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Policy assessment of an EU wide flat area CAP payments system

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ABSTRACT

While the evolution of the Common Agricultural Policy (CAP) until 2013 is clear, European Union (EU) budgetary pressures and the perceived unfairness of the distribution of CAP support across Member States has lead to uncertainty over the design of the CAP post 2013. One comprehensive reform option being considered is the implementation of an EU wide flat area payment (EUWFAP) system and a reduction of the total budget available for direct payments. It is hypothesised that the implementation of this policy proposal would lead to significant changes in the distribution of the EU budget and to the redistribution of agricultural production between the Member States, which could hinder the implementation of the proposal. This paper evaluates the rationality of the EUWFAP, based on the analysis of its budgetary and market impacts. Using the AGMEMOD 2020 combined model, the introduction of the EUWFAP in 2013 is compared with a baseline continuation of the current policy. Results suggest that there would be minor negative impacts on the agricultural production at the EU level, but that more substantial impact for some commodities, most notably beef, and could occur in the individual EU Member States. An important outcome of such a policy reform would be a substantial change in the budget allocation between Member States, which could help mitigate the budgetary tensions between the Member States.

1. Introduction

Besides cohesion policy, agricultural policy is the only significant budgetary policy of the European Union (EU), which is determined entirely at the Community level and predominantly funded from the EU budget. The primacy of the Common Agricultural Policy (CAP) stems from the desire, after World War II, for greater economic integration of Europe and a related requirement to ensure food security in post-war Europe (Tracy, 1997; Ritson and Harvey, 1997). Since its origins the CAP has been moulded through successive reforms resulting from constant internal and external pressures (Yrjölä and Kola, 2001; Garzon, 2006; Swinnen, 2008) such as domestic budgetary problems and international trade negotiation obligations (Swinnen, 2008; Cunha and Swinbank, 2009).

Since the 1992 MacSharry reform, there have been reductions in intervention prices, export subsidies and import protection, as well as the abolition of certain supply management measures. The 2003 Fischler reform and the Health Check revision of the CAP (Council Regulation 1782/03, 2003; Council Regulation 73/09, 2009) changed the basis for direct income support payments. The main aim of these reforms was to strengthen the position of the EU in the ongoing World Trade Organisation (WTO) negotiations (WTO, 2001, 2008). However, the introduction of historical payment schemes to the CAP has largely preserved the scope and distribution of CAP budgetary funds across the Member States and between farmers within Member States.

The future of the CAP will largely depend on the post 2013 EU budget debate and on the conclusions reached in relation to the size, type and justification of the direct payments to EU farmers under a reformed CAP. Any prediction of the precise nature of the long-term changes to the CAP is speculative, as such changes will largely depend on the division of power between reformist and more conservative Member States (Garzon, 2006; Swinnen, 2008), as well as on possible external factors such as developments in the WTO negotiations (Daugbjerg and Swinbank, 2007).

Contributions by Member States to the post 2013 EU budget are unlikely to increase significantly, but the pressure from the net

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contributor Member States to reduce CAP spending is likely to increase (Begg, 2005; Begg and Heinemann, 2006; Begg et al., 2008; ECORYS, 2008). There is also a realistic possibility of a re-nationalisation of Pillar I of the CAP, i.e. where all Member States would be required to co-finance CAP direct income supports from national funds (Grybauskaité, 2008).

Pressures for greater uniformity in the level of direct payments across Member States will also increase. Since expenditure on direct payments to farmers accounts for two thirds of the CAP budget, average direct payment amounts in the EU will probably decrease due to the pressures from some Member States for their abolition. The continuation of direct income support payments may hinge on reducing their redistributive nature (Begg and Heinemann, 2006; Cipriani, 2007) and on finding a new rationale for their existence, such as ensuring public goods provision by agriculture (OECD, 2003; Yrjölä and Kola, 2004; Begg et al., 2008; Bureau and Mahé, 2008).

European agricultural interest groups and certain policy makers stress the importance of the current system of direct payments to preserving the level of European agricultural production and argue that the abolishment or comprehensive reduction of payments would have large negative impacts on the production levels with knock on consequences for EU trade in agricultural commodities. However, recent studies by Nowicki et al. (2009) and Vrolijk et al. (2010) suggest that the impact of the abolishment of direct payments would not be as negative for EU27 agricultural production as argued by the many EU agricultural stakeholders. However, Nowicki et al. (2009) and Vrolijk et al. (2010) also find that the negative impacts of the abolition of direct payment could be more significant at the level of individual Member States, regions, commodities or types of farms.

In this paper, one possible post 2013 CAP reform scenario is outlined and its impact on the EU budget and agricultural markets is analysed using the AGMEMOD 2020 combined model of European agriculture (AGMEMOD Partnership, 2008). The post 2013 CAP reform scenario analysed, the introduction of an EU wide flat area payment (EUWFAP), reflects some of the content of recent public debates concerning the long term future of the CAP (Hervieu, 2010; Matthews, 2010). The main hypothesis is that the implementation of such a reform scenario could lead to significant changes in the budgetary distribution of direct payments between Member States, whereas the impacts on EU27 agricultural commodity production, while negative, would be relatively minor.

The paper is structured as follows. Section 2 outlines the perceived difficulties with the provision of CAP Pillar I direct income support and sets out some proposals for alternative farm income support mechanisms and also discusses the wider EU budget review. Section 3 discusses the structure of the model used for the analysis, with particular emphasis on the incorporation of policy measures in the model and sets out the CAP reform scenario (EUWFAP) evaluated. Section 4 details the results of the analysis and Section 5 discusses the results and draws some conclusions.

2. EU agriculture and budget

2.1. CAP Pillar I direct payments

Since the Fischler Reform of 2003, Pillar I of the CAP comprises of a combination of decoupled direct payments, price supports and coupled payments (CAP Monitor, 2009). Financially and politically, direct payments are the most important element of the CAP. A national envelope is defined for each Member State and these envelopes in effect represent historical rights to funds for direct payments. These funds are then distributed in each Member State according to the relevant implementation model of the single farm payment chosen (Council Regulation 1782/03, 2003; Council Regulation 73/09, 2009).

Member States, like France, Ireland and Spain, who in the past have generally been opposed to CAP reform, largely use the historical model of the single farm payment. Under the historical model an individual producer's payments are based on payment rights established by reference to the level of production and payments in the historical reference period (2001–2003). In contrast to this basic single payments system (SPS) scheme, England, Wales and Germany have adopted the so called regional model, whereby a uniform regional payment gradually replaces the historical payments overtime. Several Member States, including Finland, Denmark and Slovenia, use a hybrid model, which combines the elements of the historical and regional direct payments models. While the 2003 CAP reform introduced decoupling of direct payments, it also allowed the continuation of certain coupled payments and some Member States, such as France and Spain, have availed of this possibility to the maximum extent permitted. New Member States (EU12), with the exception of Slovenia and Malta, use the simplified area payment scheme (SAPS) under which in each of these Member States a uniform per hectare payment to holders of agricultural land is paid. SAPS is thus similar to the regional model, but without the system of payment rights allocated to producers. The 2008 Health Check revision of CAP encourages, but does not oblige, Member States to harmonise policy across the Union. Under Health Check Member States may change their policy towards the regional single payment model.

The proposition, that decoupled (lump sum) payments do not have production, market and redistributive effects (Conforti, 2005) only holds in the case of production neutrality and when markets are complete. However, Key and Roberts (2008) reported that with imperfect labour, credit or insurance markets, decoupled payments can have production effects. These effects tend on average to be minor, but could have significant consequences for the structure of individual agricultural holdings (Key and Roberts, 2008). Westcott and Young (2004) and Coble et al. (2008) also identify the important role that producer's expectations relating to the path of future reforms and their possible dependence on current production decisions have on the supply inducing impact of some decoupled payments.

Table 1 shows indicative estimates of average direct payments per hectare of utilised agricultural area across the Member States. There are large disparities in terms of average payments per hectare among the Member States. On average, the hectarage payment is the highest in Greece (544 EUR/ha), followed by Malta (494 EUR/ha), whereas the payments are on average lowest in the Baltic States (Latvia 83 EUR/ha) and in Romania (92 EUR/ha). These disparities have become a serious political issue between the Member States and will significantly influence the nature of the debate on the CAP post 2013.

New EU Member States, in particular Poland, Latvia and Estonia, have highlighted the disparities in the level of direct payments per hectare and have made requests for their equalisation (Agra Focus, 2008; Agra Focus, 2010b) in the direction of EUWFAP. The equalisation of payment levels across Member States so as to ensure a fairer and more equitable agricultural policy in the EU has become one of the main topics of the post 2013 CAP reform (European Commission, 2010a).

Justifying the CAP is central to forming a sustainable long-term perspective for agricultural support in the EU. It has been argued (Bureau and Mahé; Frandsen, 2008; IEEP, 2010) that agricultural policy can be justified by its role in the provision of public goods and, that accordingly, the name and stated objectives of the CAP should be changed (Buckwell, 2007; Swinnen, 2008; Begg et al., 2008; Bureau and Mahé, 2008). Pillar I CAP payments for environmental and animal welfare friendly agriculture and supports to agriculture in less favoured areas could, together with more targeted payments under the Pillar I (such as EUWFAP), form a system of payments for various public goods related to agriculture. Bureau and Mahé (2008) and Baldock et al. (2010) argue that the current single farm payment system should be replaced with a contractual payment system, under which direct payments would be paid to farmers in return for the provision of agreed levels of public goods and services.