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**Impact of the Commission proposal on Decoupling :
summary**

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Summary

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Summary

The contribution underlying this summary analyzes the European Commission proposal on the decoupling of direct payments from production.

For this purpose, the risks and opportunities of decoupling are first being examined in general terms, i.e. irrespective of the concrete EU proposal for practical arrangements. This analysis leads to the recommendation to adopt decoupling as soon as possible:

- Decoupling will improve the certainty of planning and competitiveness of businesses with development potential.
- Businesses without development potential will also acquire a better planning base. They will no longer be compelled to produce at a loss to receive direct payments and they will be preserved from using part of the direct payments to cover losses from current production.
- The starting base of the EU in the WTO negotiations will be improved.
- Furthermore, decoupling essentially presents the opportunity of improving the fair distribution of payments, whilst lowering administrative and control costs.

According to the results of our national and international research work, the concern over a sharp drop in agricultural production in some locations due to decoupling seems largely baseless. With a view to agricultural economic research, however, it must be pointed out that the information base on the international competitiveness of European farming is still very patchy and fragmented. If decoupling would really result in large areas being completely set aside (or other undesired consequences), however, then the second pillar of EU agricultural policies could be used to take effective countermeasures.

After this interim result that basically applies to any kind of decoupling, the paper addresses the concrete proposal for arrangements that the Commission presented in January 2003. The following conclusion can be drawn from an analysis of this proposal:

- Farmers who had been allocated payment entitlements within the framework of the 2000-2002 reference period, will record an increase in income in the short and medium term as decoupling will cause a rapid drop in rental prices for agricultural land. The thus benefiting farmers also stand to benefit from entitlements in the long term by accumulating payments on their owned land or by selling entitlements to farmers that own "entitlement-free" areas.
- The EU proposal will end the previous shifting of allocation of resources under agricultural policy to landowners and to the "*Sofamelker*" (farmers ceasing to farm who sell or lease their milk quota). At first sight, the implementation of the proposal will favor active farmers. Yet, when one looks at it again it turns out that this only benefits the active farmers of the 2000-2002 reference period. In the course of time, there will be an ever increasing shift from the then active farmers to the originally benefiting group of people that will have ceased to farm then in most cases. The pressure for re-

ducing payments will steadily intensify, therefore. In view of the fact that lessors incur drastic losses in the short term already in particular cases, the question arises whether this group of people should not also be entitled to protection of their legitimate expectations. Similar questions arise with a view to producers of crops that have hitherto not been eligible for payments (notably potatoes, field vegetables) for the prices for these crops will fall due to decoupling without the farmers receiving any compensation for this under the EU model for decoupling.

- Considering the drastic impact on income in some cases, the issue whether the EU proposed model could withstand a legal review should also be closely examined. The issue why the payments are made at all should play a key role in this context. If compensation for price-cutting is given as a reason as in the 1990s, we should ask (a) how long this argument can still be convincingly presented and (b) why indirectly affected people (e.g. lessors, potato producers) do not receive any compensation either. If flat-rate support for farming is given as a reason (e.g. rewarding of positive externalities) the question arises why not all farmland is eligible for premiums.
- When rental prices drop considerably, purchase prices for farmland will also come under pressure. It is true that this presents new opportunities (e.g. when implementing nature conservation measures), but it also harbors risks. Thus, banks notably will have to reflect on how to additionally secure their loans to farming (e.g. by admitting payment entitlements to serve as collateral).
- In terms of the policy system, it must be pointed out that the decoupling model suggested by the Commission is not optimally consistent with the cross-compliance concept. The decoupling model provides individual holdings with the opportunity to sell all entitlements, thus circumventing all cross-compliance requirements as well in so doing. If such examples become known, it will be difficult in the long run to convincingly "sell" the cross-compliance idea in the political sphere. The concept of a uniform area payment would not be vulnerable to attack.
- We must also critically assess the Commission proposal under the aspect of social peace in rural areas. If farms that cease production, for example, accumulate their payment entitlements on their owned land or sell it at the stock exchange, with previous lessors thus recovering their land without entitlements, fierce disputes can be expected. At farmers' meetings the concern is always felt that the income redistribution among lessors and lessees promoted by the Commission proposal would be too substantial and would overstrain the adaptability of all those concerned.

Yet, the redistributory effect could turn out quite differently than forecasted here if the Member States (e.g. under the pressure of court decrees) seize the option of turning the "hardship clause" envisaged in the Commission proposal de facto into a "young farmer's clause". Then, the demand for entitlement-free hectares would be redirected from private entitlement exchanges to public allocating bodies. Not only would entitlement-free land run short, but rental and purchase prices would not be lowered either.

As long as this option is available, the predictability of the impact of the overall concept will be considerably impaired.

In view of the above risks associated with the Commission proposal, the question concerning alternative decoupling models that would allow a "softer phasing-out" of coupled payments comes up.

In Article 58 of its reform proposal, the Commission itself enables the Member States to put a very simple alternative model in place instead of the currently discussed decoupling model. This proposal basically provides for a distribution of the entire payment volume of a specified region among all farmed agricultural areas of this region (without permanent crop areas), i.e. to introduce a uniform area payment. Yet, the Commission proposal gives only little information about the transfer of payment entitlements in this option.

The key problem arising from this alternative proposal tabled by the Commission lies in the fact that it would already result in major changes to income levels on many holdings in the year of the policy change. Whereas some of the holdings would be pleased with a generous overcompensation (e.g. extensive grassland farms, sugarbeet producers), the others would have to sustain drastic and abrupt income losses resulting from policy change (e.g. intensive cattle fattening farms). It is, therefore, unlikely that the EU Member States will adopt this alternative concept.

The concept "area payments plus individual additional payment" proposed by ISEMER (2002) promises a softer landing. The concept is composed of the following elements:

- The entire payment sum paid out to farmers of a Member State in the reference period will be split up into two parts.
- One part (the larger one) will be used to finance a uniform area payment. The nationally (or regionally) uniform sum per hectare is paid to the farmer holding the right of usufruct (ownership, leasehold) over the respective hectare. If the farmer does not use the area for agricultural production, he must ensure a minimum degree of care in order to keep the land in good agricultural condition). The uniform area payment is basically intended to end the favoring of arable land over grassland sites and of high-yielding sites over low-yielding sites.
- The other (smaller) part will be used for a person-tied additional payment. This payment is to cushion the varying levels of income losses sustained by farms (a) in the transition to the decoupled uniform payment and, if required, (b) in the abolishment of the quota regimes for milk and sugar. The basis of calculation is easy to ascertain by comparing the premium sums in the reference year (premium under the old model and under the new model). If the phasing-out of quota regimes for milk and sugar is to be initiated as well, the compensatory aids to be fixed for this purpose could also be determined for individual holdings in accordance with the quotas drawn in the reference year. The additional payment is strictly person-related and has to be reduced to zero within a specified period (e.g. 10 years).

- The funds released through the "gliding flight" of the person-related additional payment could be successively used to expand the second pillar. This will provide farming with additional financial incentives to render socially desired services (environmental conservation, animal welfare, services in rural areas). The audits deemed mandatory in the Commission proposal should first be financed as voluntary measures via the second pillar.

This proposal will also enable a swift cessation of coupled payments so that all benefits of decoupling can be realized. Yet, compared with the Commission proposal it will prevent some disadvantages. The income redistributions will turn out to be less abrupt. There will be fewer disputes between lessees and lessors. The land will not be so swiftly devalued so that the risks associated with collateral security for loans are minimized. There is hardly a danger of courts subsequently exerting influence on the distribution of payment entitlements. Cross-compliance commitments aimed at a sound use of set-aside land would cover all farmland. All stakeholders would find the decoupling system easier to understand and more calculable as far as the repercussions are concerned. This reduces the risk of subsequent alteration of the policy course, thereby exerting a positive effect on certainty of planning and competitiveness.

Ultimately the question which decoupling system should be chosen will also affect decisions of distribution policy to be made by policy-makers. The scientific community is hardly in a position to make a key normative contribution to this. It can be assumed that individual EU Member States will assess the merits of the different decoupling concepts differently only on account of the widely varying local conditions. In view of this, allowing the Member States to opt for the decoupling system they want would suggest itself. In the process, merely the key points "complete decoupling" and "ceiling on the national premium sum and its reduction over time" would have to be fixed.

The conclusion to be drawn is, therefore, to press for a greater margin of manoeuvre for Member States in the forthcoming negotiations when the issue of the beneficiaries of decoupled payments will be addressed. If this approach cannot be asserted, the arguments presented plead for introducing the concept "area payment plus individual additional payment" as an alternative to the Commission proposal in the EU debate.