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The CAP "Health Check": Relevant questions and their short answers

Single Payment Scheme (SPS)

How has the SPS been implemented in the Member States?

Member States could opt for a historic model (individual reference amounts), a regional model (regional reference amounts), or a mix of the two. Their choice (an almost even split, in budgetary terms, between historically-based and regionally-based support) reflects both objective factors, such as differences in production structures and environmental conditions, and their preferences on equity issues at the time of SPS introduction.

Should there be scope for the Member States to review their implementation?

Any system needs to provide the possibility of taking stock and making necessary adjustments. Both historical and regional implementations have advantages and disadvantages. Differences in support between producers will become harder to justify, especially in the *historic model*, as the reference period for SPS payments becomes more distant and therefore Member States may want to adjust their model towards a flatter rate. The *regional implementation*, while having more equal payment rates, provides little flexibility with respect to the activation of payment entitlements, which may result in further capitalisation of aid in land values, affecting production costs and decreasing transfer efficiency. There should be scope for simplifying payments, enhancing market orientation and improving the targeting of support.

How can the SPS be further simplified?

Some rules that have proven to be unnecessarily rigid and complex (e.g. restrictions on entitlements from the national reserve) or have become irrelevant as more sectors are reformed (e.g. 4 types of entitlements) can be simplified without altering the logic of the system. Additionally, certain implementing choices have resulted in a large number of small claims with disproportional administrative costs, which calls for a rethinking of the approach to such applications.

How could we move towards flatter rates?

Member States have the best knowledge of the conditions in their countries, the needs of farmers and rural areas, and the expectations of their public. It is therefore appropriate that the decision whether to move to flatter rates, at which scale (Member State-wide, regional...) and to which extent should be made at Member State level.

Should all farmers in the EU receive the same flat rate payment?

Natural and environmental conditions, and therefore also the costs of respecting standards and providing public goods through farming, are extremely diverse in the EU-27. An EU-wide flat rate would not guarantee that the objectives of direct payments are met everywhere, especially since the impact on land values and huge redistribution consequences between Member States and farmers could outweigh potential benefits. A flatter rate at a regional level, on the other hand, could mitigate most of these risks.

Cross-compliance

How does cross-compliance relate to farm support?

Cross-compliance is a mechanism that links full support under the first Pillar of the CAP (Single Payment Scheme and coupled payments) and under some rural development measures to the compliance of farmers with rules stemming from a list of existing and already implemented regulations and directives and from a list of standards aimed at the maintenance of land in good agricultural and environmental condition (GAEC).

What is the aim of cross-compliance?

Cross-compliance aims to contribute to the development of sustainable agriculture and to render the CAP more compatible with the expectations of society at large, by enhancing the respect of rules relating to the environment, to public, animal and plant health, to animal welfare, and to good agricultural and environmental practices that limit soil erosion, maintain soil organic matter and prevent land abandonment. To achieve this, cross-compliance incorporated in 2003, among all already existing and applicable legal acts concerning environment, public, plant and animal health and animal welfare, those rules that were considered as having the most direct relevance to farming activity.

Why do we need to reassess the scope of cross-compliance?

Cross-compliance has contributed to increasing farmers' awareness about already existing obligations related to the environment, to the public, animal and plant health and to the animal welfare and to better ensuring compliance with them. But its implementation has created some technical concerns related to controls and sanctions for Member States and farmers that were addressed recently by a Commission Report to the Council. The report foresees the screening of the scope of cross-compliance in the Health Check to improve its acceptance by all actors and the achievement of its objectives.

What criteria to consider in screening the scope of cross-compliance?

Following the recommendation of the Council, the screening of the requirements in the scope of cross-compliance has to meet certain criteria identified. These have been identified as the direct link with farming activities, farm lands, and farmer's responsibility, the assessment of the administrative burden for MS and farmers, and the relevance of rules with respect to the environment, public, plant and animal health and animal welfare and to the GAEC (land management).

What adjustments to consider in the scope of cross-compliance?

The screening of cross-compliance should identify those adjustments, whether relating to the withdrawal of some and/or the addition of other legal acts or of GAEC standards that are deemed necessary to improve the performance of the system without increasing the burden of cross-compliance for the Member States and the farmers. The impact of proposed adjustments will be assessed taking into account the criteria identified above and the controllability aspect.

Partially coupled support

Is partially coupled support still pertinent?

Partial coupling was introduced to retain a critical mass of supply for the processing industry and the economic, social and environmental benefits in regions with high risk of production abandonment. The extent of recent reforms, which integrated more sectors into the Single Payment Scheme, and recent market developments in most reformed sectors, seem to render the partially coupled support less relevant, especially in the case where a small part of the premium was kept coupled in few Member States (such as is the case in arable crops).

Does decoupling cause production losses and abandonment of land?

Decoupling introduces flexibility in the choice of producers. Farmers will continue to produce where it is profitable, and adapt their output to the market or change to alternative crops where it is adequate. Farmers are obliged to keep the land in good agricultural and environmental condition in line with cross-compliance rules – these rules clearly prevent land abandonment! We have already seen that decoupling did not imply dramatic changes in the production structure at the EU level. Certainly, risks of land abandonment exist at the regional level, but these are more related to the long-term profitability of farming in such regions.

What are the potential implications of further decoupling?

Decoupling leaves producers at least as well off as before, and most likely better off as a result of production flexibility, market orientation and major simplification. However, it is true that adjustments in production may represent a challenge for the agri-food chain. Strengthened Rural Development measures can be important in ensuring that production can meet industry demand in those areas most affected by decoupling where agriculture plays a positive role on the environment.

How can we ensure that the specificity of certain regions is respected?

Cases where decoupling could have a negative economic or environmental impact should be better addressed in a regional context. The potential risks and possible alternatives in the regions should be identified before deciding to which extent and until when partially coupled support should remain. Farmers' adaptation to other market realities can be also encouraged through Rural Development measures.

Are there specific cases in which support needs to remain coupled?

In some specific cases the minimum level of agricultural production is important to sustain economic activity in regions with few economic alternatives, or to ensure an adequate supply of raw materials to processing industries or to generate environmental benefits. In these cases if the coupled payment appears to be the best mean to address those needs, it is plausible to keep it at least for the time being analysing alternatives in a later stage.

Limits in direct payments

Why are we proposing upper limits for payments?

Calls for transparency on recipients of CAP payments are linked to the apparent imbalance which still exists in the distribution of direct support per beneficiary. The shift towards decoupled support makes this distribution more evident and puts pressure on the justification of payments – are they destined to the appropriate recipients? In this context the capping of payments, an old idea which was dropped in the past, has resurfaced.

Will capping alter the uneven distribution of payments?

In the EU-27, about 20% of beneficiaries receive around 80% of direct payments. This distribution is linked to farm size distribution in each Member State, farming intensity and which farming sectors formerly received production linked direct payments. Exactly for these reasons, only at low thresholds would capping change the distribution of payments per beneficiary. At such a low level, however, the measure also has a significant income impact on many beneficiaries.

What are the other main expected impacts from capping?

The main objective of capping is not to generate savings, which it does only at low thresholds. Savings will stay within Member States. The impact with respect to farms affected would be felt not only in the old Member States with the greatest number of large beneficiaries (DE, UK, ES) but also in some new MS (CZ, SK and HU). In the new DE Länder and the new Member States many of the large cooperative farms employing a high number of farm workers would be affected. Capping could also create the risk of larger farms avoiding the cap by splitting their holdings.

Does progressive capping mitigate such effects?

Setting a progressive capping at appropriate levels, instead of creating a single threshold, avoids a major risk of circumventing capping by limiting incentives to split a household. To accommodate specific situations such as the case of co-operatives, derogations taking into account their structure and workforce would be needed.

Why are we proposing a limitation for small amounts of payments?

The implementation of SPS made evident that, among the large number of farmers that receive small amounts of payments, often below the administrative cost of managing them, are recipients who are not genuine farmers. Therefore, for small amounts of payments a minimum area requirement and/or a minimum level of annual payments can be introduced in a way that prevents payments going to non-farmers without affecting real farmers.

Cereals & set-aside

What is the medium term outlook for arable crops?

The growth in global food demand and developments in new market outlets such as bio fuels can be reasonably expected to continue over the medium-term and to maintain prices at sustained levels - though at a lower level than at present. Although to a certain degree changes in agricultural prices are transmitted to food prices, current high prices are reflected to a much lower extent in increases in consumer prices given the low and declining share of agricultural raw materials in food production costs. Whether these developments constitute the reversal of a long-term trend of price declines of two decades is uncertain.

What are the present cereal support measures?

Before the 2003 reform the cereal CMO was based mainly on coupled direct per hectare payments, they were integrated with supply control measures (set-aside), market support (intervention) and border measures (a combination of export refunds and import tariffs). After 2003 reform most of the direct payments were decoupled and included in the SPS. The intervention system remained in place in order to ensure that internal market prices do not drop far below the intervention price, although rye and maize were subsequently excluded from the system. The set-aside obligation remained unchanged, although in the form of separate entitlements.

What is the impact of keeping intervention only for bread wheat?

Any change introduced to the intervention system should aim to ensure that it does not distort the underlying comparative competitiveness of different cereals. The withdrawal of intervention for feed grains would leave the market to establish the natural price hierarchy among cereals, maintaining a safety-net for bread wheat.

Why should mandatory set-aside be abolished?

Set-aside was introduced as a supply control measure. Over time, not only has its efficiency in limiting supply diminished, but the need to limit supply seems to constrain the arable sector in the EU from the potential benefits of increased world market prices. In addition, the administrative burden of set-aside management, both for farmers and MS, would be diminished if set-aside entitlements became regular SPS entitlements.

What would be the impact on the environment from set-aside abolition?

The implications of withdrawing set-aside have to be examined carefully with respect to the possible environmental impact. Although this impact is more localised, appropriate ways to ensure the environmental benefits from set-aside should be explored, especially by enhancing the implementation of voluntary set-aside and/or through cross-compliance.

Dairy quota

How has the changing market outlook overtaken the dairy quota system?

The quota regime was introduced in 1984 in order to limit the production effects of price-support policy in the context of depressed world prices. However, demand for dairy products has considerably increased in both the EU and the world in recent years, and is projected to grow even further in the future. Instead of high supply and depressed prices, the dairy sector is now facing strong internal and external demand and high prices. In this context, the quota acts as a constraint hampering the sector to benefit from favourable prospects.

How do changes in dairy support affect the dairy quota system?

The 2003 dairy reform decreased the level of EU dairy price support in a manner that reflected world market realities. A higher price cut and stricter limits in intervention were introduced in the product whose price was more out of line with world market prices (butter), while decoupled payments were introduced to lead the sector towards increased market-orientation and competitiveness. In the context of such an orientation, quotas go against it because they distort the price signal because quota rents prevent efficiency gains from restructuring and increase production costs.

What would be the effects of removing dairy quotas?

The sector should be able to better respond to market conditions. Preliminary analyses indicate that production would increase at the EU level, but prices would drop. Competitive regions and the sector in general would benefit from increased competitiveness in the EU and in world markets. Yet at a MS level and regional level, results will be varied, depending on the existing product mix, costs of production and prices. This could put pressure on the available market measures to keep the market in balance.

What could be done to help the sector adapt to the quota expiry?

Gradually increasing quotas until their phasing-out seems the best way to allow the restructuring of the sector proceed at a smooth pace. It would allow efficient producers to respond to demand growth and maintain competitiveness while providing a transition phase for the less competitive to adapt.

What specific situations need to be addressed?

Certain regions, especially mountainous regions, could face serious difficulties in keeping a minimum level of production, especially if current price expectations do not materialise. Some of these problems could be addressed with Rural Development measures aiming at developing added value for dairy products. However, since Rural Development policies are not designed to keep production in place, a specific solution for such regions to accommodate the "soft-landing" of quota expiry would be needed. One possibility would be to establish specific dairy support measures under a revised Art. 69 of R. (EC) no 1782/2003.

Other measures of supply control

What is the current system of support for small CMOs?

All products in the list of small CMOs benefit from coupled, or partially coupled, direct support. In some cases, aid is also given to the industry either in the form of processing aid (such as in dried fodder, flax and hemp, potato starch) or as production refund (starch). Although of different origin and justification, all of these measures have as a common feature that support is granted to sectors of limited contribution to the total value-added of EU agriculture, but equally they represent sectors whose regional importance could be significant.

Are these instruments as pertinent as before?

The 2003 Reform moved support from product to producer in order to increase competitiveness and market orientation. With 90% of aids decoupled, farmers receiving coupled aid are less oriented to markets and more limited in their production choices. Moreover, processing aid was introduced in the past either to avoid the complexity or increase the efficacy of coupled direct aid to farmers. With decoupled support, this problem is not relevant anymore.

What would be the implications of decoupling?

Farmers will continue to produce where it is profitable, and adapt their output to the market or change to alternative crops where it is adequate. Decoupling allows doing away with a complex system of additional tools (quotas, minimum prices, maximum guaranteed areas/quantities etc.) and guarantees that support remains with the farmer without causing overproduction.

Is decoupling a threat to the agri-food chain?

In general, decoupling brings positive effects for the EU food industry by encouraging farmers to become more market oriented and focused on quality production. There might be situations where adjustments in production represent a challenge for the processing industry. In such cases, it should be considered what appropriate means could play a role in ensuring that production can meet industry demand.

Are there specific cases in which coupled support needs to remain?

In some specific cases a minimum level of agricultural production is important to sustain economic activity in regions with few economic alternatives, to ensure an adequate supply of raw materials to processing industries, or to generate environmental benefits. In these cases if the coupled payment appears to be the best mean to address those needs, it makes sense to keep it at least for the time being. This option does not exclude the need to analyse alternatives at a later stage or provide a transitional period.

Risk and crisis management

What types of risk do farmers face?

Price risks, stemming from variation in output or input prices, and production risks, mainly from variation in yields, are considered as the main sources for risk that farmers face. Some of these risks are easier to identify and expect, and therefore can be kept more under control by ex-ante actions of farmers. Others, instead, are unexpected and require ex-post reactions.

What instruments are available to manage these risks?

A rather wide range of different measures exists in MS to manage agriculture-related risks. Production risks could be addressed by insurance (mainly hail) and mutual funds, principally developed by the private sector, and multi-peril insurance (mainly crops), developed on a public-private base. The main public measure is disaster aid, while MS are also active in risk prevention (sanitary and phyto-sanitary measures). With respect to price risks, public price support mechanisms still play a role, albeit more limited than in the past. In addition, for some agricultural commodities hedging (futures and options) can be used by farmers. Finally, decoupled support helped reduce substantially production and price risks by providing a fixed level of safe income.

What type of new risk are farmers faced with?

Changes that alter previously-established long-term weather patterns, such as those linked to climate change, introduce a totally new and unpredictable element in previous risks, including more uncertainty on yield patterns and more price risks related to developments in world markets (e.g. bio fuel).

Is an EU-wide scheme of risk management the best answer?

The March 2005 Commission communication, which looked into this question, included three discussion options (subsidies on insurance premiums, mutual funds, basic coverage against income crises) for a common framework at EU level, financed by one percentage point of modulation. However, Member States are exposed in different ways to risk, especially to climate change risk. Also, big differences in the legal, social, and economic background of MS render an EU-wide scheme difficult to implement and manage.

Why rural development policy for risk management?

Rural Development policy seems the best way to answer to the specific needs and the particularities of each country and region. Under existing programmes, MS have the possibility to include measures aimed at restructuring physical potential and promoting innovation which can help farmers to mitigate natural disasters and climate risk. In addition, the new RD Programmes include several measures which may be used for risk management, such as on-farm investment or measures to prevent floods, drought, or erosion. Whatever programme will be set up, a pre-condition for EU-financing will be its Green Box compatibility in WTO terms.

New challenges: Climate change, Bio Energy, Water management

Why is agriculture concerned by climate change?

Significant changes in weather conditions (increase in temperature, water scarcity and extreme climate events) with consequences on agriculture (decrease of the yields, sudden loss of crops, etc.) are already happening and are expected to become more pronounced. EU agriculture, which contributes to climate change mainly through green house gas (GHG) emissions, has performed better than other sectors in reducing emissions. Yet, more pressures on the sector are inevitable, especially given the complex interdependencies of climate change with other environmentally sensitive issues such as water management, biodiversity and bio-energy.

What Commission initiatives aim to address these issues?

The Commission Green paper "Adapting to climate change in Europe" (June 2007), which calls for early and cost-effective adaptation action to reduce damage from climate change, requires contribution from the CAP in adaptation measures, in the promotion of farming practices that are compatible with new climate conditions, and in mitigation, such as in GHG emissions. The Commission Communication "Addressing the challenge of water scarcity and droughts in the European Union" (July 2007) undertook an in-depth assessment of the situation at EU level. The EU's renewable energy roadmap has set binding targets for the share of bio fuel (10%) and renewable energies (20%) in total fuel and energy consumption by 2020.

What policy instruments are relevant to meet new challenges?

Climate change and agriculture's contribution of the Kyoto Protocol have been introduced among the strategic guidelines for Rural Development (RD) for the programming period 2007-2013. Current RD plans include measures aiming at adapting agriculture to climate change, as well as at contributing to meet the Kyoto Protocol. RD measures aiming at favouring the development of bio-energy as well as improving water management and biodiversity exist already within RD Programmes. Climate change and water management could also be pursued through the inclusion of these issues in the scope of cross-compliance. The feasibility of new instruments will be examined.

How does the Commission intend to meet these new challenges?

An assessment of the potential impact on agricultural markets from a 10% incorporation of biofuels by 2020 is already available by DG for Agriculture and RD. For climate change and water management, screening of existing measures within RD plans will allow the identification of measures with the highest potential impact, and eventual needs to further strengthen them. An assessment of the impact of existing (and eventually new) relevant measures is also being carried out.

Are more resources needed to implement those instruments?

The current financial perspectives have decreased initially foreseen funds for RD, and do not foresee additional EU funding either through the First or Second Pillar of the CAP. Thus further strengthening of the Second Pillar is essential if measures meeting these challenges are to be effectively employed.

Strengthening the Second Pillar of the CAP

What is the experience from modulation so far?

Modulation has had two main impacts. It increased funds available for the Second Pillar by shifting part of the direct payments of the First Pillar and it thus helped Member States to re-allocate available Rural Development towards the areas where more funds were needed, such as agri-environmental measures.

What will be the impact on farmers of an increase in modulation?

The increase in direct payment reductions above 5000 €, from 5% to 13%, implies a loss of support for farmers. However, since the bulk of this money will be available for project of direct benefit to farmers via Rural Development measures, the impact on overall farm income is positive due to the multiplier effect of Rural Development measures. Thus, while overall support does not change, it is re-distributed to those farmers that are more oriented towards Rural Development measures.

Will modulation do anything about the uneven distribution of payments?

The main objective of modulation is not to redistribute payments between farmers but to make more funds available for the Second Pillar. Since modulation is applied in a uniform fashion across all farmers for payments above 5000 €, it has a very limited redistribution effect towards farmers receiving low payments. The impact is limited because of the structure of the distribution of CAP support.

What are the budgetary impacts of these modulation proposals?

For EU-15, the increase in Rural Development funds will be significant, mitigating to some extent the decrease in funds agreed in the Financial Perspectives. This will contribute to meeting the increasing needs arising due to the emerging challenges for EU agriculture. For the EU-10 the increase will be smaller but it should be kept in mind that here a greater share of the budget already goes into Rural Development.