

## Articles

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### **EQUALIZATION OF DIRECT PAYMENTS IN POLAND TO THE LEVEL APPLICABLE IN OTHER EU COUNTRIES**

#### **Summary**

*The paper tackles the problem of making direct payments in the EU countries more equal. Two sets of indices and their evolution are being presented: payment rates per product and per hectare of eligible area. The need of redistribution of direct payments is being stressed, followed by the discussion on different scenarios of distribution among Member States. The model finally accepted by the EU institutions and Member States is presented, as well as calculations of shifts in per hectare rates due to direct payments redistribution. The results show increase of direct payments rate in Poland, but it is still slightly below the EU average.*

**Key words:** direct payments, European Union, the MacSharry reform, rates of direct payments, reference yield, redistribution of payments

#### **Introduction**

Making the distribution of direct payments more even, since they constitute the main form of support for farmers in the EU, is a popular slogan, however, often based on lack of knowledge or lack of information of the politicians who use it quite frequently.

There are at least some problems related to the matter.

To equalize to which level – to the EU average or rather to the level of the main beneficiaries? Next, what should be equalized? Finally, perhaps a rate per hectare of the utilized agricultural area (1 ha of UAA). But considering the lower initial level of payments in relation to other EU countries at the moment of accession, there was also the problem that they were not paid in their full volume for some products. Thus, at the starting point, the double lack of equalization has emerged concerning:

- the payment rates (product/quantity), which are no longer in force, but whose amounts determine the amounts of payments also at present;
- the payments per 1 ha of UAA.

To attempt to solve the problem, we need to recall the situation in the 1990s. The system of direct payments was introduced in 1992 (during the tenure of Commissioner R. MacSharry). It had been designed to compensate farmers for the reduction in intervention prices, but in practice it became the additional source of either growth of farmers' incomes or compensation for their decrease (Krzyżanowski, 2015). The issue of the amounts of payment rates and the overall further calculations can be presented on the example of the payments for cereals. According to the reform, which implementation was planned for 3 years, the target price for cereals, except for rice, was assumed to be 100 ECU per 1 t in the third year (ECU – European currency unit, the exchange rate in 1992 – 1 ECU = 1.29 USD). The proposed amount of the target price should correspond to the level of cereal prices in the global market, on condition of the market's stability. In 1992, the average market price of cereals in the EU countries was 155 ECU. Farmers had to be compensated for the income losses in the amount of 55 ECU per 1 t. The amount constituted a difference between the current market price of cereals, i.e. 155 ECU per 1 t and the target price of 100 ECU per 1 t. The amount could be changed together with the changes in yields as well as in the overall situation in the EU and world markets. The payment rates calculated per the area unit were established according to the average regional yields in some years prior to the reform. For example, the average yields for the whole Community calculated as above amounted to 4.6 t per 1 ha, and therefore the payment rate was 253 ECU/ha (4.6 t/ha × 55 ECU/t). In the first year of the reform, the payment was 30 ECU/t, i.e. 138 ECU/ha; in the second year 45 ECU/t, i.e. 207 ECU/ha and then in the third year the target amounts were assumed to be achieved. The change in the payment amount resulted from the following reductions in the target prices: in the first year to 125 ECU/t and in the second year to 110 ECU/t (Krzyżanowski, 1993).

According to the system, nowadays referred to as the classical, historical or standard one, the formula for calculating the payments is as follows:

$$\begin{aligned} & \text{the base area} \times \text{the payment rate/t} \times \text{yield} \times \text{the exchange rate PLN/EUR} \\ & = \text{the so-called envelope for cereals.} \end{aligned}$$

The payment rate per 1 ha would be obtained from dividing the envelope by the area (in hectares) which is declared by farmers who apply for payments.

There are, therefore, two variables to be considered in the calculations: the “single” payment rate and the level of yields.

### **Payment rates**

The rates of payments were gradually increased in the successive years and then they were changed by the reform of 1997 (the so-called Agenda 2000) package. The direct payments for the major agricultural products at the beginning of the new millennium are presented in Table 1.

Table 1

<i>Direct payments applied in the EU until 2005</i>			
Product	2000/01	2001/02	2002/03
Cereals (EUR/t)	58.67	63.00	63.00
Oilseeds (EUR/t)	81.74	72.37	63.00
Protein crops (EUR/t)	72.50	72.50	72.50
Flax and hemp (EUR/t)	88.26	75.63	63.00
Silage grass (EUR/t)	58.67	63.00	63.00
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Special beef premium (EUR/animal):			
- bulls	160	185	210
- steers	122	136	200
Suckler cow premium (EUR/animal)	163	182	200
Slaughter premium (EUR/animal):			
- bulls, steers, cows, heifers	27	53	80
- calves	17	33	50
Extensification premium (EUR/animal)	100	100	100
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Ewes (EUR/animal)	21	21	21
Potato starch (EUR/t)	98.74	110.54	110.54
Dried fodder (EUR/t)	68.83	68.83	68.83
Hops (EUR/ha)	480	480	480
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Tobacco (EUR/t)			
- Virginia	2980.62	2980.62	2980.62
- Burley	2384.23	2384.23	2384.23
- Dark air cured	2384.23	2384.23	2384.23
- Fire cured	2621.99	2621.99	2621.99

Source: Krzyżanowski, 2015.

The first reference point for further considerations will be the payment rate for cereals, which stood at 63 EUR at the end of the accession negotiations.

### The payment rate for the new Member States

The European Commission, during the whole period of the accession negotiations, was against the payment of the full rates of the EU direct support for farmers from the new Member States. The justification for such an opinion was that in the light of significant disparities between GDP in Western Europe and in the Central and Eastern European countries, the rapid inflow of the high amounts of support payments would distort the rural economies in the CEECs and would result in the growth of inflation. Moreover, according to the Commission, the Community budget would be too much burdened with the obligation to pay the full rates of direct payments for 10 new Member States (Krzyżanowski, 2009).

At last, the compromise was reached, introducing the 10-year transitional period, in which the payment rates in the new Member States were to be gradually brought to their full level applicable in the old Member States (beginning with 25% of the full rate in the first year, i.e. 2004). Also, under the agreement, the farmers in the new Member States were granted the right to obtain the complementary payments from the national budget accounting for 30% of the full payment rate. Therefore, the farmers could actually obtain up to 55% of the full EU payment rate in the first year. The national complementary payments were reduced to 20% in 2011 and 10% in 2012, whereas the EU share achieved the levels of 80% and 90% respectively.

The scheme of support payments in the new EU Member States is presented below.

Table 2

*Rates of direct payments in the new Member States (in % of the full EU rate)*

Year	EU rate	National complementary payments	Maximum share of payment, total
2004	25	30	55
2005	30	30	60
2006	35	30	65
2007	40	30	70
2008	50	30	80
2009	60	30	90
2010	70	30	100
2011	80	20	100
2012	90	10	100
2013	100	0	100

Source: Krzyżanowski, 2009.

Poland was given the full EU rates (63 EUR/t for cereals) from 2013 onwards. Thus, it may be stated that the first stage of equalization of payments (rates) has been completed.

### **Reference yield**

The second variable taken into consideration in the calculations of direct payments was the level of yield. As the rate per 1 t of agricultural production had been set, it was necessary to examine the production volume per 1 unit of production area. In the first years of functioning of the MacSharry reform, the average cereal yields in the EU were used in the calculations. After some years it was decided that the higher efficiency should be promoted and – according to the Council Regulation No. 1251/99 and 2316/99 – the EU started to use the national yields from the market years 1986/87-1990/91, i.e. the so-called reference period, from which the name of the yields originates (Kowalski, Rowiński and Wigier, 2001).

The volumes of reference yields significantly varied among the EU countries: e.g. in Spain 2.69 t/ha, in Holland 6.66 t/ha. Poland in its negotiating position aimed at establishing the cereal yield at the level of 3.61 t/ha (Stankiewicz, 2001). Finally, after long-term negotiations (this problem was one of the open questions before the end of the agricultural part of the negotiations, together with milk quotas), the level of reference yield for Poland was established at 3.0 t/ha. Not surprisingly therefore, the payments for Poland were much smaller compared with the amounts paid for the Western European countries, since the level of payments was actually determined by the level of yields.

### **Redistribution of direct payments**

In the further part of the paper, the subsequent reforms of the direct payments system were omitted, as the subject was beyond the scope of research. The focus of the research was on establishing the amounts of the basic rates of direct payments per hectare of eligible area in the EU Member States and the chances of making them more equitable (equalization).

As a result of making calculations based on reference yields, highly diversified among the Member States, the amounts of payments were also different, which is shown in Figure 1 and Table 3. The Table 3 shows also the hypothetical equalization of payments to the EU average, i.e. 222 EUR/ha.

The differences in the amounts of payments per 1 ha were particularly visible between the “old” and the “new” EU countries, which had joined the EU in 2004 and the following years. It was after some years of functioning in the direct payments system when the “new” Member States realized that the system should not be based on the historical parameters. Besides, the direct payments were expected to provide the so-called public goods by the agricultural sector, also by the less efficient farms. For these reasons Poland found itself in the group of countries which urgently requested for equalization of payments.

The last important reform that shaped the Common Agricultural Policy until 2013 was adopted in Luxembourg in 2003 (Krzyżanowski, 2015). The regulations on adjustments of the existing instruments of the CAP included also the provision to evaluate the CAP functioning (Health Check) in 2008.

The Health Check predetermined the directions of the future changes in the CAP (after 2013). The “new challenges” were defined and included in the list of the CAP objectives, covering the following issues: climate change mitigation, promoting renewable energies, improving water supply, protecting biodiversity, as well as accompanying measures, restructuring of the dairy industry and innovations in the first four spheres. The particularly important in the discussions about the future CAP was also the commitment of the European Commission and the Council **to analyze the problem of considerable diversification of direct payments at the Community level and to put forward the proposals for relevant improvements.**

Under the Health Check the so-called flat rate payment was established.

In the following years (2008-2013) other options were considered. The debate was conducted at many forums (EC, 2013). It was stated (Commission, 2011) that the distribution of direct payments would need to reflect to a greater extent their double role, consisting in the support of incomes and the provision of public goods, through better adjustment of the policy goals to the available budgetary resources (Cooper, Hart and Baldock, 2009). To avoid the serious distortions, it would be necessary to take into account the present allocation of direct payments. Some options of redistribution of the envelopes of direct payments among the Member States were considered:

- “the flat rate for the whole EU” – the direct payments are paid depending on the total eligible area (in hectares) in the Member States;
- the pragmatic approach: adjustment of the existing rules of funds allocation (to a certain extent), in order to avoid serious distortions, to the current levels of direct payments, establishing also the single EU level of payments per 1 ha according to the share in the EU average;
- the application of objective criteria: the flat rate for the whole EU is set taking into account the objective criteria based on economic, physical or environmental indicators;
- the combination of the pragmatic approach and the objective criteria.

It should be mentioned that the simulations allow for neither the duration of the transitional period nor the conditions of transition towards the new rules of distribution, which would also be dependent on the final level of redistribution. The introduction of the transitional period was important not only for the Member States, whose national envelopes of direct payments would be reduced, but also for the countries which would enjoy the growth. In some cases, the revenues from direct payments per 1 ha resulting from the above options could not only lead to the increase in land prices, but would also hinder the structural transformations, because they could discourage farmers from restructuring, developing and improving farm efficiency.

The starting point for the simulation is the current level of direct payments per hectare, calculated in such a way that the amount of the envelope for each Member State (at the end of the phasing-in mechanism in the EU-12 and allowing for

the modulation at the level of 2013) is divided by the extent of the area eligible for the Single Area Payment Scheme, declared by farmers, about which the Commission should be informed by the Member State under the IACS system.

Table 3

*Direct payments per 1 ha of UAA in the EU Member States – proposals for equalization of the EU average; the payments calculated according to the new formula*

Country	Payments per hectare 2013 EUR/ha	Redistribution of equalization of payments per hectare for EU-27 (the average 285 EUR/ha)	Changes 2013 (in %)	Final payment per 1 ha after the Health Check
1 Romania	183	102	56	208
2 Bulgaria	233	52	22	241
3 Estonia	117	168	144	164
4 Lithuania	144	141	98	182
5 Poland	215	70	33	229
6 Slovak Republic	206	79	38	223
7 Hungary	260	25	10	259
8 Czech Republic	257	28	11	257
9 Slovenia	325	-40	-12	302
10 Cyprus	372	-87	-23	334
11 Malta	696	-411	-59	550
12 Latvia	95	190	200	149
13 Portugal	194	91	47	215
14 Great Britain	229	56	24	238
15 Spain	229	56	24	238
16 Austria	262	-4	-1	260
17 Sweden	235	50	21	242
18 Finland	237	48	20	244
19 Luxembourg	275	10	-4	269
20 France	296	-11	-4	283
21 Ireland	271	14	-5	266
22 Germany	319	-34	-11	298
23 Italy	404	-119	-29	355
24 Denmark	363	-78	-21	328
25 Belgium	435	-150	-34	376
26 Holland	457	-162	-35	390
27 Greece	384	-99	-25	342

Source: Capreform, 2015 and own compilation.

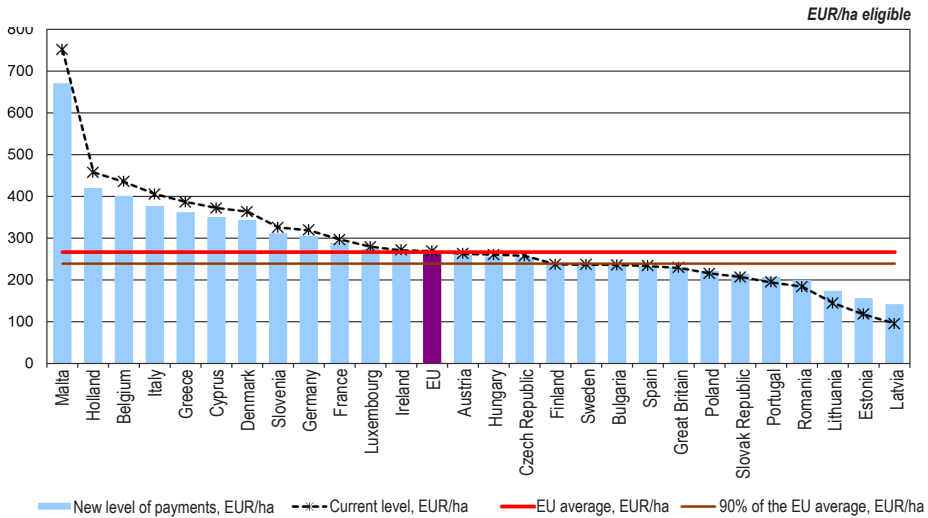


Fig. 1. Payments redistribution – 1/3 of the difference between the current level and 90% of the EU average.

Source: <http://www.slideshare.net/novastepnica/wpr-do-2020-propozycje-ustawodawcze-komisji/>, date of access 2015.08.28.

### The flat rate for the whole EU

As results from the public debate, another option would be to resign from the historical references, in favour of “the flat rate” for the whole EU (or “the EU average”), which would guarantee the same level of support funds per 1 ha for all farmers in the European Union (see Table 3).

The Table 3 shows that the existing levels of direct payments in Malta, Belgium, Holland, Italy, Greece, Cyprus, Denmark and Slovenia are high above the average, whereas the payments in the Baltic countries, Portugal, Bulgaria and Poland (i.e. mainly in the new Member States) are considerably smaller. This option would lead to losses for Malta, Belgium, Holland, Greece and Denmark, being at the same time beneficial for the Baltic countries, Portugal and Romania.

However, as it was explained in the Commission Communication (Communication, 2010), the flat rate for the EU would not reflect the differences in the economic and environmental situation of the Member States, because the level of payments exerts its influence on income in many ways and every hectare contributes to the provision of public goods differently. It should be also remembered that the agricultural land is unequally distributed among farms: in the EU-25 almost 90% of land is in the possession of 20% of farms (Annex, 2015). Thus, the shift to the flat rate for the whole EU with the same amount of direct payments per hectare would not help to solve the problem of the uneven distribution of direct payments among farms, because of the agrarian structures in the EU.



### **The pragmatic approach**

The next option, which was mentioned in the Commission Communication, was the pragmatic approach, e.g. through the agreement that the Member States would obtain at least 80% of the EU average per hectare.

According to the allocation of payments in 2013, 8 Member States did not exceed the level of 80%, while for 19 Member States the amounts were over the EU average. The costs of increasing the level of payments per hectare to 80% of the EU average (i.e. 228 EUR/ha, according to the author's calculations) in the member states below this threshold, would be covered by 19 Member States exceeding the EU average. It would imply the reduction of their national envelopes.

The operation would allow activities towards the improvement in the situation of the member states having the levels significantly below the EU average and simultaneously the reduction of the payments' redistribution to the Member States exceeding this average.

There was also the proposal under consideration that the member states whose level of direct payments was below 90% of the EU average, would fill  $\frac{1}{3}$  of the gap between their new level and the level of 90% (Figure 1). This option would involve the smaller convergence for the Member States with the amount of payments up to 90% of the EU average.

Another proposal put forward for consideration was that all the Member States would obtain at least 80% of the flat rate and none of them would be eligible for more than 120% (the option in the EU documents as "Tunnel 80-120%"). This option would be close to the flat rate. In this case the smaller number of Member States would bear the costs of convergence.

### **Application of the objective criteria**

The next option assumed the allocation of funds on the basis of objective criteria (reflecting the double role of direct payments consisting in income support and the provision of public goods), which would ensure the fairer and more effective utilization of budgetary resources.

The potential objective criteria have various characters, and therefore the levels of redistribution of direct payments are very different, due to the specific economic and environmental situation in each country.

The main disputable subjects of the public and institutional debates were the following criteria:

- among the general economic criteria – the purchasing power parity and GDP per capita: this indicator is used for corrections of the EU average in the case of Member States with the higher GDP per capita (corrected with the purchasing power parity), which obtain higher direct payments per 1 ha. These criteria could reflect the disparities in costs of living in Member States;
- among the economic criteria related to agriculture – the annual work unit, AWU and GVA/AWU, i.e. the gross value added per 1 AWU: the average EU

indicator was compared with the indicators for the member states characterized by the highest relation GVA/AWU which obtain higher direct payments per 1 ha. These criteria would indicate the differences in productivity of the agricultural sectors in the EU member states;

- among the environmental criteria – the lands in the LFA (Less Favoured Areas), Natura 2000 area and permanent pastures were considered. The indicator compares the share of these lands in the total utilized agricultural area of a Member State to the EU average. In this case, the Member States in which the share is higher, are entitled to higher direct payments per 1 ha. These criteria reflect the natural handicaps of the areas and indicate the areas particularly important for the provision of public goods.

The mixture of economic and environmental criteria is also possible so as to adjust the flat rate for the whole EU on the basis of the following formula (assuming the weight of  $\frac{2}{3}$  for economic and  $\frac{1}{3}$  for environmental criteria):

the flat rate  $\times$  [ $\frac{2}{3} \times$  [( $\frac{2}{3}$  GDP per capita +  $\frac{1}{3}$  GVA/AWU)] +  $\frac{1}{3}$  ( $\frac{1}{3}$  LFA +  $\frac{1}{3}$  permanent pastures +  $\frac{1}{3}$  Natura 2000 areas)].

The application of the objective criteria, giving more weight to economic ones, would make the gap between the EU-15 and the EU-12 more visible. The situation would improve the most (in absolute values) in the EU-15 countries: the Great Britain, Spain and France. Applying the environmental criteria would be most beneficial for Spain, Great Britain and Portugal. In the case of combination of the economic and environmental criteria the main beneficiaries would be: Spain, Great Britain and Ireland whereas the main losers – Italy, Greece and Poland (Commission, 2011).

The key issue for the choice of the above option was that it would cause the redistribution on a large scale, which would be politically unacceptable to many Member States.

### **The combination of the pragmatic approach and the objective criteria**

There are many different methods of combining of the objective criteria taking also into account the aim of convergence and the current allocation of funds, e.g.:

- ensuring the minimal level of convergence (e.g. all Member States would obtain at least 90% of the EU average) together with the application of an objective criterion to determine the Member States which exceed the EU average;
- the application of the objective criteria for measuring the difference between the current state of allocation of resources and the EU average in order to guarantee that the Member States exceeding the flat rate would limit their direct payments, but not below the level of the flat rate, whereas the Member States with the direct payments below the flat rate would increase their amounts up to the level of the flat rate.

During the EU Council of Ministers for Agriculture and Fishery in November 18-20, 2008, the final agreement was reached, after the discussions within the Health Check (Report, 2008). As a result, the new legislation modifying the foundations of the Common Agricultural Policy was introduced. The procedure for convergence of direct payments among the Member States was adopted (under the Common Financial Framework – CFF). For the Member States having the level of direct payments per 1 ha below 90% of the EU average, the difference between the current level and 90% of the average in the EU is to be reduced by a third. The procedure will be implemented gradually, starting from the budgetary year 2015 to the budgetary year 2020. Finally, all Member States ought to attain the level of 196 EUR/ha at least (in current prices). This convergence will be financed by the Member States where the volumes of direct payments are higher than the EU average.

To sum up, the steady progress of equalization of direct payments is still observed. The Table 3 shows that the amounts of payments recorded in Poland increased by 7% as compared with the year 2013. However, they are still smaller than both the average of 276 EUR per hectare and the level of 90% of the average, i.e. 250 EUR/ha.

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## WYRÓWNYWANIE POZIOMU PŁATNOŚCI BEZPOŚREDNICH W POLSCE DO POZIOMU INNYCH KRAJÓW UNII EUROPEJSKIEJ

### Abstrakt

*Artykuł porusza problematykę wyrównywania poziomu płatności bezpośrednich w krajach Unii Europejskiej. Zaprezentowano dwa zestawy wskaźników i ich ewolucję: stawkę płatności do danego produktu i na hektar uprawionej powierzchni. W artykule zwraca się uwagę na potrzebę redystrybucji płatności, a następnie przedstawia różne jej scenariusze. Na koniec prezentuje się model płatności przyjęty przez kraje i instytucje UE, a także zmiany w wysokości płatności bezpośrednich na 1 ha wynikające z redystrybucji. Wyniki rachunku wskazują na wzrost poziomu płatności bezpośrednich w Polsce, ale jest on nadal nieznacznie poniżej średniej w krajach UE.*

**Słowa kluczowe:** płatności bezpośrednie, Unia Europejska, reforma Mc Sharry'ego, stawki płatności, plon referencyjny, redystrybucja płatności