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## LAND USE IMPLICATIONS OF THE 2003 REFORM OF THE COMMON AGRICULTURAL POLICY IN THE EUROPEAN UNION

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### Abstract

The 2003 CAP reform poses a fundamental change to agricultural support in the EU. As also the influence of member states on the implementation has been increased, it has to be analysed how land use pattern are to be changed. Here the focus will be on the linkages between the main aspects of the 2003 CAP reform as well as on landscape and biodiversity issues. Risks of abandonment and opportunities of extensification can be detected as the main results.

### Keywords

CAP reform, land use, implementation of Single Farm Payment, entitlement trade

### 1 Introduction

The 2003 reforms of the Common Agricultural Policy (CAP) will result in a shift from production support to decoupled support, with stronger requirements for farmers to adhere to environmental, animal welfare, food safety and occupational safety requirements (compulsory cross compliance). Compulsory modulation (shifting funding from Pillar One to Pillar Two) and national envelopes (allowing up to 10 percent of Pillar One money to be used to support types of farming important for the environment) will increase the levels of funding available for environmental measures. These reforms are a significant advance in terms of environmental policy integration and, depending on member states implementation, could result in environmental improvements.

Because the 2003 Pillar One reforms have started to be implemented from January 2005, and the 2004 proposals for reform of Pillar Two are still in draft, it is difficult to predict how some of these policy tools will work in practice and what impact they will have on production patterns in the enlarged EU, and land management decisions in general.

This paper is divided into two main sections the first is focusing on the implementation of the 2003 CAP reform and the second on the implications for land use. This paper has been developed on the basis of a report (GAY et al., 2005) for the EU-project MEACAP (Impact of Environmental Agreements on the Common Agricultural Policy).<sup>1</sup>

### 2 Implementation of the 2003 CAP reform

Key elements of the reformed CAP as seen by the EUROPEAN COMMISSION (2003):

- A single farm payment for EU farmers, independent from production; limited coupled elements may be maintained to avoid abandonment of production,
- this payment will be linked to the respect of environmental, food safety, animal and plant health and animal welfare standards, as well as the requirement to keep all farmland in good agricultural and environmental condition ('cross-compliance'),

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1 See project website: <http://www.ieep.org.uk/projectMiniSites/meacap/index.php>

- a strengthened rural development policy with more EU money, new measures to promote the environment, quality and animal welfare and to help farmers to meet EU production standards starting in 2005,
- a reduction in direct payments ('modulation') for bigger farms to finance the new rural development policy,
- a mechanism for financial discipline to ensure that the farm budget fixed until 2013 is not overshot,
- revisions to the market policy of the CAP.

**Table 1: Common Agricultural Policy reform 2003: important changes**

	<b>Status quo (Agenda 2000)</b>	<b>CAP-reform 2003</b>
<b>Single Farm Payment</b>	Direct payments linked to arable land or animal number; production necessary.	Single decoupled farm income payment from 2005 onwards including arable payments and beef premia and starting in 2006/07 also milk premium; Base period 2000-2002; Eligible land must not be used for growing fruit and vegetables or table potatoes; Application can be postponed till 2007, if justified; Premium rights can be transferred.
<b>Regionalisation</b>		Regionalisation can be used to allocate uniform payment entitlements by taking into account all eligible hectares or to vary payments between grassland and arable land; Redistribution between regions is possible; Member states with less than 3 Mio. Ha can be considered as one region.
<b>Options</b>		Optional derogations may be applied by MS at national or regional level - 25% of hectare payments or, alternatively up to 40% of supplementary durum wheat aid - 50% of sheep and goat premia - 100% of suckler cow premium and up to 40% of slaughter premium, or instead, 100% of the slaughter premium or 75% of the special male premium. MS may also grant 10% of national ceiling as sector-specific payment in order to promote farm activities important for enhancing environment or improving quality and marketing of agricultural products (National Envelope).
<b>Set aside</b>	Compulsory set-aside of 10% for arable crops, exempting small-scale producers (92t of hectare put into set-aside; Or-reference yield); Voluntary set-aside up to 33%.	Farmers receive set-aside payment entitlements based on historical obligations which can be activated only by an eligible small-scale producers (92t of hectare put into set-aside; Or-reference yield); Voluntary set-aside up to 100%; Reduced minimum size at 0.1 ha and 10m width.
<b>Cross compliance</b>	Optional use of reductions of direct payments for enforcing 'specific environmental requirements'.	Reduction of direct payments in case of non-respect of obligations arising from EU standards in the field of environment, food safety, animal health and welfare; requirements to maintain land in good agricultural and environmental condition.
<b>Modulation</b>	Optional reduction of direct payments up to 20 %; Re- payments up to 20 %; Re- mains in member states to be spent on accompanying measures.	Modulation starts with a rate of 3 % in 2005, 4 % in 2006 and stays at 5 % from 2007 onwards (franchise of 5000 €); Modulation will be used for rural development; Allocation according to objective criteria and member states will receive at least 80 % of their contribution to modulation; an additional voluntary modulation may be applied upon member state decision.
<b>Pillar Two</b>	Co-financed measures for agri-environment, young fare; EU share 50 % or 75 % in Objective 1 areas.	Additional measures in the fields of food quality and animal welfare; EU share maybe increased to 60 % or 85 % (now upper limit and not fixed rates anymore); Investment in state owned forests and related fields; EU may be supported for ecological reasons.

Source: Own presentation of EUROPEAN COMMISSION (2003).

Details of the main changes are presented in table 1. The three key elements of the 2003 CAP reform of Pillar One, set out in Regulation (EC) 1782/2003 are decoupling, compulsory modulation and cross compliance. Modulation and cross compliance are not new to the CAP but the former was only a voluntary measure and was applied only by about half of all EU member states.

Member states with historical reference information for direct payments, all those in the EU at the end of 2003, will operate a Single Payment Scheme (SPS). New member states were given an option to apply a simplified system of flat rate regional payments called the Single Area Payment Scheme (SAPS). However, they will have to adopt SPS by 2009 at the latest. Only Malta and Slovenia have decided to adopt SPS from the beginning of their EU membership, with a regional model that distinguishes flat rate payments between arable land and grasslands.

## **2.1 Decoupling**

Decoupling is the key measure under the 2003 reform but it is not compulsory to apply in full. Various options are open to member states to adopt partial decoupling (compare table 1). Decoupling breaks the link between the production of a specific agricultural commodity and the receipt of direct payments for producing that commodity. From 1 January 2005, those farmers eligible will receive one payment rather than several separate production based payments. In order to receive decoupled support under SPS or SAPS farmers will have to comply with a range of EU Directives and Regulations and a set of standards relating to the 'Good Agricultural and Environmental Condition' of their land (cross compliance).

Under SPS, Member States can therefore retain coupled support up to a certain percentage, and are allowed to skim off funding from direct payments in order to create national envelopes and increase funds to support rural development measures in Pillar Two beyond the compulsory level of modulation.

The two main possibilities under SPS of introducing the decoupled, historically references payments are the single farm payment based on historical receipts (Regulation (EC) 1782/2003, articles 33 *et seq.*) and flat rate area payments (articles 58 *et seq.*). These forms of implementing the decoupled payments have not only different distributional effects between farms and regions, but also impacts on land management and the area controlled through cross compliance. In opting for payments according to article 58 it is also possible to introduce a hybrid-system consisting of both of the former options.

Table 2 and Map 1 summarize how each of the EU-15 member state applying SPS appears to be approaching the implementation of this new system. It outlines whether a regional model has been chosen, whether an historical or hybrid model to calculating the single farm payment has been adopted, which premia will continue to be coupled to production. It should be noted that this table and map are correct to the best of the author's knowledge at the time of writing (July 2005), but may not represent the final outcome.

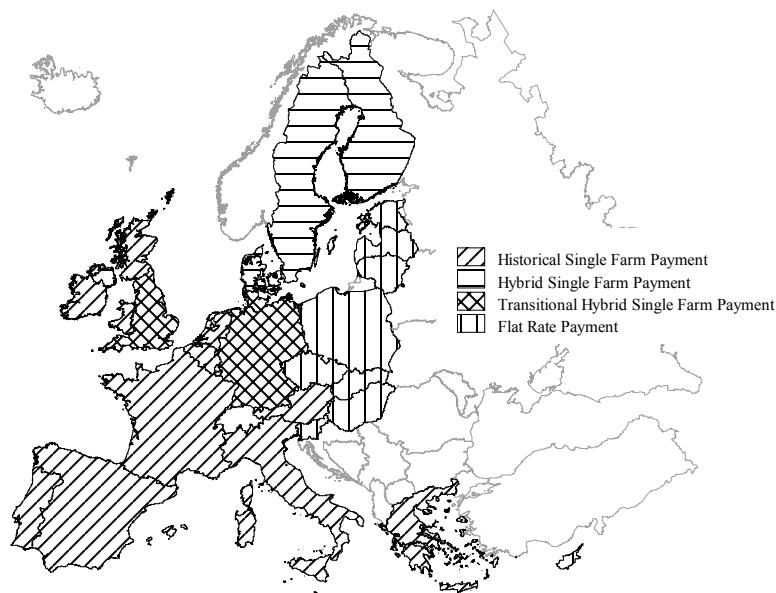
**Table 2: Summary of Single Farm Payment (SFP) implementation in EU-15**

	Year	Re-gional option	Type of SFP	National envelope	Partial or full coupling of premia for					
					Suck-ler cows	Slaugh-ter	Special beef	Sheep & goat	Arable crops	Other*
Austria	2005	-	Historical	-	Yes	Yes	-	-	-	Yes
Belgium	2005	Yes	Historical	-	Yes	Yes**	-	-	-	Yes
Denmark	2005	Yes	Hybrid	-	-	-	Yes	Yes	-	-
Finland	2006	Yes	Hybrid	Yes	-	-	Yes	-	-	Yes
France	2006	-	Historical	Yes ?	Yes	Yes	-	Yes	Yes	Yes
Germany	2005	Yes	Transitional Hybrid	-	-	-	-	-	-	Yes
Greece	2006	-	Historical	?	- ?	- ?	- ?	Yes ?	- ?	Yes ?
Ireland	2005	-	Historical	-	-	-	-	-	-	-
Italy	2005	-	Historical	Yes	-	-	-	-	-	Yes
Luxembourg	2005	Yes	Hybrid	-	-	-	-	-	-	-
Netherlands	2006	-	Historical	- ?	-	Yes	-	-	-	Yes
Portugal	2005	-	Historical	Yes	Yes	Yes	-	Yes	-	Yes
Spain	2006	-	Historical	-	Yes	Yes	-	Yes	Yes	Yes
Sweden	2005	Yes	Hybrid	Yes	-	-	Yes	-	-	-
UK- England	2005	Yes	Transitional Hybrid	-	-	-	-	-	-	-
UK- N. Ireland	2005	Yes	Hybrid	-	-	-	-	-	-	-
UK- Scotland	2005	Yes	Historical	Yes	-	-	-	-	-	-
UK- Wales	2005	Yes	Historical	-	-	-	-	-	-	-

\* seed aid, outermost regions, tobacco and hops. \*\* only in Flanders. ? indicates uncertainty.

Source: AGRA EUROPE (2004), Regulation (EC) 118/2005 and national information (July 2005).

**Map 1: Implementation of the Single Farm Payment in the EU**



Source: AGRA EUROPE (2004) and national information (February 2005).

As can be seen from the map the northern member states have opted more to use the regional premium model according to article 58 of the Regulation (EC) 1782/2003.

## 2.2 Cross compliance

Cross compliance is one key element of the 2003 CAP reform. The introduction of compulsory cross compliance means that from 1 January 2005 farmers receipts of direct payments will be required to respect a set of statutory management requirements (SMRs), as set out in annex III of Regulation (EC) 1782/2003, and maintain eligible land in good agricultural and environmental condition (GAEC), in line with the framework established by annex IV. Cross compliance requirements refer to the whole farm, including land and farm branches without direct payments. Non-compliance will lead to determined reductions of direct payments, by 3 % (1-5 %) in case of first breach, and 15 % to 100 % in case of intention, depending on severity, extent, permanence and repetition of non-compliance. Thus, both existing statutory requirements as well as GAEC standards will be enforced through controls within the direct payment system.

The SMRs refer to EU legislation in the areas of public, animal and plant health, the environment and animal welfare. The items of environmental legislation, including the Birds and Habitats Directives and three pieces of public and animal health legislation, will be applicable from January 2005. The remaining SMRs will be phased in until January 2007.

Under article 5 of Regulation (EC) 1782/2003, member states must ensure that all agricultural land is maintained in GAEC. Table 3 shows the standards adopted in order to ensure land is maintained in GAEC.

**Table 3: Standards of Good Agricultural and Environmental Condition (Annex IV of Regulation (EC) 1782/2003, with amendments by Regulation (EC) 864/2004)**

Issue	Standards
<u>Soil erosion:</u> Protect soil through appropriate measures	- Minimum soil cover - Minimum land management reflecting site-specific conditions - Retain terraces
<u>Soil organic matter:</u> Maintain soil organic matter levels through appropriate practices	- Standards for crop rotations where applicable - Arable stubble management
<u>Soil structure:</u> Maintain soil structure through appropriate measures	- Appropriate machinery use
<u>Minimum level of maintenance:</u> Ensure a minimum level of maintenance and avoid the deterioration of habitats	- Minimum livestock stocking rates or/and appropriate regimes - Protection of permanent pasture - Retention of landscape features - Avoiding the encroachment of unwanted vegetation on agricultural land

Given that the majority of agricultural land in the EU-15 is subject to direct payments under the CAP, this instrument is one of the most important tools for integrating environmental concerns into EU farming practice. The degree to which cross compliance is implemented will inevitably differ between the member states for several reasons. The national discretion available to member states on the implementation of cross-compliance is likely to result in variable policy models, especially as member states can implement cross compliance regionally. Political considerations such as the extent to which member states are willing to regulate the farming industry appear to be a factor here. Also, the EU environmental legislation listed in annex III of Regulation (EC) 1782/2003 can be implemented in a different manner by the

member states (as they are all Directives), and the enforcement of cross compliance will show some variation between the administrative structures of different member states.

### **3 Land use implication of the 2003 CAP reform**

An important aspect from a landscape and biodiversity viewpoint is how land use will be influenced by the 2003 CAP reform. In the following section the different aspects will be analysed. This can only give a first view on the issue as the implementation of the reform just started in most member states. Thus this will only be conducted in a theoretical and qualitative manner.

#### **3.1 Decoupling**

Decoupling also means that payment entitlements can be activated on area without productive land use, including landscape features. This leads to less land use pressure and offers new opportunities for the establishment of landscape features or the change of agricultural land use, as entitlements assigned to arable land can be activated on grassland or not cultivated area. However, for biodiversity objectives decoupling means not only the chance of more extensification in land use, but also possible disappearance of livestock and thus the threat of abandonment. Extensive livestock keeping and pastures are considered important elements of positive effects of agriculture on landscape and biodiversity, and for many high nature value areas extensive pastures are an important management tool (BALDOCK *et al.*, 1996). Thus, decreasing number of livestock in marginal areas due to decoupling could lead to the need of supporting livestock through Pillar Two measures. This means 're-coupling' and could be regarded contradictory to the general objectives of the reform.

#### **3.2 Cross compliance minimum level of land maintenance and transfer of payment entitlements**

If the historical based single farm payment is introduced, which will be the case in more than half of the EU-15, there is an incentive for farmers to exclude – if possible – area from the base area for which they will receive payment entitlements in order to increase the payment per hectare. However, the single farm payment is fixed according to the individual historic baseline of the years 2000-2002. Only eligible farm land registered in the Integrated Administration and Control System (IACS) during this period will receive entitlements. The inclusion especially of grassland is decisive for the area included into the new support system, as registration of grassland has remained less complete compared to arable land. At least in some regions of Germany, a significant share of grassland is not included in the IACS statistics so that the exclusion of grassland would be possible. In regions with high importance of less favoured area support and agri-environment payments of Pillar Two, most grassland has already been IACS registered. The same is true for arable land because of the direct payments for arable crops under Pillar One.

Concentration of entitlements on less area leads to higher payment entitlements per hectare and to a higher independence from land owners, because less land is needed to activate the payment entitlements. As a result, more land remains without payment entitlements. In addition, when implementing the single farm payment certain crops (sugar beets) receive no payment entitlements, but are eligible to activate payment entitlements. Also land users without direct payments in the reference period will not receive payment entitlements, but have eligible land, e.g. horse owners with grassland. Another aspect is the inclusion of landscape features into the eligible area. In case this inclusion occurs after the determination of the area with entitlements, landscape features will constitute additional eligible area, increasing the gap between number of entitlements and eligible land. Thus, eligible land for activation of

payment entitlements will possibly exceed the number of hectare-based payment entitlements to a significant extent.

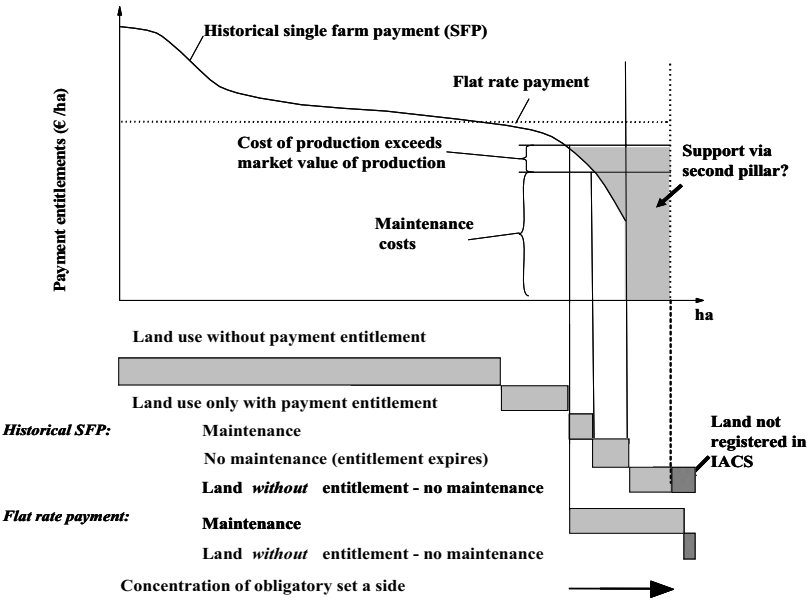
In case that flat rate area payments or a hybrid system are introduced, farmers get a stronger incentive to increase their eligible land, as for each additional hectare they will receive an additional area based payment entitlement. In difference to the historic system, the entitlements are assigned for registered land as well as 'new' eligible land for the first time registered in May 2005. OSTERBURG *et al.* (2003) show a difference of about 2 Mio. ha between different calculations for agricultural area in Germany but a large amount will have been registered in the IACS statistics until mid-May 2005. Thus, only little area will remain without payment entitlements, but payments per hectare are 'diluted' because more land is included into the system. The incentive to activate additional area not included in the IACS statistics depends especially in the hybrid-systems on the level of the area payment. In the case of low grassland payments this incentive may be too low to reach all eligible land, and farmers even may try to decrease their farm area in their application in 2005. Furthermore, the time period to legalise additional area as farm land is rather short and will definitively end by mid May 2005. Like in the historic single farm payment system, agricultural land 'discovered' after the start of the decoupled system will not get payment entitlements in the flat rate payment scheme but can be used to activate transferred payment entitlements. In conclusion, in both systems may remain a significant share of potentially eligible land without payments right, which is a precondition for transfer and reallocation of entitlements. Depending on the gap between number of entitlements and eligible land, and due to transfer of entitlements, direct payments will offer only limited possibilities to steer land management through allocation of entitlements and cross compliance requirements. However, decreasing agricultural land may lead to disappearance of the gap between number of entitlements and eligible land, leading to a surplus of entitlements and a shortage of eligible land. In this case, the 'basic support' of Pillar One direct payments will be available for all eligible land.

After the removal of coupled direct payments for cattle, sheep and goats, the maintenance of forage areas may become more difficult, as the indirect support of grazing through animal payments will cease. On land with payment entitlements, a share of the decoupled payments can be seen as an equivalent for land rent and the cost of minimum level of maintenance according to cross compliance. In most cases, direct payments will be sufficiently high to maintain such land in GAEC conditions. In case of land without payment entitlements abandonment is more probable as the 'basic support' of Pillar One direct payments is missing. Maintenance of such land can not be assured through cross compliance requirements, as farms could give up this land without losing direct payments.

Through trading, payment entitlements may be transferred to more favourable areas which are kept in agricultural use anyway or which can be maintained more easily with machinery. In this way, less favoured and high nature value land may loose entitlements. Trading of payment entitlements is possible with and without eligible land but eligible land is required to activate a payment entitlement. Article 46 (3) of Regulation (EC) 1782/2003 in combination with article 9 of Regulation (EC) 795/2004 offers member states the possibility to make a retention on sales of payment entitlements in favour of the national reserve. Most member states do not plan to use this option by now, but several consider this option to replenish the national reserve if required. France, Italy and Spain have included this option in general in their implementation rules. In France only sales of payment entitlements without land beyond borders of a Département will face retention of 50 %. In Italy all possible retention envisaged in article 9 of Regulation (EC) 795/2004 will be applied. That means all sales of payment entitlements without land will face retention of 50 % in the first three years and 30 % thereafter, sales of payment entitlements with land of 10 % and of entire holdings of 5 %. In Spain the rates of retention are 50%, 30%, 5% and 0%, respectively. Farmers commencing an agricultural activity and inheritance will be exempt from the retention requirement. The Italian and

Spanish implementation will limit the trade in payment entitlements further than the French implementation.

**Graph 1: Payment entitlements, land use and maintenance in different implementations of the Single Farm Payment**



Source: adaptation of OSTERBURG *et al.* (2003).

As can be seen from graph 1 for a proportion of the land the general land use is not dependent on a premium and for another part land use will be only be carried out if a premium is paid. These types will occur similarly in both the single farm payment generally envisaged in Regulation (EC) 1782/2003 and also the regional flat rate payment. In the case of a flat rate payment maintenance of land registered in IACS is likely to occur as the payment normally exceeds the maintenance costs. This aspect can be of interest in hybrid models as it may be the case that a flat rate payment may be below the maintenance costs for especially permanent pasture. Also in the historic single farm payment system it may occur that some payment entitlements will be below the maintenance costs and thus a payment entitlement may not be activated and no maintenance is carried out. For example, in farms with low payment rights per hectare, high maintenance cost, e. g. for grassland on slopes or in wetlands could lead to the abandonment of such areas. This problem may be aggravated by trade in payment entitlements without land, leaving the land with highest maintenance cost without entitlements.

Obligatory set aside of arable land will constitute a separated payment entitlement, and the trade with these special rights will lead to a concentration of set aside on marginal arable land. In exchange with payment entitlements which allow for productive land use, farmers in favoured areas will try to move set aside obligations into areas with less fertile soil, where voluntary set aside can be substituted through the obligatory one. Both environmental and supply control objectives of set aside are put into question through the effects of this re-allocation. Due to tradability of set aside payment entitlements, steered allocation and management of obligatory set aside in order to enhance biodiversity will be rather difficult. If a retention of set aside payment entitlements is carried out according to article 9 of Regulation (EC)

795/2004 this will be limited only to the value of the payment entitlement not to the number of payment entitlements. Thus, the area of obligatory set aside will not be diminished through retention, and set aside always has to be activated first.

The biodiversity effects of agricultural land beyond agricultural production can be summarised as such:

- Agricultural land *with* payment entitlements, but without agricultural use will be at least maintained, e.g. through mulching or mowing once in a year according to cross-compliance minimum requirements of annex IV. Uniform large scale management with machinery will possibly be a dominant strategy, and landscape variability will decrease. Extensive grazing is another option for land maintenance, e. g. on land difficult to maintain with machinery. However, control of GAEC standards will be more difficult on grazed land compared to mulching, as ‘unwanted vegetation’ could encroach. Also in this case the administrative implementation and exemptions from uniform management requirements are crucial for effects on biodiversity.
- Agricultural land *without* payment entitlements and without agricultural use will not be reached through cross compliance. Intentions to include such areas into farms will be difficult as cross compliance is binding for the whole farm and on all areas including land without payment entitlements. Thus, the basic land maintenance can not be remunerated with Pillar Two support in farms with premium rights, because they would have to maintain all their farm land in accordance to mandatory cross compliance requirements anyway. Here, a landcare crisis could arise, if no exemptions will allow for Pillar Two support for land *without* payment entitlements.

Member states obviously have anticipated possible negative impacts of decoupling on marginal grassland and therefore have chosen different options to limit them:

- Maintenance of coupled payments for suckler cows, sheep and goats (e.g. France, Austria)
- Cross compliance requirements including minimum livestock rates
- Use of the national envelope to support extensive grazing (e.g. Scotland)
- Adaptations of agri-environment schemes which will have higher impacts on maintenance of minimum livestock rates in future

### **3.3 Cross compliance and the protection of permanent grasslands**

Protection of permanent grassland and landscape features according to annex IV of Regulation (EC) 1782/2003 can have positive effects on biodiversity conservation. Effective grassland protection through cross compliance depends on the implementation of flexibility mechanisms which might endanger the maintenance of *permanent* grassland, which is of higher interest for biodiversity protection compared to grassland within crop rotations. Also, the amount of grassland without payment entitlements is relevant because this area is not included in the IACS at the start of the new system. Such ‘new’ grassland could be step by step included into the base area, thus allowing for a significant decrease of grassland through ploughing, while farmers formally comply with the cross compliance conditions because they statistically maintain the size of their grassland. Furthermore, farm specific requirements are obligatory only if the objective of maintaining 90 % of the ratio of permanent grassland in relation to the total agricultural area of 2003 is likely to be missed. Thus, the grassland maintenance regulation will be rather untargeted from a biodiversity perspective. Member states have the option of implementing a system of authorisation of ploughing grassland and adding site specific criteria to this permission. In this way, grassland protection might be used in a more targeted way, depending on the implementation at member state or regional level.

### 3.4 Landscape features

In the CAP before the 2003 reform landscape features rarely received any support but generally they are protected. The area payments for arable crops and set-aside were limited on the net area. This encouraged limiting landscape features as much as possible. In the 2003 CAP reform several landscape elements can be used to activate a premium right. This is the case for all landscape features protected through cross compliance rules according to article 30 (3) of Regulation (EC) 796/2004. This will reduce the pressure from agriculture on landscape features as payment entitlements are not lost if for example a hedgerow becomes thicker. In addition the protection via cross compliance with its monitoring and penalisation is likely to be supportive for existing landscape features. Agri-environment measures can still be used by member states to support the creation of new landscape features which subsequently fall under cross compliance, and for their management.

### 3.5 Forestry

During the 2003 CAP reform it has been clarified that short rotation coppice up to 20 years can be planted as non food product on set-aside land which remains eligible to activate payment entitlements, especially set-aside entitlements. This kind of production is at the borderline between an agricultural and a forestry land use. Also afforested arable land according article 31 of Regulation (EC) 1257/1999 is eligible to activate set aside payment entitlements. At the current stage of knowledge other afforested land would not be eligible to activate premium rights but this will only have a limited influence on land use change as most afforestation of farmland is conducted according to Regulation (EC) 1257/1999.

Another aspect of interest is the land use change towards scrubland. This should be prevented by cross-compliance regulations according to annex IV but if agricultural land has a low or no payment entitlement attached to it this may be a possible development. As discussed before the share of land with low or without payment entitlements attached to it is larger in countries implementing the historical based single farm payment.

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