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GENEDEC

A quantitative and qualitative assessment of the socio-economic and environmental impacts of decoupling of direct payments on agricultural production, markets and land use in the EU

STREP

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Work Package 1, Deliverable D1.1:

An examination of various theoretical concepts behind decoupling and review of hypothetical and actual de-coupled support schemes in some OECD countries

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CONTENTS

I. INTRODUCTION

Work Package 1 has the title *An examination of various theoretical concepts behind decoupling and review of hypothetical and actual de-coupled support schemes in some OECD countries*. It results in Deliverable 1, which has two parts: *A report on the theoretical examination of decoupling and review of hypothetical and existing schemes in EU and OECD countries. A report summarising stakeholders' reactions to the introduction of a decoupled support system in the 5 main partner countries* (Technical Annex I: 15). This document is the first part of Deliverable 1.

Technical Annex I (p. 15) describes the work to be undertaken as follows:

- Theoretical concepts and principles behind decoupling such as the reorientation of direct payments towards rural development (CARPE), the Bond Scheme and Single Payment Scheme will be examined and evaluated in terms of possible economic and environmental impacts, and problems of implementation;
- The same will be undertaken concerning actual decoupled support schemes;
- Stakeholders (farmers' unions, input suppliers, local authorities, environmental bodies and farm workers' representatives from the 5 main study countries *[France, Germany, Ireland, Italy, United Kingdom]* will be consulted as to their views on decoupled support schemes.

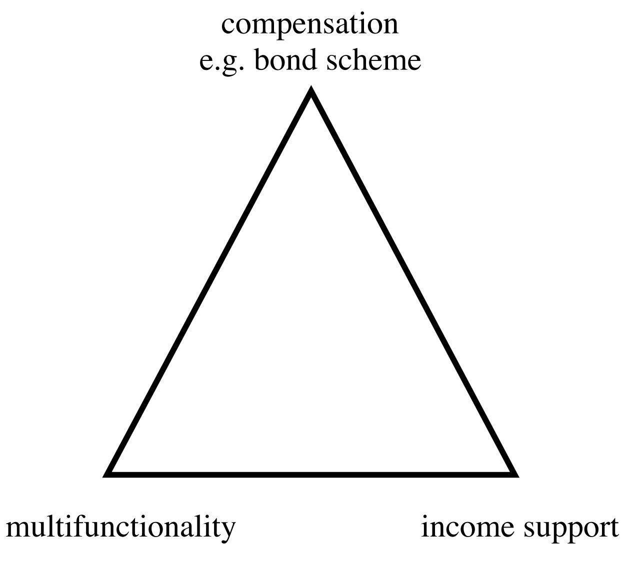
When the project was conceived, the European Commission had already suggested –for the *Mid-term Review* of the common agricultural policy (CAP)– a decoupling of the area and headage payments then characteristic of the CAP (Commission, 2002). These proposals were subsequently formalised (Commission, 2003a), and in June 2003 the Council of Agricultural Ministers approved a new system of decoupled payments –the *Single Payment Scheme*– to apply from 2005 (adopted into EU law in September 2003: Council, 2003). Thus, in terms of the bullet points in the paragraph above, the Single Payment Scheme (SPS) has moved from 'theoretical' to 'actual'. But it will be applied in different ways by each of the EU's twenty-five Member States. Accordingly, in Work Package 1, we provide an overview of the SPS across EU25, and a detailed description of how it is expected to be applied in each of five main study countries (France, Germany, Ireland, Italy and the UK). This then serves to establish the modelling scenarios that would otherwise have been undertaken in Work Package 5.

II. POLICY OBJECTIVES

One thing that is very obvious from even a cursory examination of –so-called– decoupled payment policies and proposals is that the term 'decoupled' embraces many variants, which will impact in different ways. One purpose of Work Package 1 is to set out clearly these alternative visions of decoupling. We begin our overview of the theoretical concepts behind decoupling by considering first the policy objectives that policy-makers might be trying to achieve.

There are many ways in which we might try to rationalise the policy objectives embedded in instruments of farm policy. Here we borrow an overview developed in an earlier Framework V research project (Swinbank, 2004b). Figure II.1 sets out the typology.

Figure II.1: A Triad of Policy Objectives



From Swinbank (2004b)

At the apex of the triangle we have pure compensation schemes, for example the bond scheme discussed in Section V. Here the aim is to compensate a particular group for policy change. The allocation of payment entitlement might be designed to compensate in full, or only in part, for the losses brought about by the policy change, and it might be differentiated by region, business size, etc. Schemes will probably be temporary: that is payments will be phased-out over a finite number of years. And –certainly in the bond scheme advocated by Swinbank and Tangermann (2001; 2004)– they might be *totally* decoupled from production in that entitlement would be based solely upon past activities. With the bond scheme, recipients could sever completely their past links with farming; and entitlement to future payments –the bond– could be sold.

In the bottom right-hand side of the triangle we have designated schemes that have the objective of farm income support. Thus the EU's new Single Payment Scheme is described as 'an income support for farmers' (Council, 2003: Article 1). Although decoupled from current production, the payments remain coupled to something, or some activity, be it farmland, the farm or the farmer. This then raises two questions. First, "How decoupled are decoupled payments?", a question to which we turn in the next section. Second, "Do the payments conform to the green box criteria set out in Annex 2 of the Uruguay Round Agreement on Agriculture (URAA)?", an issue we examine in Section IV. If payments are for *income support* they might be permanent rather than temporary, they might be targeted at particular regions or business types, and they might be negatively correlated with farm (and off-farm) income.

In the bottom left-hand corner of Figure II.1 we suggest that, in this instance, the motivation for decoupled payments is a concern that agriculture's multifunctional attributes, valued by the rest of society, will be undersupplied unless additional financial support is provided to the farm sector. Thus we are not here describing particular payments for the supply of designated environmental features (e.g. an annual payment for the maintenance of 100 metres of dry-stone walling), but instead a flat-rate payment per farm, labour unit, or hectare. Payments would not be linked directly to production (and in that sense are decoupled), but they might be varied by location or land cover (for example in the less-favoured areas: LFAs), and they will almost certainly be subject to *cross compliance*: farmers will have to meet minimum environmental standards on the land concerned, or indeed on their whole farm, if the payments are to be claimed. Indeed, with its new Single Payment Scheme the EU has endorsed this principle: if farmers are to receive payments in full they must comply with a set of statutory requirements, and other criteria determined by Member State. In addition, Member States are experimenting with entry level *Environmental*

Stewardship Schemes, to which all farmers would be entitled, provided they undertook basic environmental management on their farms. In England, for example, it is suggested that annual payments could amount to €30 per hectare (*Agra Europe*, 16 April 2004: N/1). This raises interesting issues of where the boundary should lie between actions that are required if part or all of the Single Farm Payment is not to be forfeited, and those that trigger entitlement to entry-level Environmental Stewardship Scheme payments. And, as with income-focussed decoupled payments, questions arise about the impact such schemes might have on production, and their compatibility with WTO provisions.

In practice, many proposed and existing schemes fall within the space defined by the triangle in Figure I.1, and disentangling their objectives, the payment rules, and their economic and financial impact is not easy.

III. THE ECONOMICS OF DECOUPLING:
How Decoupled are Decoupled Payments?

Introduction

As the OECD (2000: 6) notes, "the term 'decoupling' has been widely used both in academic literature and among policy makers". The term has been used as a descriptor of a number of policies, often with differing economic impacts. "For policy makers and in particular for those involved in agricultural trade negotiations, …. a policy is decoupled if it has no or minimal impact on production and trade" (OECD, 2000: 6). More specifically, a fully decoupled payment would be made irrespective of market conditions: it would not depend upon "current prices, factor use, or production" (Burfisher and Hopkins, 2003: 4). The purpose of this section is to explore, from a theoretical perspective, the concept of decoupling. It relies heavily on earlier literature reviews undertaken by the OECD (2000) and the USDA (Burfisher and Hopkins, 2003), and a literature review undertaken for a parallel Framework 6 project (Andersson, 2004), and thus does not attempt to trace concepts back to their original formulation.

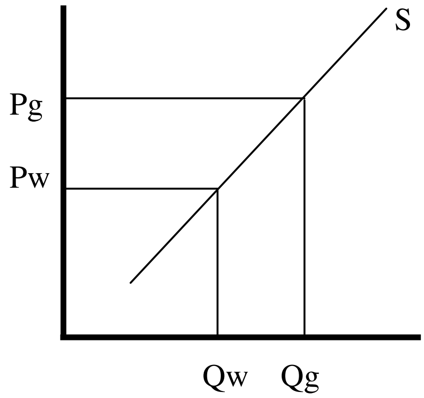
However, the literature is marked by an element of schizophrenia. In some instances (as above), the definition of decoupling rests upon payment criteria (an *ex ante*, or policy-maker's approach). In other instances (as below), the definition rests upon the payment's impact (an *ex post* approach, which is more challenging for modellers). Table III.1 contrasts the two.

Table III.1: Contrasting Definitions of Full-Decoupling

… payment criteria (*ex ante*):	**… payment's impact (*ex post*)**
"Only subsidies that do not depend on current prices, factor use, or production can be considered fully decoupled from farm production decisions" (Burfisher & Hopkins, 2003: 4).	"A policy is fully decoupled if it 'does not influence production decisions of farmers receiving payments, and if it permits free market determination of prices'" (OECD, 2000: 12, quoting Cahill, 1997).

This Section of the report focuses upon the economic *impact* of decoupled payments. In Sections IV and V we will be more concerned with payment design. We begin our present analysis with Figure III.1 that shows a typical short-run supply curve for an industry operating under perfect competition, in the absence of uncertainty. The concept of decoupling operates within a context of policy change. Consider a price guarantee of Pg, which will elicit a planned supply of Qg. We need to compare two alternative scenarios. First, the guaranteed price is removed and market price falls to Pw. Theory predicts that planned supply will contract to Qw (an analogous situation would arise with the removal of an input subsidy). Alternatively, assume that the removal of price support (the movement from Pg to Pw) is accompanied by the introduction of a decoupled payment, paid directly to the producer. Will the planned supply now fall to Qw, or to some other level?[1]

Figure III.1: Explaining Decoupling with a Simple Supply Schedule



Full Decoupling, and the Degree of Decoupling

The OECD (2000: 12), drawing on the work of Cahill (1997), who in turn had drawn on earlier writings, distinguishes between *full decoupling* and *effective full decoupling*, and introduces the concept of the *degree of decoupling*. Under full decoupling, the decoupled payment "does not influence production decisions of

[1] Such a policy change might also involve a movement in consumer prices, with consequences for traded quantities, and for (net) government expenditure; but those effects are not addressed here. Instead we focus on production. The policy context would also be important: a policy change that involved some farm crops, but not all, could for example involve a shift in inputs (particularly land) between sectors, and changed relationships in the supply chain (e.g. a change in cereals policy impacting on feed prices in the livestock sector).

farmers receiving payments, and … permits free market determination of prices (Cahill, 1997: 351). Thus, in terms of Figure III.1, a policy package that involved a removal of the price guarantee, *and* the introduction of a decoupled payment, but resulted in a planned output of Qw, would be fully decoupled. Variations in the level of the decoupled payment would not impact upon planned output, but variations in the market price (Pw) would.

However, other combinations of policy instruments could be deployed which could result in the output level Qw. An output quota, set at Qw for example, combined with a guaranteed price (Pg) above Pw, would result in planned output of Qw, which would not be influenced by movements in Pw. Thus the OECD (2000: 12) suggests that "A policy is effectively fully decoupled if it results in a level of production and trade equal to what would have occurred if the policy were not in place. … The shape of the supply or demand curves could be changed by an effectively fully decoupled policy, even if the equilibrium production and consumption were not changed".[2]

The *degree of decoupling* (DD) is an index that compares policy packages that have "the same *ex ante* effect on the total Producer Support Estimate (PSE)" (OECD, 2000: 11). It has a value of one if the policy package is effectively fully decoupled (i.e. it results in a planned output of Qw in Figure II.1), whereas it has a value of zero if its effect is undifferentiated from the original, fully-coupled, policy (i.e. a planned output of Qg).

Many so-called decoupled policies might be expected to have DD coefficients or less than one, for reasons we discuss below. Clearly this is an empirical issue that must be addressed in the modelling phase of the GENEDEC project. Furthermore, it is conceivable that policy packages can be devised that have DD coefficients that fall outside the range 0 – 1, but these are not explored here.

A Residual Price/Incentive Effect

One way in which the new policy may not be fully decoupled is that some residual production or resource use requirement might remain in place. Thus, following the

[2] Note that the OECD are here referring to *consumption* and to *trade*, which goes beyond the impact on production that is the focus of this section.

CAP reforms of 1992, scholars set about determining the degree of decoupling that had been achieved (e.g. Cahill, 1997). Price support had been reduced, but crops had to be sown, and animals kept, if area and headage payments were to be claimed. The policy reform had decoupled support from yields, but not from input (land and animal) use. Josling's guesstimate was that 70% of the normal supply adjustment might be attributed to a yield response, with the remaining 30% to an area response (Josling, 1994: 517).

Under the Single Payment Scheme, introduced by the Fischler Reforms of 2003, and discussed in more detail in Section VII, payments remained tied to land, although there is no production requirement, and the land must remain in good agricultural condition. Our view is that, from a theoretical perspective, the DD index approaches 1. However, there is a difference, however slight, between the Single Payment Scheme and the Bond Scheme outlined in Section V. Under the Bond Scheme payments are not tied to land, but instead to a paper asset (the bond): recipients need not remain farmers; and the land can go out of agricultural production.

Indeed, in terms of CAP reform, (at least) five-stages in the process of decoupling can be envisaged:

Scenario 1: CAP price support pre-1992;
Scenario 2: price cuts, with the revenue loss offset by area and headage payments, as in the 1992 reforms;[3]
Scenario 3: area and headage payments replaced by the Single Payment Scheme (SPS) (2003);
Scenario 4: replacement of SPS payments by compensation payments in a bond scheme;
Scenario 5: removal of all compensation payments.

A pertinent question to pose to modellers is to ask whether their models can differentiate between these five different states of the world.

In terms of Table III.1, any residual price/incentive effect clearly contravenes Burfisher and Hopkins' (2003) definition of full-decoupling in an *ex ante*, or programme design, sense. But the literature has also identified a number of instances in which, for Scenarios 2 to 4 above, from an *ex post* perspective the degree of decoupling might be less than expected. It should be emphasised that these are

[3] An intermediate step between 2 and 3 would be for a single unified payment rate on land planted to arable crops.

cumulative, rather than alternative, perspectives, and that the relative magnitude of each could only be determined empirically.

An Adjustment Effect

Figure III.1 is an over-simplistic representation of the adjustment to changed economic circumstances. The short-run supply schedule of the industry will typically be less price elastic than the long run schedule. Assets (both farm-specific assets, and the human capital embodied in the farmer) typically have a low salvage value, and will continue to be deployed in the sector as long as marginal (operating) costs are covered. Thus farm activities will be retained until the fixed asset is depleted, even though re-investment in the enterprise would not be justified, and the shake-out of these assets from the industry may take a long time. This will depend on a number of factors: the capital intensity of the sector, and the age of the equipment, the age of the farmer and the availability of alternative employment, etc.

Non-profit-maximising Behaviour

Figure III.1, and the discussion of the forgoing paragraph, assumes profit-maximising behaviour on the part of farmers, with 'rational' economic operators equating marginal costs with marginal revenues. However, there is considerable evidence to suggest that real humans do not always operate in this fashion, and it may well take time –perhaps prompted by cash crises– before they recognise the need to adjust. It may well be rational to be ignorant, given the personal and financial costs involved in fully informing oneself of one's circumstances. Thus Colman and Harvey (2004: 3) comment: "many dairy farmers are not profit maximisers, but operate over many years with returns to labour below the minimum wage. They persist in dairying in spite of very low financial rewards by conventional standards. They may be expected to continue to do so, at least to some extent, in defiance of conventional economic or commercial logic." A decoupled payment, in providing an income cushion, can both delay the cash crisis that might otherwise prompt change (so prolonging the adjustment effect outlined in the previous paragraph), and mask the real circumstances faced by the business. If the decoupled payment maintains the revenue flow of the business, with total revenues exceeding total costs, why worry about marginal costs and revenues?

Insights from Household Consumption Models

Decoupled payments enhance the income of the farm household, and so enlarge its range of feasible activities. This might impact upon production in a number of ways, all of which can be seen in the context of optimising behaviour. First, the concept of stewardship is important. As 'guardians of the countryside', some farmers might view decoupled payments as a payment, by society, for the intangible benefits of a 'well-farmed' countryside (i.e. multifunctionality), and believe that their side of the bargain is to deliver this. Indeed, this is the language in which the 2003 reforms are couched. In its January 2003 proposal, the Commission (2003a: 3) emphasised that to "avoid land abandonment, … farmers would have to meet stringent land management obligations", and that "Payments will only be made to farmers actively producing or maintaining land in good agronomic condition."

Second, for some individuals farming might be a consumption activity, rather than a business. The flow of revenue enables a farmer (or farm household) to continue farming even though the farm's accountant would protest that the business is operating at a loss. Although wealthy new-entrants, or hobby-farmers, might best fit this description, established farmers with a good asset base, no obvious successor, and no pressing income need, might –and probably do– also behave in this fashion.

Third, Burfisher and Hopkins (2003: 19) suggest that decoupled payments might impact upon the farm household's labour-leisure choice. Consider again the policy scenario. Price support has been removed, and in Figure III.1 planned supply has contracted to Qw. This is part of the mix of variables that determines farm income. If a decoupled payment is now added, farm revenue (and, we will assume, income) is increased. Does the farm household use this increased income to increase its leisure time, at the expense of labour supply to the farm (with supply falling below Qw in Figure III.1) or some non-farm activity either on or off the farm; or is that increased income used in some other way?

A Wealth Effect

Many authors refer to the possibility of a wealth effect, based upon the work of Hennessey (1998).[4] He had focussed on farmers' maximising utility in an *uncertain* world. In a non-stochastic (certain) world of expected-utility-of-profit maximising producers, decoupled payments have no impact upon production. Similarly, in an uncertain world, the output of risk-neutral producers will not be affected by decoupled payments. However, it is generally assumed that farmers, collectively, are risk averse. A risk averse producer would prefer a certain level of income rather than a variable level with the same expected outcome. As a consequence of risk aversion the level of investment in the industry is expected to be lower than would be the case in a less risky environment. If farmers display a *declining absolute risk aversion (DARA) preference*, that is their aversion to risk declines as income increases, then an increase in income (wealth) as a consequence of the decoupled payment can induce them to take riskier production decisions, and thus increase output, compared to the situation in which no decoupled payment is made. Clearly the estimated parameters built into models will be crucial in determining the magnitude of the wealth effect: in his simulation of maize producers in the American mid-west Hennessey (1998: 55) concluded that the "wealth effects are not large".

Despite Hennessey's rather limiting assumptions, other authors refer to potential wealth (and insurance –see below) effects in rather more grandiose terms. For example, citing Hennessey, Jotzo *et al.* (2003: 384) write: "Even when farm subsidies are partially or fully disconnected from the level of output ('decoupled'), they nevertheless tend to stimulate production because of wealth and insurance effects."

Relaxed Capital Constraint Effect

With imperfect capital markets, one typically borrows at a higher interest rate than one lends; and higher loan charges apply if the borrower's asset/income base declines. Thus a decoupled payment, in enhancing the cash-flow profile of the business, relaxes the capital constraint that many farm businesses face, and (potentially) lowers the cost

[4] This is distinct from the idea in consumption function analysis that wealth impacts upon a household's consumption, as above.

of capital. Thus, in a dynamic context, the level of investment is likely to be greater with a decoupled payment in place than would occur in the absence of those payments.[5] However, many farm businesses will be faced with a range of off-farm and on-farm activities in which they could invest, and it is not obvious that with they would chose to invest more on the farm. *Furthermore*, the fear expressed by some commentators is that if this effect is combined with non-maximising behaviour, some farmers might undertake uneconomic investments, increasing the productive potential of their farms.

An Insurance Effect

In addition to a wealth effect, Hennessy (1998) also referred to an insurance effect: "To remove the insurance effect, a DC [decoupled payment] program must be invariant to the source of the randomness" (p. 55). In his simulation of a maize producer in Iowa, Hennessey (1998: 55) concluded that the insurance effect of the U.S. loan rate and target price programme was important. (The OECD (2004a: 18) show that the risk aversion coefficient is a particularly sensitive parameter included in this and similar studies.) However, Goodwin and Mishra (2002: 5), arguing that 'a *fully decoupled payment* is one for which the level of payment is fixed and guaranteed and thus is not influenced by ex-post realizations of market conditions (e.g. low prices or area yields)', conclude 'that a truly decoupled payment really only involves wealth effects'. The OECD (2000: 19) also conclude that for lump sum payments, where the payment is contingent on neither output or price, there may be a wealth effect but there will not be an insurance effect.

More generally, it is argued, a decoupled payment helps stabilise the farm's revenue flow, stemming from output variability on the farm, thus reducing risk, and increasing investment. Whilst it can credibly be argued that a decoupled payment reduces (but does not eliminate) market-based risks, it does not reduce (indeed it may enhance) policy-induced risk. Policies are subject to change, and policy-makers (and the farm lobby) may be more or less successful in building policy certainty into decoupled payment schemes.

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[5] It should also be noted that many models will divert increased farm 'income' (revenue) to increased farm household consumption and saving ($\Delta Y = \Delta C + \Delta S$), with the increased saving invested in farm assets.

An Expectations Effect

If policies are subject to change, can the farmer be sure that the basic entitlements to receive decoupled payments might not change? Even though the present rules might state that entitlement is based on farmland holdings, rather than the crops grown or livestock kept, in the next policy review entitlements could be revised to take account of crops grown and livestock kept in a more recent base period. And if this is a possibility, would not the prudent farmer be more inclined to populate the farm with crops and livestock, just to ensure continuity in entitlements?

Two Caveats: Asset Prices and Entrepreneurial Vigour

Two important caveats need to be added to the earlier discussion. The first concerns asset prices. It is difficult to envisage a situation in which a future expected stream of decoupled payments would not be capitalised in some way into asset prices. Under a bond scheme, the present value of the revenue stream would be reflected in the price of a paper asset, the bond. Under the EU's new Single Payment Scheme, under either the regionalised or historic variants discussed in Section VII, payments will tend to be capitalised into land values in full (the regionalised scheme) or part (the historic variant).[6] Thus, in many instances, the *original* recipient will receive the income cushion that permits an extended adjustment period, and benefit from the insurance and wealth effects. Landlords, rather than tenant farmers, may however be the ultimate beneficiaries even in the short-run, depending upon the terms of the tenancy agreement.

Subsequent entrants into the farming business will face a different scenario. This will be so whether they take-up up new tenancies, or buy or inherit farms.[7] With the bond scheme, new entrants would not receive compensation payments, but they would be able to access land at prices that no longer reflected the present value of the flow of bond payments. Under the Single Payment Scheme they would be entitled to the single farm payment, provided they had acquired entitlement and had access to eligible land. Consequently, they will pay for the right to access the single farm

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[6] However, there are many factors that impinge on farmland prices, and rents. A discussion is beyond the scope of the present report.

[7] Death duties may be payable on the value of the farm assets; and co-beneficiaries (e.g. siblings) may need to be compensated for their share of the inheritance.

payment, with the full benefit tending to flow to the original recipient. Thus, over time, as new entrants populate the industry, the income cushioning offered by direct payments, and any wealth or insurance effect, will be dissipated.

The second caveat concerns the dynamic nature of the farm sector, and the impact that new entrants have upon the industry. Arguably new entrants introduce technological and managerial change, increasing productivity. This increase in productivity may be reflected in an increase in production, but this is not necessarily the case. If decoupled payments enable less efficient producers to remain in the industry for a longer period (compared to the shake-out following an uncompensated removal of support), blocking opportunities for new entrants, then –arguably– productivity improvements, and conceivably production, will be lower than might otherwise have been the case.

IV. DECOUPLED PAYMENTS IN THE WTO

The *Agreement on Agriculture*, resulting from the Uruguay Round of international trade negotiations concluded in Marrakesh in April 1994, contains three sets of disciplines.[8] These relate to 'market access', 'domestic support' and 'export competition'. Articles 6 and 7, and Annex 2, set out the disciplines that apply to domestic support. In this context, reference is frequently made to three 'boxes' –green, blue and amber– although this terminology is not found in the agreement itself.

During the negotiations, WTO Members had been keen to distinguish between agricultural policies that did impact upon production (and consumption), and hence upon trade, and which were therefore of concern to the international community, and those that did not. Policies *coupled* to production (and consumption) fall into the amber box, and are subject to reduction commitments; whereas those that met "the fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on effects on production," and meet other specific requirements set out in Annex 2 of the URAA, are green box policies that are subject to no financial constraints.

All WTO Members were invited to compute an Aggregate Measurement of Support (AMS) for the base period 1986-88, which was an estimate of the total financial benefit the farm sector received from amber box policies, with some exclusions as detailed below. This aggregate was bound (i.e. cannot be exceeded), and was reduced by 20 percent (for developed countries) over the implementation period (1995-2000). Thus the AMS sets a limit on the annual support[9] a WTO Member can grant its farm sector, over and above the exemptions set out below. According to the WTO Secretariat, 34 (of the then 144; counting the EU and its 15 Member States as one) WTO Members had built an AMS entitlement into their schedule of commitments (WTO, 2002a: 1).

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[8] All the texts that comprise the WTO legal system can be downloaded from the WTO website: www.wto.org. Authors often refer to the URAA: the Uruguay Round Agreement on Agriculture.

[9] Note that whilst both the blue and green boxes refer to budget expenditure, the amber box is an *estimate* of both tax-payer funded, and consumer, transfers; and that an important part of the calculation rests upon a *fixed* external reference price (essentially world market prices in the period 1986-88) and an 'applied administered price'. If there is no 'applied administered price' the AMS will be zero, even when import tariffs maintain domestic *market* prices above world market levels.

There are three important exemptions. First, under Article 6(2) of the URAA, developing countries are entitled to exempt various investment and input subsidies (and subsidies to encourage diversification from the growing of illicit narcotic crops), from the AMS calculations. The expenditure incurred has to be declared to the WTO, however, and this is often referred to as the S & D (indicating Special and Differential treatment for developing countries) box in WTO publications.

Second, a *de minimis* clause applies. For developed countries, product-specific domestic support that does not exceed 5 percent of the value of output of that product, *and* non-product specific domestic support that does not exceed 5 percent of total agricultural production, need not be included in the AMS calculations (Article 6(4)(a) of the URAA). For developing countries the corresponding percentage is 10. In recent years the USA has made considerable use of this exemption, as can be seen from Table IV.1.

Table IV.1: Domestic Support in the EU and USA

	EU (€ billion)		USA ($ billion)	
	1998/99	1999/2000	1999	2000
Green box	19.2	19.9	49.8	49.7
of which: decoupled payments	*0.1*	*1.0*	*5.7*	*5.5*
Blue box	20.5	19.8	0.0	0.0
AMS limit	71.8	69.5	20.7	19.9
Actual AMS	46.7	47.9	10.4	16.9
de minimis	0.5	0.3	4.7	7.4
Total value of agricultural production	213.5	233.7	190.9	184.7
Document: G/AG/N/	EEC/30 & Corr1	EEC/38	USA/36	USA/43

Source: WTO documents in the series G/AG/N as tabulated in the bottom row (e.g. G/AG/N/USA/43)

The table shows the declarations for the EU and the USA, for the two most recent years declared by the EU. The dollar-euro exchange rate varies, but the dollar and euro are broadly similar in value. Both the EU and the USA declared an actual AMS limit well below the maximum permitted, but the USA's *de minimis* support would have taken the USA well above its AMS limit in 2000 had the *de minimis* provisions not been in place. The USA provides a useful case history.

When the EU and USA negotiators met at Blair House in October 1992 –an important step in framing the URAA– they wrote into the new agreement a third exemption from what would otherwise have been amber box support (Swinbank and Tanner, 1996: 118). The blue box –Article 6(5) of the URAA [see Box IV.1]– was specifically designed to accommodate the deficiency payments regime then in place in the USA, and the area and headage payments that had become a central feature of the CAP after the 1992 reforms.

Box IV.1: Article 6(5) of the URAA: The Blue Box

5. (a) Direct payments under production-limiting programmes shall not be subject to the commitment to reduce domestic support if:

   (i) such payments are based on fixed area and yields; or

   (ii) such payments are made on 85 per cent or less of the base level of production; or

   (iii) livestock payments are made on a fixed number of head.

   (b) The exemption from the reduction commitment for direct payments meeting the above criteria shall be reflected by the exclusion of the value of those direct payments in a Member's calculation of its Current Total AMS.

The EU declares its arable area payments under 5(a)(i), and the beef and sheep/goats headage payments under 5(a)(iii). These account for the EU's blue box payments listed in Table IV.1. In 1995 the USA declared its deficiency payments under 5(a)(ii); but US farm policy was then revised. Under the Federal Agricultural Improvement and Reform (FAIR) Act of 1996, deficiency payments were replaced with *production flexibility contract (PFC) payments*. The USA declared these PFC payments to be decoupled, in the green box, although as we shall see below a WTO Panel subsequently decided they are not (WTO, 2004b). They are reported in the second row of Table IV.1.[10] This left the EU as the only significant user of the blue box category.

[10] A very large part of the USA's green box declaration is for food stamps, and other domestic food aid programmes.

Following enactment of the FAIR Act, commodity prices fell and the USA introduced emergency legislation to ameliorate the impact of lower commodity prices on farmers. *Additional marketing loss (MLA) payments* were made to PFC recipients. These, it was claimed, were not crop-specific, and because they accounted for less than 5 percent of the value of American farm output they met the *de minimis* criteria. Thus it is MLA payments that dominate the USA's *de minimis* declaration in Table IV.1. The 2002 Farm Bill, the *Farm Security and Rural Investment Act* (FSRIA), is not yet reflected in the USA's declarations to the WTO (Ayer and Swinbank, 2002).

Decoupled Payments in the Green Box

Annex 2 sets out the criteria for green box payments. Paragraph 1 lays down over-arching criteria that must be met by any green box measure. It reads:

> Domestic support measures for which exemption from the reduction commitments is claimed shall meet the fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production. Accordingly, all measures for which exemption is claimed shall conform to the following basic criteria:
>
> (a) the support in question shall be provided through a publicly-funded government programme (including government revenue foregone) not involving transfers from consumers; and,
>
> (b) the support in question shall not have the effect of providing price support to producers;
>
> plus policy-specific criteria and conditions as set out below.

The 'policy-specific criteria and conditions' are set out in Paragraphs 2 to 13.

Table IV.2: Green Box Expenditure Notified to WTO; US$ million; 1995-1998

Para:	Measure:	1995	1996	1997	1998
2a	Research	3,251.50	3,428.90	2,660.30	713.1
2b	Pest & disease control	1,339.70	2,705.70	620.1	368.3
2c	Training services	2,330.70	2,047.40	623.7	385.3
2d	Extension & advisory services	2,620.40	3,264.50	2,923.80	597.8
2e	Inspection services	326.2	660.9	295.6	140.1
2f	Marketing & promotion services	991.9	1,008.30	201.8	75
2g	Infrastructural services	28,507.30	23,664.40	18,834.00	3,179.50
2	Other general services	6,020.10	4,173.60	3,514.20	364.5
2	Non-separated general services	9,396.80	7,625.50	7,475.00	242.6
3	Public stockholding for food security purposes	2,927.30	1,375.40	1,202.80	264.5
4	Domestic food aid	40,771.10	40,131.20	37,718.20	351.5
5 (2nd sentence)	Direct payments to producers	339.8	349.4	0	0
6	Decoupled income support	2,586.50	7,316.40	7,254.30	793.4
7	Income insurance/safety-net programmes	39.8	53.9	8.3	0
8	Natural disaster relief	1,766.70	1,401.00	1,096.90	765.8
9	Producer retirement programmes	1,505.50	2,035.20	757.3	7.4
10	Resource retirement programmes	3,167.70	3,589.50	1,706.80	7.9
11	Investment aids	12,065.70	9,847.20	3,751.30	2,019.50
12	Environmental programmes	5,237.90	7,459.40	2,292.00	1,056.50
13	Regional assistance programmes	4,205.90	4,571.70	685.3	539.9
	Other measures	3,916.00	383.4	320	289
	Total Green Box	**133,331.70**	**127,091.90**	**93,980.90**	**12,161.80**
	of which (in %):				
	Total general services (para. 2 of Annex 2)	41.1%	38.2%	39.5%	49.9%
	Total public stockholding & domestic food aid (paras. 3-4 of Annex 2)	32.8%	32.7%	41.4%	5.1%
	Total direct payments (paras. 6-13 of Annex 2)	23.2%	28.8%	18.7%	42.7%
	Total other measures	2.9%	0.3%	0.3%	2.4%
	Number of Members	46	47	43	26

Source: WTO (2000a), Table 2

Although somewhat dated, Table IV.2 presents in summary form the range of green box measures used by WTO Members. Note that not all WTO Members had made the necessary declarations when the WTO Secretariat compiled this table, and that data for 1998 in particular is missing. Paragraph 2 covers general services provided by government. Thus 2(g), covering ‘infrastructural services’, includes electricity supply, roads, port facilities, etc. However it should include “capital works only”. It should not include “subsidies to inputs or operating costs, or preferential user charges”. These would be amber box measures. Paragraphs 3 and 4 are largely self-explanatory, with –as noted above– the USA a major spender under domestic food aid.

The WTO refers collectively to the measures under Paragraphs 5 to 13 of Annex 2 as ‘direct payments’. Of particular interest to our discussion are Paragraphs 5 and 6, dealing respectively with ‘direct payments to producers’ and ‘decoupled income support’. The only time the word ‘decoupled’ is used in Annex 2 is in the heading to Paragraph 6. It might also be noted that paragraphs 9 and 10 provide for ‘structural adjustment assistance provided through producer retirement programmes’ and ‘structural adjustment assistance provided through resource retirement programmes’.

Paragraphs 5 and 6 read:

> 5. Direct payments to producers
>
> Support provided through direct payments (or revenue foregone, including payments in kind) to producers for which exemption from reduction commitments is claimed shall meet the basic criteria set out in paragraph 1 above, plus specific criteria applying to individual types of direct payment as set out in paragraphs 6 through 13 below. Where exemption from reduction is claimed for any existing or new type of direct payment other than those specified in paragraphs 6 through 13, it shall conform to criteria (b) through (e) in paragraph 6, in addition to the general criteria set out in paragraph 1.
>
> 6. Decoupled income support
>
> (a) Eligibility for such payments shall be determined by clearly-defined criteria such as income, status as a producer or landowner, factor use or production level in a defined and fixed base period.
>
> (b) The amount of such payments in any given year shall not be related to, or based on, the type or volume of production (including livestock units) undertaken by the producer in any year after the base period.
>
> (c) The amount of such payments in any given year shall not be related to, or based on, the prices, domestic or international, applying to any production undertaken in any year after the base period.
>
> (d) The amount of such payments in any given year shall not be related to, or based on, the factors of production employed in any year after the base period.
>
> (e) No production shall be required in order to receive such payments.

Thus Paragraph 5 largely sets the scene for the subsequent paragraphs, although it does have a catchall provision in that any direct payment that does not otherwise meet the criteria of Paragraphs 6 to 13 would qualify if it meets the criteria

(b) to (e) of Paragraph 6. Consequently Paragraph 5 can be seen as a cut-down version of Paragraph 6.

From this we can see that the WTO's definition of a decoupled payment is both *criterion* based (compare Burfisher and Hopkins, 2003: 4, in Table III.1 above), in that it has to meet the criteria laid down in Paragraph 1 and criteria (b) to (e) of Paragraph 6, and *impact* based, in that it has to meet Paragraph 1's overarching (*fundamental*) criterion that it have "no, or at most minimal, trade-distorting effects or effects on production" (compare OECD, 2000: 12, cited in Table III.1). It should be noted however that the phrase 'or at most minimal' is not quantified, and it remains unclear how it might be interpreted by a Dispute Settlement panel. In *United States – Subsidies on Upland Cotton* for example, Brazil claimed that US subsidies 'to upland cotton producers are inconsistent with "the fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production" pursuant to paragraph 1 of Annex 2' (WTO, 2004b: paragraph 7.406). However, the Panel had already decided that the measures at issue were not green box policies, because they failed to satisfy the requirements of paragraph 6(b), and thus decided that it was 'unnecessary' to determine whether or not the fundamental requirement had been met (WTO, 2004b: paragraph 7.412).

A perusal of the WTO Secretariat's 2000 compilation of Members' submissions is not particularly helpful. Two countries made notifications under Paragraph 5: Canada for "technology innovation under the Quebec/Canada agreement", and Romania for payments "to stimulate the increasing of livestock" (WTO, 2000a: Table L). The latter does not sound like a decoupled payment.

Ten Members made declarations under Paragraph 6 (WTO, 2000a: Table M). The schemes are summarised in Table IV.2. To this list should be added Mexico, which in a later document (WTO, 2000b) declared its PROCAMPO (Programa de Apoyos Directos al Campo) programme of direct assistance for agriculture.

However, as noted above, a WTO Panel –in an as-yet un-adopted report– subsequently ruled that the US production flexibility contract (PFC) payments, listed in Table IV.2, do not qualify as green box payments (WTO, 2004b: paragraph 7.388). They infringed paragraph 6(b) of Annex 2 in that PFC payments were not made if the land was planted to fruits or vegetables. We discuss this more thoroughly in Section VI.

Table IV.2: Summary of Decoupled Income Support Schemes Declared to the WTO by 2000

Member:	Measure:
Argentina	* Social programme for small-holders (e.g. monthly income not more than twice the agricultural worker's wage) * Special fund for tobacco producers
Australia	* Farm family restart scheme * Farm household support scheme
Canada	* Western grain transition payments * Arable acres supplementary payment * Alberta hog industry programme
EU	* Transitional aid for agricultural income under Regulation 768/89 * Agri-money compensation
Iceland	* Farmers' pension fund * Direct payments to sheep farmers
Korea	* High school tuition payments, financial assistance to debt-ridden farmers, and pension insurance coverage * Support for retired aged farmers who sell or lease their land
Malaysia	* Price subsidy and guaranteed minimum price for paddy rice farmers: "both …have no effect on trade"
Malta	* Direct payments to beef producers * Refund of social security contributions
Switzerland–Liechtenstein	* Cattle owners in mountain and hill areas * Farming and summer pasturing under difficult conditions * Cow owners who do not market milk * Premiums for feed grains and pulses * Direct additional payments for additional services (i.e. multifunctionality)
USA	* Production flexibility contract payments

Source: compiled from WTO (2000a: Table M)

Discussions in the Doha Development Agenda

In the Doha Round, discussions on domestic support measures have focussed on a number of issues:

- for the amber box: i) the extent of further reduction commitments, ii) whether crop-specific AMS limits or an aggregate AMS limit (as now), should apply, and iii) whether the *de minimis* provisions should be phased out;

- for the blue box: i) whether expenditure limits should apply, and ii) whether the blue box provisions should be repealed;
- and for the green box: i) whether expenditure limits should apply, and ii) whether particular provisions should be redrafted (Swinbank, 2004a).

International pressure to phase-out, or constrain, blue box payments may have been important in persuading first the European Commission, and then the Council of Ministers, that the EU should decouple the bulk of its direct payments by adopting the Single Payment Scheme in the Fischler Reforms of 2003. The Commission had claimed, in proposing the scheme: "As regards WTO aspects, the new single farm payment will be green box compatible. Decoupling will allow the European Union to maximise its negotiating capital in order to achieve its WTO objectives such as non-trade concerns. Hence the proposals for decoupling could be crucial in getting the best deal for the European Model of Agriculture" (Commission, 2003a: 4).

At an early stage in the WTO negotiations, India proposed not only that blue box (Article 6(5)) payments should be included in the AMS, but also that various green box payments should too:

> Direct Payments along with decoupled income support and Governmental financial participation in income insurance and income safety-net programmes (paras. 5, 6 & 7 of Annex 2) as well as direct payments under production limiting programmes (Art. 6.5) should be included in the non-product-specific Aggregate Measurement of Support and should be subject to reduction commitment so as not to exceed the *de minimis* level, i.e., 5 per cent (for developed countries) and 10 per cent (for developing countries) of the value of that Member's total agricultural production (Article 6.4) (WTO, 2001: 13).

Stuart Harbinson's draft modalities document simply suggested a possible addition to Paragraphs 5, 6, 11 and 13 to read: "Payments shall be based on activities in a fixed and unchanging historical base period. All base periods shall be notified" (WTO, 2002a: 24).

The draft *Framework for Establishing Modalities in Agriculture*, circulated before Cancún, merely noted in paragraph 1.5 that "Green Box criteria remain under negotiation".[11] This was challenged by the G20 states in their paper for Cancún when they suggested: "Green box direct payments (paragraphs 5 to 13 of Annex 2 of the AoA) shall be, as appropriate, capped and/or reduced for developed countries.

[11] http://www.wto.org/english/thewto_e/minist_e/min03_e/draft_decl_annex_e.htm

Additional disciplines shall be elaborated and agreed upon" (WTO, 2003: 2). The second revision to the draft Framework document that was circulating in Cancún when the meeting ended without consensus (the so-called 'Derbez text') did little more than reiterate the wording of Paragraph 1 of Annex 2 when it said: "Green box criteria shall be reviewed with a view to ensuring that Green Box measures have no, or at most minimal, trade-distorting effects or effects on production".[12]

In short, until the Doha Round has run its course, and a revised *Agreement on Agriculture* has been agreed, the precise future treatment of decoupled payments in the green box is somewhat unclear. However, our expectation is that the Harbinson proposal, that would not impose an expenditure constraint on the green box, but would tighten-up on criteria, rather than the G20's suggestion that expenditure "be capped and/or reduced for developed countries", is more likely to prevail.

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[12] http://www.wto.org/english/thewto_e/minist_e/min03_e/draft_decl_annex_rev2_e.htm

V. PAST ATTEMPTS TO DECOUPLE PAYMENTS IN THE EU

In the 1960s and 1970s there were a number of *academic* studies that advocated CAP reform, and the use of decoupled compensation or income payments, and it was a commonplace to refer to these ideas in writings at the time. This literature has been reviewed by Beard and Swinbank (2001) and Little *et al.* (2004). In the UK in the 1960s, prior to the UK's accession to the then EEC, Nash had been an enthusiastic advocate of policy reform, arguing that:

> "the simplest method of compensating agriculture for the withdrawal of the protective system would be an unconditional payment to all those at present engaged in farming, or to those of them deemed to be in need of compensation, calculated by reference to the difference between the incomes now earned under the protective system and those capable of being earned under a system of free market prices. An annuity calculated in this way and payable for life to all engaged in farming, but not transferable to their successors, would, in theory at least, make it possible to bring the protective system to an end while fully making good the loss of income to its present beneficiaries" (Nash, 1961).

The Atlantic Institute Report of 1970

The report of an Agricultural Study Group of the UK-based *Federal Trust for Education and Research* (Marsh, 1970) could be dismissed as a particularly British perspective on a policy that was yet to be applied in the UK. However the Paris-based *The Atlantic Institute*, an organisation that promoted "co-operation among Atlantic nations and Japan in economic, political and cultural affairs" (Uri, 1970: 1), was able to draw upon a distinguished expert group that included a senior official of the European Commission (see Box V.1).

The report noted that the Mansholt Plan for restructuring European agriculture (published 1968) represented a "bold initiative", but "Unless it is complemented by a change in price relationships, including a reduction in the prices of surplus products, there is no reassurance that surpluses will not increase further under the spur of improved productivity which structural changes will accelerate." Furthermore, "The re-establishment of equilibrium requires the reduction of certain prices –and yet the understanding and consent of the Community farmers. Hence such price reductions must be compensated by income subsidies –yet of a kind which does not retard but accelerates the restructuring of agriculture and the redirection of production" (Uri, 1970: 6-7).

Box V.1: Membership of The Atlantic Institute Study Group

Denis Bergmann, *INRA, Paris*
Nicholas Kaldor, *King's College, Cambridge*
Hans-Broder Krohn, *Commission of the European Communities, Brussels*
John S. Marsh, *The University of Reading*
Manlio Rossi-Dora, *Italian Senator*
John A. Schnittker, *Robert Nathan Associates. Washington D.C.*
Carl Thomsen, *The Royal Veterinary and Agricultural College, Copenhagen*
Pierre Uri, *The Atlantic Institute* (Rapporteur)
Hans Wilbrandt, *Georg-August Universität, Göttingen* (Chairman)
Observers:
Robert Brand, *US Embassy, Paris*
Albert Simantov, *Director of Agriculture, OECD*

Source: Uri (1970: 4-5)

The plan was to "substitute, gradually, income support for price support." The system of income support would have four essential characteristics:

> The first of these would compensate for lower prices on the basis of average yield in the Community. The second would fix payments depending upon the area under cultivation *in the years preceding* the decision to lower prices. The third would involve minimum and maximum time periods and would limit the subsidy to the life of the farm operator, so that it could not be passed on to his successors. The fourth would make it vary inversely with the size of farms (Uri, 1970: 37; emphasis as in the original).

It was suggested that the maximum period for compensation would be 15 years, that it would normally cease when a farmer reached normal retirement age, and that the entitlement would not be inherited (although it could be paid for up to 5 years for the farmer's spouse or children). The scheme would contain a "degressive element" in that "compensation per hectare would decrease as the number of hectares of wheat or sugar beet per farm increased, or the number of milch cows per farmer" (Uri, 1970: 39).

The report is not categorical about the *future* level of payments should market prices differ from those predicted before the policy reform, but the implication of the discussion is that no subsequent adjustments, consequent upon movements in market prices, would be made to payments.

The Bond Scheme

A bond scheme was advocated by Tangermann (1990; 1991) in a report commissioned by the Land Use and Food Policy Inter-Group of the European Parliament.[13] If CAP support prices were to be reduced, to achieve a more economically rational structure of agriculture in the EU, "the question arises of whether farmers should be compensated…. This is a matter of political judgement to which economic analysis has little to contribute. … as a matter of practical policymaking, it would probably be difficult to secure sufficient political support for agricultural policy reform if no compensation were offered to farmers" (Tangermann, 1991: 93-94).

Decoupled income/compensation payments "can be made as annual payments, where the size of the aggregate payment … can be varied year after year. Alternatively, the total amount of payments over the whole of the adjustment period can be determined in advance" (Tangermann, 1991: 95). The latter, in the form of a one-off capital sum, has "the great advantage that it is, in the eyes of the farmers, more decoupled than any other type of payment"; and "a capital sum makes it easier for farmers to adjust professionally, through either setting up a new business or improving the production structure of the farm." However, the drawback of the capital sum approach is the large, one-off, impact on the government budget. Hence, the alternative of issuing bonds to farmers "which entitle their holders to predetermined annual payments for a given period. …. Farmers who receive such a bond are free to keep it or to sell it on the private capital market" (Tangermann, 1991: 96).

Early in 1991 the Commission proposed a reform of the CAP (subsequently known as the MacSharry reform) that involved a partial decoupling of support for cereals and beef creating the arable area and headage payments scheme (Commission,

[13] He points out that "other economists" have advocated "issuing bonds to farmers, in compensation for price cuts" (Tangermann, 1991: 100, footnote 4).

1991a). During the deliberations on this proposal, Denmark's Minister of Agriculture proposed a bond scheme as an alternative compensation package to arable area payments (Daugbjerg, 2004). Daugbjerg discusses the factors that mitigated against the bond scheme on this occasion.

More recently Swinbank and Tangermann (2001; 2004) articulated six components, or steps, by which the area and headage payments introduced by the MacSharry reforms could be transformed into a full bond scheme:

- Decouple crop payments from current land use.
- Extend this principle to livestock, and decouple livestock payments from the number of animals kept.
- Decouple payments from land (or the farm) and attach entitlement to individuals.
- Limit the duration of the payments to, say, ten or twenty years, and (possibly) make payments degressive over time.
- Definitively fix the future level of payments.
- Transform payment entitlements into bonds.

In Table V.1 we contrast the characteristics of the bond scheme with the schemes proposed by The Atlantic Institute in 1970, discussed earlier; Buckwell *et al.*'s CARPE, to be discussed next; and the Fischler reforms agreed in 2003 that will be outlined in Section VII. A crucial difference of the bond scheme is that the link with land, or farming, is completely broken. It is more decoupled than other schemes: there is no residual need to 'farm' to ensure payment entitlement. This has a number of consequences:

- First, that any capitalisation of the value of future payments will be reflected in a paper asset (the bond) rather than a farm asset (e.g. land).[14] This has implications for landlord-tenant relations.
- Second, that the bond scheme cannot be combined with cross compliance to influence land use. By contrast, under the Fischler reforms, payments remain linked to land and consequently environmental and other cross compliance conditions can be linked to their receipt.
- Third, that a different tax treatment might be applied to bond scheme payments (i.e. they may not be classified as farming income).

[14] As Wichern (2004: 48) notes of the Single Payment Scheme, "This link keeps one of the main inefficiencies of direct payments in place –they capitalise in the value of land. … the main beneficiary will be the owner of the land. … Thus, expanding the farm size will be more expensive than in a situation where the single farm payment would not be linked to the land."

Table V.1 Key Characteristics of Various Decoupled Schemes

	Atlantic Institute	**CARPE**	**Fischler Reforms**	**Bond scheme**
Decoupled from *current* prices?	Unclear	Yes	Yes	Yes
Decoupled from *current* production?	Yes	Yes	Yes, but does *not* allow the production of fruit and vegetables, which might infringe paragraph 6(b) of the WTO's green box provisions	Yes
Link retained with farmland/ farming?	Yes, paid to farmers (although retirement allowed)	Cross compliance provisions; but "it should not even depend on whether the recipient is still farming"	Yes: claims based on farmed area; and cross compliance	No
Entitlement determined in advance?	Unclear	Yes	No; could reduce as a consequence of the Financial Mechanism	Yes
Transferable?	No; but provision for spouse/ children in first 5 years	Not specified	Yes, with land	Yes, but detached from land
Duration:	Maximum 15 years	"temporary"	No limit set	15/20 years

A Common Agricultural and Rural Policy for Europe (CARPE)

In 1997 Buckwell *et al.* (1997) proposed that the CAP should be reformed, and in effect be replaced by a Common Agricultural and Rural Policy for Europe (CARPE). This would have four policy elements. First, a residual element of market stabilisation (MS), "essentially to provide a safety net for commodities subject to uncontrollable market fluctuations".

Second, environmental and cultural landscape payments (ECLP), “to protect against damage and depletion of rural resources and cultural landscapes in rural areas, and to encourage development of these resources and the social fabric”. Third, rural development incentives (RDI) to stimulate “opportunities for non-agricultural uses for farm resources and opportunities for resources released from agriculture.”

The fourth element, transitional adjustment assistance (TAA), was “to facilitate the transition from an agricultural to a rural policy” (Buckwell *et al.*, 1997: 58-59). Here the proposal was that “the compensation payments introduced in the 1992 CAP reform are transformed into transitional adjustment assistance”. Emphasis was placed on the use of the words ‘transitional’ and ‘adjustment’, as constructive and forward-looking, rather than ‘compensation’, which –it was claimed– is rather negative and retrospective. Three important principles were enunciated: that the TAA “should be decoupled from production, it should be non-distorting to competition, and recipients should respect environmental conditions”. Decoupled meant that, once determined, the payment “should in no way relate to current production decisions about production, resource use or current prices.” However, “there must be some environmental conditions attached to TAA” (Buckwell *et al.*, 1997: 80-81).

The EU’s WTO Declarations

As reported in Table IV.2, the EU declares decoupled payments to the WTO for two schemes: transitional aid for agricultural income under Regulation 768/89, and agri-money compensation. These are relatively modest sums in comparison to the EU’s overall expenditure on green box measures (see Table V.2).

With the creation of a Single Market on 1 January 1993 it became necessary to eliminate the old system of monetary compensatory amounts (MCAs) that had distorted intra-Community trade since 1969 (Ritson and Swinbank, 1997). Until December 1992, the green money system had largely protected farmers from the consequence of currency appreciation (which should have led to a fall in CAP support prices when expressed in national currency). That became more difficult with the abolition of MCAs, and consequently the EU introduced a system of compensatory payments, that Member States could claim, for farmers who suffered a reduction in support. These payments are reflected in Table V.2.

Regulation 768/89 established a "system of transitional aids to agricultural income". It stemmed from the conclusions of the European Council of February 1988 to give Member States "the option of granting transitional aids to agricultural income to provide support for the efforts of weak agricultural holdings, which would otherwise not be able to adapt successfully owing to their economic and structural situation, to adjust" (Council, 1989). It formed part of a basket of "structural stabilizers" to which the Commission attached "great importance" (Commission, 1991b: 103). However, up-take was limited, and the 1988 reforms were soon eclipsed by those of 1992. In the end only eight Member States participated (Ireland, Luxembourg, Portugal and the UK did not), and the arrangements were not renewed in 1993 (European Commission, 1994: 22). Thus it is the tail-end of the (limited) payment stream that appears in Table V.2.[15]

Table V.2: EU's WTO Declarations, 1995/96 – 1999/2000 (million ecu)

	1995/96	1996/97	1997/98	1998/99	1999/00
Total Green Box	18,779.2	22,130.3	18,166.8	19,168.0	19,930.5
of which:					
Decoupled Income Support:					
Transitional aid to agricultural income	19.5				
Agri-monetary aid	225.0	220.8	211.2	128.6	957.5
Document: G/AG/N/	EEC/12/ Rev.1	EEC/16/ Rev.1	EEC/26	EEC/30	EEC/38

Source: WTO documents in the series G/AG/N/ as listed in bottom row.

Member States wishing to avail themselves of this facility had to draw up a *programme of agricultural income aids* (PAIA), setting out objectives, geographical coverage, and eligibility criteria (Article 3). But the rules were complex. An over-arching condition was that the aids "must not stimulate production nor bring about distortion of competition (Article 1). Farms had to declare the 'overall family income … of the farmer and of those members of his family working on the holding, including any non-agricultural resources', and if this fell below a threshold (to be determined by the Member State) they became eligible for aid (Article 4). The

[15] The Commission's report to the Council and the European Parliament has not been accessed for this study (Commission, 1992).

threshold could not exceed 70% of the national GDP, or 90% of the regional GDP, per member of the working population (Article 4). Aid payments were degressive and could not exceed 2,500 euro per year per work unit, could be of no more than five-years duration, but could be capitalised (Article 6).

VI. DECOUPLED PAYMENTS IN SOME OTHER OECD COUNTRIES

In Table IV.2 we indicated the WTO Members that had notified decoupled payments under either paragraph 5 or 6 of Annex 2 of the URAA by 2000, and we noted that subsequently Mexico had declared its PROCAMPO programme to be decoupled. In this Section we examine in more detail decoupled payment schemes in the US, Mexico and Australia.

United States: PFC and DD Payments

Baffes and de Gorter (2004: 5.6) suggest that the decoupling of US farm support first began in the 1985 Farm Bill which 'froze' the yields on which government payments were based. Payments were no longer linked to current, but instead to historic, yields.

In 1996, under the Federal Agricultural Improvement and Reform (FAIR) Act, the US introduced *production flexibility contract* (PFC) payments that would apply through to 2002.[16] Support was provided to farmers on the basis of historic acreage and yields for seven commodities (wheat, maize [corn], barley, grain sorghum, oats, upland cotton, rice). Farmers made a single claim in 1996 to qualify for PFC payments in each of the years 1996 through to 2002. To be eligible, land had to have been enrolled in the deficiency payments programme of the previous farm bill in at least one of the years 1991 to 1995. A producer's *contract acreage* for each of the seven crops was equal to his/her *base area* in 1996 (i.e. the average area planted to each of the seven crops in the period 1993 to 1995), plus any land released from the Conservation Reserve Program. Payment yields were frozen at 1995 levels. Payments rates (e.g. in $/bushel) were then set for each of the seven crops for the life of the FAIR Act by dividing a fixed appropriation by the number of claims. Farmers received PFC payments on 85% of their contract acreage, provided: i) that fruit and vegetables[17] were not produced on the land, and ii) the land remained in an agricultural or related activity, and various conservation requirements were met.

[16] This paragraph, and the following three, are based heavily on WTO (2004b: paragraphs 7.212 to 7.226). See also the USDA Economic Research Service's comparison of the provisions of the 1996 and 2002 Farm Bills at: www.ers.usda.gov/Features/farmbill/titleIcommodities.htm (accessed 8 September 2004). Not all features of US farm support are mentioned.

[17] Excluding mung beans, lentils and dried peas. Wild rice became an excluded crop from 2002.

Otherwise, contract acres could be planted to any crop, or idled, without affecting the PFC payment.

As Ayer and Swinbank (2002: 26) point out, a collapse of commodity prices, and a budget surplus, then promoted Congress to grant US farmers additional subsidies in addition to those envisaged in the 1996 FAIR Act. Thus *market loss adjustment* (MLA) payments were made in each of the years 1998 to 2001. MLA payments were paid as a supplement to PFC recipients. Clearly they were related to movements in market prices, but –as with PFC payments– they were not related to current plantings or yields.

In the 2002 Farm Bill –the *Farm Security and Rural Investment* (FSRI) Act– the PFC payments of the FAIR Act were replaced by a new *direct payment* (DP) programme, and the MLA payments were replaced by a new *counter-cyclical payments* (CCP) programme. As with the PFC payments, the new DP payments are based on a fixed area (now referred to as *base area*) and yield, and paid on 85% of a producer's base area. However, with the addition of oilseeds (soybeans and 'minor' oilseeds) and peanuts, there are now ten crops covered. The complex provisions for peanuts are discussed in more detail below. To allow for the inclusion of the new crops,

> "Owners had a one-time opportunity to elect the method for calculation of their base acreage. An owner could elect to have base acreage for all covered commodities calculated on the basis of the four-year average of planted acreage during the 1998 through 2001 crop years plus acreage the producers were prevented from planting by natural disasters during the same period. Failing such an election, an owner's base acreage in the DP programme is the same as under the PFC programme for the 2002 payment (i.e. the three year average of the 1993 through 1995 marketing years …), plus the four-year average of planted acreage for eligible oilseeds during the 1998 through 2001 crop years" (WTO, 2004b, paragraph 7.221).

Payments are predetermined for the period 2002 to 2007 (displacing the PFC payments that had been scheduled for 2002), and apart from the need to make an annual application, the expansion of the programme to include new crops, and the possibilities that was offered to producers to update base areas,[18] the 2002 DP programme is very similar to the 1996 PFC regime.

[18] For CCP payments, producers were also able to update yields.

The US declared to the WTO its deficiency payments, paid under the *Food, Agriculture, Conservation, and Trade* (FACT) Act of 1990, as blue box payments. The FAIR Act, in repealing deficiency payments, thus eliminated the US' use of the blue box. PFC payments were declared as green box payments, qualifying under paragraph 6 of Annex 2 of the URAA; and it was expected that DP payments would be declared in like manner. MLA payments however, were neither green nor blue. They were amber box support, because they were contingent on price movements. But, because they were provided to PFC recipients, they were declared to be non-product-specific support and fell within the *de minimis* provisions of the URAA. Thus, they do not count as part of the current AMS. Table VI.1 summaries the US' domestic support declarations for the period 1998 to 2001.

Table VI.1: US Domestic Support, 1998-2001, as Declared to the WTO ($ billion)

	1998	1999	2000	2001
Green	49.8	49.7	50.1	50.7
of which decoupled	5.7	5.5	5.1	4.1
Blue	0.0	0.0	0.0	0.0
AMS Binding	20.7	19.9	19.1	19.1
Current AMS	10.4	16.9	16.8	14.4
de minimis	4.7	7.4	7.3	7.0
Total value of output	190.9	184.7	189.5	198.5
Document:	36	43	51	51

Source: WTO documents in the series G/AG/N/USA as indicated in the bottom row.

In its WTO challenge to the US' subsidy programme for upland cotton, Brazil argued that the PFC (under the 1996 legislation) and DP (under the 2002 programme) payments for upland cotton did not meet the criteria set out in paragraph 6(b) of Annex 2 of the URAA. The Panel concluded

> that PFC payments, DP payments, and the legislative and regulatory provisions which establish and maintain the DP programme, do not fully conform with paragraph 6(b) of Annex 2 of the Agreement on Agriculture. They are not green box measures (WTO, 2004b: paragraph 7.413).

This was because the level of payment *did* depend upon the crop grown: for most crops (including upland cotton) the PFC or DP was paid in full, whereas if a fruit or vegetable crop was grown it was not. Note that the US has said it will appeal various aspects of the Panel report (USTR, 2004), and that the report remains un-adopted.

In putting its case forward Brazil had argued that in limiting the crops that could be grown, the effect “is to funnel production on base acreage to particular types of crops” (WTO, 2004b: paragraph 7.358). The EU, doubtless conscious of similar provisions in its SPS scheme introduced by the Fischler reforms, argued that

> the reduction of payment linked to the production of fruit and vegetables must be seen as part of a scheme which permits a farmer to grow any type of crop, or even not to produce at all. Such a scheme, taken as a whole, meets the criteria that payments are not related to a type of production. To find otherwise would not permit a WTO Member wishing to introduce decoupled payments to take account of important elements of internal competition, in an historical perspective, and avoid those farmers receiving decoupled payments from enjoying both the decoupled payments and a privileged position vis-à-vis farmers who are not entitled to such payments (WTO, 2004b: paragraph 7.363).

However the panel did not comment on this issue.

In this particular instance, the panel’s view (that may yet be overturned) that the US’ PFC and DP payments were not genuine green box payments had little practical import: the US was not being challenged on the overall level of amber box support, but instead on whether these measures result in “serious prejudice to the interests of Brazil within the meaning of Article 5(c) of the *SCM* [Subsidies and Countervailing Measures] *Agreement*”. The Panel concluded that Brazil had not established that to be so (WTO, 2004b: paragraph 8.1(g)(ii)).

US Peanut Quota Buy-out, 2002

Under the 1996 Farm Bill, a two-tier pricing system applied. For production within the *marketing quota* a *loan rate* supported the price at $610 per ton.[19] Quota could be sold and leased. Production in excess of quota had to be crushed or exported. Peanut growers had been eligible for additional payments in 2000 and 2001. The 2002 Farm Bill radically changed the support arrangements. Quota was abolished, a new direct payment of $36 per ton became payable on a predetermined area, and new support price of $495 per ton was introduced. This took the form of a counter-cyclical payment which is the difference between the target price of $495 per ton *less* the higher of: i) the 12-month average market price plus $36 per tonne, or ii) the loan rate of $355, plus $36, per ton.

[19] This paragraph and the next rely heavily on www.ers.usda.gov/Features/farmbill/titleIcommodities.htm (accessed 8 September 2004).

In addition, to compensate quota owners for “the lost asset value of their quota”, five annual payments of $0.11 per pound of quota are to be paid over the period 2002 to 2006. Quota owners can opt “to take the outstanding payment due to them in a lump sum”. It is not clear why anyone would opt for five annual payments, rather than a single up-front payment of the same cash sum, unless there are tax advantages in so doing. Nor is it clear why the scheme is referred to as a ‘buy-out’, rather than a compensation package, as the legislation abolishes quota. Nonetheless, the scheme has marked similarities to the bond scheme outlined in earlier sections of this report.

Mexico: PROCAMPO

PROCAMPO (Programa de Apoyos Directos al Campo) dates back to 1994, and the entry of Mexico into NAFTA (the North American Free Trade Area).[20] It is a 15-year adjustment package to compensate for the removal of price support that is due to expire in 2008. It is paid on a flat-rate per hectare basis on eligible land: i.e. land on which seven arable crops (maize, wheat, cotton, soybeans or rice) were grown between the winter crop 1990-91 and the summer crop 1993. Barley and safflower were added later. Farmers make an annual claim, on their historic planting of both their winter and summer crops, with a slightly higher payment for the summer base area (see Table VI.2), “on the condition that the land continues to be used for agricultural activities or for an environmental programme” (WTO, 2002b: 86).[21] Table VI.2 does show some (small) annual variation in the area covered, and in the number of recipients, which suggests that entitlement is not automatically carried forward from one year to the next.

Because payments are linked to area cultivated in the base period, small producers who produce for home consumption rather than the market are beneficiaries. Further, Baffes and de Gorter (2004: 5.14) report that the minimum payment is for one hectare, even on farms smaller than this. Thus the policy is also

[20] This section is derived in the main from WTO (2002b), Sadoulet *et al.* (2001: 1045), Zahniser & Coyle (2004: 7), and Baffes & de Gorter (2004: 5.14).

[21] Baffes & de Gorter (2004: 5.14) however refer to a government turnaround, ‘requiring that land be allocated to eligible crops after initially delinking payments from the current use of land’. Zahniser and Coyle (2004: 7) report the same level of payments for summer 2004, and winter 2004/05, but higher payment rates for producers with less than 5 hectares.

one of income support. In 2000 PROCAMPO accounted for 42% of total federal public expenditure on the agricultural sector (WTO, 2002b: 89).

Table VI.2: Direct payments under the PROCAMPO programme, 1996-2001

	1996	1997	1998	1999	2000	2001*
Total payments (million pesos)	6,793	7,533	8,492	9,372	10,379	11,752
Rate of payments (pesos per hectare)						
Autumn-winter	440	484	556	626	708	778
Spring-summer	484	556	626	708	778	829
Benefiting area (thousand hectares)	14,305	13,885	13,869	13,528	13,571	14,000
Benefiting producers (thousand)	2,987	2,850	2,780	2,724	2,681	2,800

* Provisional figures.
Source: WTO (2002b: 86). Original source cited as: Poder Ejecutivo Federal, *Primer Informe de Gobierno*.

Australia

Australia, a leading member of the Cairns Group of free trading nations, has for many years canvassed that the EU, the US, and others (e.g. Japan) should make their internal markets for agricultural produce more accessible to competition from non-member states, and avoid the distortion of world market prices resulting from the payment of export subsidies. In the Uruguay and Doha Round negotiations it has advocated trade liberalisation, a decoupling of domestic policies, and more vigorous policing of green box policies to ensure that they are minimally trade distorting.

Deregulation of much of the Australian national economy has occurred over the last three decades, sweeping away restrictive practices and cartels. While this process has achieved the desired objective of making the Australian economy more competitive on a worldwide scale, it has also had a considerable effect on Australian agriculture, most recently on the dairy industry. Dairy farming was fully deregulated throughout Australia from 1 July 2000 although most states had taken steps individually to partially deregulate their own milk markets during the 1990s. In anticipation of falling farm incomes for dairy farmers in the wake of deregulation of the market, the Commonwealth Dairy Structural Adjustment Package (DSAP) was set-up to offset –if only in part– the lower farm gate prices expected in 2000 and 2001 (Smith, 2001). Interestingly, in its WTO domestic subsidy declarations, Australia lists these payments as amber box support (WTO, 2004a: Supporting Table DS: 7). Indeed, the entire *Current AMS* that Australia has declared for 2002/03 (see Table VI.3) consists of payments under the Dairy Structural Adjustment Program, and related schemes.

Table VII.3: Domestic Support, Australia, 2002/03

	$A million
AMS Limit	471.86
Amber Box	
–Current AMS	212.77
–de minimis	20.21
Green Box	
–para 2, general services	1,001.16
–para 6, decoupled income support	12.85
–para 7, income insurance/safety-net	410.00
–para 8, natural disasters	235.11
–para 9, producer retirement	7.31
–para 11, investment aids	8.54
–para 12, environmental programmes	244.28
–para 13, regional assistance	4.84
–other	19.02
*Total**	*1,943.74*
Value of agricultural production	30,998

* we have reproduced their figures, which do not quite match this total
Source: WTO (2004a)

Decoupled income support, under paragraph 6 of Annex 2 of the URAA, accounts for less than one percent of Australia's green box declaration. All of the $A12.85 million expenditure in 2002/03 is listed as *Farm Help (Income Support)*, with the following explanation: 'A short-term *welfare safety net* for low income farmers experiencing financial hardship and who cannot borrow further against their assets. The support is provided while they are deciding their future in the industry' (WTO, 2004a: 12; emphasis added).

VII. THE SINGLE PAYMENT SCHEME (SPS)

The MacSharry & Agenda 2000 Reforms

Until 1992 the CAP could largely be characterised as a ‘high price’ policy: although details differed from sector to sector the main characteristics were taxes on imports, subsidies (‘refunds’) on exports, and intervention buying to maintain domestic market prices. The MacSharry reforms of 1992 (reinforced by the Agenda 2000 reforms agreed in March 1999) represented a major change (Swinbank, 1997 & 2004c). For cereals in particular, support prices were reduced and farmers became entitled to compensation payments (see Table VII.1). These were paid as an area payment (the arable area aid scheme), based upon the average yield in designated regions during the period 1986-87 to 1990-01 (excluding the years with the highest and lowest yields). Thus the payment per hectare was determined by multiplying the level of aid (in euros per tonne) given in the final column of Table VII.1 by the regional yield (for example of 5 tonnes per hectare). The support arrangements for oilseeds were revised to bring them into conformity with these new arrangements for cereals. Claims above a certain size (the area of land on which, at the regional yield, 92 tonnes of cereals could be grown) triggered a set-aside obligation (at a default rate of 15%), but farmers also received arable area aid on set-aside land.

Table VII.1: Support Prices for Cereals following the 1992 and 1999 Reforms

ecu or €/tonne

	Intervention Price (July)	Aid (Basic Amount)
Pre-1992	177.49*	—
1995-96 to 1999-2000	119.19	54.34
2000-01	110.25	58.67†
2001-02 on	101.31	63.00†

* an average buying-in price of 155 ecu per tonne, multiplied by the correcting factor of 1.145109 valid at the time of the 1992 reforms. From April 1984, until February 1995, as a consequence of complications under the green money system, a so-called ‘switch-over mechanism’ applied that meant that a ‘correcting factor’ had to be applied to intervention and other support prices. The system was abolished on 1 February 1995, and all support prices, expressed in ecu, were automatically increased by the correcting factor then in force (Swinbank & Tanner, 1996: 44).
† plus €19 per tonne in Finland and the arctic zones of Sweden.

For beef support prices were also reduced, and farmers received compensation in the form of enhanced payments on each eligible animal kept (e.g. a suckler cow premium, and the beef special premium). These headage payments (and those already in place for sheep and goats) were limited in one or more ways: maximum stocking limits, claims per farm, entitlement quotas, and/or regional maxima. Both arable area payments, and the complex array of livestock payments, were claimed and validated through the Integrated Administration and Control System (IACS).

The MacSharry reforms partially decoupled support, in that support prices had been reduced, but crops still had to be grown (or land set-aside), and animals kept, for the payments to be claimed, thus keeping marginal land in cereal production, and encouraging farmers to keep more livestock. Because both arable area aids and headage payments formed part of production limiting programmes (e.g. set-aside for crops, and limits on payment entitlements for livestock), the EU was able to claim these were *bona fide* blue box schemes in the WTO. However, with the switch from consumer to taxpayer support, by 2000 the EU's budget for CAP price and income support was dominated by spending on direct payments (which also included other sectors such as tobacco and olive oil), as can be seen from Table VII.2.

Table VII.2: EAGGF Expenditure, 2000

row:		€m	%
1	Price support	10,761.2	25.7
2	Direct Aids	25,529.2	61.0
3 = 1 + 2	Pillar 1	36,290.4	86.7
4	Pillar 2	4,176.4	10.0
5 = 3 + 4	EAGGF Guarantee	40,466.7	96.7
6	EAGGF Guidance	1,387.3	3.3
7 = 5 + 6	Total	41,854.0	100.0

Source: Tables 3.4.1 and 3.4.2 from DG Agriculture's web site. Some rounding errors. Agenda 2000 introduced the terminology Pillars 1 and 2. Pillar 1 relates to CAP measures to support farm incomes, whilst rural development was labelled the second pillar of the CAP.

It had originally been claimed that Agenda 2000, agreed in Berlin in March 1999, would prepare the EU for Eastern Enlargement, but most analysts are agreed that the outcome –in terms of CAP reform– was limited (see for example Ackrill, 2000). It designated rural development as the second pillar of the CAP. For cereals and beef the

MacSharry reforms were deepened; and Member States were authorised to introduce cross-compliance (under which payment entitlement could be made conditional on the respect of specified environmental or other standards) and modulation (a levy of up to 20% of the area and headage payments, to be retained by the Member State for increased spending on second pillar (also referred to as Pillar 2) activities). A reform plan was agreed for milk, to apply from 2005, but in the event these arrangements were supplanted by the Fischler reforms of 2003. The planning horizon was 2000 to 2006, but the package did make provision for a mid-term review (MTR) of the CAP in 2002/03.

SPS as proposed, July 2002/January 2003

The Commission submitted its MTR in July 2002 (Commission, 2002).[22] It proposed a "set of substantial adjustments" to the CAP to achieve: i) enhanced competitiveness of EU agriculture, ii) promotion of a market oriented sustainable agriculture, and iii) a strengthening of rural development (pp. 2-3). A key part of the strategy was the Commission's plan to establish a "farm income payment". This would be "based on historical payments", giving farms "complete farming flexibility increasing market orientation". However, payments would be "conditional on compliance with statutory environmental, food safety, and animal welfare standards (Cross compliance)" (p. 19).

In particular the new scheme would replace the area payments for oilseeds and cereals as well as the aid for starch potatoes, headage payments for beef and sheep, and –on implementation of the Agenda 2000 dairy reforms– the dairy premium (p. 19). Some crop-specific payments would remain. The *payment entitlement* would be established "at the farm level", with entitlement expressed as €*x* per hectare on *y* entitlement hectares ("It is proposed to divide the overall amount of the payment by the number of eligible hectares of the farm concerned"). This would facilitate transfer "when only part of a farm is sold or leased" (p. 20).

Decoupling would "allow farmers … to focus on products that give them the best return from the market … improve … the efficiency of transfers to farmers … and should help them improve their income situation" (p. 26). In addition, it would

[22] In this report we do not intend to analyse the genesis of the Commission's proposals, or outline the debates about the need for CAP reform that both preceded and followed the publication of this document. But see Cunha (2004).

"provide a major advantage within the WTO, since the Green Box compatibility of the scheme will help secure these payments in an international context" (p. 19).

The Commission's formal proposals, now subtitled *A Long-term Policy Perspective for Sustainable Agriculture*, were released in January 2003 (Commission, 2003a). Although the language had changed somewhat –reference was now made to a *single farm payment* (p. 9), Article 1 of the draft regulation referred to "an income support for farmers (hereinafter referred to as the 'single payment scheme')" (p. 20), and Title III of the draft regulation was headed 'Single Payment Scheme' (p. 30)– the basic idea of decoupling area and headage payments remained. Entitlement would be based on a reference amount received in the period 2000 to 2002, "calculated by dividing the reference amount by the number of hectares … which gave rise to this amount (including forage area) in the reference years" (p. 9).

Subsequently, annual claims for payment had to match entitlement hectares with *eligible hectares*. Thus if a farmer had an entitlement to claim on *y* hectares, s/he must have access to *y* (or more) eligible hectares to claim the single farm payment in full. An eligible hectare could be "any agricultural area of the holding" except "area under permanent crops, forests and area used for non-agricultural purposes on 31 December 2002." If entitlement "had not been used in a period of a maximum of 5 years" it would be forfeit. Transfers of entitlement, "with or without land, between farmers in the same Member State", would be permitted (p. 10).

Farmers could use their land for "any agricultural activity except permanent crops"; but: i) cross-compliance would apply ("to statutory European standards" covering the environment, food safety, animal health and welfare, and occupational safety); ii) "in order to avoid land abandonment" recipients would "be obliged to maintain all agricultural land in good agricultural condition"; and iii) the 10% set-aside requirement would be carried forward into the new regime for former claimants of arable area payments (p. 10).

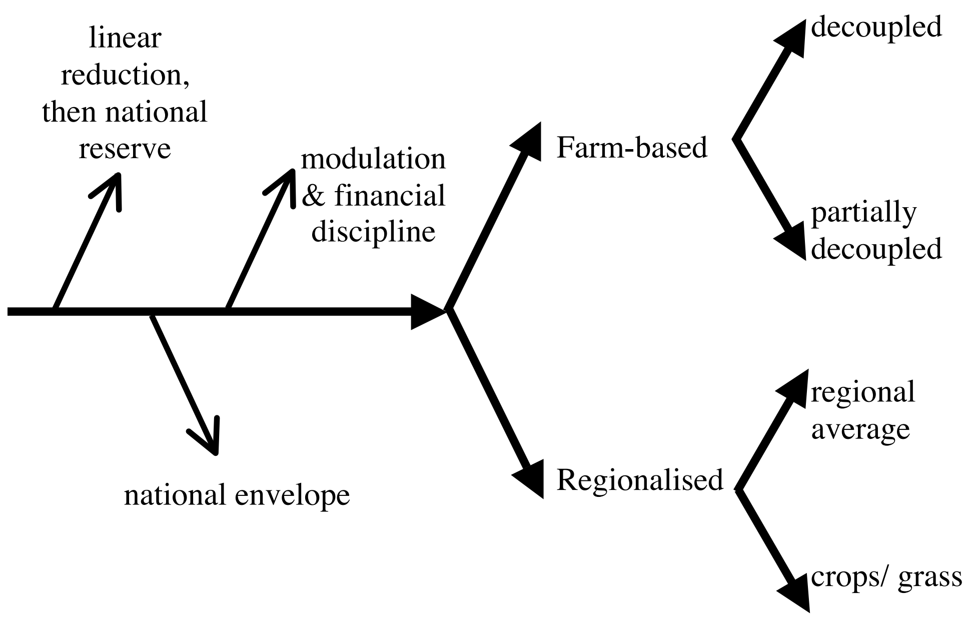
Article 58 of the draft regulation also provided for *regional implementation*. This would allow Member States, "in duly justified cases," to calculate the entitlement per hectare by reference not to the farm's historic payments, but instead to the regional average (p. 37).

Additional crop specific payments would be retained for durum wheat, protein crops (peas, field beans and sweet lupins), rice, nuts, potato starch and energy crops (pp. 37-42).

Overview of the SPS as agreed in June 2003

Political agreement on the package of Fischler reforms was reached in June 2003, and put into legal effect by Regulation 1782/2003 in September 2003 (Council 2003).[23] This introduced a number of important options that Member States could choose to pursue, and that had to be decided by 1 August 2004 (subsequently extended to 2005 for countries implementing the SPS in 2006 or 2007). Here we outline the basic scope of the arrangements (many were outlined in the January 2003 proposals, even if not reported above). Figure VII.1 is a schematic overview of the SPS scheme, which will inform the discussion that follows.

Figure VII.1: An overview of the Single Payment Scheme



NB: upward moving arrows depict the default position; downward moving arrows depict options.

[23] In addition the Commission has issued several implementing regulations.

The regulation does three things. First, it establishes common rules on modulation, cross-compliance, etc., for all "income support schemes" listed in Annex I. This does not only apply to the area and headage payments associated with the MacSharry reforms, but also, for example, the area aid on dried grapes, the aid to encourage the rearing of silkworms, tobacco premia, etc. Second, it establishes "an income support for farmers", the *single payment scheme* (SPS), which largely replaces area and headage payments, and which is the main focus of this discussion.[24] Third, it provides for the continuation of product-specific aid schemes, and establishes new schemes for nuts and energy crops (Article 1).

The new SPS system comes into force on 1 January 2005, though Member States can opt to delay application until 2006 or 2007 (Article 71). The new dairy premium becomes part of the SPS from 2007, but Member States can opt to include it, "in part or in full", in the regionalised SPS from 2005 (Article 62).

The regulation defines both a *farmer* and *agricultural activity* (Article 1). A 'farmer' is "a natural or legal person, or a group of natural or legal persons, who exercises an agricultural activity," whilst an "'agricultural activity' means the production, rearing or growing of agricultural products including harvesting, milking, breeding animals and keeping animals for farming purposes, <u>or maintaining the land in good agricultural and environmental condition</u>" as specified in the regulation (emphasis added). Thus SPS recipients are farmers, even if they choose not to produce crops or keep livestock.

National Ceilings

The basic premise remains that the SPS scheme is based on claims under the old IACS scheme in the reference period 2000 to 2002 (and milk quota on 31 March 2005 or 2007, as appropriate). This has been aggregated up to give *national ceilings*, expressed in euros, for each Member State (these are listed in Annex VIII of the regulation). This is relevant in two ways. First, if a Member State opts for *regional*

[24] English Nature (2004: 132) claims that the regulation does not explain what the single farm payment is for. It goes on to suggest that it is "best defined by what it is not: –it is not a social or an income payment since most money goes to the richest recipients; –it is not an environmental payment as it is not linked to the delivery of environmental goods; –it is not a support for food production since it is fully decoupled; and –it is not a compensation for change in a policy regime since it is not time limited or degressive."

implementation, the national ceiling is to be allocated between the regions "according to objective criteria" (Article 58).

Linear Reductions

Second, under the farm-based, or historic, approach, if the sum of the individual SPS allocations (*reference amounts*) threatens to exceed the national ceiling, then the Member State resorts to "a linear percentage reduction of the reference amounts in order to ensure respect of its ceiling" (Article 41). This could arise as a result of farm sales in the reference period. If farmer *A* sold the business to farmer *B* at the end of the year 2000, farmer *A*'s entitlement would be based on 1/3rd of his year 2000 IACS claims (though he would have to acquire 'naked' land, i.e. land which was not otherwise claiming an SPS payment, to exercise this entitlement), whereas farmer *B*'s allocation would "be based on the payments he was granted in the calendar year or years during which he exercised the agricultural activity" (Article 37). Thus, if farmer *A* had claimed 100 hectares of arable area payments in 2000, whilst farmer *B* claimed on the same land in 2001 and 2002, the subsequent SPS allocation would be based on 33.3 hectares to *A*, and 100 hectares to *B*.

It would also arise in *hardship* cases. Where production had been unusually depressed in one of the reference years as a result of *force majeure* (e.g. death or incapacity of the farmer, animal disease, etc.), or because of agri-environmental commitments under EU regulations, a more favourable reference period can be used to determine the SPS allocation (Article 40).

National Reserve

In addition to the linear reductions necessary to ensure that the national ceiling is respected, Member States are also expected to create a *national reserve*. In the first instance this is to be achieved through a further linear percentage reduction of SPS allocations, not exceeding 3%. One use of the national reserve would be allocation of SPS entitlements to farmers who took up farming after 31 December 2002 (or in 2002, but without receiving IACS payments in 2002) (Article 42).

National Envelope (Article 69)

Article 69, headed *Optional implementation for specific types of farming*, has been dubbed the 'national envelope'. This allows the Member State, on a sector basis, to "retain" up to 10% of the SPS allocation for that sector (in the Member State's national ceiling) and divert these funds to make additional payments to farmers within the sector. These additional payments are to be granted for "specific types of farming which are important for the protection or enhancement of the environment or for improving the quality and marketing of agricultural products". The sectors, specified in Annex VI, are: arable crops; potato starch; grain legumes; rice; seeds; beef and veal; milk and dairy products; and sheep and goats. In effect, if used, this provision re-couples 10% of the direct payment.

Modulation and the Financial Discipline

The regulation introduces an EU-wide system of modulation (Article 10).[25] In effect, the first €5k of a claimant's claim is exempt from modulation, but the arrangements are complex (Article 12). Thus payments in excess of €5k will be reduced by 3% in 2005, by 4% in 2006, and by 5% over the period 2006 to 2012. Funds are diverted to Pillar 2 activities, but Member States retain at least 80% (90% in Germany) of modulated funds in their own territory.

In addition, national modulation remains in force. The fifth introductory paragraph of the Regulation reads: "Until 2005, Member States may continue to apply the current modulation on an optional basis under Council Regulation (EC) No 1259/1999 of 17 May 1999 establishing common rules for direct support schemes under the common agricultural policy". Detailed rules were published in September 2004 (Commission, 2004b). It explains that "The Member States concerned should … be allowed to apply optional modulation after 31 December 2004, in so far as this is necessary to cover the financial needs arising from accompanying measures approved before 1 January 2006" (Whereas, (2)). The maximum rate, of EU and national, modulation is 20% (Article 1(2)). In July 2004 the Secretary of State announced that in England the combined modulation rate (i.e. compulsory EU level and additional

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[25] In this text we do not outline the development of the concept from the Commission's MTR document of July 2002 to the Council decision of July 2003. The French Overseas Departments, the Azores and Madeira, and the Canary and Aegean Islands, are exempt.

national rate) would be 5% in 2005 and 10% in 2006, with the level in 2007 to be decided (Beckett, 2004). This will fund the Government's sustainable food and farming proposals, and specifically the introduction of a new entry level agri-environment scheme." Jones (2004: 95) is not alone in suggesting that, to fund these schemes, the UK national modulation rate will have to be set at 10%, in addition to the EU rate of 5%.

If, from the 2007 budget on, expenditure on Pillar 1 activities (price and income support, including SPS payments) threatens to exceed the annual budget ceilings, *less €300 million*, then Article 11 determining the *financial mechanism* will apply. An "adjustment" to direct payments will be made, to ensure this budget limit is respected. The Council, on a Commission proposal, "shall fix these adjustments." Whether the Council will be willing to do so remains to be seen. Various estimates are in circulation of the additional costs of enlargement, reform of the sugar regime, exchange rate movements, etc., that could trigger these provisions. For example Jones (2004: 93) has suggested *minimum* rates of financial discipline cuts ranging from 1.7% in 2008 to 4.5% in 2013.

Historic, Regionalised, Hybrid and Dynamic Hybrids

As previously indicated, the default SPS scheme is for a farmer's entitlement to be based on that farmer's previous IACS payments (referred to here as the *historic* approach). However, Member States can choose to invoke Article 58 for *regional implementation*, and then apply the SPS at a flat –per hectare– rate within the region (Article 59). As Defra (2004a: 101) explained: "At its simplest, this involves dividing the pot of money available to England ('the regional ceiling') by the total area farmed in the first year of the scheme, 2005, to create a uniform flat rate payment to all eligible farmers in England". However, more complex arrangements are possible: e.g. pooling all the arable funds to give an arable area payment, and all the livestock funds to produce a grassland payment.

Mixed, or *hybrid*, schemes are also possible which combine elements of the historic and regionalised schemes; and if the elements change over time these schemes are referred to as *dynamic hybrids*.

Partial Decoupling

Member States can exclude the production aid for seeds, and –in Finland, and in Sweden north of the 62nd Parallel– the supplementary area aid reflecting higher drying costs, from the SPS. Similarly, all payments in the French Overseas Departments, the Azores and Madeira, and the Canary and Aegean Islands, can be excluded from the SPS (Article 70). If Member States take up these options, then product-specific aids remain in force.

Articles 66 to 68 allow Member States to keep some part of the area and headage payment linked to production. Table VII.3 summarises the arrangements. In all these instances (of complete or partial opt-outs from decoupling), the provisions of the old regime are carried forward into the new.

Table VII.3: Options for Partial Decoupling in Articles 66 to 68

Sector:	**Coupled to production:**
Arable crops (area payments) (excludes rice, seeds, potato starch and grain legumes)	*Either*: up to 25%, except the payment for compulsory set-aside; *Or*: up to 40% of the durum wheat supplement.
Sheep and goats	Up to 50%.
Beef and veal	Up to 100% of the calf slaughter premium; *AND*, *Either*: up to 100% of the suckler cow premium and up to 40% of the slaughter premium for adult animals; *Or*: up to 100% of the slaughter premium for adult animals; *Or*: up to 75% of the beef special premium.

Other Aid Schemes

In addition, throughout the EU, product-specific aid schemes continue. Thus, although the durum wheat area aid has been subsumed into the SPS, there is a new quality premium for durum wheat of €40 per hectare, on a smaller base area than before (Articles 72 to 75). Similarly, a protein supplement (Articles 76 to 78) and a rice payment (Articles 79 to 82) are retained, even though the bulk of the compensation package has been bundled into the SPS; and an aid for farmers producing potatoes for the manufacture of potato starch (e.g. at €66.32 per tonne of potato starch from 2005 on) is retained (Articles 93 to 94). New area payments for nuts (Articles 83 to 87) and energy crops (Articles 88 to 92) are introduced, again with maximum guaranteed areas laid down. The dairy premium, introduced in 2004, also falls in this category, until included in the SPS (Articles 95 to 97).

Set-aside

The set-aside obligation of the old arable area payments scheme is carried forward into the new scheme. Thus, under the *historic* option, a farmer would receive two SPS entitlements: a number of entitlement hectares based on his former IACS claims net of compulsory set-aside, and a number of *set-aside entitlement* hectares corresponding to the three-year average of compulsory set-aside (Article 53). To claim against the set-aside entitlement, land must be set-aside (Article 54). Furthermore, this set-aside obligation must be met before the remaining SPS entitlement can be claimed ("set aside shall be claimed before any other entitlement": Article 54(6)). Land that was permanently set-aside, including forestry, under earlier schemes fulfils this requirement (Article 54(2). Where an entire holding is managed as an organic farm, the set-aside requirement is waived (Article 55). Set-aside land can be used "for the provision of materials for manufacture within the Community of products not primarily intended for human or animal consumption, provided that effective control systems are in place" (Article 55). Otherwise it "shall not be used for agricultural purposes and shall not produce any crop for commercial purposes;" but it must be "maintained in good agricultural and environmental condition;" and it may be rotated (Article 56).

When Member States opt for regionalised payments for the old arable area payments scheme, a set-aside requirement is also carried forward. The aggregate amount for the region is set at 10% of the regional land area on which arable crop area payments were claimed in the old scheme. These set-aside entitlements are then allocated to claimants under the regionalised scheme on a proportionate basis (Article 63). If the new scheme simply covers the old arable area payments, and land use and areas remain unchanged, this will mean the 10% carries through into the new scheme. If, however, the new scheme pools both arable and livestock payments, then non-arable farmers could find themselves allocated set-aside entitlements, which have to be exercised before the rest of the SPS entitlement can be claimed. However, 'small' claimants (i.e. those whose overall SPS area claim would be lower than the regional average area needed to grow 92 tonnes of cereals) would not be subject to set-aside (Article 63(2)).

Cross-compliance and Permanent Pasture

Cross-compliance is outlined in Articles 3 to 9 of Regulation 1782/2003. First, farmers in receipt of all direct payments (not just the SPS) must respect the statutory requirements set out in 18 EU directives listed in Annex III, relating to the environment, public animal or plant health, and animal welfare, some from 1 January 2005 and others from 2006 or 2007.

Second, they have to respect the ‘good agricultural and environmental condition’ established under Article 5. This introduces an element of discretion into the Regulation, because it is the responsibility of the Member State to “ensure that all agricultural land, especially land which is no longer used for production purposes, is maintained in good agricultural and environmental condition”; and furthermore to define, “at national or regional level, minimum requirements for good agricultural and environmental condition …, taking into account the specific characteristics of the areas concerned, including soil and climatic condition, existing farming systems, land use, crop rotation, farming practices, and farm structures.” Under the heading “minimum level of maintenance”, for example, the requirement could include “minimum livestock stocking rates or/and appropriate regimes” (Annex IV). Quite how these requirements are to be imposed, and what implications they have for farmers’ costs and the retention of a production requirement to remain qualified for the SPS payment, and how these requirements might differ from one Member State to another, are not easy to determine.

There is then a third requirement. The general rule is that “land which was under permanent pasture at the date provided for the area aid application for 2003 is maintained under permanent pasture”, unless that land is to be afforested (but not for the plantating of Christmas trees). However, under “duly justified circumstances”, a Member State can derogate from this provision “provided that it takes action to prevent any significant decrease in its total permanent pasture area” (Article 5(2)).

If a farmer fails to comply with these requirements then "the total amount of direct payments … shall be reduced or cancelled" (Article 6, emphasis added). In the case of negligence the minimum percentage reduction should not exceed 5% (15% in the case of repeated non-compliance). For "intentional non-compliance" the reduction will be not less than 20%, and "may go as far as total exclusion from one or more aid schemes and apply for one or more calendar years." The Single Payment Scheme would be one aid scheme.

These are potentially serious penalties. Take a farmer who has more entitlement hectares than eligible hectares, and decides to lease-in 'naked' hectares in order to claim his full SPS entitlement. If this rented-in land is not contiguous with, or near to, the main farm, management may be difficult, and the farmer may be jeopardising part of the SPS payment on the whole of his farm.

Eligible Land, and the 10 Month Rule

To make their annual claim for SPS entitlements, farmers must have *eligible hectares* to match their entitlement hectares. These eligible hectares must be "at the farmer's disposal for a period of at least 10-months" within the year of claim (Article 44). Eligible hectares are "any agricultural area of the holdings taken up by arable land and permanent pasture except areas under permanent crops, forests or used for non agricultural activities" (Article 44(2)). However, there is a further restriction on the use of agricultural land. Thus, under the historic scheme, farmers may not claim SPS payments on land used to grow fruit and vegetables, and potatoes other than for the manufacture of potato starch (Article 51).

By contrast, under the regionalised scheme, farmers can grow fruit and vegetables, and potatoes, on SPS land. However, a regional ceiling is then imposed on the total area of these crops that can qualify for SPS payments, which in effect caps an individual claimant's area (Article 60). Thus Member States can devise schemes that allow fruit and vegetable, and potato, growers to claim the regionalised SPS payment, even though they had no IACS payments in the past, but to limit the area on which claims are paid to the farm's past production.

Stacking

There is however a potential derogation to the requirement that farmers must match entitlement hectares with eligible hectares, that the Irish have termed ‘stacking’. Article 49 reads:

> By way of derogation from Articles 36(1) and 44(1), a farmer who has such payment entitlements for which he did not have hectares in the reference period, shall be authorised by the Member State to derogate from the obligation to provide a number of eligible hectares equivalent to the number of entitlements on the condition he maintains at least 50 % of the agricultural activity exercised in the reference period expressed in livestock units (LU).
>
> In case of a transfer of the payment entitlements, the transferee may benefit from this derogation only if all the payment entitlements subject to the derogation are transferred.

In Appendix A3 Kelly explains that this derogation will allow farmers to consolidate, or ‘stack’ their entitlements, and that it will be particularly valuable to farmers who were renting land in the reference period, and who might lose access to that land on the expiry of their lease. The farmer’s overall SPS entitlement will not increase, but it can be claimed against fewer hectares.

‘Landless’ Livestock Producers

Article 48 makes special provision for livestock producers who had no land in the reference period, but nonetheless qualified for SPS payments, or whose land holding was so small that their entitlement was in excess of €5,000 per hectare (e.g. shepherds, or dairy farmers buying-in their feed). In effect they will be entitled to a continuation of payments. However, under regionalised schemes the advantage of this concession will be lost (although we understand that in Denmark payments will continue to ‘landless’ producers).

Transfer of SPS Entitlements

SPS entitlements cannot be transferred between Member States; and a Member State may determine that they cannot be transferred between regions. They can be inherited (by “actual or anticipated inheritance”); but if sold or leased this has to be “to another farmer established within the same Member State.” They can be leased “only if the payment entitlements transferred are accompanied by the transfer of an equivalent number of eligible hectares". They can be sold "with or without land." But a farmer can only sell entitlement without land if he has used at least 80% of his entitlement at least once (although this percentage threshold could be reached by handing back some entitlement to the national reserve). Member States can decide that on sale of entitlement, with or without land, part of the entitlement should revert to the national reserve (Article 46). Any entitlement that has not been used for three years reverts to the national reserve (Article 45). Further restrictions apply to the transfer of entitlement that came from the national reserve (Article 42).

Fischler Reforms II: Olive Oil, Tobacco, Cotton and Hops

It had always been implicit that once the first phase of the Fischler reforms had been agreed, then the direct payments for olive oil, tobacco and cotton producers would be re-examined, and that in due course a reform plan for sugar would be tabled. The tobacco, cotton, olive oil and hop regimes were characterised by direct payments to producers, which –by analogy with phase 1 of the Fischler reforms– could be rolled over into the new SPS within the same budgetary ceiling. Sugar, however, was more problematic in that sugar reform potentially involved the introduction of *new* compensatory payments to EU producers (and preferential suppliers in the ACP (African, Caribbean and Pacific) states?), and hence an increase in the calls on the EU budget. Proposals for the reform of the olive, tobacco, cotton and hops regime were tabled in September 2003 (Commission, 2003b), and after a protracted debate the package was agreed in April 2004 (European Commission, 2004a). A number of Member States directly concerned were rather reluctant to decouple payments.

For hops the area aid is to become part of the SPS from 2005 or 2006, however a maximum of 25% of the payment can remain tied to production and/or paid to producer organisations.

For cotton, 65% of the aid will be rolled into the SPS, with 35% retained as coupled support on a maximum area in Greece, Spain and Portugal.

Olive oil producers with less than 0.3 ha will have their payments completely decoupled from 2006. For holdings above 0.3 ha, a minimum of 60% of the payment entitlement will be fully decoupled in the SPS, whilst the remainder can be retained by Member States "as national envelopes to grant producers of an additional olive grove payment".

For tobacco, decoupling is to be introduced over a four-year transition period beginning in 2006, during which time at least 40% of the premium has to be decoupled in the SPS. However Member States can differentiate between Objective 1, and other, regions. From 2010 "tobacco aid will be completely de-linked from production": 50% will be included in the SPS, and 50% "will be used for restructuring programmes under the rural development policy".

Sugar

The sugar sector is yet to be reformed, and faces considerable pressure in the WTO. The EU's offer in the Doha Round negotiations to eliminate export subsidies, eventually, given a satisfactory outcome overall, and the likelihood it will lose the WTO challenge to its export refund regime for sugar initiated by Brazil, puts added pressure on the EU (*Agra Europe*, 6 August 2004: EP/8). In July 2004 the Commission (2004a) tabled its suggestions for reform of the sugar regime, although it will be some time before these are decided. In essence the Commission has proposed a cut of 33% to the support price and the introduction of "partial compensation in the form of a direct decoupled payment within the CAP budget limits, with the same historical reference period, as used in the 2003 CAP reform (2000-2002). This payment will be integrated into the single farm payment scheme" (p. 3).

In the meantime land sown to sugar-beet is eligible land for the SPS, and can be used to claim either historic or regionalised SPS entitlements.

Implementation of the SPS, EU15

Member States had until August 2004 to notify the Commission of how they intended to implement the SPS. This was extended to 1 August 2005 for those Member states (Finland, France, the Netherlands and Greece) that will not implement the SPS until 2006 (*Agra Europe*, 6 August 2004: EP/7). In Table VII.4 we summarise our understanding of the intended implementation, in EU15, of this uncommon policy within the CAP. In Appendix A we have details of the SPS schemes to be applied in Ireland, Italy, France, Germany and the UK.

The New Member States, and the Single Area Payment Scheme (SAPS)

Accession negotiations were concluded in Copenhagen in December 2002, before the Fischler reforms had been agreed. Quotas, base areas, reference yields, etc., were all agreed in the accession negotiations. On direct payments the deal was that farmers in the newly acceding states would be entitled to payment at 25% of the EU15 rate, rising to 100% of the then applicable EU15 rate in 2013 (European Commission, 2004b: 14; Daugbjerg and Swinbank, 2004). The progression is illustrated in Figure VII.2. In addition, various top-ups are allowed. In particular the new Member States can top-up by a further 30 percentage points, provided the total payment does not exceed that applying in EU15. Again this is illustrated in Figure VII.2. Funding for this must come from national sources, except that in the period 2004 to 2006 EU monies that would otherwise have been used for Pillar 2 spending in the new Member States can be diverted to this purpose. During this transitional period, modulation does not apply.

Although the Fishler reforms were agreed after the Copenhagen summit that settled the accession details (but before accession on 1 May 2004), the phasing-in of the new compensation package for milk will follow the same rhythm. However, in its proposal for the reform of the sugar regime the Commission (2004a: 8) has proposed that "farmers of all Member States" would be "treated in an equal manner": i.e. there would be no phasing-in.

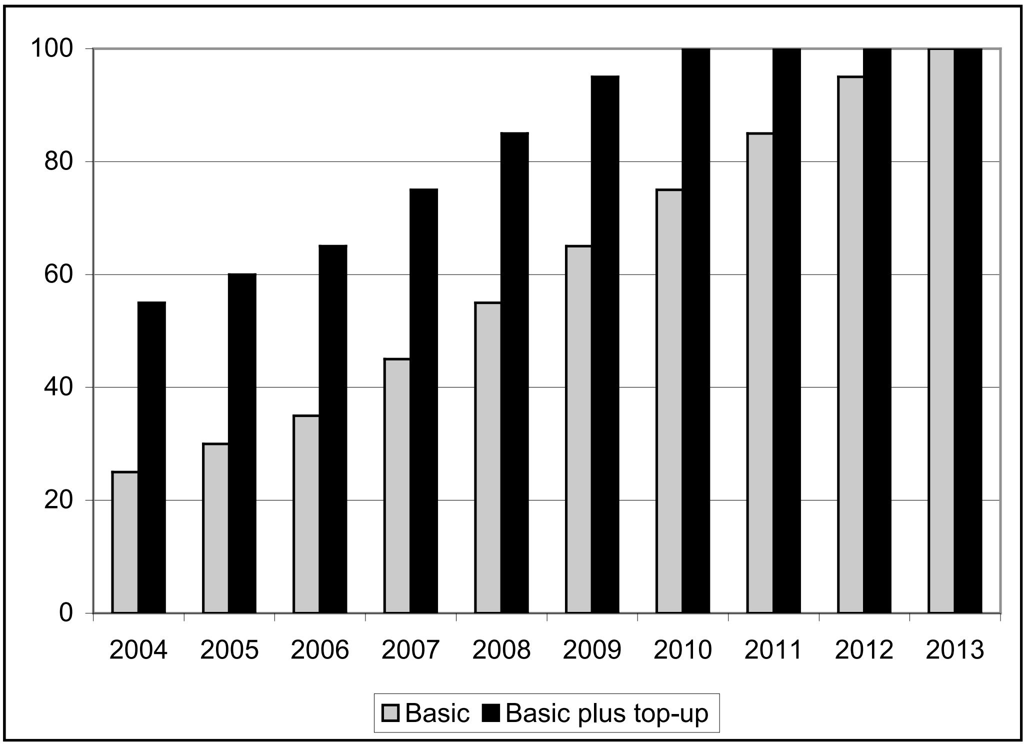
Table VII.4: Implementation of the SPS in EU15

	From	Full or partial?	Milk	Historic or regional?	10% abatement?	Source: AE = Agra Europe
Belgium	2005	Partial: 100% suckler; 40% calf slaughter (Flanders only); seeds		Historic (but two regions)		AE, 6 August 04: EP/7
Denmark	2005	Partial: 75% beef special; 50% sheep		Static hybrid: Denmark one region		AE, 6 August 04: EP/7
Germany	2005	Full; except hops (25%), tobacco until 2009 (60%)	2005	Flat-rate for arable (except dried fodder & 25% of potato starch). Dynamic hybrid for livestock: start off with a grassland payment comprising the slaughter, premium, beef national envelope & 50% of extensification premium. Remainder (dairy, suckler cow, etc) on an historic basis. Shift (from 2010) to fully regional by 2013 with harmonisation of grassland & arable payment in each Länder. Limited redistribution between Länder: max €18/ha		AE, 16 January 04: N/4 *Inside Track*, February 04 AE, 5 March 04: EP/4 AE, 25 June 04: N/1 AE, 6 August 04: EP/7
Greece	2006	Partial: tobacco, cotton, olive oil, 50% sheep & goats, beef slaughter, 40% durum wheat?	?	Historic		AE, 28 May 04: N/3 AE, 6 August 04: EP/7
Spain	2006	Full, except 100% seeds; 100% outer regions		Historic		AE, 5 March 04: N/2 AE, 6 August 04: EP/7
France	2006	Partial: 25% arable, 50% ewe, 40% beef slaughter, 100% suckler cow and calf slaughter, 40% slaughter. Overseas: 100% linked.		Historic		AE, 6 August 04: EP/7
Ireland	2005	Full	From 2005	Historic		AE, 6 August 04: EP/7

	From	Full or partial?	Milk	Historic or regional?	10% abatement?	Source: AE = Agra Europe
Italy	2005	Full (except seeds)	2006		8% arable; 7% beef; 5% sheep	AE, 6 August 2004: N/1
Luxembourg	2005	Full		Static hybrid (one region)		AE, 6 August 04: EP/7
Netherlands	2006	Full; except for beef slaughter premium (40% adult & 100% calf) & 100% linseed. Provisional arrangement for 4 years, after which "further decoupling can be expected"	From 2007	Historic	None	AE, 30 April 04: N/3 AE, 6 August 04: EP/7
Austria	2005	Cereals: full decoupling (except hops: 25%). Livestock: partial. 100% suckler cow, 40% slaughter, 100% calf slaughter coupled		Historic		AE, 24 October 03: N/2 AE, 5 March 04: EP/3 AE, 6 August 04: EP/7
Portugal	2005	Cereals: full decoupling; suckler cow 100%; slaughter 40% (100% calves); sheep & goats 50%; seeds 100%; outer regions 100%			1% for environmental measures	AE, 12 March 04: N/4 AE, 6 August 04: EP/7
Sweden	2005	74.55% special beef	2007: 65% on historic, 35% on regionalised approach	Static hybrid, 5 regions. 40% of slaughter, 75% of beef special, 50% suckler cow, 67.5% dairy on an historic basis (until 2009?, or just beef special?). Otherwise regionalised. All grazing land: €125/ha. 5 arable payment regions.	0.45% for beef	AE, 20 February 04: N/2 AE, 23 April 04: N/2 AE, 6 August 2004: EP/7
Finland	2006	75% beef special; 10% arable?; 100% seed?: 50% sheep?	From 2006	Dynamic hybrid: "about 85%" on a flat-rate basis. Regionalised: 3 yield regions; 25% of beef & 30% of dairy. Farm: 75% of beef & 70% of dairy. Sheep: to be decided.	Beef: 10% abatement	AE, 28 May 04: N/3 AE, 6 August 2004: EP/7

	From	Full or partial?	Milk	Historic or regional?	10% abatement?	Source: **AE = Agra Europe**
UK –England –Scotland –Wales –Northern Ireland	2005	 E: Full. Seed from 2005 S: Full W: Full NI: Full	 E: 2005 S: ? W: 2005 NI: ?	 E: 3 regions (standard, moorland, non-moorland LFAs). Dynamic hybrid: fully regionalised by 2012 (90:10 split in 2005, etc). S: Historic W: Historic NI: 'static hybrid'. Flat-rate made up of 50% beef special, 50% slaughter; 35% of sheep; 80% of the LFA sheep supplement; 20% arable	 E: None S: beef W: ? NI: None	AE, 13 February 04: N1, AE, 6 August 04: EP/7 Note: national modulation

Figure VII.2: Direct Payments in the New Member States as a Percentage of the EU15 Rate



The acceding states had the choice of applying the EU's IACS scheme from the date of accession, or opting for a simplified *Single Area Payment Scheme* (SAPS). Slovenia and Malta opted for the full IACS scheme, whereas the eight will apply SAPS in 2004. The SAPS scheme lasts for three years (extendable to five), after which the regionalised SPS will apply. SAPS is a *simplified* scheme, motivated by the concern that the new Member States would have neither the necessary data nor administrative capacity to implement the old IACS scheme when first they entered the EU (Daugbjerg and Swinbank, 2004). The basic idea is that the new Member State's IACS entitlement (based on the base areas, reference yields, quotas, etc., written into the Accession Treaty) would be paid at a uniform rate per hectare of agricultural land, "calculated by dividing the national financial envelope by the utilised agricultural area" (European Commission, 2004: 16). There are no limitations on the use of the land, except that it must be kept in "good agricultural and environmental condition", and the new cross-compliance conditions in EU15 (and Slovenia and Malta) are optional.

Potential Impact of the Fischler Reforms

It is not our intent in this paper to review the various impact assessments that appeared during the debate on the MTR, or following the June 2003 agreement. However, it is noteworthy that many have shown a relatively modest impact. For example the OCED (2004b), using its Policy Evaluation Model (PEM) –"a comparative static simulation model of the crop and dairy sectors" (p. 16)– under a 'maximum decoupling' scenario, suggested production changes in the cereals/oilseed sector of less than 1% (see Table VII.5).

Table VII.5: OECD's PEM Analysis of the 'Maximum Decoupling' Scenario

% change in:	Area	Yield	Production
Land for crops and dairy	3.2%		
Wheat	–2.2%	1.9%	–0.3%
Coarse grains	–2.5%	1.8%	–0.7%
Oilseeds	–2.8%	1.8%	–0.7%
Rice			–44.6%
Other arable crops	–0.7%		
Dairy area	16.2%		
–stocking density	–14.0%		

Source: OECD (2004b: 24)
NB the beef sector is not explicitly represented in the PEM.

Land Prices and Rents, and Other Asset Values

How all these measures will impact upon land prices and rents, and quota, and be reflected in the price of freely traded SPS entitlement, is unclear.[26] Some issues will be teased out below.

It is generally accepted that agricultural support tends to be capitalised into asset values and that it also affects rents. Where land is the input in limited supply, support tends to be reflected in land prices (the landlord's, rather than the tenant's, asset); but where quota limits supply, and quota is transferable, ownership of quota

[26] Both the CLA (2004) and Defra (2004b: Annex 2) attempt an exploration of the issues involved.

can attract value.[27] Milk quota can be owned by landlord or tenant, whereas (in the UK at least) ewe and suckler cow premium rights are typically held by the tenant.

The support price reductions of the Fischler reforms, together with the decoupling of the dairy premium, will result in a reduction, if not elimination, of the value of milk quota. Decoupling of livestock premia will result in the elimination of any value attached to ewe and suckler cow premium rights. In both instances the capitalisation of CAP support will be transferred to land, and SPS entitlements. For livestock tenant farmers there is a clear danger that value will be transferred from a tenant's asset (the livestock premia rights, and in some instances milk quota) to a landlord's asset (land), potentially eroding their asset base.

In broad terms the decoupling of arable area payments will not affect the overall capitalisation of CAP support, spread across land and SPS entitlements. When Member States adopt the regionalised scheme, however, there will be some reallocation of payments, for instance when additional land becomes eligible for a regionalised arable or grassland payment, and when arable and livestock payments are pooled. Intensive dairy farms, for example, are likely to see their SPS payments diluted if paid on a regionalised, rather than an historic, basis.

In densely populated countries, many factors impact on the value of farmland: the CLA (2004: 46) refers to "development pressure, taxation provisions for land ownership, succession and management; the options for alternative uses; the amenity value of land; and the premium value of farm houses associated with land." Thus, changes in CAP support might not be reflected in the sale value of farmland. However the CLA (2004: 47, footnote 26) does suggest that "IACS registered land has traded at up to 25% above non-registered land" and that "Rents for registered land could be up to even 75% more than unregistered land." Indeed the arable area payment is likely to determine the minimum rent that a landlord would expect to receive for fertile arable land.

How then will SPS support be capitalised into land (particularly rents), a landlord asset, and SPS entitlements, which will be allocated to farmers (be they tenants or owner-occupiers)? We suspect that under most tenancy agreements a tenant

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[27] In addition, other farm assets may change in value, and some of the benefits of CAP support will be captured by input suppliers, purchasers and processors of agricultural raw materials, hired labour, and farm income.

will not be able to sell the SPS entitlement without the landlord’s permission; but on the change of tenancy will the outgoing tenant be able to extract a large capital sum from the incoming tenant for the transfer of SPS entitlements? Existing tenants are unlikely to be able to negotiate rent reductions with their landlords. Incoming tenants will be unlikely to be willing to pay twice for the future SPS payment stream: first by buying the entitlement from the outgoing tenant, and second by paying high rents for land. Although the outcome of these pressures is unclear, the outgoing tenant would seem to be in a weak bargaining position, and it is likely that the ultimate beneficiary will be the landowner (i.e. the value of the SPS payment will continue to be reflected in the rent).

A farmer can farm without having access to SPS entitlements (whereas access to milk quota is still a pre-requisite of milk production whilst quota limits remain binding), but a SPS entitlement can only be exercised if the owner has access to eligible land. Thus there is pressure on an individual with ‘surplus’ SPS entitlement to access ‘naked’ land, or sell surplus SPS entitlement to someone who can use it. As farmland is developed, or redeployed (e.g. as golf courses, or forestry), surplus SPS entitlements will emerge.

Someone who has access to ‘naked’ land does not have to acquire SPS entitlement to farm it; and therefore will only be willing to buy SPS entitlement if it is a better financial investment than other outlets for surplus capital, bearing in mind all the risks associated with the asset (for example, modulation, the financial discipline, other policy changes). Moreover, acquiring additional SPS entitlements could limit a farm’s future use. If no ‘naked’ land is retained, then a future loss of farmland to some other use will mean the farm is left with surplus entitlement.

Furthermore, the number of ‘naked’ hectares is likely to be limited. Under the regionalised scheme it is likely to be very low indeed, if in the first year of the scheme farmers and landowners strive to register *all* available farmland in an attempt to maximise subsidy payments. However, if for some reason farmers and landowners failed to register all eligible land, then some ‘naked’ land could subsequently become available.

Under the historic scheme there will be ‘naked’ land. Eligible land that in the reference period 2000-2002 was used to grow non-IACS crops, or keep non-IACS animals, for example sugar-beet and outdoor pigs, would not attract a SPS entitlement, but could nonetheless be used to claim against a SPS entitlement. The CLA (2004: 54 & 58), quoting estimates from FPDSavills, suggests that 'naked' land is likely to account for between 2 and 5% of the eligible land in England, with getting on for 2% accounted for by sugar-beet. A reform of the sugar regime, under an historic scheme, would presumably lead to the allocation of more entitlement hectares to former sugar beet growers, thus reducing the 'naked' area.

Some of these likely future influences on the market for SPS entitlement are outlined in Table VII.6. From this analysis we conclude that the demand for SPS entitlements is likely to be weak, whereas there may be an ongoing (potential) supply of entitlements over time as land is lost to agriculture. The consequence is that the price of SPS entitlement is likely to be low, and more so under a regionalised rather than an historic scheme.

Table VII.6: Factors Influencing the Market for SPS Entitlements

Supply side:	***Demand side:***
Entitlements can only be used by matching eligible farmed hectares against entitlement hectares. If not used for 3 years, then forfeited to the national reserve. However, entitlement can only be sold without land if at least 80% of it has been used at least once, fuelling the demand for 'naked' hectares.	SPS Entitlements are not a pre-requisite to farm. Demand for entitlement is driven by financial investment considerations.
Land moving out of agriculture into other uses (e.g. housing, roads, forestry, etc.) will mean some farmers have excess entitlements.	Very few 'naked' hectares, particularly under regionalised schemes.
Under the historic scheme, farmers who gave up land in the reference period (2000-02) will be allocated entitlement even though they may no longer have eligible land. Although there is scaling back, to ensure the national ceiling is respected, this is in financial terms (euros per hectare) rather than entitlement hectares.	
Creation of new entitlements, for new entrants, from the national reserve.	

The impact on the land market is however likely to be the exact opposite of the entitlements market. If the future SPS income stream is not reflected in the sale price of SPS entitlements, then it will probably be reflected in the return to land (particularly rents). Thus landowners, rather than tenant farmers, will be the long-term beneficiaries of the scheme.

In modelling terms, land will have a high value in agricultural, as opposed to its non-agricultural use, reflecting the fact that the SPS payment is conditional upon farming activity. However, *within* the agricultural sector the opportunity cost of land in alternative agricultural uses will be low, reflecting the fact that the SPS payment pays the rent and –under full decoupling– it is not dependent upon any particular crop.

Additional complications are ‘stacking’, as applied in Ireland, the possibility that Member States may apply a siphon on the sale of entitlement with or without land (Article 46(3)), the cost of cross-compliance across the whole farm (which reduces the net value of the payment), and the fact that some countries (e.g. the UK) seem intent on diverting a large portion of their modulated funds into entry-level environmental schemes that, in theory, could be claimed on all eligible farmland in the country.

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Description of the measures to apply the MTR in France

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1. Introduction

The measures adopted to comply with the application of the Medium Term Review (MTR) in France are consistent with the French government position in the negotiations, which led to the final compromise and the Luxembourg agreement.

In particular, the French government defended the following points:

- Maintenance in part of the former production subsidies for some agricultural activities.
- Linkage of the single payment entitlements (SPE) to "land". Additionally, transfers should be subject to retention to finance a national reserve used to operate a redistribution programme.

France intends to make full use of these two options.

The French government's position reflected concerns regarding the possible abandonment of agriculture in some marginal areas, and the transformation of entitlements into pure financial assets possibly disconnected from any agricultural activity.

The enforcement of the reform is established by two texts:

- Decisions of the Council of Ministers of 18 February 2004, dealing with the choice of the method of decoupling and the type of production to be concerned with partially decoupled payments.
- Decisions introduced at the "Conseil supérieur d'orientation" on 18 May 2004, setting out the management rules of single payment entitlements. Some general guidance was given at that time regarding the conditions to be observed for continued receipt of payments and also giving definition to the good agricultural and environmental

condition in which farm land no longer used for food production would be required to be kept (cross-compliance).

2. Decoupling regime and maintenance of partial decoupling

The general provisions of the decoupling regime as it is to be applied in France are as follows:

- Date of commencement of the single payment system (SPS): 2006.
- No regionalisation*:* The calculation of the unit value of the payment entitlements is based on individual references, and consists in the average of payments received during the reference period.
- Reference period*:* 2000-02 (three harvests).
- The support for arable crops and livestock will remain partly coupled in metropolitan France and fully coupled in the *Départements d'Outre-mer* (oversea territories) within the authorised limits of the Luxembourg agreement.
- In metropolitan France:
    - Arable crops: partial decoupling. 75% of subsidies per hectare are decoupled, 25% are "recoupled".
    - Durum wheat: in traditional areas the premium is to remain partly coupled (25%). The new quality premium is fully coupled. In other areas the premium is to be withdrawn within three years.
    - Dried fodder: if the budget is maintained, it will be redirected to a subsidy paid to processors and producers.
    - Legume crops: the extra-subsidy is to remain coupled and is to become a subsidy per hectare.
    - Starch potatoes: 40% of subsidy is to be decoupled.
    - Rice: the subsidy is to be increased but the price will be decreased and intervention quotas are to be fixed
    - Nuts: a subsidy per hectare is to be introduced in 2004.
    - Livestock:
        - Premium for maintaining suckler cow herds: 100% recoupled
        - Slaughter premium for calves: 100% recoupled
        - Other slaughter premia: 40% recoupled
        - Beef premium: 100% decoupled
        - Sheep and goat premia: 50% recoupled
    - Milk: in accordance with the Luxembourg agreement, the payments made for milk and which will be paid from 2006 onward, are to be fully decoupled.
    - Tobacco: partial decoupling until 2010 and then total decoupling

- Olive oil: 60% of the present subsidy is to be decoupled
- Cotton: 65% of subsidies are to be decoupled
- Hops: The subsidy will be totally decoupled but with an option to partially recouple up to 25%.
- Energy crops: a coupled 'carbon credit' is planned to be introduced in 2004.

	Decoupled (€/(t/ha) or €/head)	Recoupled (€/(t/ha) or €/head)
Arable crop	47.25	15.75
Voluntary set-aside		15.75
Suckler cow premium	0	200
Special male bovine premium: Beef Bull-calf	 150 210	
Bovine slaughter premium	48	32
Additional slaughter premium Eligible suckler heifer Other female > 8 months	 79.79 18	
Calf slaughter premium	0	50
Complément extensif: N° 1 N° 2	 80 40	
Sheep meat	10.5	10.5
Sheep milk, goats	8.4	8.4
Additional ovine premium	3.5	3.5
Supplement for protein plants	?	55.57 €/ha
Durum wheat supplement: Traditional area Non-traditional area	 213.75 €/ha ?	 71.25 €/ha 0
Durum wheat quality premium (TA)	?	40 €/ha
Carbon aid		45 €/ha
Rice aid: Metropolitan France Guyane	 559.98 €/ha 766.02	 411.75 €/ha 563.24 €/ha
"Nuts" aid	?	120.75 €/ha
Starch potatoes aid	44.22 €/t of starch	66.32 €/t of starch
Dried fodder aid: Producers Industries (?)	 ? ?	 0 33 €/t

3. Management of single payment entitlements

During the negotiations and the development of the European regulation on transfer of entitlements published in February 2004, the French authorities insisted that the regulations be so drafted as to be sufficiently flexible to incorporate present French structural policy. It is noted that structural policy in France is often more closely directed by central government than the equivalent policy followed in other less centralised Member States.

Since the *Lois d'Orientation Agricole* (general law governing agriculture) dating from 1960 and 1962, a control by the *Direction Départementales de l'Agriculture* (DDA, departmental agricultural committees) on the settlement of farmers and the enlargement of farms has been established. Such control has been extended to the transfer of milk production quotas. Such transfers were mainly conducted through an administrative process utilising a national reserve, deducting quotas from transfers and redistributing them between farms.

The same logic prevails in the French position on payment entitlements transfers, namely:

- The monitoring and supervision of the market for payment entitlements by the public authorities
- The maintenance of a strong link between entitlements and land. The underlying objective has been to prevent the entitlements becoming pure financial assets disconnected from agricultural activity.
- The establishment of a tax on single payment entitlements transferred out of the agricultural sector to finance a national reserve fund. The reserve fund redistributes 'freed' SPE to existing farmers or to those seeking to become established (settlement).

As mentioned previously, France has chosen an individual historical reference method to calculate the value of single payments for each farm. The total single payment is divided by the reference area (hectares) into single payment entitlements and thereby maintains the link between the single payment and land.

The application of the reform is to be instigated in two transitional stages

- First transitional period: 1 January 2000 – 15 May 2004
    - In the case of a transfer between 2 landowner farmers, the vendor keeps 10% of the reference period SPE with the balance of 90% reverting to the reserve. The buyer gets 100% of SPE at their reference value.

    - In the case of a 6-year lease signed during this period, 50% of the seller's SPE will revert to the reserve plus a further 5% for each additional year up to a maximum of 20%.
    - In the case of a change of tenant, the former tenant keeps his or her SPE unless he or she is discontinuing any farming activity. If the former tenant does not recommence an agricultural activity of at least 80% of the value of the previous operation within 12 months of the date of the transfer, they may not sell their SPE to a third party unless it is accompanied by land of appropriate value. The new tenant will get back the SPE in 2006 by way of distribution from the reserve.

- Second transitional period: 16 May 2004 – 15 May 2006
    - The assignor remains owner of the SPE corresponding to the hectares, which are let. However it is possible to include a clause in the contract of sale or lease specifically including or excluding the transfer of the entitlements.
    - In case of inheritance, merger, scission, modification of status or juridical denomination, SPEs are automatically transferred with the land without first having to pass through the reserve

- Final transfer system: effective from 16 May 2006
    - Creation of a national reserve of single payments entitlements, supplied with a tax on transfers and redistributing entitlements.
    - In the case of sale of payment entitlements <u>without</u> land, 50% of the value of each Payment Entitlement (PE) will revert to the national reserve.
    - In the case of sale of payment entitlements <u>with</u> land, to enlarge a farm that has already reached a 'critical size' (as defined by the Commission Départementale D'orientation Agricole), 10% of the value of PE will revert to the National Reserve (NR).
    - In the case of sale of PE with or without land no retention will be applied to a farmer commencing an agricultural activity, or to a young farmer settled for less than 5 years and who fulfil the main criteria for settlement.
    - Young farmers can benefit from free additional payment entitlements given by the NR to reinforce their settlement. But a father cannot sell his PE without land expecting the NR to provide his son with free PE.
    - In any other case of sale of PE with land, 3% of the PE value will revert to the NR.

- In the case of a change of owner, the assignor owns the SPEs and is exempted of tax if he transfers them directly to the purchasing farmer.
- In case of disability of a tenant, because of decease or illness, the spouse or child who takes over the land is automatically allocated all attaching SPEs.
- Payment entitlements, which have not been used for 3 years, will revert to the national reserve. This time limit is reduced to 1 year for SPEs allocated by the reserve for a period of up to 5 years after their allocation.
- PE can only be transferred within the same "département".

The transitional regimes described above are likely to lead to a situation where demand on the reserve for entitlements will exceed supply. Therefore an initial deduction will be made on SPEs distributed by the Reserve in its favour. The deduction rate will be determined in 2005 after the general overall value of SPE for all farms has been calculated.

4. Conditionality of aids, cross-compliance and modulation

4.1 Legislative background

Conditionality and cross-compliance focus on the articles of European Union directives relating to animal and plant health and welfare, known as the statutory minimum requirements (SMR) and the maintenance of farm land in good agricultural and environmental condition (GAEC). Individual Member States are required to determine appropriate inspection programmes to ensure farmers are complying with the SMR and GAEC conditions.

However the European Commission wants all aspects of SMR and GAEC to be checked and verified and considers that non-compliance with any of the conditions decided upon by the Member State could be made subject to penalty deductions from payments. The reduction of payments in instance of default is extensive within the range of 5% for simple omission to a maximum 20% for deliberate omission. All regulations will become enforceable effective from 1 January 2007.

Examples of EU Directives Rules to be observed and respected are the Nitrates Directive in vulnerable areas, the regulations relating to the use and abuse of pesticides and on water cleanliness and pollution. In addition to these regulations already in force, the additional cross-compliance measures will introduce two new innovations for French farmers namely:

- The obligation for farmers to put 3% of their arable land into grass, for example in strips alongside water courses to protect them from possible fertiliser and/or pesticide contamination;
- An obligation for farmers to have a diversified rotation of crops, including at least three different crops or two families of crops to be grown on agricultural land area other than permanent crops.

4.2 Conditionality of aids and indicators

Moreover the French Ministry of Agriculture intends to distinguish four types of land: cultivated land (arable land, permanent crops etc.), grassland, set-aside land and "non-productive" land. For the latter it will be compulsory to plant species with an environmental interest for the region and to maintain the land in good condition in a similar manner to that to be observed for set-aside land. The DDAs are required to draw-up a schedule of cross-compliance conditions by July 2004.

The Ministry of Agriculture has suggested the following indicators:

- The mapping of areas with at risk from soil erosion;
- A ban on the burning of straw and crop residues;
- The respect of existing cross-compliance rules for irrigated arable areas; and
- A regime of minimal maintenance of land.

It is the intention of the French government to set up an agricultural consultancy service for farmers in 2007.

After the general outcry from agricultural organisations and unions, the French government advised in a note dated 28 July that they had decided to relax the proposed measures regarding the establishment of grass strips and the diversity of crops that are to be permitted to be cultivated within the crop rotation.

The introduction of grass strips totalling a minimum of 3% of the area planted to cereal crops remains a requirement of the regulations and establishment of strips beside watercourses is compulsory. The cultivation of oilseeds, flax, hemp or set-aside is permitted in such grass strips. But if there is no water course(s) on the farm, or if after having introduced grass strips along all watercourses that are present, the 3% minimum area is not achieved, the requirement can be fulfilled without regard to the shape of fields.

In accordance with the note, the shortest field edge boundary must be a minimum of 5m and the total field area must be at least 5 ares (500 m^2). However the ministry propose that grass strips should be located in a relevant manner such as having regard to slope (to avoid soil erosion), on water catchment areas and along permanent elements of landscape (hedges, ponds, thickets, law walls, ditches). Grass strips can be established on plots/fields registered as set-aside, permanent pasture or grassland. Grass strips established beside watercourses can be taken into account to fulfil the 3% requirement, provided their width does not exceed 10m.

The second matter addressed by the note of 28 July concerns the diversity of crop rotation: at least 3 different crops or 2 different crop families must be grown on the agricultural area apart from permanent pastures, non-cultivated set-aside and perennial crops. "Crop families" are small grains, maize, oilseeds, protein crops, potatoes, beetroots, vegetables, rice and temporary grassland. The share dedicated to a crop or a crop family cannot be less than 5%. In case of a single-crop farming system, the soil must be totally covered during winter. The list of authorised intercrops will be advised to farmers at a later date.

A "group for the monitoring of conditionality" met at the French Ministry for Agriculture on the 23 September with the objective of drawing up a draft list of conditionality checkpoints to be applied from 2005 onwards. The checkpoints are to be ranked in order of priority with those that are considered by the CSO as having the highest priority becoming "indicators".

4.3 Modulation

In accordance with Luxembourg agreement, modulation deductions from payments to fund rural development programmes under Pillar 2, will be made at the rate of 3% on SPE in 2005, 4% in 2006 and 5% in 2007. In France, 1% of these amounts will be retained to create a crisis management fund.

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Agra Presse Hebdo: n°2974, 2975

Implementation of decoupling in Germany

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1. Introduction

Final agreement on the Fischler reform was reached in June 2003. Regulation 1782/2003 gives Member states a variety of options for implementation. It is for example allowed to choose between the standard model where the level of future payments is based on the payments each farm received in a base reference period and a regional model where the payment per farm is based on its amount of eligible area. Furthermore it can be decided whether a scheme with a partial- or full decoupling is introduced.

The law concerning the method of implementation to be adopted in Germany completed its legislative process by end of July 2004. The scheme is called 'Combi – model' and combines as a dynamic hybrid elements of both the standard model and the regional model. It was decided to implement full decoupling.

The 'Combi – model' will be introduced in 2005. In the beginning, total farm entitlements consist of a combination of farm individual single payments and area-based entitlements. The farm individual part is based on the historical values of the main share of headage premia and the total of milk premia. The area-based entitlements consist of regionally unified payments for grassland and arable land. Payments for arable land and grassland are harmonised in stages during the period of 2010-2013. Similarly the share of farm individual payments on total entitlements is reduced stepwise. Therefore in its final stage the 'Combi – model' will be a fully regional model.

Objectives, main characteristics and implications of the 'Combi-model' are described in the following pages.

2. Objectives and main characteristics of the 'Combi-model'

The German method of implementation is motivated by several policy objectives. With regards to the Single Farm Payment (SFP) it is argued that:

- The SFP is backward-oriented in compensating income losses due to price reductions by former reforms of CAP. This type of compensation may not be accepted by society in the long term. For example, it could be difficult to convince people that a farmer in 2010 should receive payments derived from headage premia, although he abandoned beef production in 2004.
- Due to the relatively long time span between the reference period (2000-2002) and the introduction of decoupling (2005 or 2007 at the latest) a large number of 'hardship cases' will emerge. The number of hardship cases will be much lower, as eligible areas in the Regional Model are based on 2005 levels.
- Area based payments might be more sustainable if they are more oriented towards societal needs, e.g., landscape protection. It is argued that area based entitlements can be seen as a remuneration for the provision of external goods.

Other objectives are:

- Reduction of imbalances of the existing premia schemes, e.g., at the regional level, between subsidised maize for silage and other roughage fodder crops or grassland, and between rather intensive and extensive systems of land use in favour of the latter.
- Reduction of administration efforts and problems related to hardship cases.
- Improvement of the transparency of premia systems (unified level of entitlements).

The 'Regional Model' will be introduced stepwise as a 'Combi-model' between 2005 and 2013, ending in regionally unified, but inter-regionally differentiated levels of entitlements in 2013. Farmers should have time to adjust to the new framework conditions.

The main principles/elements are:

- Full decoupling from 2005 onwards
- Partial redistribution of direct payments between Länder
- Transformation of direct payments into area based entitlements starting in 2005 with a combination of
  - entitlements determined on a farm individual basis: and
  - area based entitlements related to arable (AL) and grassland (GL)
- The level of entitlements will be adjusted between 2010 and 2013, ending in unified entitlements related to UAA in 2013, differentiated by Länder.

– Entitlements can be activated by providing evidence for corresponding eligible areas only. In this context no distinction is made between arable land and grassland.

These elements (and their modification based on the state of negotiations) are described in the following.

2.1 Regional redistribution of direct payments

Due to a regionally heterogeneous structure of production (farm size, intensity and concentration, especially of beef and dairy production) and resulting differences in the level of premia, Länder with a rather low premium level like Saarland and Brandenburg, called for harmonised premium levels.

Paragraph 3 of the regulation states the total national budget of decoupled payments of 5,468 mill € (in 2006) should be distributed to the Länder on the basis of the factors mentioned in Annex 1 (see Table 1). This will happen in 2005; the remaining volume from the last step of the milk market reform (330 mill €) will be distributed in 2006 related to the regional milk quota on March 31, 2005.

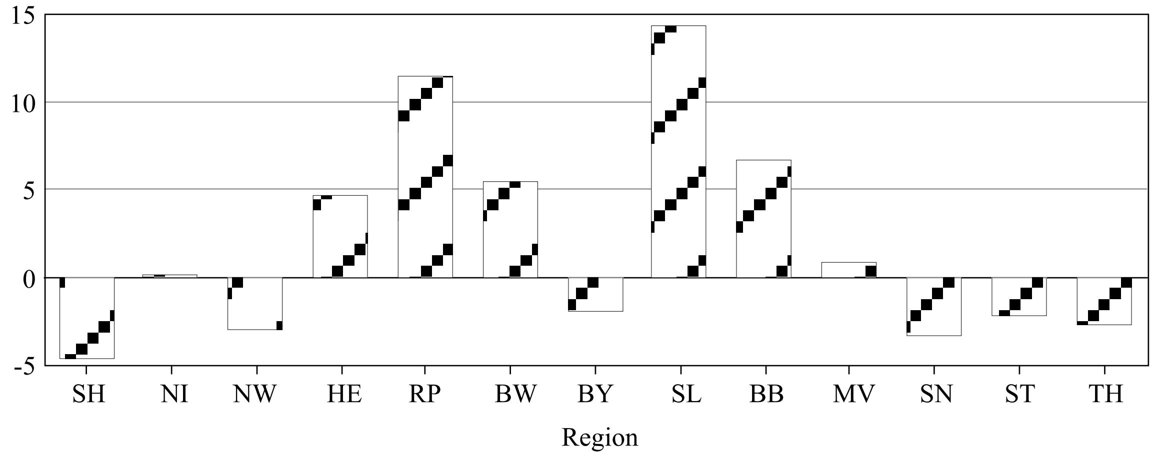
Table 1: Regional share of decoupled payments (5.46 bill €) by Länder

	Share on nat DP %
SH/HH	6.1
NI/HB	15.6
NW	8.8
HE	4.5
RP	3.8
BW	8.4
BY	19.2
SL	0.5
BB/B	8.0
MV	8.1
SN	5.5
ST	7.0
TH	4.7

Based on shares of reg_UAA*0.35 + reg_DP*0.65 on national UAA/DP

The factors mentioned above are derived by multiplying the shares of the Länder on the total eligible area (UAA excluding permanent crops) by 0.35 and on the total of direct payments by 0.65, respectively. The choice of factors is a compromise, allowing that none of the Länder will lose more than 5% of total premia. The main agricultural regions such as Lower Saxony and Bavaria can expect changes of direct payments of +/- 1%, while the Saarland will get 14 % more premia (see Figure 1).

Figure 1: Regional re-distribution of DP by Länder



2.2 Determining the share of area based premia and farm individual premia

From the total of direct payments in 2005, 3930 mill € will be related to land. The rest is based on the main part of headage and milk premia for the reference period 2000 - 2002 and 31 March 2005 respectively. The classification of the different premium elements is shown in Table 2. Entitlements are determined by the following compounds:

– Arable land: premia for arable crops, seed and 75 % of the decoupled share for starch potatoes

– Grassland: 50 % of extensification supplements for beef premia, the national envelopment of beef premia and the slaughter premia for large animals

– Farm individual premium volume: based on special premia for bulls, suckler cows, slaughter premia for calves, milk premia, half of extensification premia, for dry fodder, for sheep and goats and 25 % of potato starch premia.

The regulation gives no details on the calculation scheme of area-based entitlements. Only the share of entitlement level of grassland related to arable land is mentioned in Annex 2 (see Table 3). In fact, the factors are derived by the following procedure.

First, the farm individual part of premia is deduced from the total adjusted premium volume of the Länder. Secondly, the remaining premium volume is divided by the sum of total arable area and grassland weighted by the above mentioned factor.

Table 2: Share of decoupled payments related to Single Payments/area based entitlements

	DP for		Farm individual premia [1)]	Area based entitlements	
1	Beef				
	Special beef premia		100 %		
	Suckler cow premia (SC)		100 %		
	Slaughter premia for calves		100 %		
	Extensification premia		50 %	50 %	
	Other Slaughter premia			100 %	GL_premia
	Supplemts to beef & SC-premia			100 %	
2	Sheep and gaot		100 %		
3	Dry fodder		100 %		
4	Starch potatoes (share decoup.)		25 %	75 %	
5	Milk premia		100 %		
					AL_premia
6	Arable crop premia ...			100 %	
7	Seed			100 %	
8	Hop premia (share decoup.)			100 %	
9	Tabac premia		100 %		
	Total Mio Euro	2006	1518	3930	

1) Based on the reference periode 2000-2002, for milk premia based on quota of 31.03.2005.

Länder can modify the factors for grassland by up to +/- 0.15. An increase of the factor results in higher grassland and lower arable area premia respectively.

Using the farm individual premia, farm specific entitlements are calculated and added to the regionally based entitlements for arable areas (excluding set aside) and grassland forming the total of entitlements of each farm. Although there are different premium levels, no distinctions between arable areas and grassland are made for eligible areas with regard to the trade of entitlements.

2.3 The harmonisation of entitlement levels

The level of each of the three entitlements will be modified based on the calculation scheme shown in Figure 2. The difference of the starting (2006) and the ending value (2013) of entitlements will by multiplied by a degressive factor (Figure 2), and the product added to the ending value. Ending values for arable and grassland are the same, while the ending value for the farm individual part is zero. Figure 3 shows the development of entitlement levels for two farm types, with and without headage or milk premia. The level of entitlements for arable areas and grassland in 2005/6 and for the whole UAA (in 2013) is shown in Figure 4.

Table 3: Relation of entitlements for GL in relation to AL (=1)

	Factor 1)
SH	0.26
NI	0.39
NW	0.39
HE	0.15
RP	0.18
BW	0.18
BY	0.30
SL	0.19
BB	0.25
MV	0.19
SN	0.21
ST	0.16
TH	0.18

1) Derived from the share of non-individual headage premia and grassland area.
Factor can be up- or degraded by Laender by up to 0.15.

Figure 2: Modification of entitlements during 2005/6 and 2013

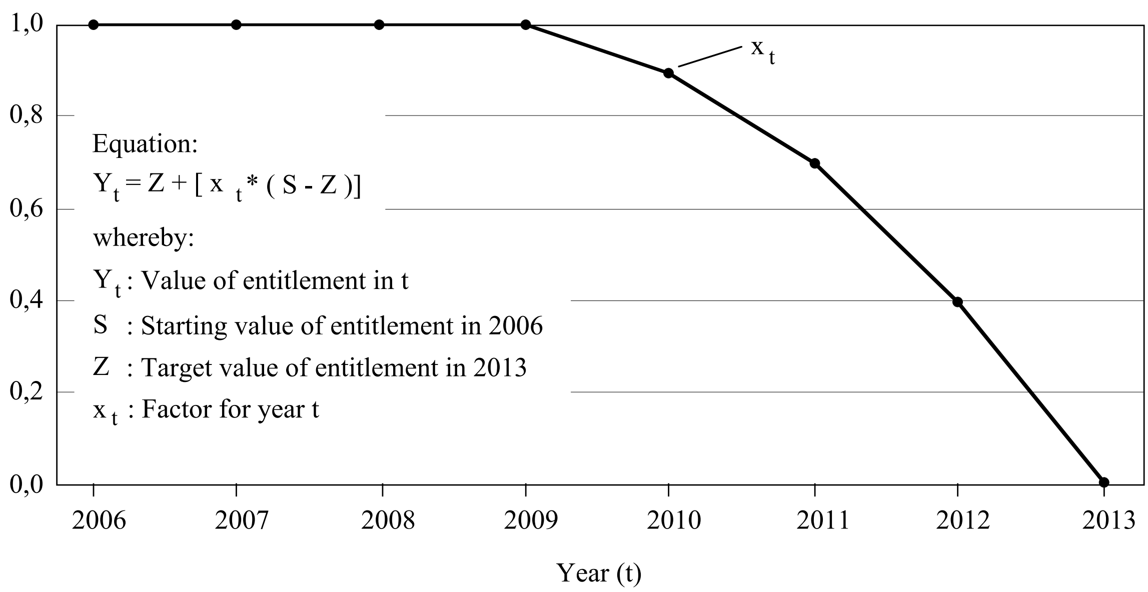


Figure 3: Development of entitlements between 2005/6 and 2013

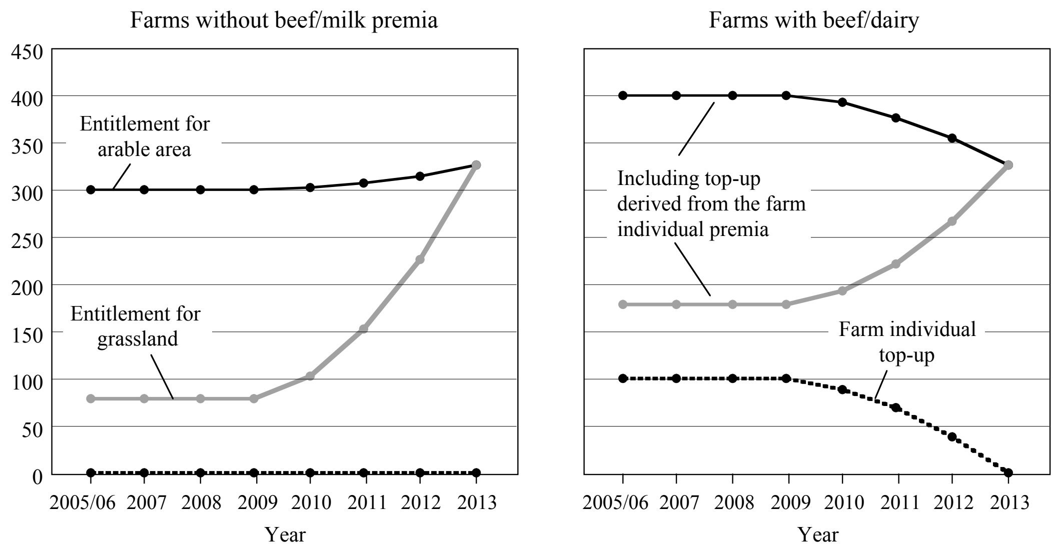
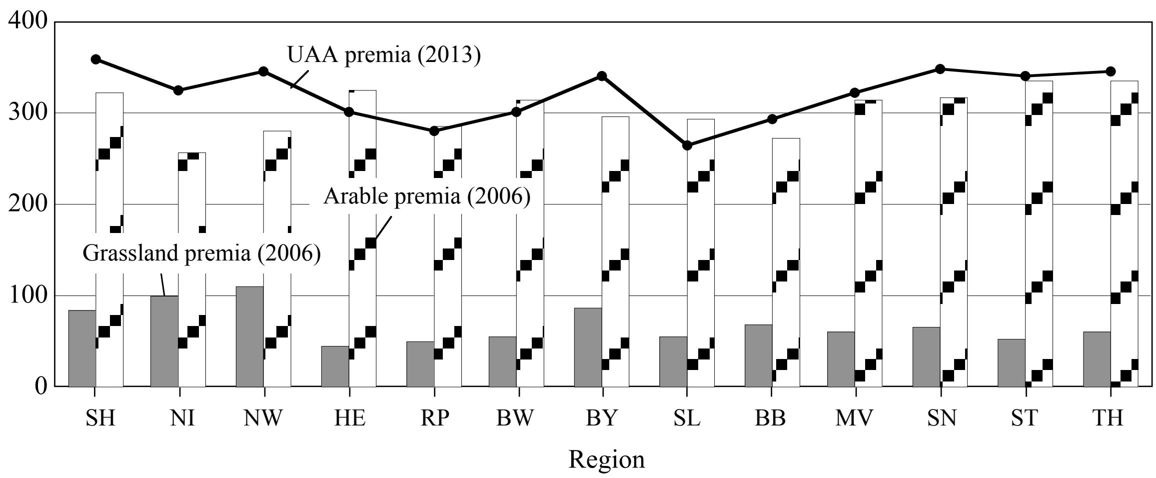


Figure 4: Area based entitlements by Länder



2.4 Comments on the scheme

Despite the simplicity of the scheme there are some problems in addition to the large redistribution effects on income and land values:

– The level of entitlements related to land cannot be determined before the new scheme is implemented. The statistical database is not at all complete for this subject. Therefore, eligible areas will be determined on the total of applications of the scheme in 2005. This means that the level of entitlements cannot be calculated and published until end of 2005. This induces some intransparency with regard to the trade of entitlements.

- The share of farm individual entitlements will become zero after full implementation of the scheme. This is also true for special entitlements (farms without land). Sheep rearing and some large dairy farms in the east of Germany will be affected. This problem could be overcome, if farms are renting/buying land, preferably before 2005 (i.e., *x* hectares, such that the special entitlement divided by *x* hectares equals to 5000€/ha). Nevertheless they will have large premium reductions in 2013 compared to 2005 from, e.g., from 5000 to 300 €/ha.
- Based on the principles of the scheme, no exceptions can be seen for further market reforms, i.e., for sugar, as long as there is no EU-wide obligatory regulation of a partial de-coupling. Direct payments under the market reform for tobacco and hops are still included in the system. The premium volume is redistributed to the entire land area. This will result in an increase of entitlement level in affected regions. In Rheinland-Pfalz, for example, the level of entitlement will rise by about 10 €/ha, while tobacco producers lose hundreds of €/ha of tobacco.

3. Impacts of the 'Combi-model' on the level of direct payments

The German implementation will have large distribution effects, especially in its final stage. Some illustrations are given in the following. In Figure 5, direct payments at the county level, which are projected on the basis of national FADN data, are shown for both the Single Farm Payment and the 'Combi-model'. In the first case, rather high payment levels can be seen in the northwest and the southeast due to a high concentration of beef and milk production in these areas. The 'Combi-model' reduces the variances in premium levels between the regions.

Figure 5: Single payment versus 'Combi-model'

Single payment 2013

Combi-model 2013

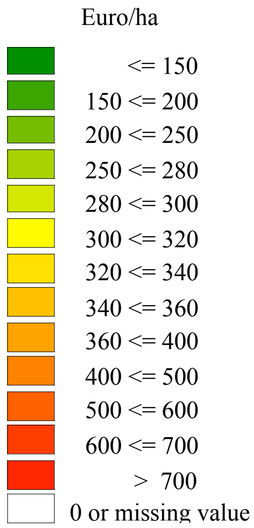
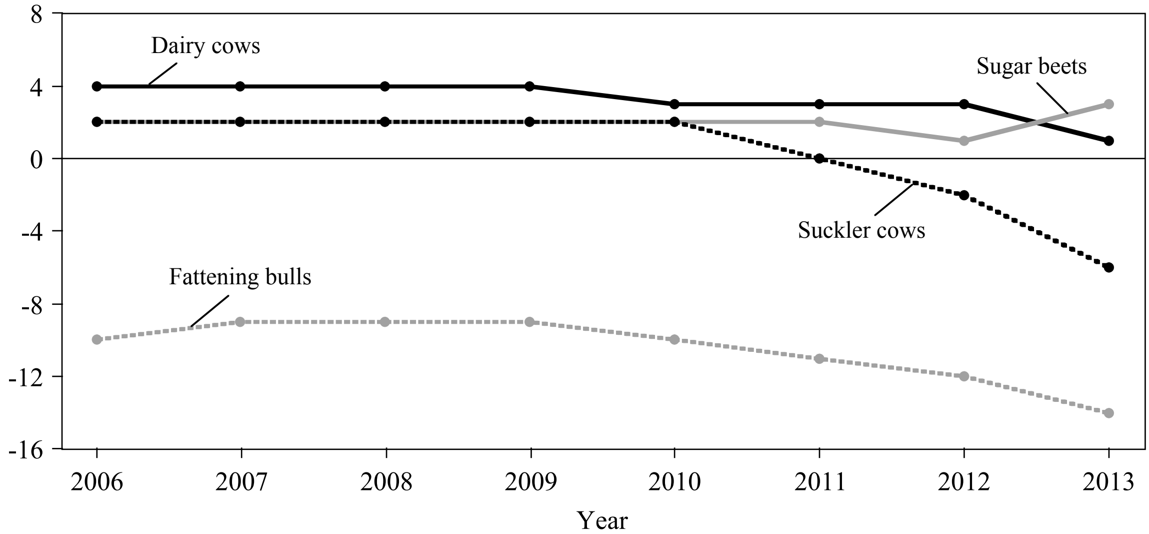


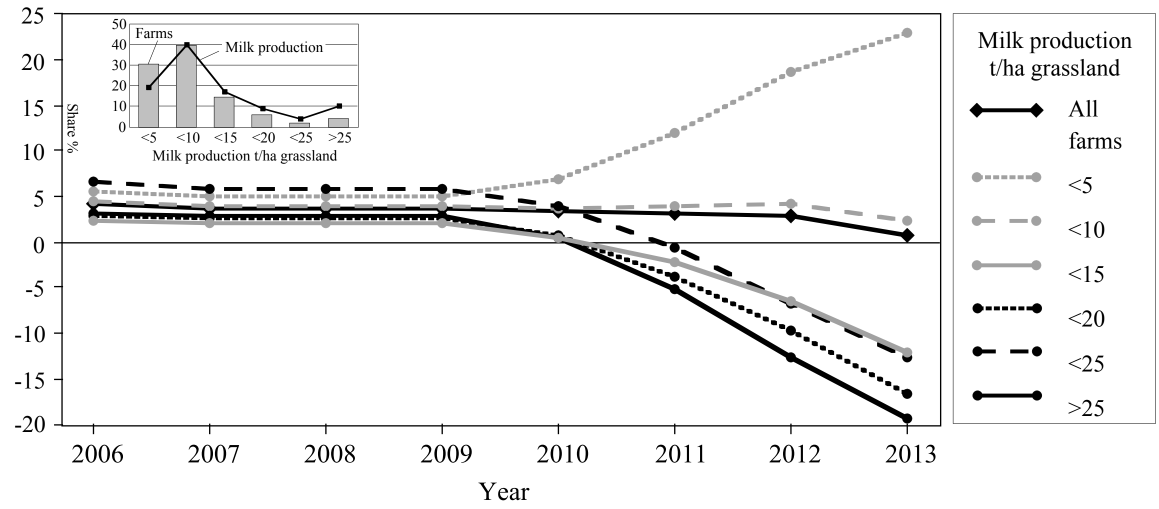
Figure 6 shows, that on average, farms with milk production will profit by around 4% higher premia in the first period. Farms with suckler cows will profit in the first period, while they will lose in the latter periods. Farms with bull finishing will lose about 10% of their premia. On the other hand, farms with sugar beets, which are not yet affected by CAP reforms, will gain, as long as there is no reform of the market regime for sugar.

Figure 6: Change of the level of direct payments induced by the 'Combi-model' for the average of farms with …



Changes of direct payments depend largely on the intensity or concentration of production. Figure 7 shows that dairy farms with a low level of milk production/ha of grassland will gain, while farms with high level of milk production/ha will lose up to 20 % of the total amount of direct payments.

Figure 7: Change of direct payments induced by the 'Combi-model' for farms with dairy cows



4. Conclusions

– Supply effects of 'Combi-model' and SFP do not differ significantly
– Economic impacts of the 'Combi-model':
  - Large redistribution effects of direct payments and farm income by regions, farm types and intensities (intensive beef & dairy farms affected most)
  - Increase of rental values of land especially in less favoured regions and of grassland (□ increasing transmission of direct payments towards landlords)

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Bundesministerium für Verbraucherschutz, Ernährung und Landwirtschaft: Agrarreform konkret - so werden die Reformbeschlüsse in Deutschland umgestezt. http://www.verbraucherministerium.de/index-0002A3407CD31022B9146521C0A8D816.html

Details of how the Single Payment Scheme (SPS) will be applied in Ireland

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June 2004

1. Introduction

At the time of writing, the detailed rules for the SPS in Ireland had not been finalized.

The Agenda 2000 Berlin Agreement of March 1999 set out EU agriculture policy to 2006 subject to a review of its operation in 2003. This Mid-Term Review (MTR) was subsequently brought forward to 2002. As part of the MTR, an initial communication from the Commission to the EU Council of Ministers was published in July 2002 (European Commission, 2002). This was followed by detailed legislative proposals for agriculture policy reform in January 2003 (European Commission, 2003).

On 26 June 2003 Agriculture Ministers from across the European Union (EU) reached a compromise on reform of the Common Agricultural Policy (CAP). The Luxembourg Agreement (Council of the European Union 2003), as it has become known, provides the setting in which farming in the EU will take place over the next decade and beyond. The dominant feature of the Council compromise agreement is the decoupling of agricultural income support payments from production.

A feature of the Luxembourg Agreement, which reflects its compromise nature, is the menu of decoupling options, which are offered to Member States. The options are listed in Box 1.

2. Decoupling of dairy payments

Agenda 2000 provided for the intervention price of butter and skimmed milk powder to be cut by 15% in three equal steps as from the 2005/06 milk year. As part compensation for these cuts, direct payments to producers were to be introduced in the 2005, 2006 and 2007 milk years. (The milk marketing year runs from 1 July each year and ends on 30 June of the following year).

Box 1. The Luxembourg Agreement

Decoupling

From January 2005 or January 2007 at the latest, the decoupled or partially decoupled payment is to be introduced. The basis for the decoupled payments is the average of subsidy receipts for the three years 2000, 2001 and 2002 for crops, beef and sheep payments.

Beef: Full decoupling of beef payments is one of a number of options that are available at Member State level. The other two options are to:

- Retain up to 100% of the suckler cow premium and retain up to 40% of the slaughter premium

- Retain either up to 100% of the slaughter premium or alternatively retain up to 75% of the special male premium

Sheep: Apart from full decoupling the option available is:
- Continue up to 50% of the ewe premium in less favoured areas

Crops: The intervention price for cereals remains unchanged. Intervention for rye is abolished. Apart from full decoupling the options are to either:

- Retain up to 25% of the single farm payment in coupled form

or
- Retain up to 40% of the durum wheat payment in coupled form.

Dairy: The new dairy payment will not be part of the single farm payment immediately. The payment remains coupled to production until 2007 when it becomes part of the ‘single farm payment’.

- The quota system is retained until the 2014/15 milk year. A 1.2% EU quota increase goes ahead as outlined in Agenda 2000. No further increases in milk quota are agreed.
- From 2004 intervention prices for dairy products are reduced on a phased basis by 25% for butter (over four years) and 15% for skimmed milk powder (over three years). The target price for milk is abolished.
- Compensation is fixed as follows: €11.81 per tonne in 2004, €23.65 in 2005 and €35.5 from 2006 onwards. There will be a gradual phasing in of a 30,000 tonne annual limit on butter intervention purchases before tendering, starting from 2004 at 70,000 tonnes and reaching 30,000 tonnes, (in 10,000 tonnes annual reductions) by 2008.

Key Horizontal Measures

Cross-Compliance: In order to continue to receive the ‘single farm payment’ producers must meet a series of European standards in terms of the environment, food safety and animal health and welfare. In addition the producer must maintain land in “good agricultural condition”.

Modulation: Begins in 2005 with a cut of 3% in the single farm payment, rising to 5% from 2007 onwards. The first €5,000 in payments per farmer is exempt each year.

Financial discipline (degressivity): From 2007 onwards if direct payments are projected to overshoot the budget, reductions in individual payments will take place.

3. Choice of payment systems

The Luxembourg Agreement modified the Commission Proposals of January 2003 to allow the Single Farm Payment to be made on a 'regional' or national basis and also on a 'historic' basis or 'flat rate' basis.

4. Ireland's choice

On 19 October 2003, after extensive analysis and consultation, Ireland became the first member state to announce its choice of options for implementing the decisions, which were announced in the 'Luxembourg Agreement'.

The decision was simple and radical. There was to be the maximum amount of decoupling of direct payments from production and the decoupling was to be done at the earliest possible date. The single farm payments were to be made on a 'historical' basis and there would be no regionalisation.

The total decoupled payment for a farmer is called the 'Reference Amount'. The Reference Amount is based on the average of the relevant aid payments over a reference period of 2000, 2001 and 2002 valued at the 2002 rate of payment. The Reference Amount divided by the average quantity of 'eligible' land farmed during the reference period is called the 'Entitlement'/ ha. Eligible land is any type of agricultural land, except that used for growing permanent crops, (such as fruit and forestry) and includes land used for sugar beet even though there was no direct 'compensation' payment for producers of this crop. It does not include the area of land used for potatoes. The payments that will be added up and divided by the number of 'eligible' hectares are shown in Box 2. If a farmer was prevented from farming during one or two reference years by *force majeure*, the remaining year or years are used. There is provision for inclusion of the payments made in earlier years in cases where a farmer was unable to claim payments in the reference years. Typical instances of *force majeure* would be illness, or depopulation of the farm due to control measures for Foot and Mouth Disease.

The payments included in the 'Entitlement' are shown in Box 2

Box 2. Payments making up the 'entitlement'/ ha.

Premium	2002 value (€)
Special Beef Premium 9 months	150
Special Beef Premium 21 months	150
Bull Premium	210
Suckler Cow Payment	224.15
Slaughter Premium	80
Heifer Slaughter top-up	22.85
Suckler Premium Heifer top-up	76.18
Extensification (less than 1.4 LU per ha)	80
Extensification (less than 1.8 LU per ha)	40
Ewe Premium	21
National Envelope Ewe top-up	1.22
Rural World Premium (Ewe)	7
Cereal aid per ha	383.04
Set-aside per ha	383.04
Maize Aid per ha	365.40
Oilseeds Aid per ha	383.04
Protein Crop Aid per ha	440.80
Linseed Crop Aid per ha	383.04

Source: Department of Agriculture and Food, *Schemes and Services, 2002*

Payments that are not already 'coupled', such as those made under the Rural Environment Protection Scheme (REPS) and the area based payments in disadvantaged areas, are not part of the 'Entitlements'. They will continue to be paid as at present and will be paid in addition to the 'Entitlement'.

5. Method of payment

As 'Entitlements' are historically based, the details of the payments made to farmers in the Reference Period are, for the most part, already known to the paying agent - the Department of Agriculture and Food. In order to claim any of the payments listed in Box 1, farmers would have had to complete and submit an 'Area Aid Form'. Farmers will be automatically advised of their entitlements by the Department of Agriculture and Food. The 'compensation' payments to dairy farmers for the milk price reductions under Agenda 2000 and the Mid-Term Review were not payable in the reference years and so will have to be applied for by farmers. About 14,000 farmers will have to submit an Arable Area Aid form for the first time in 2004. The essential point is that all Entitlements are made up of payments claimed using the Arable Area Aid form and information from these forms the basis of the Entitlement calculation for each farm.

The decision to have the maximum level of decoupling as soon as possible will mean that the Department of Agriculture and Food will only have to process 136,000 claims for 2005, rather than the 469,000 claims for the previous schemes. This is a 71 per cent reduction in the number of claims to be processed.

The amount of money available to Irish farmers under the new scheme is greater than was paid under the previous livestock and arable schemes in the reference years due to the inclusion of the new dairy premium, which commences in 2004.

The value of the previous schemes was €1.093 billion and the value of the dairy premium is €186 million. The total pool of money, or 'reference amount' is €1.322 billion. This gives an average payment of €280/ha for each of 4.7 million eligible hectares.

6. Amount of payment

Table 1 shows that Entitlements per farm vary widely between the types of farm classified in the Irish National Farm Survey. Average payments per farm range from €9,877 on specialist sheep farms to €21,526 on specialist tillage (arable) farms.

Table 1: Estimated Entitlement by Farm System in Ireland 2007.

Farm System	Average Entitlement (€)	Average Entitlement per ha (€)
Dairy	13,199	296
Dairy and Other	18,972	290
Cattle Rearing	10,392	333
Cattle Other	14,147	349
Tillage	21,526	231
Sheep	9,765	363

Source: Thorne (2004)

7. The 'National Reserve' and Modulation

7.1 National Reserve

A deduction from the reference amount (i.e. the sum of eligible payments to a farmer) is made for the 'National Reserve'. The National Reserve has been created to provide a fund of Entitlements to award to new entrants to farming, to make up losses of Entitlements in cases of *force majeure* and so on.

The National Reserve will be established by a 3% cut in each farmer's reference amount in 2005. Thereafter, Member States can operate a 'claw back' on sales of Entitlements. This can be up to 50% of the value of Entitlements sold *without* land in the first three years of the operation of the SPS and up to 30% thereafter. The claw back on the value of entitlements sold *with* land can be up to 20% of their value but only 5% if the entire holding is sold. No claw back is permitted where Entitlements are sold with or without land to new entrants.

Unused Entitlements will go back into the National Reserve. It is possible that some very low value Entitlements may not be used. After year one, the National Reserve may be allocated and Entitlements from the Reserve may be consolidated, ('stacked') on to a farmer's existing Entitlements if his or her existing Entitlements are below the national or regional average. Where farmers have Entitlements whose value is above the national or regional average they will need new or spare hectares to claim payment of these new entitlements.

Entitlements awarded to farmers from the National Reserve cannot be sold or leased for five years and must be used every year for five years.

7.2 Modulation

All entitlements will be reduced by 3% in 2005, 4% in 2006 and 5% in 2007 and for each year thereafter. Farmers who have an Entitlement of €5,000 or less will have the modulation reduction returned to them. This means there is effectively no modulation for Entitlements of less than €5,000.

8. 'Activation of the Entitlement'

Entitlements may only be paid to a farmer once they have been 'activated'. The Entitlements will be activated by the farmer submitting an 'Area Aid Application Form' in 2005. This must be done even if the farmer had no previous claims for any of the 'coupled' payments. Examples of such farmers are dairy farmers who only kept a dairy herd and had no other enterprises to which the payments in Box 1 applied and lowland sheep farmers who were not in the Rural Environment Protection Scheme, (REPS). Any Entitlements not used for three years go into the National Reserve.

Farmers will be able to establish all of their Entitlements in 2005 by applying for 0.3 of an Entitlement on 0.3ha. In practice all farmers will want to apply for payment on all their Entitlements in 2005 in order to maximise their payment.

9. Consolidation ('Stacking') of Entitlements

Some groups of farmers will be able to consolidate, or 'stack', their Entitlements. This concentrates their payment over a smaller area than that on which it was calculated. They will thus have a smaller number of Entitlements than was originally calculated but each Entitlement will be of a higher value. The overall payment such a farmer receives will not change but can be claimed with fewer hectares.

This provision benefits farmers who were farming rented land for the reference years but who might suffer a net loss of land when their leases expire. Without consolidation ('stacking'), they would have to seek extra land in order to claim all their Entitlements.

Consolidation is available to:

- Farmers who have afforested some of their land since the beginning of the reference period;
- Farmers who have disposed of land to a public authority for a non-agricultural use, (e.g. compulsory purchase of land for road building);
- Farmers who had rented land during the reference period but the lease or rental agreement has since expired;
- Farmers who declared land situated in Northern Ireland during the reference period;
- Farmers who afforested some of their land since the beginning of the reference period and
- Farmers who disposed of land by sale or lease after 2003 *other than* to a public authority for non-agricultural use.

In order to be paid on all entitlements, the total area declared on the Area Aid Application must continue, annually, to be at least 50% of the average area declared in the reference period. To avail themselves of the stacking concession, farmers must declare *all* of the land available to them.

The mechanism for 'stacking' will be the National Reserve, so Entitlements that are 'stacked' will be subject to the same rules regarding use and forfeiture as Entitlements from the National Reserve.

10. Set Aside

The rules relating to Entitlements based on Set-aside payments are still to be finalised. The position in mid-June 2004 is stated in Appendix 1.

11. Cross compliance

In order to be paid their Entitlements, farmers will have to engage in 'good farming practice', to ensure that when Entitlements are paid, the environmental, food quality and animal welfare goals of the MTR are met. This is known as 'cross compliance'.

Cross compliance makes payment of Entitlements conditional on complying with 18 EU managerial requirements. Most of these requirements are already enshrined in Directives or other legislation. The 18 measures come into operation in three stages. These stages are:

- 1 January 2005, rules governing the environment, identification and registration of farm animals;
- 1 January 2006, rules governing public, animal and plant health;
- 1 January 2007, rules on animal welfare.

The 18 measures are set out in Appendix 2.

11.1 Inspections for eligibility and cross-compliance

There will be two types of inspections in relation to Entitlements. One will be to confirm general eligibility for payment and one to confirm that all cross-compliance measures are being observed.

11.2 Eligibility

Every year about 6,800 farmers (5%) will be inspected for eligibility for payment. This will cover issues such as eligible land, area declared for payment and environmental condition of the land.

11.3 Cross-compliance

Each year 1% of applicants will be inspected on the 18 cross-compliance measures. In addition, 5% of applicants will also be inspected for cattle tags and cattle registration and this will be done at the same time as the inspections for eligibility and cross-compliance.

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Appendix 1

Set-aside

The level of set-aside in 2005 will be 10%. The 10% will apply to areas on which obligatory set-aside applied in the reference years. So if a grower had 10% set-aside in 2000, 15% in 2001 and 17% in 2002, the average rate of set-aside was 14%, [i.e. (10+15+17)/3] but the rate that applies in future will be 10%, (the obligatory amount). BUT if the rates were 10%, 0% and 11%, the average rate was 7% [i.e. (10+0+11)/3] but the rate for the future is 6.67% [i.e. (10+0+10)/3]. The rate for the reference years applies regardless of decreasing or increasing area. The only way that farmers with set-aside can decrease their obligation is to sell all or some of the set-aside Entitlements. Set-aside can be rotated each year but can only be placed on land that was classed as 'eligible' under the former policy.

Farmers who had set-aside in the reference years will receive set-aside Entitlements for the required area and this must be put in place before the other production entitlements can be 'activated'.

Set-aside Entitlements can be sold and with each one goes the obligation to have set-aside.

Only growers who had set-aside in the past will be obliged to have set-aside. New entrants to arable farming or those expanding from the previous 'simplified scheme' will not have an obligation to set land aside.

Appendix 2

Regulations for Cross-compliance

Environment Regulations: to apply from 1 January 2005

1. EU Council Directive 79/409/EEC of 2 April 1979 on the conservation of wild birds. Also national legislation in the Wildlife Amendment Act.
2. Directive 80/68/EEC on protection of groundwater against pollution by certain dangerous substances.
3. Directive 86/278 on protection of soil where sewage sludge is used in agriculture.
4. Directive 91/676 on protection of waters against pollution caused by nitrates from agricultural sources.
5. Directive 92/43 on the conservation of natural habitats, wild flora and fauna. The Wildlife Amendment Act where it covers Natural Habitat Areas, (NHAs).

Public and Animal Health Identification: Registration of Animals: to apply from 1 January 2005

6. Directive 92/102 on identification and registration of animals. Also Regulation 21/2004 on sheep tagging.
7. Regulation 2629/97 (and Regulation 820/97) on ear tags, registers and passports for bovines.
8. Regulation 1760/2000 on identification and registration of bovines and labelling of beef.

Public, Animal and Plant Health: to apply from 1 January 2006

9. Directive 91/414 on the marketing of pesticides.
10. Directive 96/22 on prohibiting the use of certain substances having hormonal or thyrostatic action and of beta-agonists.
11. Directive 178/2002 – general food law.
12. Regulation 999/2001 on the rules for dealing with BSE, scrapie and similar diseases.

Notification of Diseases: to apply from 1 January 2006

13. Directive 85/511 – concerns Foot and Mouth Disease.
14. Directive 92/119 on certain animal diseases including swine vesicular disease (SVD) in pigs.
15. Directive 2000/75 on provisions against blue tongue disease.

Animal Welfare: to apply from 1 January 2007

16. Directive 91/629 on standards for the protection of calves.
17. Directive 91/630 on standards for the welfare of pigs.
18. Directive 98/58 on the protection of animals kept for farming purposes.

The Italian Aid System in the Framework of the New CAP Reform

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1. Introduction

The official position of the Italian Government toward the CAP reform was presented at the end of April 2004 by way of a Ministry document in which the relevant questions concerning the Single Payment Scheme (SPS) options contained in EU Regulation 1782/2003 were, at least in part, answered. The debate on the Italian position with regard to how the Single Payment Scheme would be applied in practice has seen the Government, regions and professional organizations deliberating from September 2003 until May 2004 on the possible impacts the various options if applied may have.

During those meetings, the Minister for Forestry and Agricultural Policy (MIPAF) presented an official document ("Posizione Governativa sull'Attuazione della Riforma della Politica Agricola Comune in Italia"), which gave notice of the Government's intent and outlining its strategy. The points made included:

- Maximum utilisation of the available budget;
- Efficient allocation of resources in order to achieve a competitive agricultural industry;
- The defence of agricultural incomes and maintenance of population numbers in rural areas with particular attention being given to those areas where limited natural resources specifically constrain agricultural productivity;
- To strengthen the national supply-chain mechanism and to enhance variety within the supply-chain;
- To simplify administration and achieve appropriate cost-savings wherever possible.

These main issues will sought to be achieved by the application of the total decoupling principle throughout all of the Italian Regions. It is pertinent to highlight at this point that the Regions have very largely been in favour of total decoupling without first needing to be persuaded by the Italian central government (see Table 1), as they believe decoupling generally to provide the real incentive necessary to improve the competitiveness of the agri-food sector. This is true except for a few particular instances where the CAP reforms if implemented could adversely effect general economic development.

In order to most usefully describe the application of the chosen strategies and the implications for the various sectors affected within the Italian agri-food system by the CAP reforms, we propose to analyse the following supply-chains: arable crops, beef and veal, milk, tobacco and olive oil.

ITALY 2

Table 1: Region Position on MTR.

	Arable Crop Options			Beef and Veal Options				Regionalisation Option		
Regions	Full Decoupling	25% coupled	40% coupled at durum wheat	100% coupled at veal slaughter	100% coupled at sucker cows and 40% at slaughter	100% coupled at slaughter	Full Decoupling	In Favour	Not in Favour	**Regions**
Piemonte	•				•				•	**Piemonte**
Campania			•		•				•	**Campania**
Sardegna			•		•			No Position		**Sardegna**
Liguria	•			•	•				•	**Liguria**
Lombardia	•					•			•	**Lombardia**
Emilia-Romagnaa	•				•				•	**Emilia-Romagnaa**
Umbria	•						•		•	**Umbria**
Prov. Bolzano	•						•	No Position		**Prov. Bolzano**
Prov. Trento	•						•	No Position		**Prov. Trento**
Friuli Venezia Giulia	•				•			•		**Friuli Venezia Giulia**
Marche			For 3 year with a progressive adjustment to full decoupling		100% coupled at sucker cow and 10 % ex art. 69 reg. 1782/2003				Progressive regionalisation of SPS on the basis PAC 1992 zoning	**Marche**
Puglia	•						•			**Puglia**
Basilicata	•			•	•				•	**Basilicata**
Sicilia	•						•	•		**Sicilia**
Molise			•		•				•	**Molise**
Toscana			•		•			No Position		**Toscana**
Veneto	•				•				•	**Veneto**

The information available from the Italian Government document also describes the implementation in Italy of Regulation CE 1782/03. Considered as a whole, we can say that the MIPAF has chosen to adopt full decoupling for each productive sector as allowed for by the communitarian regulation except for seeds production and without regionalisation plans. Nevertheless, the document proposes to apply Article 69 of the Regulation in order to maintain high levels of national food procurement and to assist agricultural production in less developed areas. However, the official Ministry documentation does not indicate the measures to be adopted as regards cross-compliance and in particular, the measures relating to 'Good Agricultural Practice'.

2. Arable Crops

Generally, it is possible to assert that arable crop subsidies are to be fully decoupled. Actually, all the coupled aids for cereals existing in the reference period 2000/2002 are to be included within the single payment scheme after the adjustments permitted by the Reg. Ce 1782/2003.

Studies made by MIPAF institutes have verified that the level of coupled aid established by the partial application of the decoupled single payment scheme, does not comprise sufficient incentive to avoid the risk of abandonment of presently cultivated farmland. Furthermore, on the basis of the Agriculture Ministry analysis, the partial application of the decoupling scheme is not convenient in terms of management of costs. These considerations and the strategies indicated above, have brought Government to apply the total decoupling scheme while at the same time preserving the option for applying the provisions of Article 69 in order to define a coupled payments intervention in less developed areas and where production quality and environmental concerns are a major factor.

The Ministry documents effectively concentrate the application of the CAP reforms around the objective of maximisation of the use of the maximum ceiling attributed to Italy and to the preservation of farm incomes as far as is possible. The Ministry is conscious of safeguarding the need for specific crop production on a national basis while understanding the risk inherent in decoupling as regards possible land abandonment but overall attempting to maintain the level of supply for the national agri-food industry.

The relevant decisions taken by the Italian Agriculture Ministry on the use of retained payments for the arable crops sector as foreseen by Article 69 of the new regulation 1782/2003 are as follows:

- Allocation of the additional payment on durum wheat farming in order to improve quality production. The only commitment for producers who want to benefit from this coupled payment consists in the using of certified seeds. Article 69 applied at durum wheat production (Table 2) will be realized using 7% sector plafond (without rice). The amount of unit aid per hectare can be estimated on the basis of the sector ceiling at €48.
- Allocation of the additional payment (Table 3) on oilseeds in order to guarantee protein procurement and environment enhancement through compatible production methods.

Financial coverage of these additional payments is ensured through retaining 7% of national ceiling (€1781), corresponding to €124 million. This amount is divided among durum wheat and oilseeds at, respectively, 65% and 35%: €80 million in favour to the durum wheat production and the remaining €44 million for the oilseeds. If the amount of total aid will be distributed to the producer on the basis of the maximum land established for each of those sectors, the level of unit aid coupled to one hectare of cultivated land is equal to €48 for durum wheat, while for oilseeds the level of unit aid is estimated at €116. This estimation assumes that all land allocated to these two crops will be used with the respect to the conditions fixed by the Agricultural Ministry following the rule contained in the Article 69. In a more realistic framework, the level of the unit aids have to consider the effective level of surface cultivated with the respect of these rules.

Durum wheat importance imposes a deeper analysis on this kind of aid. It is interesting to note how this cultivation represents, in the Italian farm sector, the main production, in terms of acreage, among COP production

In the European context (Table 4), Italian durum wheat growers produce almost half of the EU-15 total production at 43% (European Commission). Moreover, this kind of cultivation is prevailing in the central and southern Regions, which are economically less developed areas.

Given these national features, Government strategy is aimed at guaranteeing additional aid coupled to production in order to limit possible damage to the food chain induced by a decrease in the planted acreage of this crop. In fact, the base aid (€63/tonne) and the additional premium (€285/ha) will be completely introduced in the single payment.

The growing of durum wheat is functional in order to promote the use of seeds that satisfy the qualitative and technological needs of the agro-food supply-chain and that are in compliance with the environmental characteristics of national productive areas.

The only exception, in the arable crop sector, of exclusion from SPS is the direct payment coupled at seeds production. This option, provided for in the regulation, is linked to the necessity of ensuring a substantive degree of national procurement and safeguarding production quality from GMOs.

Table 2: Arable Crop Additional Aid.

	¤ (Million)	%	Reference Acreage (ha)	Unit Aid ¤/ha
National Plafond for decoupled payments (except rice)	1781			
Percentage for additional aid		7		
National Plafond for additional aid:	124			
- Durum wheat	80	64,5	1.655.266	48,33
- Soybean and sunflower	44	35,5	377.944	116,42

Table 3: Arable Crop - Government Position

Options	Government Decision
Start of SPS	2005
Arable Crops Payments	Full Decoupled (SPS)
Durum Wheat Payment	Full Decoupled (SPS)
Seeds payments	Excluded from SPS
Additional Payment 10% (art. 69)	Withdraw from Crop ceiling, except rice, with aid coupled at durum wheat, soybean and sunflower (7%)
Regionalisation	No
National Reserve	- Application at central level -Reduction percentage will be decided after the verification of reference amount and national ceiling capacity.

Table 4: Crop Arable Growing Distribution in Italy

Product	Acreage (000 ha)				
	2000	2001	2002	Weighted Average	Incidence %
Maize	1197	1258	1216	1264	27%
Durum Wheat	1576	1639	1854	1748	37%
Other Crops	888	832	944	919	20%
Soybean	242	249	128	211	4%
Sunflower	238	240	114	202	4%
Rape-seed	43	47	3	31	1%
Protein Plants	64	65	8452	74	2%
Set-Aside	202	213	200	212	5%
No food set-aside	22	21	22	22	0%
Total COP	6478,1	6571,1	14942,1	4689,1	-

Table 5: Arable Crop - PAC Evolution

2004	2005	2006 and next
Additional coupled aid reduction at 313 ¤/ha.	- Decoupled Payment: ¤63/t refers to 2002 yields; - Additional coupled aid reduction at ¤291/ha.	- Decoupled Payment: ¤63/t refers to 2002 yields; - Additional coupled aid reduction at ¤285 /ha.
New specific aid for quality of ¤40/ha (coupled).	Idem	Idem + Article 69: 10% coupled in order to safeguard less developed areas (48,33).

3. Beef and Milk

3.1. Beef and Veal

For what concerns beef and veal aids frame, The Italian Government (Table 6) proposes a full decoupling of subsidies plan in order to ensure a full exploit of available financial resources and improve, in terms of costs, administrative efficiency (control and management).

The Government, on the basis of economic studies, has defined the allowed coupling rate as not sufficient to cancel retreat risk. Hence, he has denied the other aid schemes set by regulation 1782/2003, making reference to the principle for which a market forces equilibration can make arise competitive productive structures rather than policy instruments.

Nevertheless, in the document on the reform application, MIPAF refers to additional payment schemes ex article 69 and, in compliance with European legislation, to Second Pillar in order to safeguard specific cattle-farming type in less developed areas. Particularly, in beef and veal sector, it has been proposed, following the contents of the article 69, a reduction of the sector ceiling amount of 10% and the relative creation of financial fund, of €44.9 million, to allocate as a production additional aid in a coupled scheme. Supplementary payments, structured as showed in Table 7, are linked to suckler cows farming located in mountain zones and for particular quality race of cows registered in Italian genealogical books; and to slaughter of bull in farming from, at least, 6 months and bred in accordance with quality rules (CE regulation 1760/2000).

3.2. Milk

Milk and dairy sector will be animated by a new support aid scheme. Government document puts forward an anticipation of the milk aids inclusion in the SPS, from 2007 to 2005.

The capitalization of additional milk aid in the single payment, on the basis of the Agriculture ministry issues, exclude additional charges on the price of the milk quota, facilitating exchanges of milk quotas. In fact Government position on this point is clear and concise:

"[…] Milk and dairy payment inclusion in the Single Payment System implies a clear cost reduction of production quotas, boosting rights owner to sell given that he will see payments ex art. 95 and 96 Reg. 1782/2003 as ensured and composing his portfolio of single farm rights. Furthermore, quota purchasing is promoted by its minor value since it does not capitalize aid value. […]".

MIPAF refers directly to the subsidy plan established by the European regulation, which is made up by a payment link to the milk quota (article 95) and national additional aids (article 96), whose distribution criteria are not been yet expressed (Table 8). In sum, he Italian position for the premium on milk consists in a payment coupled to the milk quota for the production period 2004/2005 and a fully decoupled scheme starting from 2005.

Table 6: Beef and Veal - Government Position.

Options	Government Decision
Start of SPS for Beef and Veal Sector	2005
Beef and Veal Payments	Full Decoupled (SPS)
Start of SPS for Milk and Dairy	2005
Additional Payment10% (art. 69)	Withdraw from Beef and Veal sector ceiling and additional aids in favour of bull slaughter and number of suckler cow
Regionalisation	No
National Reserve	- Application at central level -Reduction percentage will be decided after the verification of reference amount and national ceiling capacity.

Table 7: Beef and Veal - Additional Aid.

	¤ (Million)	%	Reference Head	Unit Aid ¤/head
National Ceiling for decoupled payments (except rice)	449			
Percentage for additional aid		10		
National ceiling for additional aid:	44.9			
- Suckler cows	18.9	42%	274.906	68,75
- Bull slaughter premium	22	58%	521.104	49,89

Table 8: Milk and Dairy - Subsidies Plan.

	2004	2005	2006 and next
Coupled Payment (art. 95)	8,15 ¤/t	16,31 ¤/t	24,49 ¤/t
National Ceiling for Additional Payment (art. 96)	¤36,34 Million	¤72,89 Million	¤109,33 Million

4. Tobacco and Olive Oil

The olive oil and tobacco sectors have great relevance in the Italian agricultural system both in employment terms and production. MIPAF have not yet marked official guidelines to ratify communitarian directives, also because these last proposals have been set recently (April/May 2004). It is possible asserting that in the Council of the European Union table, Italian Minister has tried to delay terms of decoupling application.

4.1.Tobacco

It is well known that European debate on CMO Tobacco is argued a) on a moral issue about supporting a product injurious to health, b) on production quality and c) on incidence of this supply-chain in the European economic system. Arguments deeply related each other.

Adopted solution concerning the first issue was taken on the consideration that even tobacco farm prohibition does not decrease product demand, and this will disadvantage commercial balance. But it has been set funds, financially supported through resources of this sector, with a purpose of contrasting nicotinism and promoting conversion of tobacco farms.

For what concerns production quality, several cultivation have been classified in qualitative categories in order to modulate coupled subsidies.

The incidence of tobacco sector on national economy was particularly binding Government position in the debate. While gross European production in 2001 was 340500 ton, raw tobacco quantity belonging from Italian growing was 129000 ton (almost 38%). It should be noted that three first producer Countries (Italy, Greece and Spain) reach a share of 90% on tobacco communitarian gross acreage and production.

It is important remember that tobacco-plantings supply, in the national agricultural frame, a relevant employment outlet. Generally, it is calculated that tobacco growing generates almost 16300 employed. But must be considered all workers present in the derivates products sector.

These short considerations allow asserting that modifying actual CMO, reducing incentives to this cultivation, could strongly affect local economic system, in terms both of income and of employment.

That is why, during the Council of European Union meeting, MIPAF has rejected the previous proposal of aids modulation trough 3 classes of production and has promoted the new subsidies plan. This will apply full decoupled payments in 2010, after a transition period (2006-2010) while decoupling rate will be set not lower than 40% of reference amount of tobacco ceiling. Moreover, the coupled part of payments will be bound to certain qualitative level and to the location of the producer, which must be in one region of the Objective 1.

This plan has got only temporary significance. From 2010 all subsidies will be decoupled, according to a program for which 50% of aid will be into SPS and remaining 50% will finance a restructuring fund. A sum equal to 4%, for 2006, and 5%, for 2007, of aid must be devolved to the Community Tobacco Fund.

Table 9: Tobacco Reform.

Start of temporary scheme	2006
Decoupled Payments	40%
Coupled Payments	60% for Object 1 Regions or for some tobacco quality
Community Tobacco Fund	4% (2006), 5% (2007).
Start of full decoupled program	2010
Payment Decoupled after 2010 (SPS)	50%
Community Tobacco Fund	50%

4.2. Olive Oil

An official MIPAF position regarding the last communitarian legislation on the CMO Olive Oil is yet missing.

It is interesting to note that, for this CMO regulation, Council of the EU tried to reduce distortion effects of a sudden full decoupling application, like requested by reg. 1782/2003.

For what concern Olive Oil sector, MTR establishes that almost 60% of the average of current payment, linked at production of 2000-2002, will be changed in subsidy entitlements, in the SPS frame, only for farm those acreage is higher than 0,3 ha. The amount assigned to each producer is calculated on a period of 4 commercial years from 1999 to 2006.

For those farms having reference acreage of less than 0,3 ha payments will be full decoupled from 2006. Member States will be allowed to retain remaining share of resources (40%) to allocate an additional aid coupled to olive growing. Unit aid (referred to a single olive plants) less than €50 will not be allocated. Member States will be allowed to utilize 10% of sector plafond for promoting quality.

To avoid market imbalances, access to SPS will be limited at olive growing already present on May, 1, 1998 and at new plants considered in Commission approved program.

Actual scheme will be applied until commercial year 2004/2005.

Table 10: Olive Oil Reform.

Start of New Scheme	2006
Decoupled Payments for Olive Oil. Acreage Farm >0,3 ha	60%
Couplet Payment Olive Oil	40%
Decoupled Payments for Olive Oil. Acreage Farm <0,3 ha	100%
Quality Additional Premium	10%

5. Cross compliance and good agricultural and environmental conditions

5.1. Cross compliance

The rules stated in the Reg. 1782/03 for the single payment establish that farmer receiving direct payments shall respect statutory management requirements fixed in the annex III of the horizontal regulation, in which a normative frame are stated about:

- Environment,
- Public, animal and plant health,
- Identification and registration of animals,
- Notification of diseases and
- Animal welfare.

The respect of these rules is a necessary condition to receive payments under the SPS.

The Italian Agriculture Ministry has presented a proposal about the application of the conditions contained in the CAP reform documents but concerning only the compulsory rules applicable from 1 January 2005. For the others years, the decision is delayed to a later document. In any case, the relevant elements keep in account in the Ministry document are the control and audit schemes to activate when the new CAP reform will enter into force. On the basis of this act, the methodology in order to formulate commitments and control indicators has to refer to the contents of the Commission document on the cross-compliance produced on the last February 2004. As far as the identification of the engagements for the public body involved in this control action, it is important to define the responsibility level for each cross compliance rules. In fact, according to the administrative responsibility, the control indicators will be established at national and/or regional level (see Table 11).

For the purposes of the Agriculture Ministry, the managing of the cross compliance rules will be distributed at territorial level as follows in Table 11.

Table 11: Cross compliance and control responsibilities

Cross compliance rules (year 2005)	Level of responsibility
1. Council directive 79/409/EEC/1979 on the conservation for wild birds	National/Regional
2. Council directive 80/68/EEC/1979 on the protection of groundwater against pollution caused by certain dangerous substances	National/Regional
3. Council directive 86/278/EEC/1986 on the protection of the environment, and in particular of the soil, when sewage sludge is used in agriculture	National/Regional
4. Council directive 91/676/EEC/1991 concerning the protection of waters against pollution caused by nitrates from agricultural sources	National/Regional
5. Council directive 92/43/EEc/1992 on the conservation of natural habitats and of wild flora and fauna	National/Regional
6. Council directive 92/102/EEC/1992 on identification and registration of animals	National
7. Commission regulation EC n. 2629/97 laying down detailed rules for the implementation of Council regulation EC n. 820/97 as regards ear-tags, holdings registers and passports in the framework of the system for the identification and registration of bovine animals.	National
8. Regulation EC n. 1760/2000 of the European Parliament and of the Council establishing a system for the identification and registration of bovine animals and regarding the labelling of beef and beef products and repealing Council regulation EC n. 820/97.	National

Each of the previous assignments will be applied into SPS scheme only if the national and/or regional control system will be implemented. In case of absence of this kind of procedures or indicators the corresponding rules will not be applicable.

5.2. Good agricultural practices

As stated in the regulation 1782/2003, each Member States shall ensure that all agricultural land, especially land, which is no longer used for production purposes, is maintained in good agricultural and environmental condition. Moreover, each Member States shall define, at national or regional level, minimum requirements for good agricultural and environment conditions on the basis of the framework set up in the Annex IV of the horizontal regulation.

The Agriculture Ministry has defined that the responsibility in order to design the rules for the application of the so-called "good agricultural practices", has to remain at central level, but the formulation of the official act will be made with the participation of the Regions and social parts (i.e. farm producers associations). In fact, the proposal document of the Ministry derives from a discussion among different territorial actors, like Regions, Provinces and farmer associations. The Italian proposal gives a particular attention to the compatibility between the conditions that will be stated for the application of the article 69 and the current rules present in the rural development plans.

The table 12 presents the list of national regulations responding to the commitments arise by the issues contained in the Annex IV of the Reg. EC 1782/2003.

Table 12: National scheme of good agricultural practices.

Rules	Soil erosion	Soil organic matter	Soil structure	Minimum level of maintenance	Control indicator
A) Arable surfaces cultivated with products contained in the Annex I of Reg. 1782/2003					
1. Prohibition burn the surfaces after harvest	X	X		X	RV F
2. Uniform seed of the land and managing up to the closing	X				RV, F
3. Prohibition to conduct agro-mechanic operations with bathed or frozen soil			X		RV
4. To execute temporary furrows on hanging soil	X				RV, F
5. Prohibition of mono-substitution of oilseeds and cereals	X	X		X	RV, F, RD, RA
B) Permanent pasture					
6. Managing of the grassland and the grazing	X	X	X	X	RV, F, RD
C) Set aside or deactivated land					
7. Rules for set-aside	X	X	X	X	RV, F, RD
D) Olive groves					
8. Not defined				X	RV, F, RD
E) Horizontal conditions for the minimum level of maintenance					
9. Maintenance of ditches				X	RV, F

Remarks: RV: Visual control; F: Photogrametry; RD: Documental control; RA: Analytic control.

In the table presented above the good practices measures are specified with the contextual definition of the control indicators. It is important to highlight that this kind of rules are defined also for the land not allocated to crops but considered eligible by the SPS, as stated by article 2 of Reg. EC 1782/2003 and article 2 of Reg. EC 796/2004.

The Single Farm Payment as applied in the United Kingdom

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1. Introduction

From the outset, the UK Government declared that the single farm payment would be applied individually by the English government and each of the respective devolved administrations in Scotland, Wales and Northern Ireland. As it has transpired, each country has decided upon a different route resulting in four different applications of the CAP reforms within the UK.

In England, Northern Ireland and Wales, all subsidies are to be fully decoupled from production with only Scotland intending to retain some sector support by use of a 'national envelope' in respect of quality beef production. In all four countries, the CAP reforms will be applied from the earliest possible date namely 1 January 2005. None of the countries within the UK intend taking advantage of the delayed implementation timetable permitted by the EU.

2. ENGLAND

2.1 Single Farm Payment

In England, the Government announced on 12 February 2004 that it had decided to adopt a dynamic hybrid model that will move in graded steps over a transitional period of eight years from a largely historic receipts pattern in 2005 to a completely flat-rate payment in 2012 (see Table 1 below). From 2012 onwards all payments will be made on a flat-rate basis with no element of historic receipts being included. Payment is to be assessed on an 'eligible area' basis of land available to farmers in 2005 with certain uses such as buildings, forestry and permanent crops (e.g. top fruit) being excluded from the calculation.

Table 1: Schedule of Single Farm Payments

	2005	2006	2007	2008	2009	2010	2011	2012
Flat Rate (%)	10	15	30	45	60	75	90	100
Historic receipts (%)	90	85	70	55	40	25	10	0

Source: Adapted from Department of Environment, Food and Rural Affairs (2004)

For the purposes of calculating the Single Farm Payment, England has been divided into three regions; moorland within the Severely Disadvantaged Areas (SDA), non-moorland within the SDA and lastly all other agricultural land. Initially the country had been divided into two regions being the upland SDA (moorland and non-moorland) and the rest, but following representations made by interested stakeholders, the upland SDA was divided into that land above the moorland line and that within the SDA but below the moorland line. Representations to the government's Rural Payments Agency (RPA) can be made by upland farmers concerned with the present demarcation of their land into moorland or non-moorland sectors.

It is intended that each of the three regions will attract a different flat rate of subsidy payment. The amount of subsidy to be paid to a region will be dependant on the aggregate of subsidy paid to that region during the pre-defined reference period, that is the calendar years 2000, 2001 and 2002. The Department for Environment, Food and Rural Affairs (DEFRA) have estimated that the national subsidy ceiling for England for 2006 will be about €2.48bn (£1.74bn). Of this sum, they estimate that the subsidy ceiling for the SDA in aggregate (moorland and non-moorland) will be about 6% of the England total or €150m (£104m). The current schemes that will be withdrawn on inception of the SFP in England are as follows.

- Arable Area Payments Scheme (AAPS)
- Beef Special Premium (BSP)
- Extensification Payment Scheme (EPS)
- Sheep Annual Premium Scheme (SAPS)
- Suckler Cow Premium Scheme (SCPS)
- Slaughter Premium Scheme (SPS)
- Veal Calf Slaughter Premium Scheme (VCSPS)
- Dairy Premium
- Dairy Additional Payments

It is not yet clear how much land will be registered for payment. Land that had previously been excluded for payment such as that used for horticulture (fruit, vegetables and potatoes) may now be registered for payment. To be able to receive payment from 2005, landowners and/or tenants must register their eligible land on the Rural Land Register maintained by the RPA in 2005 to establish their 'entitlements' to receive payment under the Single Payment Scheme.

As already noted, the historic element of the SFP will diminish over an eight-year period to 0% from 2012 onwards. The actual amount of payment that individual claimants may receive is derived from the claimant's subsidy record over the reference period. Where claimants believe that their receipts were depressed at any time during that period because of exceptional circumstances or *force majeure* they may apply to have that particular enterprise struck from the record for calculation purposes. Incidents such as an animal disease, for example Foot and Mouth, or entry into an agri-environment scheme resulting in de-stocking for example, may prove a case in point for such adjustments to subsidy receipts to be reconsidered in the claimant's favour. Should the whole of a claimant's business have been adversely affected during the 2000-2002 period, a claimant may apply to have the reference period amended to an earlier reference period, probably 1997-1999 should that period represent a more typical trading period.

DEFRA estimate that the full falt-rate payment rates could be in the range of £20 - £40/ha for SDA moorland, £110 - £130/ha for SDA land other than moorland and £210 - £230/ha for all other land. An exchange rate of £0.70/Euro is implicit in these estimates and the figures do not include deductions made such as modulation and funding of the national reserve. [Our calculations suggest that the actual rates may be in the lower part of these ranges based on DEFRA's figures for the amount of land contained in each of the three regions and the estimated national subsidy ceiling for 2006 noted above (£1.74bn).]

It has been estimated by one agricultural consultancy that SFP's will be increasingly reduced as a result of modulation and the triggering of the financial discipline 'brake' such that actual payment rates may fall by up to 25% of gross individual SFP's by 2012. This would mean that payment rates in the lowlands would be in the range £150-£170/hectare, in the non-moorland SDA's to £65-£90/ha and moorland rates to £15-£30/hectare.

2.2 Modulation, the National Envelope and other deductions

There are essentially four possible types of deduction that can be levied against the Single Farm Payment, namely modulation both from the EU at a standard rate and a national 'voluntary' modulation deduction, funding of a 'national envelope', funding of a national reserve and finally (eventually), deduction as a consequence of the financial discipline limits being breached (degressivity).

As regards modulation, DEFRA have concluded that the SFP payable to individual farmers will be reduced over and above the EU standard modulation rates of 3% in 2005, 4% in 2006 and 5% in 2007 by use of a 'voluntary' national modulation deduction. The voluntary modulation rate for England to be levied in addition to the EU standard rate is to be 2% in

2005 and 6% in 2006. A rate for 2007 onwards has yet to be announced. The total rate of modulation will therefore be 5% in 2005 and 10% in 2006.

Modulation funds are to be used to fund schemes under the current England Rural Development Programme (ERDP), which is scheduled to continue until the end of 2006. Existing schemes presently within the ERDP are grouped either into land-based schemes (including the 'agri-environment schemes' such as the Countryside Stewardship Scheme, the Environmentally Sensitive Areas and the Organic Farming Scheme) or into project based schemes such as the Rural Enterprise Scheme and the Vocational Training Scheme. Modulation receipts are 'match-funded' by the UK Exchequer, presently on a 50:50 (EU/Exchequer) basis, although this may change in the future as there is an option under EU rules to move to a 60:40 arrangement from 2005. A decrease in the contribution from the Exchequer would result in an increase in the modulation rate in order to finance a fixed level of agri-environment scheme funding.

It is intended that a new Environmental Stewardship scheme will be launched by DEFRA in England in 2005 to replace the current three agri-environment land-based schemes. The Environmental Stewardship scheme will be funded by the voluntary modulation deductions with the project-based schemes continuing to be funded by the EU modulation fund. It is DEFRA's belief that demand for Environmental Stewardship funding will increase significantly in the early years of the scheme because of maturing existing agri-environment scheme claimants transferring to the new scheme and also because of new claims made by those landowners and/or tenants joining an agri-environment scheme perhaps for the first time seeking to replace 'lost' production subsidy funding.

The Environmental Stewardship Scheme is likely to have two strands namely an entry-level scheme and a higher-level scheme. It is anticipated that the higher level scheme will be more attractive to those claimants already taking part in the present three agri-environment schemes such as Countryside Stewardship and the Environmentally Sensitive Areas Scheme whereas the more basic entry level scheme is designed to attract those potential claimants who have chosen not to register for one of the existing agri-environment schemes in the past.

If DEFRA is correct in its assessment, it can be surmised that the total rate of modulation for 2007 onwards is unlikely to be less than the 10% rate expected for 2006. The rate of voluntary modulation is to be determined by the cost of the ERDP less the funding received from the EU standard modulation deduction. The United Kingdom is expected to receive

9.8% of the aggregate EU modulation fund with each EU member state receiving a guaranteed payment of a minimum of 80% of the modulation funds derived from its own farmers.

It should be noted that the first €5000 of SFP per farmer will effectively be free of EU modulation, but not of national modulation, whilst all further funding paid under the SFP will be subject both to deduction at the EU standard rate of 3% in 2005, 4% (2006) and 5% (2007) in addition to the national 'voluntary' modulation deduction. The EU deduction will be levied on the whole SFP due and a rebate made to the farmer for the deduction on the first €5,000 of SFP.

As has already been noted, agricultural subsidies are to be fully decoupled in England. There will therefore be no funding of a 'national envelope' as matters currently stand.

A national reserve will be established from 2005 and will be funded by a deduction of up to 3% from all individual farmers SFP. A national reserve is a requirement of the EU Regulations. The main purpose of the reserve is to act as a transitional fund to assist farmers who made changes to their business after the reference period, for example by buying or leasing additional land, to prevent them from being disadvantaged relative to other claimants.

Finally, with regard to possible deductions from SFP, a new mechanism has been devised and agreed that will effectively limit the CAP budget. Previously known as 'degressivity' but now known as the 'financial discipline', the agreed intention is that overall expenditure EU wide can be restricted member state by state when the EU Commission judge that the CAP budget is likely to be breached. The mechanism becomes effective from 2007 and it is intended to be invoked when the Commission judges that expenditure is within €300 million of the budget ceiling. The financial discipline therefore acts as a brake on further expenditure in an budget year and if applied would reduce the SFP to individual farmers by scaling back payments.

2.3 Cross Compliance and Set-aside

Payment of the Single Farm Payment is conditional upon certain agricultural and environmental prescriptions being observed by the claimant. These prescriptions are referred to as 'cross compliance' and it is important to note that should landowners and/or tenants choose not to comply with them that the SFP is not payable in any amount although it is thought unlikely that many farmers or landowners will choose not to apply for the SFP. The cross compliance requirements will also be applied to other growers claiming direct payments for crops such as peas and field beans.

There are two main elements of the cross compliance regime namely statutory management requirements (SMR) and secondly, the maintenance of farmed land in good agricultural and environmental condition (GAEC). Under SMR, the claimant will need to comply with existing EU regulations stemming from 19 EC Directives or Regulations concerning matters such as animal health and welfare, public health, plant health and environmental legislation. For cross compliance purposes, it is intended that the SMRs will be introduced over three years commencing from January 2005 with nine in 2005, seven in 2006 and the remaining three in 2007.

The second strand of the cross compliance prescriptions relates to the keeping of land in good agricultural and environmental condition (GAEC). There are 11 'standards and requirements' and these were advised to farmers in outline terms on 26 August with publication of the DEFRA document *Single Payment Scheme: Information for farmers and growers in England (July 2004 update)*, which was sent to all farmers. The 11 standards and requirements can be briefly listed as follows.

- Protection of hedges and watercourses. From July 2005, protective buffer zones must be established alongside hedges and 'seasonably wet watercourses'.
- Hedgerows. Hedges should not usually be cut between 1 March and 31 July
- Stone walls must not be removed without consent or damaged
- Rights of way must be kept free of obstruction (existing legal requirements apply)
- Set-aside buffer strips of six to ten metre width to be established next to sensitive habitats
- Protection and maintenance of soil to minimise erosion and run-off
- Heather and grass burning to be controlled in accordance with existing statute law
- Overgrazing to be prevented by appropriate management of stock levels
- Permanent pasture as a national resource must not be reduced to less than 95% of 2003 levels
- Land not wholly in agricultural production must be kept clear of invasive plant species and establishment of scrub vegetation prevented
- Protection of landscape features by compliance with existing legislation protecting for example archaeological sites, Sites of Special Scientific Interest (SSSI) and hedgerows

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The DEFRA document advised farmers that more complete details of the GAEC regime would be advised to them in autumn 2004 but it also noted that many of the requirements of both GAEC and SMR followed either existing legislation or 'common sense farming practice'. DEFRA considers therefore that adherence to the cross compliance regulations ought not to place a further additional burden on farmers in most instances.

The MacSharry reforms of 1992 instigated the practice of compulsory 'set-aside' where arable cropping land was deliberately taken out of production with the farmer being recompensed by way of subsidy for the profit foregone. The amount of land placed in set-aside except for the very smallest landowners and farmers is presently 10% of potentially productive land. Farmers were permitted to set-aside land in strips within fields of a minimum width of 20m or to put whole fields into set-aside. They were however required to maintain set-aside land in good agricultural condition and to be able to return it to productive capacity at the earliest appropriate time should they be required to do so.

New CAP rules concerning set-aside land came into effect from January 2000 when in addition to the usual 20m wide strip requirement, 10m wide strips could be established alongside water courses and bodies of standing water such as streams and lakes. It is important to note that set-aside has the dual purpose of reducing agricultural surpluses and thus the aggregate amount of subsidy paid to farmers thereby reducing or influencing the size of the total CAP budget but also instigating positive environmental benefits and public good by encouraging extension of biodiversity. This latter benefit is evidenced for example by the establishment of beetle banks, cover for ground nesting farmland birds and of so-called wildlife corridors permitting and assisting the transmigration of species between longer established but otherwise remnant habitats.

Turning to the requirements of the SFP, DEFRA advised farmers and growers in their booklet *Single Payment Scheme: Information for farmers and growers (July 2004 update)* that 'the rules for calculating set-aside entitlements …are different from the rules for determining set-aside obligations that applied until 2004 under the Arable Area Payments Scheme (AAPS)'. The rules have in fact been relaxed somewhat in order to assist farmers in the delivery of environmental benefits.

Set-aside entitlements are to be established on land capable of arable crop production ('eligible hectares') and of satisfying existing set-aside rules. It is expected that some farmers who have never had to set land aside before because of the type of farming practice they employ such as livestock farmers with all temporary grassland, will now have to put some of their eligible hectares into set-aside. This is largely the reason why only 8% of land will now need to be put into formal set-aside rather than the present 10%. A further reason for the lower percentage figure is because some existing set-aside land that has been under grass for five years at the assessment date of 15 May 2003 will be considered as permanent grassland by DEFRA rather than as productive arable land used temporarily as set-aside.

Not all farmers however will be required to put some of their land in set-aside. This category of exclusion applies to farmers whose holdings are entirely within the English moorland Severely Disadvantaged Area, those whose land is wholly ineligible for set-aside and those farmers whose business qualifies them as a ‘small producer’. Additionally those farming within the non-moorland SDA are required only to put 1.3% of their land into set-aside.

It is implicit in the cross compliance programme that a system of inspection and enforcement is introduced with penalties being imposed on non-compliant claimants. The Rural Payments Agency will be responsible for carrying out inspections and ensuring that the cross compliance standards and requirements are adhered to. In the event of non-compliance, penalties will be applied such that payments may be reduced by a sum ranging from 3% where non-compliance is the result of negligence on the part of the farmer up to total exclusion from the Single Payment Scheme where intentional non-compliance on a persisting basis is found.

3. NORTHERN IRELAND

3.1 Single Farm Payment

The Northern Ireland administration announced on 9 February 2004 that full decoupling of all direct payments in the beef, sheep, dairy and arable sectors would be introduced from 2005.

In contrast to the dynamic hybrid model to be adopted in England, Northern Ireland has chosen to introduce a static vertical hybrid model. The model comprises a static element derived from the proportion of the single farm payment originating from the amount of historic and area based payments previously paid and which will not vary from year to year (basic flat-rate assistance) coupled with a vertical element derived from the proportion of funds arising from each of the to be discontinued support schemes, which proportion varies between schemes. Each entitlement to SFP is comprised of a combination of both static and vertical elements.

The basic flat-rate assistance (area payment) element of a farmers entitlements will be funded by the release of funds from the present budgets allocated to the following to be decoupled schemes:

- 50% of Beef Special Premium;
- 50% of Slaughter Premium including the heifer top-up;
- 35% of Sheep Annual Premium;
- 80% of Less Favoured Area Sheep Supplement;
- 20% of Arable Area Payments.

It is anticipated that the above funds will provide a budget sufficient to produce a basic area payment of a minimum of €68/ha (£48/ha) on all eligible land in Northern Ireland. The basic area entitlement will be 'topped-up' for each individual farmer by an amount to be calculated based on historic claims made. The budget for this element of the SFP will comprise the balance of the remaining decoupled funds from the above schemes together with all funds from the suckler cow, extensification and dairy premium schemes.

3.2 Modulation, National Envelope other deductions

The administration in Northern Ireland announced its intentions as regards modulation and the 'national envelope' along with other aspects relating to the CAP reform programme on 9 February.

While the Northern Ireland administration were not considering instigating a national envelope in support of any particular part of the agricultural industry at the time of the initial announcement, the future setting-up of such an envelope was not discounted if in the future the need became apparent.

The Northern Ireland Minister with responsibility for Agriculture and Rural Development announced that voluntary modulation of possibly up to 3% to fund the national reserve was likely in addition to the EU compulsory rates of modulation deductions of 3% in 2005, 4% in 2006 and 5% in 2007. As with other countries within the UK and the wider EU, the first €5,000 of SFP is effectively exempted from EU modulation deduction CHECK. Delete if uncertain.

3.3 Cross-compliance

As in all other parts of the UK, farmers will need to comply with EU legislation as regards the Statutory Minimum Requirements and in addition maintain land in good agricultural and environmental condition in a similar manner to other constituent parts of the UK. The Northern Ireland Minister for Agriculture and Rural Development announced on 23 September that details of cross-compliance measures would be made available later in the autumn of 2004.

4. SCOTLAND

4.1 Single Farm Payment

Scotland like Wales decided to base its payments regime on historic payments made over the reference period of calendar years 2000 – 2002 but alone amongst the countries of the United Kingdom it also decided upon the introduction of a 'national envelope' to support its beef rearing sector. As in England, the start date for the SFP in Scotland will be 1 January 2005.

According to information published by the Scottish Parliament (*Frequently Asked Questions* correct as at 17 March 2004), the entitlement for receipt of the Single Farm Payment goes to the business that was farming or managing the land during the reference period. All farmers and crofters who received direct support payments during any of the reference period years will be eligible for payments.

The Single Farm Payment will replace the present six main direct support schemes together with associated payments such as the Less Favoured Area (LFA) sheep Supplement.

- Arable Area Payments Scheme (AAPS)
- Beef Special Premium Scheme (BSPS)
- Extensification Payment Scheme (EPS)
- Sheep Annual Premium Scheme (SAPS)
- Slaughter Premium Scheme (SPS)
- Suckler Cow Premium Scheme (SCPS)

4.2 Modulation, National Envelope and other deductions

The Scottish government has decided to set a combined rate of modulation of 10% to become effective by 2007. This rate of deduction combines the EU standard rate of modulation (3% in 2005 and 6% in 2006) together with a voluntary national deduction.

As mentioned above and following consultation with farmers and other stakeholders, the Scottish government decided that it would instigate a national envelope in respect of the beef sector. The Scottish government consider it necessary in the short to medium term to support the production of quality beef calves in 'peripheral areas' specifically for the public benefit to be derived by so doing in terms of the protection and enhancement of the environment and biodiversity.

4.3 Cross-Compliance

Scottish farmers will be required to adhere to a similar cross-compliance regime as other farmers within the UK in respect of the Statutory Minimum Requirements (SMR) enshrined in present EU legislation such as the Habitats Directive and Birds Directive and also Good Agricultural and Environmental Conditions (GAEC), in order to receive their full SFP.

The Statutory Minimum Requirements are already in force but in respect of cross-compliance they are to be phased in over a three year period in common with the remainder of the UK. Examples of EU legislation included in the SMR regime are:

- Birds Directive (79/409/EEC)
- Habitats Directive (92/43/EEC)
- Groundwater Regulations (80/68/EEC)
- Identification and Registration of Livestock

The Scottish Executive following consultation with stakeholders published its framework for GAEC on its website on 13 September 2004 (www.scotland.gov.uk/). The framework comprises 18 measures with attendant good practice guidelines covering four areas of concern namely soil erosion (six measures), soil organic matter (two measures), soil structure (one measure) and minimum level of maintenance (nine measures). Additionally there are two overarching conditions applicable to all measures being that all land must be capable of return to agricultural use by the next growing season at the latest and secondly that the land must be capable of inspection sufficient to determine the landscape features that should be excluded.

5. WALES

5.1 Single Farm Payment

The Welsh Assembly Government (WAG) announced on 11 February 2004 that payments under the Single Payment Scheme would be based purely on historic receipts received during the reference period 2000 – 2002. The SFP regime would commence on the same date at the remainder of the UK namely 1 January 2005.

The SFP will replace the following current schemes with effect from 1 January 2005:

- Arable Area Payments (AAPS)
- Beef Special Premium Scheme (BSPS)
- Suckler Cow Premium Scheme (SCPS)
- Extensification Premium Scheme (EPS)
- Slaughter Premium Scheme (SPS) and Veal calf slaughter
- Sheep Annual Premium Scheme (SAPS) and LFA Supplement
- Aid for Grain Legumes (GLS)
- Hops Income Aid & Special Temporary Measures Compensation Seed Production Aid

5.2 Modulation and 'National Envelope'

The Welsh Assembly after consultation with farmers and other stakeholders has decided not to instigate a national envelope at this time.

The present rate of voluntary modulation in Wales is 3.5% (2004) and is due to rise to 4.5% in 2005 and 2006. The Minister for Environment, Planning and Countryside announced on 14 July 2004 that a new entry-level agri-environment scheme to be known, as *Tir Cynnal* would be introduced in 2005 to be 50% funded through voluntary national modulation with the balance being match-funded by the Treasury. It is estimated however that the rate of total modulation will need to be in the region of 10% by 2006 should take-up of the new scheme meet the Assembly's expectations.

5.3 Cross-compliance

Similar cross-compliance rules will apply in Wales as in England and the remainder of the UK particularly in regard to the 18 Statutory Minimum Requirements, which will be phased in over three years commencing from 1 January 2005.

Precise details of the cross-compliance requirements to maintain land in good agricultural and environmental condition (GAEC) have not yet been published (as at 22 September 2004) but will cover the areas of soil erosion, maintenance of soil organic matter, maintenance of soil structure and management of landscape features and it is anticipated that they will be instigated to commence from 1 January 2005

It should be noted that Wales operates similar agri-environment schemes to those in operation in England in so far as they have similar objectives but they are organised differently from those presently operated in England.

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