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The future of direct payments system in the EU agriculture; European Commission scenarios

Abstract. The paper deals with the future of direct payments system in the EU agriculture. Different scenarios of the current system adjustments, as proposed by the European Commission, are presented. Four possible scenarios are being discussed: An 'EU flat rate', a pragmatic approach, the use of objective criteria and a combination of a pragmatic approach and objective criteria. It seems that the best option for the New Member States are the flat rate or the pragmatic approach criteria.

Key words: agriculture, Common Agricultural Policy, direct payments, EU Commission scenarios.

The system of direct payments in the EU has a long history, but their nature has changed significantly over the years. With the 1992 reform, they were introduced as coupled payments, linked to production based on farm acreage or number of animal heads and compensating farmers for cuts in price support. From 2003, direct payments were gradually decoupled from farmers' production decisions. For the rate of payment each farmer was eligible for, previous support receipts (linked to either the individual farmers' or the regions' production history) were used as reference.

Today, considerations have to be made with respect to a more equitable distribution of support between Member States and between farmers as well as to a strengthened role of the income support and public goods provision.

Distributional concerns stem from the current uneven distribution of support between individual farms and Member States. The latter issue is especially emphasized in the inter-institutional and public debate and by many of the new Member States (EU-12) that feel disadvantaged compared to the EU-15 countries, because their average levels of direct payments per hectare are lower.

Today, as adjustments in all agricultural sectors have taken place and as twelve more Member States have joined the European Union with a substantially different production and support history, differences in support levels based on historical references cannot be justified. Even more so because farm structures and production patterns have of course changed since the reference periods. Moreover, direct payments based on historical production patterns do not reflect the fact that important environmental public goods tend to be provided by farms with lower yields. Those farms also tend to be more economically vulnerable and so in need of greater support.

Present discussion is especially vital because of the preparation for the new Financial Perspective 2014-20. That is why decisions about the level of future direct payments across EU should be taken soon.

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Redistribution of direct payments

The future distribution of direct payments (DP) should better reflect the dual role of direct payments for income support and provision of public goods by ensuring a better fit between these policy objectives and the budgetary means available. At the same time, the current distribution will need to be taken into account to avoid major disruptions. Several options for redistribution of direct payments envelopes between Member States can be foreseen:

- an 'EU flat rate': direct payments are distributed evenly on the total of potentially eligible hectares across Member States
- a pragmatic approach: limited adjustment of the existing distribution in order to avoid major disruptions to current DP levels, while setting an EU-wide minimum level of per hectare payment based on a share in the EU average
- an application of objective criteria: the EU flat rate is adjusted by objective criteria based on economic, physical and/or environmental indicators
- a combination of a pragmatic approach and objective criteria.

It should be noted that the simulations do not address the issue of the length and the modalities of a possible transition to the new distribution which will also depend on the final level of redistribution involved. The calibration of the transition period would not only be of importance for the Member States which would see their national direct payments envelope decreasing but also for the Member States which will benefit from an increase. Indeed, the sometimes important gains in direct payments per hectare in the following options could not only drive up land prices but also prove to be an impediment to structural changes, as they could prevent farmers from restructuring, growing and improving the profitability of their farms.

The starting point of simulations is the current level of direct payments per hectare, which is calculated by dividing the total direct payment envelope for each Member State (with 'phasing in' completed for the EU-12 and modulation taken into account at the level of 2013) with the total potentially eligible area for SPS/SAPS as declared by farmers and communicated by Member States to the Commission in the frame of the IACS (Integrated Administration and Control System; claim year 2008).

All simulations of the direct payments redistribution assume the budget for direct payments set out in the proposal for the Multi-Annual Financial Framework (MFF). Results of the different options are presented in comparison to the existing national envelopes based on the current distribution of direct payments.

EU flat rate

One option arising from the public debate would be to move away from historical references towards an EU wide 'flat rate' (or 'EU average') with the same level of aid per hectare to all farmers in the EU (option called 'EU flat rate' in the Commission documents). For the EU-27 the average level of direct payments, i.e. the EU flat rate would be EUR 267/ha of potentially eligible area (PEA).

This option would produce significant losses for Malta, Belgium, the Netherlands, Italy, Cyprus and Denmark while substantial gains for Latvia, Estonia, Lithuania, Poland

and Romania. In absolute terms, the biggest winners would be Romania, Poland and Estonia, while the biggest losers would be Italy, Denmark and France. The total amount redistributed would reach EUR 4,394 million.

However, as explained in the Communication on the CAP towards 2020, a flat rate payment across the EU may fail to reflect differences in the economic and environmental situation in the Member States, since a given level of payment does not have the same effect on income and each hectare does not equally contribute to the provision of environmental public goods [Communication... 2010]. Moreover, the change from current levels of support to the flat rate could be disruptive in certain cases as indicated above.

Finally, it has to be kept in mind that land is distributed unevenly between farms: in the EU-25 almost 90% of land is concentrated in 20% of holdings. Therefore, a move to an EU flat rate with an even rate of direct payments per hectare would not solve the problem of an uneven distribution of direct payments between farms as this is based on the structural reality of farming in the EU.

Pragmatic approach

Another option mentioned in the Communication is to adopt a pragmatic approach, by providing for instance that all Member States get at least 80% of the EU average per hectare.

In the status quo distribution, eight Member States are below the 80 % threshold, while eleven Member States are above the EU average. The cost of lifting the per hectare payments in the poorer Member States to 80% of the EU average (i.e. to EUR 213/hectare) would be covered on a proportional basis by the eleven Member States that are situated above the EU average. This would require a reduction of their envelopes, while the envelopes of those Member States who fall between 80% and 100% of the EU average would remain unchanged.

This option would allow addressing the situation of Member States which are significantly below the EU average while mitigating the impact of redistribution on those above the EU average. In absolute terms, the biggest winners would be Romania, Latvia and Lithuania, and the biggest losers France, Denmark and Italy. The total amount redistributed would come to EUR 847 million.

It could also be envisaged that Member States that currently have direct payments below the level of 80% of the average will by 2014 close 1/3 of the gap between their current level and the 80% level.

This option would provide less convergence for the Member States below 80% of the EU average. Consequently, the cost of convergence to be borne by Member States above the EU average would also be more limited. In absolute terms, the biggest winners would be again Romania, Poland and Estonia, while the biggest losers would be Italy, Denmark and France. The total amount redistributed would come to EUR 738 million.

Alternatively, it may be envisaged that all Member States get at least 80% and that no Member State gets more than 120% of the flat rate (option called 'Tunnel 80').

This option would provide a more substantial convergence around the flat rate. However, the cost of convergence would be borne by a more limited number of Member States that would face significant reductions in their envelopes. In absolute terms, the biggest winners would be again Romania, Latvia and Lithuania, while the biggest losers

would be Italy and the Netherlands. The total amount redistributed would come to EUR 847 million.

Use of objective criteria

Another option would be to base the distribution on objective criteria that reflect the dual role of direct payments in providing income support and public goods and would thus ensure a more equitable and efficient use of budgetary resources.

Possible objective criteria are very diverse in nature and may provide a very different outcome in terms of redistribution of direct payments on account of the specific economic and environmental situation of each country. The difficulties with reaching agreement on such objective criteria should not be underestimated. A selection of the criteria which have been most discussed in the institutional and public debate is given below.

For general economic criteria, PPS (purchasing power standard) and GDP/cap: an index is used for the adjustment in relation to the EU average, with the Member States with higher GDP/capita (expressed in PPS) receiving higher direct payments/hectare. These criteria would reflect disparities in the costs of living between Member States.

For economic criteria related to agriculture, AWU (annual working unit) and GVA/AWU (gross value added per AWU): a comparison to the EU average, with the Member States with higher GVA/AWU receiving higher direct payments/hectare. These criteria would reflect differences in productivity in the agricultural sectors of Member States.

For the environmental criteria, acreage of less favoured areas (LFA), Natura 2000 zones and permanent pasture: The index compares the share of the relevant area in the Member State's total utilised agricultural area (UAA) to the EU average. Thus Member States with a higher share of these types of areas get higher direct payments/hectare. These criteria would reflect disadvantages in particular areas or areas that are particularly important for the provision of public goods.

Another approach would be a combination of economic and environmental objective criteria to adjust the EU flat rate, based on the following formula (using a weight of 2/3 for economic and 1/3 for environmental criteria).

Flat rate $\times [2/3 \times [(2/3 \text{ GDP/cap} + 1/3 \text{ GVA/AWU})] + 1/3 (1/3 \text{ LFA} + 1/3 \text{ permanent grassland} + 1/3 \text{ Natura 2000 area})]$, where the components are relations to the EU average.

The use of objective criteria giving more weight to economic criteria would accentuate the gap between the EU-12 and the EU-15 Member States (United Kingdom, Spain and France) and it would most improve the situation of the last in absolute terms. With environmental criteria Spain, United Kingdom and Portugal would profit most. With a combination of economic and environmental criteria Spain, United Kingdom and Ireland would be the greatest winners while in addition to Italy and Belgium also Poland would be among the biggest losers. For the smaller Member States (Malta and Luxemburg) an ad hoc solution would be most likely in any case when using objective criteria, given the extremity of the impact for these Member States.

The main problem with this option is the fact that it would entail massive redistributions (e.g. with the latter formula combining economic and environmental objectives the total amount redistributed comes to EUR 4,516 million which could, however, vary depending on the exact weighting of the different objective criteria taken

into account) which is likely to make it politically unacceptable for many Member States to agree to such a redistribution.

Combination of a pragmatic approach with objective criteria

Obviously, there are different ways to combine objective criteria. There are also different ways of combining objective criteria while taking into account the convergence objective and the current distribution, such as:

- to ensure a minimum level of convergence (e.g. that all Member States get at least 90% of the EU average) while using objective criteria to define the level of payments in Member States currently above the EU average (option called 'Min90% with objective criteria' in the Commission document [Communication... 2010]); the total amount redistributed would be EUR 2,164 million
- to apply the objective criteria to the difference between the current distribution and the EU average so as to ensure that all Member States that are above the flat rate will be reducing their direct payments but still remain above the flat rate and those that are below the flat rate will be increasing their direct payments but still remain below the flat rate; the total amount redistributed would be EUR 2,534 million.

The discussion is still going on and will most probably be this way till the end of 2012. However, the best option for the New Member States are the flat rate or pragmatic approach criteria.

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