The Fischler's Proposals for the Common Agricultural Policy: Paving the Way for the Future?

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Abstract

The Mid-Term Review proposals presented by the European Commission in July 2002 and January 2003 correspond no doubt to the most radical CAP reform since the latter was established in the early 1960's. This is not because these proposals include firm commitments on market access and export competition dossiers in the perspective of WTO talks. The proposals are silent on these points. This is because they finally achieve the shift from product to producer support by replacing all existing or newly introduced direct income payments, with a few exceptions, by a single decoupled payment per farm, based on historical references and conditional upon cross-compliance to environmental, animal welfare as well as food security and quality criteria. In addition, they expand the scope of rural development instruments to promote food quality, meet higher standards and foster animal welfare and they increase amounts available for rural development by transferring funds from the first to the second pillar via the introduction of an EU-wide system of degression and modulation. This paper discusses these proposals from both an external and internal point of view. We analyse to what extent the MTR proposals could facilitate the EU negotiation position in the WTO. From a domestic point of view, these proposals correspond to appropriate changes in the right direction with however some important qualifications. We analyse these qualifications. We also discuss to what extent the MTR proposals should be considered as the ultimate reform of the CAP or as the third step, after 1992 and 1999, in the long-term process where public intervention would be mainly reserved for correcting market failures, notably the promotion of positive externalities and public goods as well as the reduction in risk and instability faced by agricultural producers.

Keywords: Common Agricultural Policy (CAP), decoupling, cross-compliance, modulation, World Trade Organisation (WTO)

JEL classification: Q18, Q17,

Résumé

Les propositions « Fischler » de réforme de la Politique agricole commune : une solution pour l'avenir ?
Les propositions de réforme de la Politique agricole commune présentées par la Commission européenne en juillet 2002 et en janvier 2003 peuvent être considérées comme une révolution. Non parce qu'elles contiennent des engagements à une plus grande ouverture du marché européen ou à une diminution des subventions à l'exportation dans la perspective des négociations agricoles multilatérales du cycle de Doha. Mais parce qu'elles achèvent le mouvement amorcé en 1992 d'un soutien interne aux produits vers un soutien aux producteurs, via le remplacement des aides directes actuelles par une paiement unique par exploitation déconnecté des choix de production, calculé sur une base historique. En outre, le versement de ce paiement serait conditionné au respect de normes en matière d'environnement, de bien-être animal, de sécurité et de qualité des produits. Les propositions permettraient également d'augmenter les ressources disponibles pour financer les mesures dites du deuxième pilier, i.e., les mesures liées à la politique de développement rural. Cet article analyse les propositions d'un double point de vue, externe et interne. Sur le premier point, il s'agit notamment d'examiner dans quelle mesure leur adoption permettrait de faciliter la position de négociation de l'Union européenne à l'Organisation mondiale du commerce. Sur le deuxième point, nous montrons qu'il s'agit d'un nouveau pas, après ceux de 1992 et de 1999, dans la bonne direction même si certains problèmes ne sont que très partiellement résolus (par exemple, celui de l'inégale répartition du soutien entre productions, exploitations, etc.) et même si plusieurs interrogations méritent une analyse quantitative plus approfondie (par exemple, l'impact de ces propositions sur le prix du foncier, le nombre de producteurs, l'abandon éventuel de surfaces, etc.).

Mots clef: Politique agricole commune (PAC), découplage, conditionnalité, modulation, Organisation mondiale du commerce (OMC)

Classification JEL: Q18, Q17

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1. Introduction

For the first time in 1992, the European Union (EU) significantly reformed the Common Agricultural Policy (CAP) for cereals, oilseeds, protein crops and beef.[1] It is now recognised that the end product of the 1992 CAP reform was designated to placate the long-standing demands of the United States (US), supported by other agricultural exporters, mainly the Cairns Croup (CG) countries, and channelled into the framework of the General Agreement on Tariffs and Trade (GATT). Indeed an agricultural agreement in the Uruguay Round (UR) could not have been found without such a CAP reform.

The 1992 CAP reform did not cover all agricultural sectors and was clearly far less ambitious relative to initial European Commission (EC) proposals as regards the reorientation of European agriculture towards meeting the long-run objectives of increased competitiveness and resource conservation (CEC, 1991). However it can be considered as a revolution by the magnitude of the shift from market price support to direct payments borne by taxpayers. At that date, these direct payments were explicitly designated to compensate for the reduction in price support. For cereals, oilseeds and protein crops, farmers were entitled to claim an area payment while for beef, compensation was provided by a complex system of headage payments.

The Agenda 2000 CAP reform adopted in Berlin in March 1999 represents a deepening (cereals and beef) and extension (milk) of the 1992 reform through further shifts from price support to direct payments still linked to production factors (land, livestock and production rights). In addition, it defines a new framework for the EU rural development policy by bringing a series of measures together in a single package aiming to offer support to all rural areas. This integrated rural development policy is clearly presented as the second pillar of the CAP (EC, 1999b).

One achievement of the Agenda 2000 CAP reform that should be not underestimated is the definition of a new set of objectives for the CAP. In very general terms, the priorities of the Agenda 2000 CAP are to ensure that European agriculture would become more competitive on both the domestic and world markets, more environmentally sensitive and that farmers livelihoods would be protected. According to the EC, these priorities would be upheld within the package of measures adopted in Berlin (EC, 1999). However the encouraging rhetoric towards environment preservation and rural development does not really translate into very increased budgetary commitments. In practice, the yearly amount available of about 4.3 billion Euro for financing the second pillar would not be significantly greater than the amount available in the six-year period 1994-99 for the same measures (von Urff, 2002).[2] In fact, it appears that the Agenda 2000 CAP reform is mainly designated to cope with the constraints of the Agricultural Agreement in the Uruguay Round (AAUR) and the preparation of the Millennium Round (MR) in the World Trade Organisation (WTO). As a result, the focus on price support cuts in order to increase the price competitiveness of European products on both the internal and external markets. However the Agenda 2000 reform makes no proposals to change existing world trade commitments. This led some authors to write that what is proposed in Agenda 2000 is as far as the EU is prepared to go in WTO negotiation (Marsh, 1998) and that the reform is based on the premise that AAUR blue box exemptions would be extended (Tielu and Roberts, 1998).

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[1] The milk quota reform in 1984 was not marginal but concerned only one sector.

[2] Most measures financed by the Guarantee Section of the European Agriculture Guidance and Guarantee Fund (EAAGF) under Agenda 2000 were formerly funded through the Guidance Section of the EAAGF.

In that context, one can wonder at the rashness of the Mid-Term Review (MTR) proposals presented by the EC in July 2002 and January 2003.[3] These proposals correspond no doubt to the most radical CAP reform since the latter was established in the early 1960's. This is not because the MTR includes firm commitments on market access and export competition dossiers in the perspective of WTO talks. The MTR is silent on these points.[4] This is because the MTR finally achieves the shift from product to producer support by replacing all existing or newly introduced direct income payments, with a few exceptions, by a single decoupled payment per farm, based on historical references and conditional upon cross-compliance to environmental, animal welfare as well as food security and quality criteria. In addition, it expands the scope of rural development instruments to promote food quality, meet higher standards and foster animal welfare, and it increases amounts available for rural development by transferring funds from the first to the second pillar via the introduction of an EU-wide system of digressivity and modulation.

The remaining of the paper is organised as follows. Section 2 briefly presents the MTR proposals, as laid down in the Communication of the Commission to the Council and the European Parliament (CEC, 2002) and Council regulation proposals (CEC, 2003), and replaces them in an historical perspective. Section 3 discusses these proposals from an external point of view. Our purpose here is to analyse to what extent the MTR proposals could facilitate the EU negotiation position in the WTO and the EU enlargement process. Section 4 discusses these proposals from an internal point of view in a longer run perspective. In a general way, the MTR proposals correspond to appropriate changes in the right direction with however some important qualifications. We analyse these qualifications. We also discuss to what extent the MTR proposals should be considered as the ultimate reform of the CAP or as the third step, after 1992 and 1999, in the long-term process where public intervention would be mainly reserved for correcting market failures, notably the promotion of positive externalities and public goods as well as the reduction in risk and instability faced by agricultural producers.[5] Section 5 concludes and analyses problems, notably in the WTO negotiation context, that would cause the time report of the reform and/or a political agreement on a compromise far less ambitious than the MTR proposals as regards decoupling and second pillar issues.

2. The MTR Proposals in an Historical Perspective

A brief history of the CAP: From the treaty of Rome to Agenda 2000

The initial objectives of the CAP laid down in Article 39 of the Treaty of Rome were (i) to increase agricultural productivity through the rational development of agriculture towards the optimal utilisation of the factors of production, (ii) to ensure a fair standard of living for agricultural producers, (iii) to stabilise agricultural markets, (iv) to guarantee regular supplies of food to consumers and (v) to ensure reasonable prices of food to consumers (CAP Monitor, 2002, page 1-1). These objectives were not well defined. Some might even conflict. Initial political decisions were mainly guided by the productivity increase objective. They were then essentially determined by the agricultural income support objective and constrained by the budget (Koester and Tangermann, 1990).

The farm income support objective was primarily achieved by two mechanisms, i.e., (i) by applying variable import levies at the EU frontiers in such a way that third-country imports could not be sold at a price lower than the desired price (threshold price) and (ii) by buying up the surplus supplies of products when domestic prices threaten to fall below minimum prices (intervention prices). The

[3] The January 2003 proposals do not explicitly refer to the MTR of the Agenda 2000 CAP. For convenience, we however will continue to present them as the January 2003 MTR proposals. We will use the term "MTR proposals" for elements included in both the July 2002 and January 2003 proposals.

[4] Note however the intention of the EC to "negotiate a change and a simplification of the EU border protection for wheat and rice which, in current circumstances, functions unsatisfactorily and does not meet its objectives." (CEC, 2002). In other words, the current regime fails to provide, at least in some circumstances, a sufficient protection vis-à-vis imports of some third countries.

[5] Risk and instability are not market failures. There is here market failure because risk markets are incomplete in agriculture.

system was supplemented by variable export subsidies (export refunds) to compensate the gap between domestic and world market prices and allow EU farmers to export competitively to the world market (CAP Monitor, 2002, pages 1-3 and 1-4). With intervention prices set considerably above world market prices, surplus production resulted and the EU gradually shifted from a net import to a net export position for many agricultural and food products. This translated by increases in intervention stocks and budgetary costs, as well as growing distortions of agricultural markets and international pressures from trading partners for reform.

Although many factors contributed to shape the 1992 CAP reform, it is clear that domestic forces alone were unable to generate a reform of this extent. In a similar domestic context, the course of action adopted in 1984 in the dairy sector was the opposite of the route followed in 1992 for cereals, oilseeds, protein crops and beef (production quotas to maintain high domestic prices in 1984 versus lower support prices compensated by direct aids linked to the area used or the number of animals in 1992). The international pressure, led by the US and channelled into the framework of the GATT, was a major factor in 1992 CAP reform design (Guyomard et al., 1994). The arable land set-aside program supports this view. Its purpose was to reduce excess supply of cereals with very little attention to environmental concerns.

The Agenda 2000 CAP reform agreed upon at the Berlin meeting of the Council of Ministers in 1999 has deepened (cereals and beef) and extended (milk) the 1992 reform through further shifts from price support to direct payments. It also had aimed to develop a coherent rural development policy officially presented as the second pillar of the CAP.

Policy objectives of the CAP are now as follows: (i) improved competitiveness of EU agriculture, (ii) guarantee of food safety and food quality, (iii) a fair standard of living for the agricultural community, (iv) stability of incomes, (v) integration of environmental goals into the CAP and development of the countryside stewardship role of European farmers, (vi) creation of income and employment complements or alternatives for farmers and their families, on and off farm, and (vii) contribution to economic cohesion within the EU. These new objectives are again not well defined and officially ranked. Some are still potentially contradictory and only two initial objectives are maintained (a fair standard of living for the agricultural community and stability of incomes). But even if the EU does not assign explicit weights to the various factors that motive this new reform of the CAP, it appears that the latter is mainly designed to cope with existing and future WTO constraints. Hence the focus on price support cuts in order to increase the price competitiveness of EU agricultural products on both the external and internal markets. One must however note that immediate decisions are limited to arable crops and the beef sector. The reform of the milk sector is postponed to 2005/06 and important sectors, sugar in particular, are not even touched.

Table 2.1 presents main agricultural commodity regimes under Agenda 2000. Table 2.2 shows total support to EU agriculture and by commodity, and their evolution since 1986. These tables reveal a great heterogeneity between commodities both in terms of instruments used and levels of support. Table 2.2 also shows that total support to EU agriculture (in million Euro and in percentage) has not really declined over the ten past years or only very slightly. For the sectors concerned by both the 1992 and 1999 reforms, part of support has shifted from the market price support category to direct payments linked to area planted or animal numbers. But even for these sectors, there has been no significant reduction in support.

(insert Table 2.1 and Table 2.2)

The whole Agenda 2000 package also defines the European budgetary framework for the seven-year period 2000-06. In particular, it fixes CAP expenditure ceilings for this period, on average 40.5 billion Euro per year of which nearly 90 % correspond to market measures and 10 % to rural development measures (see Annex 1, Table A1.a). About 30.4 billion Euro would be reserved over the seven-year period 2000-06 for promoting rural development within the Guarantee Section of the EAGGF. However practically all measures of the new rural development regulation (Rural Development Regulation (EC) 1257/1999 of 17 May 1999) already existed although in different administrative settings, and the total amount available for these measures does not really increase relative to the period 1994-99 (von Urff, 2002). In other words, the growing importance of environment preservation and rural development issues comes more from the official reference to them as the second pillar of the CAP than from the increase in budgetary allocations (Swinnen, 2001).

The importance of another Agenda 2000 regulation, Council Regulation 1259/99 of 17 May 1999, merits to be underlined. This regulation sets out common rules for direct support schemes under

the CAP that offer Member States (MS) the options of cross-compliance and modulation. Cross-compliance allows MS to make direct aid payments conditional on farmers fulfilling nationally defined environmental management standards and impose penalties, or even withhold payments entirely, for non-compliance. Modulation allows MS to reduce direct aid payments per farm by up to 20 % according to three criteria, i.e., (i) the labour force of the holding falls shorts of limits set by the MS, (ii) the overall prosperity of the holding rises above limits set by the MS and (iii) the total amount of payments granted under support schemes exceeds limits set by the MS. Funds saved thanks to modulation can be switched to the second pillar for agri-environmental measures, early retirement schemes, less favoured areas and areas with environmental restrictions and forestry. Cross-compliance and modulation are voluntary under Agenda 2000. At the moment, cross-compliance is in play in six MS (Austria, Denmark, Finland, France, Greece and the Netherlands) but does not appear very constraining (von Urff, 2002). After the suspension of the French scheme in May 2002, the United Kingdom (UK) is currently the only MS which is modulating direct aids, the flat rate rising from 2.5 % in 2001/02 to 4.5 % in 2005/06 (CAP Monitor, 2002, page 1-6).[6] Cross-compliance and modulation would be compulsory under the MTR proposals. Furthermore they would be applied on an EU-wide basis.

The July 2002 MTR proposals

Does Agenda 2000 go far enough to address the various challenges European agriculture will face in the near future and in the long term? Many commentators consider that the answer to this question is no. The EC itself recognises that although much has been achieved since 1992, many problems have not been solved by Agenda 2000 (CEC, 2002, page 5).

The EC claims that both proponents and opponents to the Agenda 2000 CAP broadly agree upon policy objectives established in Berlin in 1999 and enhanced in the European Summit of Göteborg in 2001. These objectives are as follows: (i) a competitive agricultural sector, (ii) production methods that support environmentally friendly, quality products that the public wants, (iii) a fair standard of living and income stability for the agricultural community, (iv) diversity in forms of agriculture, maintaining visual amenities and supporting rural communities, (v) simplicity in agricultural policy and the sharing of responsibilities among Commission and Member States, and (vi) justification of support through the provision of services that the public expects farmers to provide. It recognises that the current CAP is not able to achieve these objectives and hence proposes a set of substantial changes to simultaneously enhance the competitiveness of EU agriculture, promote a market oriented, sustainable EU agriculture and strengthen rural development.

On the price support side of things and as far as cereals are concerned, the MTR objective is to complete the reform process by implementing the further 5 % cut in the cereal intervention price envisaged by Agenda 2000. It proposes to end intervention for rye, to reduce specific aids for durum wheat and to cut the intervention price for rice by 50 %, three products for which market imbalances are likely to be severe in the near future without reform. No changes are envisaged for beef and milk beyond what has already been agreed in Berlin at Agenda 2000. However, in the case of milk, the EC presents potential consequences of four scenarios (maintaining the status quo until 2015, increasing quotas and reducing intervention prices, reducing quotas for the domestic market with unlimited volumes for export markets, and abolishing the quota system from 2008 and cutting intervention prices). In addition, the EC underlines the fact that there are a series of sectors where reform proposals have still to be submitted in 2003 (sugar, tobacco, olive oil and possibly wine as well as fruit and vegetables). In a general way, proposed and future reforms of Common Market Organisations (CMOs) are guided by one long-run objective, i.e., to use the public intervention mechanism as a safety net measure only and no more as an income support instrument as it was the case before, at least implicitly. Decoupling income support direct aids (see below) and considering intervention as a safety net only would allow EU agricultural producers to respond more importantly to market signals while protecting them from extreme price fluctuations.

The four key words of the July 2002 MTR proposals are decoupling, cross-compliance, dynamic modulation and rural development. Table 2.3 presents these four points and compares them with corresponding Agenda 2000 provisions.

[6] In France, smaller producers were not subject to modulation.

(insert Table 2.3)

A decoupled whole-farm payment based on historical references and backed by cross-compliance requirements. The main innovation of the July 2002 MTR proposals is to replace existing or newly introduced pillar one direct aids by a single decoupled direct payment per farm, based on historical references and conditional on the respect of statutory environmental, food safety and animal welfare standards as well as occupational safety requirements for farmers. The focus of these cross-compliance requirements is on supporting the enforcement of good farming practices defined as encompassing mandatory European standards. The MTR includes the replacement of the current rotational set-aside on arable land by a long-term (10 years) non-rotational set-aside, officially for both supply control and environmental objectives. This long-term set-aside is also an element of cross-compliance requirements.[7] In addition, it introduces a system of mandatory farm auditing as part of cross-compliance requirements for producers receiving more than 5000 Euro per year in direct payments.

The EC alleges that the whole-farm payment would be decoupled (at least in theory and/or in terms of URAA box classification) because production would not be required and producers would have almost complete farming flexibility.[8] It would achieve the shift from product to producer support. It would thus greatly increase the market orientation of EU agriculture allowing farmers to fully benefit from market opportunities in supplying the products that consumers want.[9] In addition, it would represent a major simplification and contribute to environmental integration by removing production specific incentives that potentially damage the environment.

Strengthening rural development by transferring funds from the first to the second pillar thanks to dynamic modulation. The second major innovation of the July 2002 MTR proposals is the so-called dynamic modulation by which all direct payments would be reduced by 3 % per year up to the maximum of 20 % agreed in Agenda 2000 (digressivity mechanism). The smallest farms would be exempt from payment cuts (franchise mechanism) while ceilings would cap direct aids for largest farms (capping mechanism).[10] Funds saved through the dynamic modulation would be switched from the first to the second pillar. The latter would be consolidated and strengthened, first by defining new accompanying measures (introduction of two new chapters related to food quality issues and farmers' adaptation to mandatory standards), second by widening the scope of current rural development measures, notably the agri-environment chapter (inclusion of animal welfare payments and increasing of the co-financing rate). The MTR proposals include temporary, digressive and targeted direct aids to assist farmers in meeting standards and permanent, non-digressive and targeted direct aids to support farmers in providing public goods and positive externalities beyond mandatory requirements.

Table 2.4 summarises the main elements of the July 2002 MTR proposals linking policy objectives and solutions proposed to achieve them.

(insert Table 2.4)

The January 2003 MTR proposals

One conclusion of the Brussels Summit in October 2002 was to set a budget ceiling on pillar one agricultural expenditure for the 2007-13 period. Corresponding expenditure shall be kept below the

[7] Current provisions allowing production of non-food crops, including energy crops, on set-aside land would be eliminated. Support for energy crops would be provided by a specific payment of 45 Euro par hectare. The stated aim of these "carbon credits" is to favour carbon dioxide substitution.

[8] Including haying and grazing, but excluding fruit and legumes.

[9] High support prices for sugar, milk and beef notably would however continue to provide powerful production incentives.

[10] After the application of both the digressivity and franchise, the maximum of direct payments which could be made to a producer would be 300 000 Euro. The new US farm bill also includes a cap of 360 000 Dollar on the amount an individual farmer can receive.

2006 figure in nominal terms, increased by 1 % per year. At the Copenhagen Summit in December 2002, heads of States and Governments from the EU-15 and ten candidate countries reached agreement on a formula for enlarging the EU to encompass ten new MS from 2004. The outcomes of the Copenhagen Summit can be summarised as follows, as far as agriculture is concerned: (i) a rural development package for the ten candidate countries, broadened in scope and in comparison to the funds available for the existing MS, financially more important (5.1 billion Euro for the three years 2004-06 and measures co-financed by the EU at an increased rate of 80 % at maximum), (ii) a special measure to make semi-subsistence farms viable, (iii) a gradual introduction of direct payments over a transition period of ten years, from 25 % in 2004 to 100 % in 2013, (iv) the possibility to top up direct payments[11], (v) a simplified implementation of direct payments allowing new MS to grant them in the form of a decoupled area aid applied to the whole agricultural area, and (v) the setting of production quotas, premium rights, etc. on the basis of the most recent historical periods for which data are available (EC, 2002c). Whether or not this agreement will comply with budgetary guidelines adopted at the Brussels Summit two months before remains to be seen. Many commentators consider that it will be very difficult to fit additional expenditure into the Brussels financial framework without further CAP reforms (see, for example, Swinnen, 2003).[12] What is certain is that the budget constraint translates in immediate and unfortunate consequences for the MTR proposals as a large part of funds saved thanks to digressivity and modulation is now reserved to cover "future financing needs", i.e., more simply, to finance additional reforms in some sectors (dairy, sugar, etc.).

Although the general philosophy of the July 2002 and January 2003 MTR proposals is the same, the EC has made a number of significant changes relative to its earlier proposals. The two most important changes are related to the reform of the dairy policy and to the dynamic modulation mechanism.

For arable crops and beef, market measure changes are minor: in the case of durum wheat, replacement of the quality top-up premium of 15 Euro per ton by a premium of 40 Euro per hectare in traditional production areas, within the Maximum Guaranteed Area (MGA) limit, provided certain quantities of seed are used from varieties selected for their quality for semolina and pasta production; in the case of protein crops, establishment of a MGA of 1.4 million hectares; in the case of starch potatoes, suppression of the minimum price and introduction of a direct aid of 110,54 Euro per ton of starch, 50 % of this aid being granted as a specific payment. Dairy quotas would be maintained at least until 2014/15. In this sector the EC proposes to advance the Agenda 2000 reform by one year to cover the three years 2004 to 2006, with asymmetric intervention price cuts of 3.5 % per year for Skimmed Milk Powder (SMP) and 7.5 % per year for butter. These price reductions would continue in 2007 and 2008, with increases of 1 % per year in quotas and adapted increases in compensatory payments. Direct payments would be decoupled from 2004 and included in the single whole-farm payment. Intervention purchases of butter would be more severe with a buying-in by tenders above 30 000 tons.

The July 2002 and January 2003 MTR proposals can be characterised by the same key words, i.e., decoupling, cross-compliance, digressivity and modulation, and rural development. However there are a number of changes that merit to be underlined (for a synthetic presentation of these changes, see Table 2.3).

The decoupled whole-farm payment remains central to the plans. It would be based on direct aids received in the three reference years 2000, 2001 and 2002. It would be broken down into payment entitlements per hectare. These entitlements would be calculated at the farm level by dividing the reference amount by the average number of all hectares which gave right to direct payments in the reference years. Total amounts of decoupled aid would be capped at a country level by the setting of national ceilings.[13] Entitlements could be transferred between farmers within the same MS or within a region of a MS. They could be transferred by sale with or without land. They could also be transferred by lease but in that case only if the transfer of an equivalent number of eligible

[11] More precisely, a MS will have the possibility to complement direct aids by 30 %, financed by its rural development funds and national funds up to 55 % in 2004, 60 % in 2005 and 65 % in 2007. From 2007, the financing will be entirely from national funds.

[12] Swinnen (2003) considers that numbers used by the EC correspond to "optimistic" assumptions. Furthermore, they do not take into account for the costs of Bulgaria and Romania joining, theoretically from 2007.

[13] These national ceilings « replace » the individual ceiling of 300 000 Euro of earlier proposals.

hectares accompanies them. In addition, to prevent aid entitlement trade by speculators, the single payment would be tied to the area of land held annually. Farmers would be required to maintain land in good agronomic condition, but not necessarily to produce. They would be allowed to use hectares for any purpose except permanent crops (fruit and vegetables are no longer excluded). The compulsory cross-compliance system would establish sanctions which would take the form of a partial or entire reduction of the decoupled single farm payment and coupled specific direct payments in case of non-respect of obligations arising from about forty legislative acts applying directly at the farm level, good farming practices and maintaining permanent pasture. Under the new proposals, the farm audit would be obligatory for farms receiving more than 15 000 Euro in direct aids (the original threshold was 5 000 Euro) or having an annual turnover greater than 100 000 Euro.

More important changes concern the dynamic modulation mechanism. Table 2.5 presents the new proposals in that domain. Digressivity (from now called degression in EC documents) and modulation would not start before 2006 (original start date was 2004). In 2006, all direct payments would be reduced by 1 %, farmers receiving less than 5 000 Euro per year in direct aids being exempt. From 2007, reduction rates would be less important for a farmer who receives between 5 000 and 50 000 Euro per year in direct aids than for a producer who receives more than 50 000 Euro per year in direct aids. For the former, the reduction rate would progressively increase from 1 % in 2006 to 12.5 % in 2012. For the latter, it would increase until 19 % in 2012. Funds saved thanks to digression and modulation would be used, for part to finance pillar two measures, for part to finance new reforms of Common Market Organisations (CMOs). As a result, by the year 2012 less than 50 % of funds saved thanks to degression and modulation would be transferred to the second pillar of the CAP (see section 4). This is in sharp contrast with earlier proposals where all funds saved thanks to dynamic modulation were dedicated for rural development spending.

(insert Table 2.5)

3. Analysis from an International Perspective

The MTR proposals and the WTO negotiations

The AAUR was concluded in 1994 and WTO member countries had until 2000/01 to implement the agreement. Although the concrete consequences of the AAUR on world agriculture and agricultural support worldwide have been modest since six years, its significance should not be underestimated. Of major significance is the move away from open-ended price support in agriculture and the placement of agriculture on the agenda of current multilateral negotiations, the so-called MR. Of equal significance is the definition of a negotiation framework in three main areas (market access, export competition and domestic support) to deal with agricultural issues. In other words, the Uruguay Round (UR) has resulted, if not in much effective agricultural liberalisation, at least in a framework to build on in the next round of agricultural negotiations (Swinnen, 2001).

WTO member countries agreed to re-initiate agricultural negotiations for continuing the reform process one year before the end of the implementation period of the AAUR, i.e., by the end of 1999.[14] These preliminary talks have now been incorporated into the broader negotiating agenda set at the 2001 Ministerial Conference in Doha, Qatar. According to Paragraph 13 of the Ministerial Declaration adopted on 14 November 2001, agricultural negotiations aim at substantial improvements in market access, reductions of, with a view to phasing out, all forms of export subsidies and substantial reductions in trade-distorting domestic support. Paragraph 13 explicitly recognises that special and differential treatment for developing countries shall be an integral part of all elements of the agricultural negotiations and non-trade concerns shall be taken into account. According to Paragraph 14, modalities for the further commitments on the agricultural dossier shall be established no later than 31 March 2003 and the agricultural negotiations shall be concluded as part and as the date of conclusion of the negotiating agenda as a whole, i.e., no later than 1 January 2005 (WTO, 2001).

[14] Recognising that the long-term objective of substantial progressive reductions in support and protection resulting in fundamental reform is an ongoing process, Article 20 of the AAUR included a commitment to engage in a new round of multilateral agricultural negotiations before the end of 1999.

The provisions of the AAUR and their effects on world agriculture since 1994 are well documented in the literature. In a general way, quantitative effects were very modest (Tangermann, 2001). This is also the case for the EU (Anania, 2002). The problem is then to analyse to what extent the MTR proposals would allow the EU to comply with future WTO commitments even it is difficult, of course, to predict what could be precisely these commitments. More generally, it is also to analyse to what extent the MTR proposals would allow the EU to adopt an offensive attitude in the MR in pressing for some issues it wants to include and protect like international recognition of food safety criteria, animal welfare standards or country of origin labelling. At this stage, one will simply note that the time report of the MTR reform, i.e., the time report of the decision of its implementation aggravated by uncertainties surrounding the final form it would take, will certainly handicap the EU negotiators at the WTO.

The MTR proposals do not include commitments to reform EU agricultural trade policies. The market access elements of the AAUR focused on converting non-tariff border measures to tariffs, binding all tariffs and reducing them by 36 % on average over six years from a 1986-88 base, with a minimum reduction of 15 % per tariff line, as well as ensuring the provision of minimum access opportunities and maintenance of current access levels essentially through Tariff-Rate Quotas (TRQs).[15] In the EU, tarrification translated by the conversion of variable import levies into fixed tariffs. In a general way, market access commitments were not a problem for the EU over the six-year implementation period of the agreement.[16] Fixed tariffs were calculated by taking the average difference between the domestic intervention price and the world Fob (Free on board) price, plus 10 % and monthly increments, over the base period 1986-88. This allowed the EU to set initial tariffs at sufficiently high levels so that imports above minimum and current access levels are still unlikely to occur in the next years if tariffs are not further significantly reduced in the MR (at least for a majority of agricultural commodities). In addition, there is considerable water in the tariffs for some products and the EU, as many other developed countries, is in position to accept significant reductions in bound rates before these cuts translate in reductions in applied rates (AAUR commitments were to reduce bound rates, not actual applied rates). In the same way, impacts of TRQs on EU agricultural imports were generally small over the implementation period of the agreement. This is not surprising notably because existing concessions were considered as part of access commitments (Huan-Niemi and Niemi, 2001).

In the framework of MR talks, several countries have adopted an aggressive approach on the market access dossier calling for deep cuts in tariffs, reduction in tariff complexity and dispersion as well as simplification and transparency in TRQ administration in order to reduce, if possible eliminate, their underfill (IATRC, 2001). The EU has adopted a much more conservative attitude since the EC proposes to duplicate AAUR commitments by offering an overall average tariff reduction of 36 %, with a minimum reduction per tariff line of 15 %. The EC proposal presented in December 2002 also contains specific provisions for developing countries, i.e., as far as market access is concerned, no less than 50 % of developed countries' agricultural imports from developing countries at zero duty, duty-free and quota-free access for all imports from Least Developed Countries (LDCs) into developed and advanced developing countries as well as a significant reduction of tariff escalation on products of particular interest to developing countries by reducing the level of tariff protection, both ad valorem and specific (EC, 2002a).

How to explain the very prudent strategy of the EC on the market access dossier, notably on tariff and TRQ reform? Simply because the sustainability of many domestic policies and more generally of both the Agenda 2000 and MTR CAP requires maintenance of sufficient import protection. In other words, the EU needs to preserve as much of the existing import protection system as possible to meet Agenda 2000 and MTR policy objectives within the budgetary framework agreed in Berlin in 1999 and in Brussels in 2002. This is notably the case for sectors where income support is still mainly achieved by market price support measures. Huan-Niemi and Niemi (2001) show that the EU would be able to maintain a comfortable border protection for most agricultural commodities, with the noticeable exception of butter, in a scenario where European tariffs will be

[15] For developing countries, the tariff reduction was 24 % over ten years.

[16] This is true for a large majority of countries. Despite the reductions agreed in the UR, agricultural tariffs currently average over 64 % compared with less than 4 % for non agricultural commodities (Gibson et al., 2001).

further reduced along the same lines as those used in the AAUR.[17] However their calculations suggest that the margin of protection could become small by the end of the decade if tariff peaks were reduced by higher percentages than 36 %, in particular if the Euro is strong vis-à-vis the US Dollar and if world prices are low. This explains why the EU is not willing to accept a tariff reduction formula that would cut high tariffs more than low tariffs.[18] These high tariffs generally apply to sensitive markets where domestic prices are still significantly higher than those prevailing on the world market. Dairy products are an obvious case in point. Interestingly enough, one would note that the Doha Ministerial Declaration explicitly mentions the elimination of tariff peaks in the industrial sector but does not address this issue in the case of agriculture (Rude and Meilke, 2002). In a similar way, expanded TRQs open to all exporters could constitute a serious concern for the EU in particular, but not only, for markets where domestic prices are much higher than world prices. At this stage, one would note that the EC does propose expanding TRQs and eliminating in-quota duties for developing countries, but not for developed countries. In other words, the EC does not make concrete offers to allow developed countries to increase their in-quota exports to the European market.

The EC rightfully points out that the EU is still today the world's largest importer of agricultural goods (60 billion Dollar in 2001), the world's largest importer of farm products from developing countries (38 billion Dollar in 2001 compared with 22 billion Dollar for the US, 12 for Japan, 2 for Canada and less than 1 for Australia) and the world's largest importer of agricultural products from LDCs (EC, 2002b). However, for several products, import penetration ratios and/or import shares decreased in the EU in the post-AAUR period as compared to the pre-AAUR 1990-94 or 1986-89 periods. Table 3.1 illustrates this point.

(insert Table 3.1)

The export competition elements of the AAUR focused on direct export subsidies which were, for the first time, subject to disciplines. Developed countries agreed to reduce subsidised export volumes by 21 % and value by 36 % over the six-year period 1995-2000 from base period 1986-90 levels. It is clear that the main constraint the AAUR imposed on EU agriculture and agricultural policy since 1994 lied in export commitments. According to Anania (2002), the AAUR had a limiting effect on EU subsidised exports in at least one of the five year 1995-1999 for rice, olive oil, wine, fresh fruit and vegetables, beef, poultry meat, cheese and other milk products. In several cases including wine, fresh fruit and vegetables, poultry meat and cheese, the EU was however able to increase non-subsidised exports when the constraint on the volume of subsidised exports became binding. Anania (2002) adds that if Agenda 2000 was not implemented, the EU would also very likely have had to face binding constraints from 2001 on wheat and coarse grains. More important perhaps than immediate effects of export commitments on exported volumes, with and without subsidies, is their impact on CAP design since 1994. It is clear that this consideration was largely influential in shaping the EC proposals for CAP reform in both Agenda 2000 and the MTR.

In the area of export competition, the MR negotiations have presently covered export subsidies, export credits, food aid and export state trading enterprises (WTO, 2002). A central issue is whether export subsidies should be phased out or whether the negotiators should only seek further reduction commitments (Rude and Meilke, 2002). The CG and the US are in favour of elimination. The EU does not seem ready to accept the immediate, i.e., during the implementation period of the

[17] Eight products are analysed (butter, skim milk powder, beef, pig meat, poultry meat, wheat, barley and corn). Two scenarios are considered. The first scenario assumes that the Euro is strong vis-à-vis the US Dollar (1 Euro for 1.20 US Dollar). The second scenario assumes that the Euro is weak vis-à-vis the US Dollar (1 Euro for 0.80 Dollar).

[18] Such as the so-called Swiss formula proposed by the CG or the US proposal for a straightforward reduction in tariff peaks. Agra Europe reports, unfortunately without formal demonstration except for butter, that application of either the CG or US proposal for tariff reduction "would have a devastating effect on the current highly effective livestock import tariffs" adding that in the case of dairy products, " the application of the Swiss formula could result in a level of tariff at the end of the five years which would reduce the protection level to below the domestic support price even after the deduction of the 15 % cut in the EU milk target price from 2005." (Agra Europe, 20 September 2002).

MR agreement, elimination of direct export subsidies.[19] It addition, it rightfully points out that export commitments should include all forms of promoting exports because they can be as trade distorting as direct export subsidies. In practice, the EC "proposes an average substantial cut in the volume of export subsidies and an average 45 % cut in the level of budgetary outlays on the condition that all forms of export subsidisation are treated on an equal footing." (EC, 2002a). Interestingly enough, one would note that the EC proposal includes a specific reduction target for budgetary outlays, but not for subsidised export volumes. This is not surprising because further export subsidy quantity commitments are likely to be binding more quickly and more severely than export subsidy budgetary commitments (Huan-Niemi and Niemi, 2001).

The MTR proposals would allow the EU to adopt an offensive stance on the domestic support dossier, at least a less defensive attitude. Inclusion of commitments on domestic support in the AAUR was an important breakdown since it explicitly recognised that domestic policies do link to international trade. In practice, the agreement differentiated domestic support policies according to their perceived abilities to impact on production and disrupt trade flows.

Green box policies correspond to domestic farm programs that are deemed to be minimally trade distorting and hence are exempted from reduction commitments and expenditure limits. Eleven types of green box policies are distinguished and for each type, specific guidelines define the eligibility of the program for the green box.[20] One category refers to decoupled income support which is defined by three main requirements, i.e., (i) clearly defined eligibility criteria for a fixed base period, (ii) payments not related to the volume of production, prices or factors of production in any year after the base period and (iii) no requirement to produce to receive payments. Blue box policies correspond to direct payments under production-limiting programs and are also excluded from reduction commitments. To be included in the blue box, direct payments must be based on fixed area and yields, or made on 85 % or less of the base level of production or in the case of livestock payments, made on a fixed number of head. The US target price - deficiency payment in place before 1996 was a blue box program. The arable area and livestock payments currently in place in the EU are blue box programs. Although blue box payments can potentially distort trade, they are allowed under the premise that supply limit criteria partially offset the subsidies' incentives to over produce and disrupt trade (Burfisher, 2001). Amber box policies are defined by default. They correspond to all the measures that are not classified as green or blue. The agreement provides for a 20 % reduction of countries' aggregate levels of amber domestic support during the six-year implementation period from an agreed base corresponding to the average 1986-88.[21] This commitment applies to the whole of the agricultural sector rather than being for individual products. In addition, within the amber box, some programs can be exempted from reductions if their AMS amounts are considered too small to count. These exemptions are referred to as de minimis exemptions.

In practice, the domestic support discipline proved the least binding AAUR constraint as all countries fulfilled their commitments and for many of them, by a large margin (OECD, 2002). This is also the case for the EU. Table 3.2 clearly shows that the EU has so far had no difficulty meeting its AMS obligation. More interestingly, it also indicates that the EU would have stayed within the limits imposed by the agreement even without the blue box provisions. In that case, the margin would however have been low by the end of the 1990s (about 2 billion Euro in 1999/00). Huan-Niemi and Niemi (2001) show that the EU would not face any problems in staying within its AMS commitments even if amber box measures were further reduced by 20 % over the six-year period 2004/05-2009/10. This is the case notably because full implementation of Agenda 2000 (from 2002) will switch support from the amber to the blue box.[22]

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[19] To quote Commissioners Lamy and Fischler, the Doha Ministerial Declaration fits out mandate on export competition because it "clarifies beyond doubt that there is no commitment now to negotiate the elimination of [direct] export subsidies." (EC, 2001).

[20] The eleven categories are 1/ general services, 2/ public stockholding for food security purposes, 3/ domestic food aid, 4/ decoupled income support, 5/ government financial participation in income insurance and income safety net programs, 6/ disaster payments, 7/ producer retirement schemes, 8/ resource retirement schemes, 9/ investment aids, 10/ environmental payments and 11/ regional assistance. For more details, see, for example, Blandford (2001) or Hart and Babcock (2002).

[21] AMS reduction commitments are 13.3 % for developing countries.

[22] According to Anania (2002), this shift would decrease the EU AMS by about 9 billion Euro.

Blue box programmes that were exempt from cuts in domestic support in the AAUR are recognised as less market distorting than the same levels of open-ended price support, and even coupled production support without supply limiting arrangements. Nevertheless many countries consider that blue box payments are yet still too distorting and push for the elimination of the blue box exception in the MR. This blue box exception is not really used by WTO member countries, except the EU. Without shifting a large part of domestic support from the blue to the green box, the EU will be constrained to ask for maintenance of the blue box for its direct compensatory payments. In other words, shifting domestic support from the blue to the green box with decoupling would allow the EU to focus on its main weakness, i.e., a lower cost and price competitiveness relative to many other agricultural exporters. Without decoupling, it is likely that other WTO countries would try to use the blue box leverage to obtain more severe commitments on market access and/or export competition dossiers. Furthermore the AAUR definition of the green box is perhaps not unchanging, notably because many countries consider that some green box measures are in fact not minimally trade distorting (Roberts, 2003). In that context, it is clear that life will be easier for the EU with the MTR CAP as adoption of the latter would allow European negotiators to concentrate their efforts on market access issues as well as on the green box definition (more precisely, on a sufficiently large definition of the green box to include the decoupled whole-farm MTR payment and pillar two measures).

(insert Table 3.2)

The MTR proposals and the EU enlargement process to Central and Eastern European countries

It is no more time to ask whether the MTR proposals could have facilitated accession negotiations of Central and Eastern European countries to the EU. These negotiations were concluded at the European Council in Copenhagen on 12 and 13 December 2002. Ten new countries will join the EU on 1 May 2004. The Copenhagen Council also confirmed the objective of welcoming Bulgaria and Romania as EU members in 2007. In practice, the main question is to know whether the 2007-13 agricultural budget guideline on pillar one measures will be sufficient to face additional costs implied by market support measures and direct aids in the new MS. Even if official figures presented by the EC suggest that pillar one measures would (could) remain below the ceiling, many observers consider that event as unlikely. The enlargement agreement on direct aids would quickly put pressure on the pillar one ceiling, notably after 2008 when both Bulgaria and Romania will have join. At this stage, it is worthwhile to note that there is no equivalent ceiling for pillar two expenditure. As a result, the MTR proposals could (should) alleviate the budgetary constraint by transferring funds from the first to the second pillar. In a longer-term perspective, one can nevertheless regret that both the enlargement agreement and the January 2003 MTR proposals send what can be considered as wrong signals. The first wrong signal is to allow accession candidate countries to complement direct aids by funds of the second pillar.[23] The second wrong signal is that the January 2003 MTR proposals reduce total amounts transferred from the first to the second pillar by reserving a large part of resources saved thanks to degression and modulation to finance future reforms of some Common Market Organisations (CMOs).

4. Analysis from a Domestic Perspective

The MTR proposals viewed as an application of the targeting principle

Any discussion on the future of European direct aids raises first the question of policy objectives pursued through their use (Swinnen, 2001). In 1992, direct payments could largely be considered as compensations for support and market price declines. At that date, the Council of the European Communities referred explicitly to the need to compensate the loss of income caused by the

[23] Corresponding funds are however not very important and the possibility to use second pillar resources to complement pillar one direct aids applies only for the three years 2004, 2005 et 2006. Furthermore adoption of the MTR proposals would allow to reduce the length of the transition period for a full application of direct aids in Central and Eastern European Countries, from 10 to 7 years.

reduction in institutional prices. This is far less evident today as changes in terminology suggest (Beard and Swinbank, 2001).[24] The MTR document does not contain the term of compensatory payments. It however explicitly recognises the need of direct aids to ensure a fair standard of living and stability of income for the agricultural community (CEC, 2002, page 7). In addition to income support and stability objectives, direct aids can also be granted to reward farmers for specific activities, notably for providing non-commodity outputs which very often are public goods and/or amenities and thus may require public intervention. Measures of the second pillar can partially be analysed using this reading grid.

One can interpret the MTR proposals on the decoupling of direct aids and the fund switching from the first to the second pillar as an application of the targeting principle which requires that "when distortions have to be introduced in the economy, because the values of certain variables have to be constrained, the optimal (or least-cost) method of doing this is to choose that policy intervention that creates the distortion affecting directly the constrained variable." (Bhagwati, 1971). The maintenance of agricultural incomes remains a major objective of the MTR CAP. More than the validity of the policy objective in itself, the question is whether or not the single decoupled payment per farm is an efficient means of achieving it. In that context, one can wonder about the interpretation of cross-compliance requirements, including the long-term set-aside. Analysis will lead us to formulate a proposal for a domestic support policy which explicitly recognises that European farmers have different functions that require specific forms of public intervention and which should comply with current and future WTO commitments.

The single decoupled direct aid per farm: Some advantages

All the different ways governments use to support farmers' incomes can potentially distort trade and reduce economic welfare. But some income support policies can be less trade distorting and/or more efficient than others. It is now well admitted, at least among a majority of agricultural economists, that trade policies and market price support policies are inappropriate devices for supporting agricultural incomes in so far as there exist other types of income support policies that are simultaneously less distorting and more efficient. In a simplified word without market failure, the income support objective will certainly be best achieved through a decoupled direct payment from taxpayers to producers. In that context, the AAUR defines seven criteria that an income support measure shall meet to be classified as a decoupled income support instrument. In practice, these seven conditions can be interpreted as an attempt to define a concrete instrument that duplicates the effects, more precisely the absence of effects, of lump-sum transfers of the theory. In other words, a prime reason for decoupling direct payments to producers is to simultaneously reduce trade distortion effects, making them more acceptable on the international scene (cf. supra), and increase transfer efficiency.[25]

The MTR proposals on decoupling should increase the market orientation of European agriculture notably because producers would have almost full farming flexibility. They should allow farmers to better respond to market demands by removing current incentives to produce for direct subsidies. They also should reduce administrative costs for both farmers and public administrations. Of course, the more sectors that are covered by the program, the greater these market and administrative benefits. Important commodities are however still excluded (sugar) or only partially reformed (milk). The political and courageous rhetoric towards the integration of a maximum number of sectors into the scheme is likely to come up against the budgetary constraint problem.

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[24] Beard and Swinbank (2001) compare the terms used in 1992 (MacSharry reform) and 1999 (Agenda 2000 reform).

[25] This does not mean that a direct payment that is classified as decoupled according to the AAUR has no effect on production and trade. In particular, any income support policy induces wealth and insurance effects causing production to increase and distorting trade (Hennessy, 1998). These wealth and insurance effects add to coupling effects when support is provided through a production-linked instrument. The policy issue is whether or not orders of magnitude of wealth and insurance effects differ when support is provided through a decoupled program versus a coupled mechanism (for a same level of support). Although there is a lack of theoretical and empirical evidence, it is generally admitted that decoupled government payments that would replace the same average levels of coupled support are likely to result in lower trade distortion effects (ABARE, 1999).

The above mentioned advantages are well known and explain why the MTR proposals on decoupling, degression and modulation as well as second pillar measures have been generally well received by a majority of agricultural economists. This does not mean that the MTR proposals do not present some drawbacks. Some of them are summarised in Table 4.1 for the main innovation of the proposals, i.e., the whole-farm decoupled direct aid. They are discussed in the following sections of the paper.

(insert Table 4.1)

A problem only very partially addressed: The uneven distribution of support

The MTR proposals do not really address the equity problem across countries and regions as well as across farmers. Since the direct payment per farm would be based on historical references, it should continue to benefit proportionally more to North-European countries and largest farms even when the degression rate will be maximum. After all, a fund switching of 20 % (July 2002 proposals) or much lower than 20 % (January 2003 proposals) from the first to the second pillar means that the bulk of budgetary support will still be provided through a mechanism that will continue to favour largest farms which were previously specialised in specific products. The degression and modulation mechanism would however modify the uneven distribution of current direct aids. In practice, the redistributive effects of the MTR proposals will derive from two sources, the way pillar one direct aids will be reduced and the way funds saved in this way will be allocated on pillar two measures and agricultural sectors not yet reformed.[26]

Let us first consider the dynamic modulation mechanism of the July 2002 proposals. Figures show that the capping of pillar one direct aids would have mainly hurt larger-scale farms of Eastern Germany (Kleinhanss, 2002). Of the 204 million Euro that would have been withheld the first year of application (i.e., with a digressivity rate of 3 %) through the capping mechanism, 182 million Euro (89 %) would have been withdrawn from eastern Germany and of the 100 million Euro that would have been be withheld the last year of application (i.e., with a digressivity rate of 20 %), 92 million Euro (92 %) would have been withdrawn from eastern Germany. The impact of capping on other countries would have been null or negligible (Table 4.2). Even if the savings from capping would have been redistributed according to the amount capped in each Member State (MS), this very uneven impact of the capping mechanism casts serious doubts on both its economic and political opportunity. It is unlikely that a political priority is to hurt more severely farms of Eastern Germany relative to, for example, largest farms in Italy or the UK. The digressivity of pillar one direct aids, weighted by the franchise mechanism by which smallest farms would be exempt, would have allowed to transfer funds from the first to the second pillar for an amount equal to 490 million Euro the first year of application (digressivity rate of 3 %) and 3.263 billion Euro the last year of application (digressivity rate of 20 %). Countries would have been be unequally affected (Table 4.2). This uneven impact of the digressivity and franchise mechanisms simply reflects the fact that current direct aids are themselves unequally distributed across commodities and countries (Table 4.3), as well as between farms.[27]

(insert Table 4.2 and Table 4.3)

The Agenda 2000 reform saw the first consolidation of rural development and agri-environmental policies into a single framework. Rural Development Regulation (EC) 1257/1999 of 17 May 1999 sets out the measures that may taken by each MS to promote rural development and protect environment. It includes seven chapters for which the EU can provide support through the EAGGF (for more details, see Annex 1). In practice, under Agenda 2000, the growing importance of rural development comes more from the official reference to the need of a second pillar for the CAP than

[26] The silent of the MTR proposals about the "optimal" repartition of funds between the first and the second pillar makes life easier for the EC as it clearly allows the latter to sell the reform to established farmers on the premise that the proposed sharing could be permanent, at least be maintained on a "sufficient" period of time.

[27] According to the EC (2002), less than 2000 producers receive more than 300 000 Euro, 7 % of beneficiaries receive 50 % of direct payments and 70 % of beneficiaries receive less than 5 000 Euro (financial year 2000).

from the increase in budgetary allocations which remain very moderate relative to market expenditure (within the Guarantee Section of the EAAGF, respectively 4.3 and 36.2 billion Euro per year over the period 2000-06). The dynamic modulation mechanism included in the July 2002 MTR proposals should have gradually increased funds available for the second pillar from nearly 700 million Euro the first year of application (including 204 million Euro from capping) to about 3.36 billion Euro the last year of application (including 100 million Euro from capping).[28] The way the funds saved by the dynamic modulation would have been allocated on existing or newly introduced rural development measures is difficult to predict. Contrary to the savings from capping that would have been kept by each MS, the savings from digressivity would have been distributed to countries "on the basis of their agricultural area, agricultural employment and a prosperity criterion to target specific rural needs." (CEC, 2002, page 23). Sumpsi and Buckwell (2002) rightfully point out that ideally the criteria used for defining the redistribution rule of digressivity funds should have been the demand for agri-environment services and rural development. They add that the three criteria proposed by the EC are probably the most workable proxies. We can agree with their claim but as very often, the devil can be in detail as most countries are likely to do all their possible to keep the maximum of funds saved thanks to digressivety in their national accounts. Table 4.4 compares MS annual indicative receipts from the Rural Development Regulation (EC) 1257/1999 with their respective contributions to the second pillar through modulation. It also compares the financial consequences of two allocation mechanisms of funds saved thanks to digressivety. The first mechanism assumes that these funds are kept within each country while the second assumes that they are redistributed using the Agenda 2000 repartition key set out in the Rural Development Regulation (EC) 1257/1999. The latter would penalise first the UK in both absolute and relative terms. It would hurt France in absolute value, but the loss would be less severe in relative value in that country compared with the UK. Main winners would have been, in absolute terms Austria, Ireland, Finland and Portugal, in relative terms Luxembourg, Austria, the Netherlands and Portugal. The fact that some North-European countries such as Luxembourg, the Netherlands and Belgium would have gained while some South-European countries like Greece and Spain would have loose means that the Agenda 2000 allocation key is no doubt a very bad proxy for environmental and rural development services.

(insert Table 4.4)

Let us now consider the degression and modulation mechanism of the January 2003 proposals. In order to not hurt larger-scale farms of Eastern Germany, the EC has decided to suppress the capping of the single whole-farm payment. According to the EC (2003), total amounts saved via the degression and modulation mechanism would be equal to 3.34 billion Euro in 2012. This figure is confirmed by Chatellier (2003) who finds that total amounts would be equal to 3.52 billion Euro in 2012, of which 1.55 billion Euro only would be transferred to the second pillar (to be compared with the figure of 3.26 billion Euro in the case of the July 2002 MTR proposals where all funds were dedicated for rural development spending). Table 4.5 shows how MS and regions would be unequally affected by the degression and modulation mechanism of the July 2003 proposals (this table does not take into account how resources saved will be reallocated). Table 4.6 is the counterpart of Table 4.4 but for the January 2003 proposals (this table does not take into account how resources destined for financing future market needs will be reallocated). Conclusions derived from tables 4.4 and 4.6 are qualitatively the same, in particular the classification of countries as winners or losers in function of the repartition key adopted to allocate new resources of the second pillar.

(insert Table 4.5 and Table 4.6)

Income support direct aid: Tied to land or not?

Some agricultural economists will argue that the MTR proposals do not go far enough to capture all the benefits of decoupling. The extreme solution advocated by, for example, Swinbank and Tangermann (2000), is to support agricultural incomes of established producers through a bond scheme. To that end, they propose a six-step process under which Agenda 2000 area and headage payments could be transformed into a fully decoupled bond scheme. Step 1 would involve the decoupling of crop payments from current land use. Step 2 would extend this principle to livestock. Step 3 would involve the decoupling of resulting payments from land and the attaching of

[28] See Table 4.2.

entitlements to individuals. Step 4 would limit the duration of payments to, say, ten or twenty years, and could make these payments digressive over time. Step 5 would fix definitively the future level of payments while final step 6 would involve the transformation of payments entitlements into bonds. They claim that the full benefits of their proposals would be achieved only if the six steps are implemented, ideally at the same time transforming current payments into bonds in one time.[29] They however grant that adopting only one or two steps can reap many advantages of their solution. In practice, the MTR decoupling proposals include steps 1 and 2 as well as one element of step 4 (reduction of payments over time). In theory, they could also include step 3, i.e., the decoupling of payments from land and the attachment of entitlements to individuals. Unfortunately the January 2003 proposals remain unclear on this point. The decoupled farm income payment would be clearly decoupled from land use since it neither depends on the type, nor the amount of the crop produced nor the level of the market price. However, in practice, it is likely that payment entitlements would be transferred between farms of a same MS together with the transfer of land although draft legal texts stipulate that they might be transferred by sale with or without land (CEC, 2003, page 34).[30] Furthermore an entitlement transfer independently of land would render the cross-compliance mechanism unworkable (Agra Europe, 2003). If this interpretation is correct, it means that part of the decoupled farm income payment would be capitalised in land prices (as it is the case today for area payments). As a result, land prices would continue to be distorted reflecting in addition to market returns, the effects of government intervention including the single decoupled direct aid per farm. The beneficiaries of the latter would remain the current owners of land. Potential entrepreneurs without heritage or personal wealth would continue to be artificially discouraged to enter.[31]

Other agricultural economists like, for example, Buckwell (2002), consider that aid should stay linked to land. The reasoning is the following. Political and administrative reasons prevent the immediate and complete switch of current budgetary aids to environmental and rural development payments. Cross-compliance requirements included in the MTR proposals represent good proxies for longer-term conversion to environmental and territorial payments. During the adjustment process, a large part of pillar one measures and pillar two payments will thus have the same justification, i.e., to recompense land managers for their supply of non-market, environmental and rural development measures which would not otherwise be provided, at the minimum under provided relative to levels society desires. As a result, payments should stay linked to land both in the transition period and in the long term.

This reasoning suffers from one drawback. Permanent transfers are obviously more easily justifiable if they are payments for some legitimate public good or positive externality provision. The environmental and countryside stewardship role of agricultural producers, be they land owners or not, should be recognised and rewarded in its own right. This is in practice the route followed by the MTR even if one can regret that the step in the right direction is still too timid. It is however difficult to legitimate the MTR direct aid per farm on the grounds that it corresponds to environmental and territorial services currently provided by land managers above legal minimal standards reflected by cross-compliance requirements. The EC explicitly recognised that the 1992 direct aids "were introduced as compensation for a reduction in prices and therefore should be seen as temporary adjustment aids aimed at helping producers to adapt to the new situation." (EC, 1997a). This is still the case of the MTR direct aid per farm because it is not given in counterpart for the explicit delivery of public environmental and territorial services above legal minimal standards. The first objective of the MTR direct aid per farm remains farm income support. The economic issue is not the validity of this political objective, but whether or not a decoupled direct payment is the most efficient way of achieving it.[32] And for the sole objective of farm income

[29] In other words, the decomposition into six steps is proposed only for explanatory reasons. They do not correspond to six successive phases, i.e., to a reform that should be gradually implemented.

[30] In addition, legal texts make clear that lease or similar type of transactions would be allowed only if the entitlements transferred are accompanied by the transfer of an equivalent number of eligible hectares (CEC, 2003, page 34).

[31] On this point, see Mahé and Ortalo-Magné (1999).

[32] Measuring agricultural incomes is very difficult, even conceptually. Evidence suggests that total support to European farmers is very unequally distributed, first because support levels vary a lot across commodities, second because market support and direct aids increase with farm size. This will be still the case if the proposed decoupled direct payment per farm is implemented because the

support, it is likely that the answer is yes. Furthermore continuing to link income support direct aid to land raises the two issues of capitalisation of support in land price and barriers to entry (see supra).

In fact, linking income support direct aid to land could be justified on other grounds. First there is the question of land quantity that could be idle if the MTR decoupling proposals were implemented. This problem is aggravated by the fact that such idling of land, if any, could be concentrated in poorest agricultural regions with negative consequences for the countryside. Second there is the related issue of the number of agricultural producers who could decide to cash the single direct aid and quit production, with negative implications for rural development if this exit is concentrated in less favoured regions and/or leads to large increases in farm sizes in other agricultural regions. These issues should not be neither overestimated nor underestimated. Swinbank and Tangermann (2000) consider that these two problems are not good reasons to argue against decoupling. For these authors, it does not make good economic sense to shape the regime of payments for the whole of the European territory only in order to avoid that too much land falls idle in some regions. A more efficient approach would be to use specific and targeted policies in those regions. In the same way, it does not make good economic sense to artificially maintain farmers in business. That some producers decide to leave if income support is decoupled is seen as a positive development for three reasons. It provides leaving farmers with the opportunity of looking for better jobs, facilitates structural adjustment in agriculture and strengthens European agriculture competitiveness.

From our point of view, land abandonment and rural depopulation are however two sufficient reasons to, at least, analyse the advantages and the costs of an income support payment explicitly linked to land versus a decoupled direct aid. The essential reason for agricultural producers to receive annual payments is to reward them for providing environmental and rural development services to society. Corresponding aids should be fully coupled to these non-market services, permanent and non-digressive over time. As noted by Buckwell et al. (EC, 1997b), this turns the attention towards defining these non-market goods and ensuring that the payments do relate to their creation. Except risk, uncertainty and stability considerations, there are few economic arguments for further transfers. This implies that the MTR income support aid should be designed only to compensate for the loss in capital implied by lower market support.[33] It should be paid only to allow adjustments by producers that would involve either expansion to compete at a lower cost or retirement without bankruptcy. As a consequence, it should be digressive over time and transitory, with an announced end-date. Throughout the transitional phase corresponding to the progressive phasing-out of the income support aid and the concomitant phasing-in of environmental and rural development support payments, the former could stay linked to land if a full decoupling leads to effects (land abandonment and rural depopulation) too negative to ensure an optimal provision of environmental and rural development services in the long term, especially in marginal areas. Unfortunately existing macroeconomic agricultural models are not able to deal satisfactorily with these issues. Primary factor markets are more often not explicitly modelled and when they are represented, total agricultural land is fixed or exogenously defined. More generally, one weakness of the MTR proposals is that they are not accompanied by evaluation studies including impacts on land abandonment and the number of farms.

Uncertainty surrounds effects of the MTR proposals, especially the single decoupled direct aid per farm, on producers' behaviour, product choice and agricultural land use. The problem is not really that changes in agricultural land use could occur. After all, one merit and one objective of the decoupling of income support policy is that farmers will react more to market signals focusing "on products which give them the best return from the market reflecting their skills, initiative and local agronomic conditions." (CEC, 2002, page 26). The problem is again support heterogeneity, both in terms of levels and instruments, between commodities. Unlike a food potato producer, a starch potato producer should benefit from the single decoupled direct aid and hence from a definitive competitiveness advantage relative to the former.[34] In the same way, some producers of cereals or

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latter would be based on historical references. In other words, the MTR decoupled direct aid per farm can be justified for efficiency reasons, not for equity motives.

[33] Note however that this compensation motive gradually declines as first support price cuts were introduced in 1992.

[34] According to the January 2003 proposals, 50 % of the current payment to producers of starch potatoes would be included into the single farm payment, the remainder being maintained as a crop specific payment for starch potatoes.

oilseeds who no longer have to plant crops to claim payments could switch to potatoes or field vegetables. They also could decide to invest in pork and poultry production taking advantage of the cash flow that represents the single decoupled direct aid.[35] A related problem is that these changes in agricultural land use could occur very (too) quickly causing market price declines and bankruptcy of disadvantaged producers.[36] A possible solution to this potential problem would be to gradually increase the quantity of land on which beneficiaries from the single decoupled direct aid would have full flexibility on all crops, including haying and grazing.

Parallels with the 1996 US FAIR ACT

MTR opponents will argue that it does not make sense to apply in the EU a political recipe (the decoupling) that was at the heart of the US Federal Agricultural Improvement and Reform (FAIR) Act of 1996, given the failure of the latter. Obvious parallels can be drawn between the US Production Flexibility Contract (PFC) payments and the EU single decoupled direct aid per farm. And one knows what happens in the US, i.e., the abandon of an exemplary policy structure with respect to market orientation in favour of an explicit recoupling of the US agricultural policy at the opportunity of the Farm Security and Rural Investment (FRSIA) Act of 2002. It is clearly beyond the scope of this paper to propose a thorough analysis of the FRSIA Act and its potential effects on US production and trade, world prices and WTO negotiations. In particular, whether or not these reforms will comply with current and future WTO requirements remains to be seen (on this point, see, for example, Haniotis, 2002). At this stage, one will simply note that the problem is not really a problem of income support, but more a problem of income stability. A price support policy allows policy makers to simultaneously achieve two objectives, agricultural income support and agricultural price and market stability. Direct aids, whether they are coupled or decoupled, are likely a more efficient policy instrument to support agricultural incomes, but not to stabilise agricultural prices and markets (note however that they contribute to stabilise farmers' incomes by ensuring a sure transfer from taxpayers to agricultural producers). As future markets are incomplete in agriculture, there is clearly room and legitimacy for public intervention in this area. It is not sure that safety net mechanisms scheduled by the EC in its MTR proposals will be sufficient to stabilise agricultural prices and markets in a efficient way, in particular for animal productions. There are clearly lessons to derive from the case of pork and poultry.

Cross-compliance requirements and rural development measures: A question of agricultural land use rights

Good farming practices and beyond: The use of a red and green ticket strategy. The MTR proposals make the full granting of the single decoupled farm income payment and other (coupled) direct aids conditional "on the respect of a certain number of statutory environmental, food safety and animal health and welfare standards, as well as occupational safety requirements for farmers." (CEC, 2002, page 21). In the case of non-respect of these standards and requirements, direct payments should be reduced. According to the EC, attaching such conditions to farmers' support payments is a way of improving and supporting the enforcement of "good farming practices" defined as encompassing mandatory standards. This approach known as cross compliance is given new emphasis in the EU following Agenda 2000. However cross compliance in Agenda 2000 is restricted to environment making the payments of hectare and headage direct aids possibly dependent upon compliance with environmental criteria. Agenda 2000 gives MS very wide discretion in deciding on the measures to be taken with the result that environmental cross

[35] The switch to milk and sugar, two of the most supported agricultural commodities in the EU, is largely precluded as long as these productions remain controlled by quotas (Swinbank and Tangermann, 2000).

[36] In the case of France, preliminary simulation results suggest that in the medium term land devoted to cereals, oilseeds and protein crops would decrease by about 7.3 % while land devoted to forage would increase by about 8.5 % (relative to the base year corresponding to "average" 2004-06). Production would decrease by 6.0 % for wheat, 8.7 % for barley, 3.4 % for corn and 5.1 % for oilseeds. Beef production would slightly decrease (-0.7 %) thanks to an extensification effect. Pork and poultry production increases would be very small, 0.3 % and 0.4 % respectively. For more details, see Gohin (2002).

compliance is not really an obligation, but an option left to countries' discretion. In practice, there are currently no further requirements than to comply with relevant national legislation as the definition of reference levels and environmental conditions have been left entirely to MS. Building on this embryo, the MTR proposals aim then to strengthen cross compliance by making it obligatory at the EU level and extending its scope (inclusion of food safety and animal welfare conditions). Cross compliance would be based on a whole farm approach, with conditions attached to both used and unused agricultural, and farm audits. The focus of farm audits would be material flows and on-farm processes relating to environmental, food safety, animal welfare and occupational safety standards. Farm auditing would be mandatory as part of cross-compliance requirements. In the same way, the long-term (10 years) non-rotational set-aside on arable land would also be an element of cross-compliance requirements.[37]

The MTR proposals on cross compliance can be interpreted as an application of the so-called red ticket approach (Batie and Sappington, 1986). Eligibility to the single decoupled direct aid per farm and other direct payments would be made contingent upon farmers complying with statutory standards and there would be partial or complete withdrawal of payments in the case of non-compliance. In addition, the MTR proposals would extend the scope of the current development rural regulation by introducing a new chapter called "meeting standards" to "help farmers to adapt to demanding standards based on Community legislation in the field of the environment, food safety and animal welfare as well as implementing farm audits." (CEC, 2002, page 24). Temporary and digressive direct aids, for a period of maximum five years and up to a maximum of 200 Euro per hectare the first year, could be granted to farmers to compensate for the loss of income implied by European standard adoption.[38] Support for farm audits would be given under the form of a flat-rate aid.

The red ticket approach described above, making income support direct aids contingent upon farmers' attainment of statutory standards, would be supplemented by the augmented use of the so-called green ticket approach allowing farmers to receive additional support if they exceed mandatory standards, i.e., for efforts that go beyond minimum reference levels.[39] Agenda 2000 explicitly recognises the essential role that farmers (can) play in providing environmental services that go beyond basic legal standards. To that end, direct aids are granted to farmers who undertake agri-environmental commitments for a minimum of five years. Annual aids are calculated according to the income loss and additional costs resulting from the undertakings, as well as the need to provide a financial incentive. Maximum payments are 600 Euro per hectare for annual crops, 900 Euro per hectare for specialised perennial crops and 450 Euro per hectare for other types of land use (EC, 1999a). The MTR proposals would strengthen (environment) and extend (food safety and animal welfare) the green ticket approach initiated in Agenda 2000. Funds available for these measures would be increased thanks to the degression and modulation mechanism (see Table 4.3).

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[37] Producers currently subject to the set-aside obligation will continue to set-aside an area equal to 10 % of their current COP surface for receipt of the single whole-farm payment. This set-aside would be non-rotational and would apply for a period of ten years starting on 1 January 2004 (CEC, 2003). Unfortunately this long-term set-aside does not target land parcels that are the most sensitive from an environmental point of view. In most cases, the set-aside of normal land is not justified from both an economic and environmental point of view (wasting of economic resources and unclear environmental benefits). However it is generally recognised that the environmental value of set-aside land increases the longer it is left uncultivated. In practice, it appears that this new set-aside instrumentation pursues not only environmental objectives, but also supply control objectives which are not very well justified if the January 2003 MTR proposals were applied.

[38] The EC document however makes clear that "in no case would aid [understood meeting standard aid] be payable where the non-application of standards is due to the non-respect by an individual farmer of standards already incorporated in national legislation." (CEC, 2002, page 25).

[39] Cross-compliance policies generally include both the red and green ticket approach, as well as the so-called orange ticket approach where eligibility for agricultural support payments is dependent on farmer enrolment in an otherwise voluntary scheme which attracts incentive payments (Baldock, 1993; Baldock and Mitchell, 1995). However the green ticket approach cannot properly be considered as a cross-compliance policy since payments are in addition to basic support levels (Webster and Williams, 2000). In the EC document, cross compliance is implicitly restricted to the red ticket approach. We also follow this narrow definition of cross compliance.

Long-term sustainability of the red and green ticket strategy. The red ticket approach of the MTR recognises that as a minimum, farmers should respect basic requirements as regards environmental, food safety and animal welfare concerns without specific payment. In other words, the farmer has not the right to manage his property freely as he must comply with mandatory standards. In the case of non-compliance, negative incentives should be theoretically used. In the MTR proposals, they would take the palliative form of a partial, possibly complete, withdrawal of the single direct aid per farm and other direct payments. Several rural development measures are consistent with the green ticket approach.[40] They are based on the principle that land use rights above the statutory levels embraced in legislation and reflected in red ticket cross-compliance requirements are private property of the land user. If society asks farmers to pursue environmental, food safety or animal wealth objectives beyond these statutory levels, then society must pay for those public services. And payments should be permanent and non-digressive.

The main weakness of the MTR proposals on cross-compliance is that they explicitly exclude some commodities and some producers by targeting only farmers who are eligible for largest income support direct aids. Again the root of the problem lies in the unequal distribution of support, both in terms of levels and instruments, across commodities, farms, regions and countries. Sumpsi and Buckwell (2002) rightfully point out that all food, not only food covered by income support direct aids, should be subject to food safety regulation and sanctions for non-compliance. This remark also applies to animal wealth or environment. There is non-sense to enforce minimum animal wealth standards through cross compliance in the beef sector and not in the pig and poultry industry. In the same way, there is non-sense to exclude some farmers from environmental cross-compliance requirements on the grounds that they produce commodities that are little or not supported by income direct aids. All farmers regardless of specialisation or size should follow law and in the case of non-respect, should be penalised.

The red ticket approach should be used to ensure that agricultural producers comply with the legislation in force and to improve conformity with good agricultural practices if this concept is broader than statutory standards. The EC suggests that this is the case since good farming practices are explicitly defined as encompassing mandatory standards (CEC, 2002, page 21). The two notions should ideally be synonymous. If there exists a gap, it should be temporary reflecting the fact that good farming practices change over time with growing scientific knowledge and increasing standards of living. A delay is inevitable to translate these changes into legislation.

5. Concluding Comments

The MTR proposals are likely to be sufficient to comply with future WTO commitments on the domestic support dossier. They would allow the EU to concentrate efforts on its main Achilles' heel in the current round of WTO agricultural negotiations, i.e., the necessity to maintain a sufficient import protection over say, the next ten years, in particular in sectors where the EU price competitiveness is still very low and price support is still very high. The overall sustainability of the MTR package, more generally of the European model of agriculture proposed by the EC, requires maintenance of a sufficient frontier protection over the next decade to prevent surge increases in imports. This is a necessary condition to sell the reform to current farmers and pursue the long-term process, initiated within the 1992 MacSharry reform, aiming at increasing the price competitiveness of European agricultural products and promoting European agricultural trade on a fair basis.

The MTR proposals present other advantages. They would improve transfer efficiency from taxpayers to producers and increase funds available for rural development measures. On this point, one can regret the lowness of the fund switching from the first to the second pillar entailed in the January 2003 proposals. Note however that the EC makes clear that this transfer is only "a first step in the necessary reinforcement of rural development, without prejudice to future discussions." (CEC, 2003, page 5). This statement clearly "reflects the continuing evolution in what is considered important for EU agriculture, i.e., a much greater emphasis on food quality and safety, protection of the environment, animal welfare and rural development to meet the growing demand of [domestic] consumers and environmentalists." (Kelch et al., 2002). At this stage, one can simply regret that the EC does not precise the next steps of its reform, in particular the way pillar one

[40] This is not the case for all rural development measures, for example the early retirement scheme or aids available for the processing and marketing of agricultural products.

funds would (should) be reduced after 2012 and simultaneously the way funds saved in this way would (should) be allocated on pillar two measures. Current and future farmers need clear and stable game rules. It would be a great mistake to give farmers the impression that the 2012 repartition of funds between the first and the second pillar should not evolve after that date. Many MS condemn the EC proposals for being too radical. This is clearly reflected by immediate reactions of the French Minister of Agriculture to the July 2002 proposals. The latter considers that the MTR proposals "go far beyond the mandate defined by the Heads of States and Governments at Berlin in 1999 which does not intend for the MTR any more than a certain number of technical changes, where necessary, based on experience to date." He adds that he "cannot subscribe to the [EC] approach as [it is not possible] to define in a matter of weeks the future of the CAP, any more you can change it every three years it." (Gaymard 2002).[41] The last remark clearly applies to the MTR proposals. Game rules should be defined not only for the budgetary period 2006-13, but also for the longer term to give farmers right political signals they need to take their investment decisions. This remark also applies to compromise solutions proposed by some MS, notably France. A solution of partial decoupling, be it horizontal (inclusion of current direct aids into the single farm payment for some commodities only) and/or vertical (inclusion of a certain percentage of current direct aids into the single farm payment for all commodities, the rest being maintained as product specific payments), would allow to go out from the current political deadlock. Such a political compromise is not a solution for the long term and very quickly would lead to a reopening of discussions.

Several aspects of the MTR proposals raise questions. Some of them have been analysed in this paper: impact on land prices, land use, land abandonment, the number of farms, etc. All these issues merit detailed impact analyses at a local level, in particular in intermediate regions and less favoured areas. The multifunctional character of European agriculture is well accepted. The general philosophy underpinning the MTR proposals is that agricultural producers should observe minimum levels of good agricultural practices but that additional public services above these minimum levels should be paid for by the society through targeted measures. Unfortunately MTR second pillar measures are likely to be too complex and too general to guarantee that they automatically will lead to a reduction of negative external effects and an augmentation of positive external effects. As noted by Bureau (2002), the MTR proposals on decoupling amount, to a large extent, to freeze the current distribution of budgetary support across farmers, regions and countries. As a result, they would continue to favour the largest and more intensive farms. In other words, the MTR proposals do not address the question of small and poor farmers, very often located in marginal zones where agriculture is still a major economic activity and where employment alternatives are seldom. In the same way, the MTR do not satisfactorily address the question of agricultural price and income instability. Income support expenditure should be significantly reduced and funds saved in this way used to implement public stabilisation programmes.

[41] Quoted in The Scottish Parliament, The Information Centre, 31 July 2002, translation of H. Gaymard's speech at the Council of Agricultural Ministers on the 15th July 2002.

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Table 2.1. Main agricultural commodity regimes in the European Union under Agenda 2000

	Policies		
Commodity	Market and income	Income	Supply control
Cereals	Export refunds Import tariffs (and tariff quotas) Intervention mechanism (minimum guaranteed production price)	Hectare payments	Compulsory set-aside
Oilseeds	-	Hectare payments	Compulsory set-aside Maximum guaranteed area (1)
Sugar	Export refunds Import tariffs (and tariff quotas) Intervention mechanism (minimum guaranteed production price)	-	Production quotas (quotas A and B) Possibility to produce sugar C at world price
Dairy products	Export refunds Import tariffs (and tariff quotas) Intervention mechanism (minimum guaranteed production price for butter and skim milk powder) Domestic use subsidies (intermediate and final consumption)	Animal payments (from 2005/06)	Production quotas
Beef and veal	Export refunds Import tariffs (and tariff quotas) Intervention mechanism as a safety net Aids to private storage	Animal payments	Headage limits Stocking density limits
Pigmeat	Export refunds Import tariffs (and tariff quotas) Aids to private storage	-	-
Eggs and poultry	Export refunds Import tariffs (and tariff quotas)	-	-

Source: From CAP Monitor, 2002. (1) Restriction no longer in force pending any WTO challenge.

Table 2.2. Support in the European Union for some agricultural commodities (million Euro)

	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001P
EU agricultural sector																
PSE	88329	84784	81880	78380	93455	113165	95487	95190	94761	96123	91727	92664	102330	108241	97244	103937
- MPS	77346	72 810	68503	62048	75815	91934	73355	66245	61114	59795	50925	51866	63971	70618	57573	60620
- PBAAN	1980	2325	2945	3787	4562	5080	9046	15195	19848	24200	25873	24487	24733	23675	25977	27954
PSE in %	*52*	*39*	*36*	*36*	*37*	*44*	*38*	*37*	*35*	*35*	*32*	*32*	*36*	*39*	*34*	*35*
Wheat																
PSE	8246	8298	7076	4283	6112	10319	7354	8922	9087	8692	6505	7188	9756	10633	9903	9163
- MPS	7488	7514	6219	3211	4834	8801	5659	4473	3041	1601	-1258	-346	2205	2898	1031	91
- PBA	364	383	450	566	695	701	629	3621	5278	6363	6797	6524	6487	6521	7481	7747
PSE in %	*54*	*56*	*47*	*26*	*39*	*57*	*46*	*52*	*51*	*44*	*30*	*36*	*49*	*55*	*46*	*44*
Oilseeds																
PSE	2691	3033	2759	3586	3665	3793	2125	2056	1921	2159	2057	2142	2172	1608	2085	1963
- MPS	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
- PBA	3	5	6	9	11	11	1909	1819	1662	1928	1783	1824	1828	1200	1676	1517
PSE in %	*62*	*61*	*53*	*59*	*64*	*62*	*52*	*48*	*40*	*44*	*42*	*38*	*37*	*35*	*42*	*40*
Sugar																
PSE	2985	2916	2734	1894	2330	2848	3770	3052	4313	2222	2534	2789	2898	3326	2699	2397
- MPS	2897	2821	2634	1783	2202	2703	3068	2698	2116	1930	2256	2494	2622	3026	2488	2207
PSE in %	*63*	*62*	*55*	*36*	*45*	*55*	*64*	*55*	*60*	*42*	*46*	*48*	*54*	*60*	*50*	*46*
Milk																
PSE	20528	18337	16662	17285	21336	20848	20887	21114	20348	21546	20534	19835	22325	19185	16752	16077
- MPS	19568	17407	15096	15610	19642	18909	18858	18449	18145	18905	18315	17670	20545	17337	14978	14407
PSE in %	*63*	*58*	*51*	*49*	*62*	*59*	*59*	*59*	*57*	*54*	*52*	*51*	*58*	*51*	*43*	*40*
Beef																
PSE	16163	13505	11319	12530	14426	18768	16139	13585	14078	15180	17098	21045	20629	21178	18949	23945
- MPS	14474	11995	9489	10395	11914	16165	13039	9918	8611	8581	7643	11460	12290	13226	11866	13506
- PBAN	706	665	835	1206	1635	1711	2043	2025	3861	4911	6158	5594	5852	5671	5483	6489
PSE in %	*70*	*59*	*48*	*52*	*61*	*78*	*64*	*52*	*52*	*53*	*61*	*74*	*77*	*83*	*78*	*91*

Source: OECD, PSE/CSE database 2002. PSE: Producer support estimate. MPS: Market price support. PBAAN: Payments based on area planted and/or animal numbers. PBA: Payments based on area planted. PBAN: Payments based on animal numbers. PSE in %: Ratio of the PSE to the value of total gross farm receipts. P: provisional.

Table 2.3. Comparison of Agenda 2000 provisions, July 2002 MTR proposals and January 2003 MTR proposals

	MTR proposals	
Agenda 2000	Communication (July 2002)	Draft legal texts (January 2003)
- *Partial decoupling of income support direct aids*	- *Decoupling of income support policy*	- *Decoupling of income support policy*
Commodity-specific income support direct aids for arable crops, rice, beef, sheep and milk (1)	Single whole-farm income support payment based on historical payments for arable crops, rice, beef, sheep and milk (2)	Single whole-farm income support payment based on historical payments (2000, 2001 and 2002) for arable crops, rice, beef, sheep, milk, seeds; certain regional aids are included
	No production is required and almost full farming flexibility	No production is required and almost full farming flexibility
- *Optional cross-compliance at a national level*	- *Compulsory cross-compliance at the EU level*	- *Compulsory cross-compliance at the EU level*
Possibility for MS to condition commodity-specific income support direct aids to specific environmental requirements	All direct payments conditional on the respect of statutory legal standards which cover food safety, environmental protection, animal welfare and occupational safety	All direct payments conditional on the respect of forty legislative acts applying directly at the farm level (minimal list, possibility for MS to complement these minimal requirements) with good farming practice and maintaining permanent pasture
If no compliance, possibility for MS to reduce direct payments	If no compliance, partial or entire reduction of direct payments	If no compliance, partial or entire reduction of direct payments
- *Optional modulation at a national level*	- *Compulsory "dynamic modulation" at the EU level*	- *Compulsory "degression and modulation" at the EU level*
Possibility for MS to increase second pillar funding under optional national modulation programs	All direct payments (i.e., direct payments of pillar one) reduced by 3 % per year from 2004 up to a maximum of 20 % (modulation mechanism)	All direct payments reduced from 1 % in 2006 to 12 % in 2012 (farms receiving between 5 001 and 50 000 Euro per year in direct aids) or 19 % in 2012 (farms receiving more than 50 000 Euro per year in direct aids)
	Small farms (farms receiving less than 5 000 Euro per year in direct aids) exempt from payment cuts (franchise mechanism)	Small farms exempt from payment cuts

	Introduction of a ceiling (300 000 Euro per year) on direct aids an individual farm can receive (capping mechanism)	Suppression of the capping mechanism
- *Rural development as the second pillar*	- *Strengthening the second pillar*	- *Strengthening the second pillar*
Rural development funding at about 4.5 billion Euro per year	Annual spending on rural development nearly doubled	Annual spending on rural development augmented by 228 million Euro in 2006 to 1 481 million Euro in 2012
	Introduction of new measures related to food quality, meeting standards, support for farm audit and animal welfare	Introduction of new measures related to food quality, meeting standards, support for farm audit and animal welfare

Source: CEC, 2002 and 2003. (1) In the case of milk, from 2005/06. (2) The long-run objective is to include as many sectors as possible. As a result, other sectors scheduled for reform (sugar, olive oil, some fruit and vegetables, etc.) could (should) follow later.

Table 2.4. The MTR proposals: domestic policy objectives and instruments

Objectives (1)	Instruments
A competitive agricultural sector	Market orientation: public intervention as a safety net only and decoupling of income support direct aids
Production methods that support environmentally friendly, quality products that the public wants	Respect of minimum legal standards: cross-compliance requirements and strengthening second pillar measures
Fair standard of living and income stability for the agricultural community	Income support direct payments and public intervention as a safety net
Diversity in forms of agriculture, maintaining visual amenities and supporting rural communities	Fund switching from the first to the second pillar (dynamic modulation) and strengthening second pillar measures
Simplicity	Decoupling of income support direct aids
Justification of support through the provision of services that the public expects farmers to provide	Cross-compliance and strengthening second pillar measures

(1) Policy objectives as presented in the explanatory memorandum of the Communication from the Commission to the Council and the European Parliament (CEC, 2002)

Table 2.5. Degression and modulation in the January 2003 MTR proposals

	2006	2007	2008	2009	2010	2011	2012
Percentage of reduction in function of annual amounts of direct aids received by a farm							
- from 1 to 5 000 Euro	0	0	0	0	0	0	0
- from 5 000 to 50 000 Euro	1	3	7.5	9	10.5	12	12.5
- above 50 000 Euro	1	4	12	14	16	18	19
Of which percentage reallocated on measures of the second pillar							
- from 5 001 to 50 000 Euro	1	2	3	4	5	6	6
- above 50 000 Euro	1	2	3	4	5	6	6
Of which percentage reallocated for financing future market needs							
- from 5 001 to 50 000 Euro	0	1	4.5	5	5.5	6	6.5
- above 50 000 Euro	0	2	9	10	11	12	13

Source: CEC, 2003.

Table 3.1. Import penetration and import shares (in volume) in the European Union

	Import penetration ratio (1)			Share in world import volume		
	1986-89	1990-94	1995-99	1986-89	1990-94	1995-99
Wheat	3.2	2.0	3.2	2.6	1.7	3.2
Rice	36.1	31.8	28.1	7.4	6.1	4.1
Coarse grains	4.1	3.6	3.4	4.6	3.6	3.6
Sugar	15.0	14.3	13.5	7.6	7.1	5.6
Bovine meat	4.6	5.2	5.3	10.3	9.0	7.5
Skim milk powder	3.2	2.5	6.7	3.7	2.6	5.1
Butter	4.1	4.0	5.3	8.3	8.7	12.8
Cheese	1.8	1.6	1.9	12.0	10.4	10.3
Pig meat	0.5	0.3	0.4	5.0	2.7	2.1
Poultry meat	2.0	3.0	3.6	7.9	7.9	5.7

Source: OECD (2002). Excluding intra-EU trade. (1) Import penetration: Ratio of agricultural imports to apparent consumption in volume.

Table 3.2. AMS ceilings, notified AMS, blue and green box support in the European Union, 1995/96-1999/00 (in billion Euro)

	1995/96	1996/97	1997/98	1998/99	1999/00
AMS ceiling (1)	78.672	76.369	74.067	71.765	69.643
Notified AMS (2)	47.5264	51.0090	50.1940	46.6830	47.8857
Blue box support (3)	20.8455	21.5208	20.4428	20.5035	19.7921
Green box support	18.7792	22.1304	18.1668	19.168	19.9305
Difference					
(1) – (2)	31.1456	25.3600	23.8730	25.0820	21.7573
(1) – (2) – (3)	10.3001	3.8392	3.4302	4.5785	1.9652

Source: Adapted from Anania (2002).

Table 4.1. Main advantages and limits of the decoupled whole-farm direct payment

Advantages
- WTO acceptability - Transfer efficiency - Market orientation - Simplification
Limits
- Important sectors not yet covered by the program (milk, sugar, olive oil, tobacco, etc.) and unlikely to be fully integrated because of the budgetary constraint - Equity issues only very partially addressed because payments are based on historical references, but potential correction of the uneven distribution of current direct aids thanks to the degression and modulation mechanism - "Optimal" allocation of funds between first and second pillar budgetary measures in the long term - Potential capitalisation of the single decoupled direct payment per farm into land price, notably in function of the option or not to sell part of payment entitlements independently or not of land; More generally, questions of support capitalisation in land prices and barriers to entry for new farmers without heritage or personal wealth Land hectares that could be idle (concentration in less favoured regions) and number of farmers who could quit production (concentration in less favoured regions where agriculture is still the buttress of the rural economy)

Table 4.2. Impact on pillar one direct payments of the dynamic modulation mechanism of the July 2002 MTR proposals (in million Euro)

	Digressivity rate of 3 %			Digressivity rate of 20 %		
	Modulation	Capping	Total	Modulation	Capping	Total
Belgium	4	0	4	25	0	25
Denmark	14	1	15	93	0	93
Germany	74	182	256	493	92	585
-west	38	0	38	252	0	252
-east	36	182	218	241	92	333
Greece	19	0	19	124	0	124
Spain	57	4	61	379	1	380
France	146	0	146	971	0	971
Ireland	8	0	8	56	0	56
Italy	39	11	50	261	3	264
Luxembourg	0	0	0	2	0	2
Netherlands	1	0	1	9	0	9
Austria	5	0	5	31	0	31
Portugal	5	0	5	31	0	31
Finland	14	0	14	95	0	95
Sweden	8	0	8	50	0	50
UK	96	7	103	643	3	646
EU-15	490	204	694	3263	100	3363

Source: Kleinhanss, 2002.

Table 4.3. Area and animal premiums in the European Union at Member State level (1998)

	Area premiums				Animal premiums			Total
	cereals	oilseeds	set-aside	total	cattle	goats	Total	
EU15 (million Euro)	11784	3115	1263	16162	4253	1535	5788	21950
(per cent of EU15)								
Belgium	1.1	0.1	0.4	0.9	2.6	0.1	2	1.2
Denmark	4.1	2.7	4.6	3.9	1.1	0.1	0.8	3.1
Germany	20.4	18.1	24.4	20.3	8.2	2.3	6.7	16.7
Greece	3.8	0.3	0.2	2.8	1.2	10.3	3.6	3
Spain	9.7	9.7	13.9	10	9.3	27.3	14.1	11.1
France	28.2	38.3	29.5	30.2	25.1	10.2	21.1	27.9
Ireland	0.9	0.2	1.3	0.8	12.8	7.1	11.3	3.5
Italy	12.3	13	5.1	11.8	4.5	8.3	5.5	10.2
Luxembourg	0.1	0	0	0.1	0.1	0	0.1	0.1
Holland	1.1	0	0.3	0.8	1.3	0.7	1.1	0.9
Austria	2.2	2	2	2.2	2.3	0.1	1.7	2
Portugal	1.1	0.6	0.4	1	2	3.4	2.4	1.3
Finland	1.5	0.6	2.3	1.4	0.9	0.1	0.7	1.2
Sweden	2.7	1.3	4.9	2.6	1.8	0.2	1.3	2.3
UK	10.8	13.1	10.7	11.2	26.8	29.8	27.6	15.5

Source: Melgaard and Frandsen (2002).

Table 4.4. Rural development measures: Comparison of receipts under Agenda 2000 and July 2002 MTR proposals (Guarantee Section of the EAGGF, annual average)

Member States	B	DK	D	GR	SP	FR	IRL	I	L	NL	A	P	FIN	SW	UK	Total
Rural development measures under Agenda 2000																
Million Euro	50	46	700	131	459	760	315	595	12	55	423	200	290	149	154	4339
%	1.2	1.1	16.1	3	10.6	17.5	7.3	13.7	0.3	1.3	9.7	4.6	6.7	3.4	3.5	100
Funds saved via modulation (digressivity rate of 20 %, capping funds excluded)																
Million Euro	25	93	493	124	379	971	56	261	2	9	31	31	95	50	643	3263
%	0.8	2.9	15.1	3.8	11.6	29.8	1.7	8.0	0.1	0.3	0.9	0.9	2.9	1.5	19.7	100
Pillar two resources under MTR assuming that digressivity funds are kept within each country (million Euro) (1)																
Excluding capping	75	139	1193	255	838	1731	371	856	14	64	454	231	385	199	797	7602
Including capping	75	139	1285	255	839	1731	371	859	14	64	454	231	385	199	800	7701
Pillar two resources under MTR assuming that digressivity funds are redistributed using the Agenda 2000 repartition key set out in the Rural Development Regulation (EC) 1257/1999 (million Euro) (2)																
Excluding capping	91.2	83.6	1223.9	228.1	805.8	1330.4	554.9	1041.5	22.8	98.8	737.4	349.7	509.3	258.5	266.1	7602
Including capping	91.2	83.6	1315.9	228.1	806.8	1330.4	554.9	1044.5	22.8	98.8	737.4	349.7	509.3	258.5	269.1	7701
Difference (2) - (1)	16.2	-55.4	30.9	-26.9	-32.2	-400.6	183.9	185.5	8.8	34.8	283.4	118.7	124.3	59.5	-530.9	0
Difference in %	21.6	-39.9	2.6	-10.5	-3.8	-23.1	49.6	21.7	62.9	54.4	62.4	51.4	32.3	29.9	-66.6	0
Agricultural area (%)	1.0	2.0	12.9	2.6	21.7	22.4	3.3	11.4	0.1	1.5	2.6	2.8	1.6	2.3	11.8	100
Agricultural employment (%)	0.8	0.9	8.3	10.8	16.9	9.5	1.9	31.2	0.1	1.9	3.5	7.3	1.5	1.1	4.3	100

Source: EC(1999a) DGA Fac-Sheet on "CAP reform: Rural development", Kleinhanss (2002) and authors' calculations.

Table 4.5. Impact of the degression and modulation mechanism of the January 2003 MTR proposals on direct aid receipts in 2012, by Member State and by region

	Farms		Impact		
	number	**%**	**In Euro per farm modulated**	**In % of direct payments**	**In million Euro**
Finland	48 900	88.7%	-1 570	-9.2%	-77
Sweden	35 300	88.9%	-2 080	-10.0%	-73
Austria	55 200	64.8%	-950	-7.6%	-53
Ireland	90 500	70.3%	-1 230	-8.4%	-111
United-Kingdom	120 100	90.5%	-5 500	-13.0%	-661
UK-North	47 000	96.2%	-4 250	-12.1%	-200
UK-Centre	46 200	89.1%	-5 370	-12.7%	-248
UK-East	26 900	84.1%	-7 900	-14.1%	-213
Denmark	41 500	84.8%	-2 560	-10.6%	-106
Netherlands	42 700	53.0%	-1 830	-9.5%	-78
Belgium & Luxembourg	31 400	72.7%	-1 700	-9.2%	-53
Germany	217 600	78.6%	-2 940	-11.6%	-640
Germany-North	52 400	88.7%	-2 370	-10.1%	-124
Germany-East	11 500	90.3%	-25 740	-16.9%	-295
Germany-West	78 200	72.5%	-1 550	-9.0%	-121
Germany-Bayern	75 500	77.7%	-1 310	-8.5%	-99
France	322 400	79.6%	-3 000	-10.9%	-967
France-North-Paris	35 100	93.2%	-4 090	-11.5%	-144
France-Centre	46 800	81.7%	-5 150	-12.1%	-241
France-West	77 000	87.1%	-2 470	-10.2%	-190
France-East	20 100	89.8%	-3 770	-11.5%	-76
France-Massif Central	30 900	96.5%	-2 010	-9.7%	-62
France-South West	81 700	84.6%	-2 410	-10.4%	-197
France-South East	30 800	43.6%	-1 860	-9.6%	-57
Italy	206 900	19.7%	-1 300	-8.9%	-270
Italy-North	79 900	23.3%	-1 570	-9.4%	-125
Italy-Others	127 000	17.9%	-1 140	-8.5%	-144
Spain	234 900	38.2%	-1 330	-8.8%	-312
Spain-North	25 300	32.0%	-690	-6.6%	-17
Spain-Others	209 500	39.1%	-1 410	-9.0%	-295
Portugal	21 700	6.9%	-1 520	-9.5%	-33
Greece	131 100	25.7%	-700	-6.6%	-92
European Union	**1 600 100**	**42.2%**	**-2 200**	**-10.4%**	**-3 526**

Source: Chatellier (2003).

Table 4.6. Rural development measures: Comparison of receipts under Agenda 2000 and January 2003 MTR proposals (Guarantee Section of the EAGGF, annual average)

Member States	B	DK	D	GR	SP	FR	IRL	I	L	NL	A	P	FIN	SW	UK	Total
Rural development measures under Agenda 2000																
Million Euro	50	46	700	131	459	760	315	595	12	55	423	200	290	149	154	4339
%	1.2	1.1	16.1	3	10.6	17.5	7.3	13.7	0.3	1.3	9.7	4.6	6.7	3.4	3.5	100
Funds saved through degression and modulation (year 2012)																
Million Euro	49	106	640	92	312	967	111	270	4	78	53	33	77	73	661	3526
%	1.4	3	18.2	2.6	8.8	27.4	3.1	7.7	0.1	2.2	1.5	0.9	2.2	2.1	18.7	100
Funds saved through degression and modulation available for rural development by country (6 % in 2012)																
Million Euro	25.1	50.3	258.6	42.9	141.1	441.9	55.8	125.9	2	39.5	26.7	13.5	40.2	33.8	249.7	1547
Pillar two resources under MTR assuming that modulation funds are kept within each country (million Euro) (1)																
Million Euro	75.1	96.3	958.6	173.9	600.1	1201.9	370.8	720.9	14	94.5	449.7	213.5	330.2	182.8	403.7	5886
Pillar two resources under MTR assuming that modulation funds are redistributed using the Agenda 2000 repartition key set out in the Rural Development Regulation (EC) 1257/1999 (million Euro) (2)																
Million Euro	70.6	64.7	947.6	176.6	623.9	1030.1	429.7	806.4	17.7	76.5	570.9	270.8	394.4	200.1	206	5886
Difference (2) - (1)	-4.5	-31.6	-11	2.7	23.8	-171.8	58.9	85.5	3.7	-18	121.2	57.3	64.2	17.3	-197.7	0
Difference in %	-6	-32.8	-1.1	1.6	4	-14.3	15.9	11.9	26.4	-19	27	26.8	19.5	9.5	-49	0
Agricultural area (%)	1.0	2.0	12.9	2.6	21.7	22.4	3.3	11.4	0.1	1.5	2.6	2.8	1.6	2.3	11.8	100
Agricultural employment (%)	0.8	0.9	8.3	10.8	16.9	9.5	1.9	31.2	0.1	1.9	3.5	7.3	1.5	1.1	4.3	100
GDP per inhabitant*	23 343	23 997	22 463	14 277	16 953	21 395	23 226	20 449	25 980	21 713	23 178	15 111	20 886	19 985	20 348	20 610

Source: EC (1999a) DGA Fac-Sheet on "CAP reform: Rural development", Chatellier (2003) and authors' calculations.*: Purchasing Power Standard.

Annex 1. Regulation (EC) 1257/1999 on rural development: Main dispositions (Sources: Regulation (EC) 1257/1999 of 17 May 1999; EC, 1999a, DGA Fac-Sheet on "CAP reform: Rural development"; CAP Monitor, 2002, Section 1)

Measures

1. Investments in farm businesses
Support for investments in farm businesses with the aim of modernising farming machinery, equipment and systems, to improve incomes as well as the living standards and the working and production conditions of farmers.

2. Human resources: young farmers, early retirement and training
Aids for promoting the entry of young farmers, for early retirement (accompanying measure) and for training initiatives.

3. Less favoured areas and areas subject to environmental constraints (accompanying measure)
Compensatory payments for farmers in less favoured areas (mountains areas, areas threatened with abandonment, areas affected by specific handicaps) and areas subject to environmental constraints. Adaptation of payments to fit the role farmers must play in managing these areas (in concrete terms, aids per hectare instead of per head of livestock).

4. Forests
Aids for woodland which is owned by individuals, associations and local authorities covering numerous measures, notably investment aids, and aids for the forestation of agricultural land (accompanying measure) to cover management costs (up to a maximum of 5 years) and compensate for losses due to forestation (up to a maximum of 25 years).

5. Processing and marketing of agricultural products
Aids for the processing and marketing of agricultural products.

6. Agri-environment (accompanying measure)
Aids to farmers who undertake agri-environmental commitments for a minimum period of 5 years; aids granted annually and calculated according to the income loss and additional costs resulting from the undertakings as well as the need to provide a financial incentive (maximum of 600 Euro per hectare for annual crops, 900 Euro per hectare for specialised perennial crops and 450 Euro per hectare for other types of land use).

7. Various measures for the general development of rural areas
Aids for land improvement, reparcelling, setting-up farm relief and farm management services, basic services for the rural economy and the population, renovation and development of villages, protection and conservation of the rural heritage, diversification of agricultural activities as well as activities close to agriculture to provide multiple activities and alternative incomes, agricultural water resources management.

Financing

Rural development measures are financed by the Guarantee Section of the EAGGF, i.e., the section of the EU budget which also covers market expenditure of the CAP, except for non-accompanying measures for Objective 1 regions of the Structural Funds. For these regions, the source of funding is the Guidance Section of the EAGGF.

The budget for rural development within the Guarantee Section of the EAAGF is fixed at about 4.3 billion Euro per year for the seven-year period 2000-06 (Table A1.a). It is allocated across Member States on an annual basis according to objective criteria that take account of specific needs, especially those related to the environment, employment and countryside management (Table A1.b). Most schemes include a national co-funding with the EU committed to paying a given percentage of the project cost. The rate of co-financing varies in function of measures and is more important for less favoured areas and Objective 1 regions.

(insert Table A1.a and Table A1.b)

Table A1.a. CAP expenditure 2000-2006 (billion Euro, 1999 prices) (1)

	2000	2001	2002	2003	2004	2005	2006	Total
Total CAP, of which	40.92	42.8	43.9	43.77	42.76	41.93	41.66	297.74
- markets (2)	36.62	38.48	39.57	39.43	38.41	37.57	37.29	267.37
- rural development (3)	4.3	4.32	4.33	4.34	4.35	4.36	4.37	30.37

Source: EC, 1999a, DGA Fac-Sheet on "CAP reform: Rural development." (1) For calculating amounts at current prices, a 2 % deflator will be used. (2) Including veterinary and phytosanitary measures and excluding accompanying measures. (3) Including accompanying measures and rural development initiatives outside Objective 1 programs previously funded by the EAGGF Guidance Section.

Table A1.b. Support for rural development, 2000-2006, within the EAGGF Guarantee Section: Financial allocation to Member States (indicative amounts in million Euro at 1999 prices and percentages)

Member States	B	DK	D	GR	SP	FR	IRL	I	L	NL	A	P	FIN	SW	UK	Total
Annual average	50	46	700	131	459	760	315	595	12	55	423	200	290	149	154	4339
%	1.2	1.1	16.1	3	10.6	17.5	7.3	13.7	0.3	1.3	9.7	4.6	6.7	3.4	3.5	100

Source: EC, 1999a, DGA Fac-Sheet on "CAP reform: Rural development."

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