

# *The reform treadmill: the changing architecture of the Common Agricultural Policy*

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## **Introduction**

As the Common Agricultural Policy (CAP) seemingly lurches from one reform to another, the most radical reform proposals to date, in the shape of the Mid-Term Review (MTR), offered the prospect of the sort of policy regime long argued for by many commentators. For some time CAP analysts have pointed to the economic distortions and negative environmental impacts created by a system that effectively coupled the support a farmer received with production decisions. The vision of the MTR was to make farmers increasingly 'market facing', at the same time as improving environmental management and strengthening rural development and, importantly, strengthening the EU's negotiating stance in the current WTO talks. At the centre of the plan was the contentious proposal to break the link between subsidy receipts and production by decoupling support and providing farmers with a single income payment based on historical aid entitlements. The inevitable compromise eventually agreed on June 26 is, in many respects, significantly different from the earlier proposals. The key concept of decoupling remains but the agreement is highly permissive in terms of the degrees of freedom granted to member states in terms of implementing different decoupling scenarios, opting for different implementation dates, varying modulation rates, granting additional payments and broadening the scope of the CAP's rural development programme (also known as pillar 2 of the CAP). This paper examines some of the arguments surrounding the latest reform of the CAP, outlines some of the key features of the reformed CAP and considers some implications for rural economies and the environment.

## **The decoupling debate**

In many ways the MTR proposals aimed to strengthen and deepen the Agenda 2000 reforms by further reducing intervention prices and strengthening rural development. While Agenda 2000 and the earlier MacSharry reforms had introduced a degree of partial decoupling via direct support payments, the

MTR proposals went further by suggesting that almost all direct payments to farmers should be converted into a decoupled 'single income payment' to be calculated on the basis of average area (of supported regimes) and entitlement to direct payments in an historic reference period (2000-02).

Decoupling, it was argued, would bring many benefits, reducing the bureaucracy associated with farm support, improving market balance, promoting extensification and, most importantly from a policy perspective, decoupling would go a long way towards 'WTO-proofing' the CAP. In WTO terms current CAP direct support payments are known as 'blue box' payments and are subject to reduction commitments as a consequence of their distorting effects. Fully decoupled payments however, fall under the 'green box' heading and would not be subject to reductions (under the existing WTO agreement). Opponents of decoupling, on the hand, point to the potential for decoupling to stimulate restructuring with possible undesirable environmental, economic and social impacts. Indeed, decoupling is designed to speed up restructuring and stimulate changes in production levels. Based on the January 2003 MTR proposals DEFRA estimated that UK beef and sheep production could both fall by up to 15%, although this would be accompanied by a rise in prices. Opponents of decoupling argue that change of this nature could undermine future production potential, particularly if restructuring was spatially and sectorally concentrated, and lead to declines in associated agricultural infrastructure (such as abattoirs and markets). From an economic perspective, decoupling would create efficiency gains as resources were released from agriculture although the socio-economic multiplier effects could be wide ranging. One of the main forms of restructuring involves reducing labour and the main trend in the farm labour force in recent decade has been a reduction in the number of farm workers. One way of achieving the sort of efficiency gains that defra expect to emerge from the MTR would be for further reductions in labour which could have knock-on effects for rural communities. Other restructuring responses may involve keeping machinery for longer, reduced spending on inputs, etc, all of which may have knock-on effects.

### **The June 2003 CAP reform agreement**

The agreement reached on the 26<sup>th</sup> of June to reform the CAP has been variously described as 'historic', 'fundamental' and 'a real shift in agricultural policy'. The agreement does represent a marked break with the past policy framework and the degree of subsidiarity granted to individual member states means that in the coming years each country may be operating a significantly different version of the CAP, prompting some observers to claim that the reform agreement represents the re-nationalisation of the CAP. Decoupling remains a key component and has been presented by the EU Agriculture Commissioner as the default position around which members states have the freedom to implement various partial decoupling models. The key aspects of the reforms are as follows:

#### *Single Farm Payment*

The centrepiece of the reform is the Single Farm Payment (SFP, previously referred to as Single Income Payment (SIP) in the MTR

proposals) which will be decoupled from production and will be introduced in 2005 (although member states have the option of delaying implementation until 2007). The bulk of existing direct support payments will be subsumed within the new SFP calculated on the basis of aid receipts during the reference period 2000-2002.

Member states have a number of options as an alternative to the 'default' full decoupling scenario:

- Maintain up to 25% of current coupled arable aid payments **or** maintain up to 40% of current durum wheat payments.
  - Maintain up to 50% of current sheep and goat premia.
  - Maintain the current suckler cow premium at 100% and 40% of the slaughter premium
- Or**
- Maintain the current beef slaughter premium at up to 100%
- Or**
- Maintain 75% of the current beef special premium

The payments will be tied to land use although the production of potatoes, fruit and vegetables is prohibited on land with a SFP entitlement. This deals with earlier concerns that previously unsupported crops could be grown on land with support entitlements. The transfer by sale of SFP entitlements with or without land is allowed but transfers by lease must be accompanied by an equivalent amount of eligible hectares. A national reserve of SFP entitlements will be established to provide aid entitlements to those unable to establish their eligibility in the reference period. Member states also have the option to make additional payments (representing 10% of national aid entitlement) at a national or regional level to address the potential negative impacts of decoupling, encourage environmentally friendly farming systems and improve marketing.

In contrast to the earlier reform proposals there will now be no reduction in the cereals intervention price and the original increase in dairy quotas scheduled under Agenda 2000 will be delayed by one year. The additional increases in quota proposed under the original MTR proposals will be decided upon later. The dairy quota regime will remain in place until 2014/15 and the new dairy aid payment to be introduced in 2004 will remain coupled until 2008 (although here too member states have options for more rapid decoupling).

### *Cross-compliance*

The original cross-compliance proposals received criticism from some commentators that they were overly complex and based on compliance with far too many EU standards. Under the reform agreement full payment of the SFP and other payments will be conditional on compliance with a (now reduced) range of statutory environmental, food safety, animal health and welfare standards. In addition, farmers have to maintain land in 'good agricultural and environmental condition'. The explicit inclusion of the

environment (which was absent from the original wording) should be welcomed although it is up to each individual member state to define these conditions (based on a broad EU framework). Failure to meet cross-compliance conditions will result in direct payments being reduced. 25% of receipts from cross-compliance penalties can be retained by the member state, leading some farming organisations to claim that this creates an incentive for governments to be over enthusiastic in the application of cross-compliance penalties.

### *Degressivity and modulation*

The original degressivity proposals (automatic reductions in direct payments at the farm level) has been replaced with a new mechanism (financial discipline) to be introduced in 2007. Under the new provisions, direct payments will only be reduced when the CAP market support budget ceiling is forecast to be exceeded. Farmers receiving less than €5000 will be exempt from any resulting cuts in the SFP.

Modulation (reduction in direct payments and recycling of funds to pillar 2 rural development) will begin in 2005 (rather than 2006 as previously proposed) and at a higher rate than previously proposed. Modulation will operate at 3% in 2005, 4% in 2006 and thereafter will be set at 5%. Farmers receiving less than €5000 will be exempt from modulation. The UK will be allowed to modulate at a higher level in the earlier years in order to meet existing spending commitments. There had been considerable concern under the earlier MTR proposals that the UK would lose out under the proposed redistribution criteria. Those criteria remain but the new agreement specifies that 1% of the modulated money will be retained by the member state and that each country will retain at least 80% of its own modulated funds.

### *Rural Development*

The new arrangements for modulation will see approximately €9 billion available for rural development spending up to 2013 compared to less than €7 billion under the January proposals. A range of new (optional) measures have also been introduced under the amended rural development regulation including incentive payments for improvements in the quality of agricultural products and assurance schemes, financial support to help farmers meet statutory standards not yet included in national legislation, increased support for young farmers and a new animal welfare scheme.

## **Implications**

As seen from the preceding section the UK, along with other member states, faces a wide range of decisions regarding the implementation of the reform agreement. The timing of implementation, degree of decoupling, option of regionalised payments, provision of additional payments and broadening of the scope of rural development under the CAP are all at the discretion of the individual member state. It is not surprising given its

strongly liberalising agenda in relation to the CAP that DEFRA has already indicated that it will implement the default 'fully decoupled' CAP model although the response to the new rural development options has been more lukewarm. While DEFRA has previously stated that it is unlikely to take up the new provisions, they will be consulting on the idea of an animal welfare scheme and proposals to support local groups in setting rural development strategies. Although the precise shape of the new CAP is as yet unknown it is possible to consider some of the implications for the environment and the agricultural sector.

The new SFP is designed to be decoupled from production decisions. However, as a result of cross-compliance, it is effectively recoupled to a basic land management requirement and so will continue to have some impact on land management decisions and inevitably, production. A more significant concern though arises from proposals to allow the transfer of SFP entitlements. If the transfer of SFP entitlements is allowed such entitlements will gain a capital value and a market will develop dealing in their transfer. One concern is that land which has had its entitlement sold will be no longer protected by environmental cross-compliance measures (which only apply to land in receipt of the SFP). Depending on the scale of any transfers this could potentially leave environmentally important land without the basic protection of cross-compliance measures if for example, hill farmers chose to cash in their entitlement and transfer it to expansionist farmers in the lowlands. Alternatively, it is possible that in core productive areas farmers could release their entitlements and then enjoy the freedom to farm without CAP constraints. National environmental legislation would still have to be respected but any additional benefit currently or potentially provided through cross-compliance would be lost.

In terms of the environment, given that decoupling is designed to break the link between support payments and production decisions, the MTR should stimulate extensification which in areas of high and over stocking would bring about environmental benefits. However, there is a danger that in some areas with already low levels of grazing any further extensification would lead to undergrazing. The decoupling induced extensification effect is likely to make participation in agri-environmental schemes easier, particularly in the context of the new agri-environment Entry Level Scheme (ELS). However, much depends on the interaction between cross-compliance conditions and the requirements of the ELS. If the distance between the two is not sufficient additional participation in the ELS will bring about little additional benefit.

The implications at the farm level are particularly difficult to ascertain given the wide range of factors involved. DEFRA commissioned research on the earlier MTR proposals pointed to net economic gains for the UK in the region of €0.6-0.9 billion and an average 16% increase in NFI (Net Farm Income). Research conducted by the CRR into the impact of the January 2003 MTR proposal on Devon also indicated a rise in NFI of 16%. However, the reformed CAP will be faced by farms at different stages in

the business cycle, different stages in the household lifecycle and farms with different endowments of capital and skills and different degrees of ability and willingness to shift production and take advantage of rural development opportunities. Although significant short term restructuring is unlikely given the relatively fixed nature of capital assets, in the medium to longer term, as farmers face investment decisions, the sector will undergo restructuring. In addition, to the extent that the CAP reform agreement changes the policy framework within which farmers operate, their actions in the past may no longer be a useful guide to their behaviour in the future. Much decision making in the past was conditioned by the coupled nature of the support system. In the future, assuming DEFRA follow the default full decoupling route, decisions will be much more market based. However, well established trends such as the reduction in hired labour and the increased use of contractors seem likely to continue. To the extent that decoupling speeds up agricultural restructuring, it will clearly have implications for upstream and downstream sectors. The social and local economic impacts of such changes in turn, this places greater emphasis on the use of CAP rural development funds and structural funds to mitigate undesirable social and economic change.

The 2003 reforms have fundamentally altered the architecture of the CAP. The UK now has the opportunity to mould agricultural policy to meet national objectives of a more liberalised and market facing sector. However, while some of Agriculture Commissioner Fischler's original MTR vision remains, the reality is that a few years across the EU member states will be operating different versions of a now 'semi-renationalised' CAP. The result is that in addition to uncertainties surrounding the impact of the reform agreement on EU and UK farming, it is unclear whether the new CAP is sufficiently WTO-proof or if the EU will soon be climbing aboard the reform treadmill yet again.