it is clear that the current preoccupations with very short term issues leave no room for this type of medium or long term reasoning.

With regard to all these questions, which the reforms currently taking place cannot address, there is one possible answer, which is implied in the 2003 regulation and in practices observed on the ground: that of nationalisation, or even the regionalisation of the support policies for production activities. The common agricultural policy would evolve towards a Common Environment and Territorial Development Policy (second pillar), while economic and trade management policies for markets and risks would once again be the responsibility of states or regions.

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