FROM PRICE SUPPORT TO DIRECT INCOME SUPPORT: THE EU EXPERIENCE

ENPARD-IAMM Seminar
Exploring potentially useful lessons from the EU experiences

Tel Aviv, 18-19 May 2016

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Historical perspective on direct payments

- **1962-1992** Market price support
- **1992-2003** Compensatory payments (semi-decoupled)
- **2003-2014** Decoupled direct payments – Single payment Scheme
- **From 2020 onwards?**

**Budget constraints**
- Gatt negotiations

**EU enlargement**
- WTO Doha round

**Tension on EU budget**
- Legitimacy of CAP expenses

**EU farming crisis**
- Simplification?
Historical perspective on direct payments

- Export refunds
- Coupled direct aids
- Decoupled direct aids with greening (min.)
- Decoupled direct aids (max.)
- Rural development (RD) (min.)
- Possible margin for RD
- Possible margin for direct aids
- Market-related expenditure


Values in billion EUR - current prices
Single Payment Scheme


Move towards full decoupling

- Enables to anticipate CAP expenditures
- «This gives farmers the freedom to produce according to market demands to production» ...
- «whilst guaranteeing them a more stable income, independently of what and how much they produce».

- Farmers are granted payment entitlements
- With a given value per eligible hectares
- Giving a « conditional right » to a single annual payment
- Under cross-compliance conditions
Historical model: on the basis of the payments received by the individual farmer during a reference period – Different aid levels per hectare

Regional model: flat rate per hectare calculated by dividing all payments received in a region by number of eligible hectares

Hybrid model

Consequences of the historical model:
- Heterogeneous payments to identical farms!
- Reinforces past unequal access to aid
- Entry barrier for new farmers

the regional model:
- Disruption in support granted: economic and political consequences
Tradable entitlements

Possibility to transfer entitlements to another farmer (sale/lease) independently of the transfer of land (under certain conditions)
Regulated market

**Why?**

Expectations that trade can increase the efficiency of the SPS and facilitate new entrants and restructuration

**Consequences:**

Speculative acquisitions: purchase of high value entitlements activated on low value land with unconstraining GAEC – ensuring a high stable income to little active farmers
Cross compliance

Entitlements can be activated even if land is not cultivated

**BUT**

- Farmers must comply with legal « Mandatory management requirements » and
- Farmers must demonstrate that they are keeping their land in «Good agricultural and environmental conditions » (GAEC)

**must be respected by the farmer**

**Consequences:**

- *How to justify the GAEC requirements and avoid feelings of unequal treatment?*
- *Costs of controls (borne by public authorities AND farmers)*
- *Distinguish between true fraud and negligence/misunderstanding*
Strengths of SPS

References:

- European Court of Auditors, 2011, SPS: issues to be addressed to improve its sound financial management, Special report No 5, 84 pages

- Direct payment budget can be stabilized and fully anticipated
- Payments should be administratively simpler and entail lower transaction costs
- Stable and guaranteed income for farmers: the risky share in total income is reduced
Weaknesses of SPS

- **SPS can slow down structural change** in the agricultural sector: delay actual retirement of farmers, be barriers to entry for new farmers, slow down incentives to innovate and to adapt quickly to market changes.

- **Capitalization in land values and land rental prices** (especially in the regional model and if number of entitlements are greater than eligible area).

- **Insurance effect** may increase risk-taking strategies in agricultural activities: for example less diversification in crops.

- **No apparent logic in the allocation of support**:
  - It does not reflect the cost of maintenance of land nor the public positive externalities.
  - Distribution of support essentially based on the surface of land without taking into account the specific circumstances of the recipient and of the economy.
  - Payments may seem arbitrary and lose legitimacy in the public’s eye.
Dependance of farm revenues from CAP payments

- Share of direct payments and total subsidies in agricultural factor income (2007 constant prices) -

For more information: [http://ec.europa.eu/agriculture/analysis/perspec/index_en.htm](http://ec.europa.eu/agriculture/analysis/perspec/index_en.htm)

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Contact: DG Agriculture and Rural Development, Agricultural Policy Analysis and Perspectives Unit
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The 2014 CAP reform

Introduction of a new direct payment system: Basic Payment Scheme

• Fairer
• Greener
• Simpler
• More effective

Principles:

• Better targeting
• Uniform payments per eligible hectare in the same agro-pedo-climatic zones
• Degrssivity and capping
• Conditional to the respect of environmental practices
Breakdown of direct payments

- All agricultural land eligible to the BPS
- BPS reserved to « active farmers »
- Black list: airports, railway services, permanent sport grounds etc.

Source: DG Agriculture and Rural Development.
Greening

Cumulative environmental benefit

- **Mandatory** with financial support
- **Voluntary** with compensation (for costs incurred and income foregone)

- **Cross compliance**
- **Greening**
- **Agri-environmental Measures (2d pillar)**
Three agricultural practices beneficial for the climate and the environment

- Crop diversification
- Maintenance of permanent grassland or equivalent practices
- Ecological focus area on 5% of arable land

Not a voluntary measure! Inobservance induces the cancellation of the green payment AND a reduction of direct basic payments

**Issues:**

- Identify « across-the-board » practices to ensure equal treatment but not much environmental justification
- Input-based rather than result-based policies
- Individual rather than collective incentives
- Short-term (annual) instead of long-term
- Ensure additionality (compared to current practices and cross-compliance)
- Non compliance: greening less effective in times of high prices when it is most needed ... and vice versa
• Payments targeted at « Active farmers »:
  Definition might be controversial
  Eliminate: hobby farms? Subsistence farming? Unconventional farm activities?

• Additional payments for young new farmers
  To facilitate their establishment and renewal of generation
  Definition of young farmer (age?) and additional criteria (training, skills, start-up project)

• Payments for areas with natural constraints
  Definition of natural constraints (mountain area, climate, aridity... and specific constraints (peri-urban? other...)

• Small farmer scheme
  Simplified lump-sum payment for small farms without cross-compliance or greening constraints and pre-established forms
Redistribution and equity

Convergence
Basic payments per hectare must converge towards a uniform value per region
Several models of convergence: immediate to progressive
Consequences on farm revenue: discontinuity in business plan and general discontent

Degressivity / capping
Payments per beneficiary are reduced by a given % above a certain threshold
Possibility to cap total direct payments per beneficiary
Adjust the cap to take account of the farm ‘s contribution to objectives such as rural employment

Redistributive payment:
Possibility to provide additional payments to the first hectares of each farm to grant additional support to small and medium-sized farms
Opportunities and threats

• Multi-layered structure of direct payments = clarification of agricultural policy objectives
  but amounts paid defined by budget constraints, NOT by evaluation of needs or cost compensation or value of ecosystem services

  Does respond only partially to the issue of CAP expenses legitimacy (within the agricultural sector and outside)

• Unresolved issue of price volatility: Direct payments do not provide adequate responses in times of price crisis.
  - Can they aggravate risks of price falls (bargaining position of farmers? Specialization and oversupply?)
  - Need to do add another instrument to deal with price falls (safety nets? Insurance? Public stock?)

• Dependence of farm revenue on CAP decoupled direct payments: identity crisis in the farming sector, administrative fatigue, uncertainty for farmers on the continuation of payments...
Recommendations and alternatives?

- Legitimacy of direct payments to farmers: both for the agricultural sector and for the rest of society. Need to think and communicate on payment calculations and justifications.

- Envisage combinations of instruments to ensure more efficiency and equity: capping /degressivity linked to price levels, employment, location, countercyclical payments, insurance...

- Analyse how risk-related strategies and incentives for innovation and adaptation change with direct payments and foresee consequences.
Recommendations and alternatives?

- Beware of perverse effects: bargaining position with the rest of the supply chain, demand for land etc.

- Design carefully the transition from price support to direct income support – Predictable horizon is needed – Importance of perceptions and attitudes