THE CAP "HEALTH CHECK": WHAT'S AHEAD?

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The Health Check of CAP reform

- On 20 November 2007 the European Commission presented a communication on the ***Health check*** (HC), and then, on 20 May 2008, adopted its formal proposals, in terms of changes in the CAP basic regulations
- The Commission has always underlined that *HC is not a new fundamental reform*, but only a review of the reform decided in 2003 and started in 2005-06; nevertheless, its objectives are very important for the future of the CAP, and can be summarize as follows
  - ***To finalize the 2003 reform, strengthening and locking-in its key points***
  - ***To introduce some adjustments*** to further simplify the CAP, to grasp new market opportunities and to face new challenges (climate change, water management and bio-energy)
  - ***To prepare the CAP*** for the debate on the budget review, which will start in 2009

Future agenda

- *End of November 2008:* Council shall adopt its decision on the HC (under French presidency…)
- *January 2009:* a new co-decision procedure between Council and Parliament will become effective: the decision process will become more complex, long and uncertain, and this puts some pressure to close the HC by the end of 2008…
- *During 2009*
  - In the Spring the *European elections* will be held
  - On I November the *new Commission* will take office
  - The *Budget review* will be carried out, preparing the following debate on the financial perspectives for the period after 2013
- In this context the role and the financial allocation that the EU will attribute to agricultural policies will be decided
  - the evolution of the CAP and how public opinion will perceive such a policy will be important; and the results of the HC will be crucial in this process

The main points of the Health check

The most important points of the HC are the following:

1. ***Dismantling the residual market instruments of the "old PAC"*** (set aside, export subsidies, intervention price regimes, milk quotas)
2. ***Completing the process of full decoupling***
3. ***Extending the so called "Regionalisation", basing decoupled payments on more flat rates***
4. ***Reviewing and extending the additional payments under Article 69*** of the basic CAP regulation
5. ***Introducing stronger*** "***Modulation"*** of direct payments, shifting financial resources from the I Pillar (market policy) to the II Pillar (rural development)
6. ***Giving some indications to address the "new challenges"***

1. Market support

- ***Set aside will be abolished by 2009*** as a supply control tool, but will be maintained in the II pillar as environmental (voluntary) measure
- ***Market intervention will be significantly reduced***
  – The intervention will be completely eliminated for rice, durum wheat and pig meat, frozen for feed grains, and retained (on a tender basis) only for bread wheat and for butter and skimmed milk powder (within buying-in limits)
- ***Energy crops premium*** (€45/ha) will be abolished
- ***Milk quotas will be phased out and eliminated by I April 2015***
  – There will be a *soft landing*, consisting in five annual quota increases by 1% per year between 2010 and 2014, in addition to the 2% increase already applied from I April 2008
  – Special payments will be allowed to extensive livestock in mountainous areas, threatened by the abolition of the quotas

- ***The HC proposals on market support are welcome***: they cancel measures that were designed to meet constraints no longer relevant, paving the way for a more flexible policy
- *In a more marked oriented and decoupled CAP, set aside as a mean of supply control is completely out of date:*
  - not surprising, in the context of high food prices, its abolition has been "sold" very well to the media by the Commission, putting it on the forefront of press releases concerning the HC
- *The removal of the intervention mechanism is appropriate*, but producers will be more exposed to price and yield variability
  - a mix of less distorsive and more flexible measures would be welcome, in order to manage market crises and ensure a safety net (index based insurance systems, future, contracting…)
- *Ending of milk quotas is very welcome as well, but it is a politically sensitive issue for some countries*:
  - it may be envisaged a non-linear increase of national quotas during the transition period, allowing higher increases in countries (like Italy) where current quotas are binding

2. Full decoupling

- The 2003 CAP reform introduced decoupling as a general principle, but Member States were allowed to retain some coupled payments
  - As far as the 2003 package is concerned, full decoupling was adopted only by Germany, Ireland, Italy, Sweden, and UK
- The HC proposes to remove by 2010 all the residual (but still substantial) forms of partially coupled support
  - The only exception is the possibility to maintain coupled support *"to sustain economic activity in regions were alternatives are few or do not exist"*
  - This is sound: when there is an evident joint production of private and public goods, coupled payments can be a suitable tool for targeting support
  - The Commission approach is appropriate and moderate on this ground: the case for coupled payments is limited to suckler cows, sheep and goats and rice in sensible areas

Full decoupling 2

- Full decoupling is an *unquestionable objective*, which represents *the most qualifying element of the Health check;*
  - The recent food crisis is showing the importance of an agriculture free from the cage of coupled support and therefore able to respond promptly to market signals.
- but the approval of full decoupling cannot be taken for granted, and the Commission should be supported on this point
- Nevertheless, ambiguity persists regarding the rationale and justification of decoupled payments
  - The HC might have been a good occasion to explicitly address this crucial issue

3. “Regionalisation” of decoupled payments

- In the 2003 reform Member States could choose between two different models to implement decoupled payments: historic and regional
  - In the historic model payment entitlements are based on the individual amounts received by each farmer in the reference period (2000-02)
  - In the regional model flat-rate payment entitlements are given to all farmers of a region, based on average amounts
- In the historic model the amounts of the individual payments are very differentiated; these differences among similar recipients could have been acceptable in the transition period, but are non sustainable in the long run
- On the other hand, the regional model provides more equitable support, despite some initial redistribution. This is the reason why the HC proposes to allow (and encourage) Member States to move towards flat payment rates

National models of decoupled payments

Historic Model	Regional Model
Austria	Denmark
Belgium	England, North Ireland
France	Finland
Greece	Germany
Ireland	Luxemburg
Italy	Sweden
Netherlands	
Portugal	All new member states (compulsory)
Spain	
Wales and Scotland	

Most old member states have chosen the historical model, and the regional model has been applied gradually, with "hybrid" modalities

Four different options are presented:

1. ***No change***
2. ***"Approximating" the value of historic payments***, in 3 steps as from 2010, limited to farmers with historic entitlements
3. ***Shifting from the historic to the regional model*** (limited to 50% of the ceiling, but applied also to farmers without entitlements)
4. ***"Approximating" the regional payments:*** for those countries which had opted for hybrid regional models

- ***A system of flat single farm payments is the obvious consequence of decoupling, and is welcome***
- The (decoupled) payments to farmers are neither a compensation for price reduction any longer, nor a support to a specific product; so it makes no sense to keep them differentiated among recipients
- It would have been better to impose the regional model from the beginning, because where payment entitlements have been allocated on a “historic” base, it is now difficult to impose a switch to flat-rate payments, to those who will be penalized…
- Nevertheless, the ***regional model is the future***, and sooner or later, has to be applied; it might be appropriate *to announce and decide it as soon as possible*, even though a later application might be negotiated…

4. Articles 68 to 70 (former article 69)

- The HC broaden the scope of former article 69 (now 68), which allows Member States to cut up to 10% of the single farm payments, to fund special payments targeted to specific objectives. The new article 68 grants support:
  a) for specific types of farming which are important for environment, quality and marketing (former article 69);
  b) to farmers in the dairy, beef, sheep and goat and rice sectors in sensible areas;
  c) To top up entitlements in areas subject to restructuring or development programs;
  d) To contribute to crop insurance premiums to face natural disasters;
  e) To contribute to mutual funds for animal and plant diseases
- The measures under a), b) and e) do not meet the conditions of the WTO Green Box; therefore they should comply with the *de minimis* franchise, and be limited to 2,5% of national ceilings

- The revision of article 69 is welcome: it allows greater flexibility, also removing the restriction that funds have to be spent in the same sector where they are taken from
- Member States may use this opportunity to achieve some key objectives of national agricultural policy
  - For instance, in Italy, allocating *special payments to suckler cows* seems particularly appropriate from the environmental and territorial point of view
- Of course, these *payments should be really selective*, in order to avoid the "race to the bottom" experienced with former article 69, which turned the special payments in a un-necessary form of indiscriminate re-coupling

5. Modulation

The HC proposes to reinforce the ***compulsory modulation***, namely the cuts applied to the single farm payments in order to finance the II pillar

- it is proposed to ***increase modulation rate from 5% to 13%,*** through an annual increase by 2% as from 2009;
- it is decided to abandon the idea of imposing ceilings to single payments, in favor of a *progressive modulation* based on increasing additional cuts (3%, 6%, 9%) according to payment thresholds;
- it is agreed that the additional amounts raised by the new modulation shall NOT be re-distributed among Member States, remaining where they are generated;
- it is proposed to ***abolish all the individual payments below a minimum ceiling*** (250 €) and/or below a minimum size of eligible area (1 hectare).

New thresholds for compulsory modulation

Years	< 5.000 €	5.000 to 99.999 €	100.000 to 199.999 €	200.000 to 299.999 €	> 300.000 €
2008	0	5%	5%	5%	5%
2009	0	7%	10%	13%	16%
2010	0	9%	12%	15%	18%
2011	0	11%	14%	17%	20%
2012	**0**	**13%**	**16%**	**19%**	**22%**

In 2012 the cuts due to modulation will be substantial, from 13 to 22%

Modulation will find strong opposition, even though some Member States, having avoided the ceilings to higher payments and the redistribution of funds among countries, might welcome it as a ***"silent step" towards some national co-financing*** of the CAP.

As a matter of fact, modulation is a transfer of funds from the I pillar (which is not co-financed by national Governments) to the II pillar (which is co-financed), and implies a ***net increase in the financial resources available*** to the agricultural policies

6. “New challenges”

- The ***new challenges*** mentioned in the HC cover 4 aspects, to be faced under the II pillar
  - Climatic changes
  - Renewable energies
  - Water management
  - Biodiversity protection
- The proposal is still quite general (perhaps this is not avoidable, as it deals with issues that are really new); however it is less confused compared to the November proposal and offers some practical indications for targeting support within Rural Development Programs:
  - under axis 1, energy and water saving equipment and production of renewable energy from biomass;
  - under axis 2, biodiversity, water management and climate change mitigation actions;
  - under axis 3 and 4, local scale renewable energy projects

Mediterranean products

- The CAP reform process is going slower for Mediterranean products: their market organizations has been decided and implemented after the 2003 Fischler reform
  - *Olive oil, Tobacco, Cotton*: decided on April 2004; implemented by 2006
  - *Fruits and vegetables*: decided on June 2007; implemented by 2008
  - *Wine*: decided on December 2007; implemented by 2008/09
- This delay explains why for these products (with the wine exception) many coupled payments are still in place
  - Anyway, the main reason is that these products largely go to processing industry, which is strongly interested in keeping subsidies coupled to agricultural production, to get an abundant supply of raw material at low price
  - Unfortunately, these pressure may influence the position of some Mediterranean countries, reinforcing the potential coalitions against the full decoupling proposed by the HC

The Health check: a global assessment

The Commission's package is sound and convincing; more convincing and less generic than in November

- It does not give in with respect to key points (decoupling, modulation, regional payments)
- It proposes an interesting extension of former art. 69
- It reduces the degree of generality of some proposal (this is the case of the "new challenges")
- It makes clear enough the Commission's vision on the future of the CAP, even though some ambiguity persists on important points. For example:
  - the issue of competences between EU and Member States is not addressed, and above all…
  - the nature (and justification) of the decoupled payments to the farmers in the long run is not explicitly discussed

After 2013…

The future of the CAP after 2013 depends on two elements:

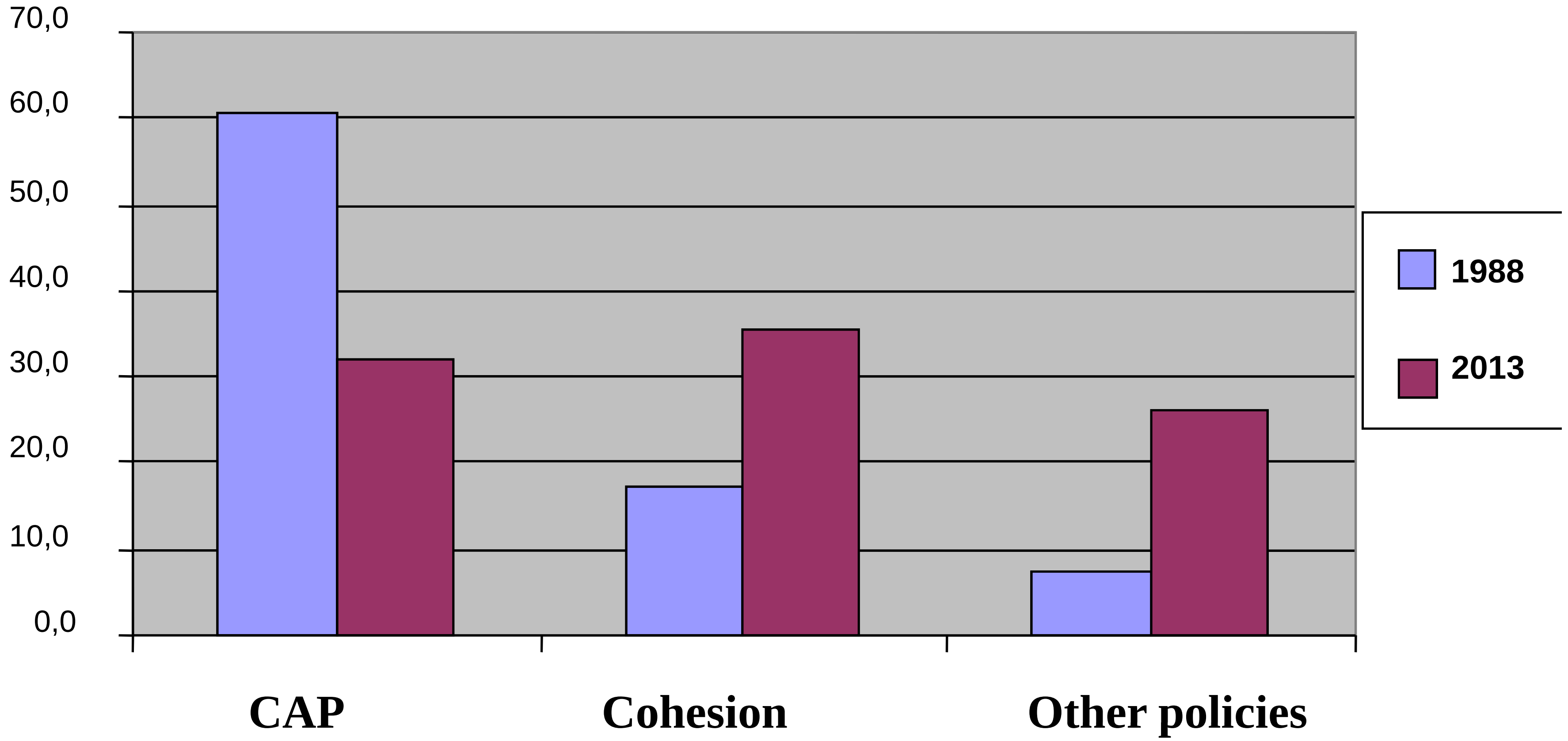
1. The first is the "degree of ambition" of Council's final decisions on the HC, which is uncertain
   - On several issues the opposition of many countries will be strong and a compromise will be necessary, and…
   - the decisions will be taken under the French presidency, which probably will support a conservative approach
2. Even more important will be the debate that is going to start with the Budget review in 2009, in relation to several important issues:
   - The size of the EU budget as a % of the GDP
   - The financing mechanisms
   - The distribution among Countries of budget balance
   - And above all: the share of total expenditure devoted to agriculture

The CAP in the debate on the EU budget

The budget negotiation will be very tough, the critics against CAP will continue, but its position is probably stronger than in the past

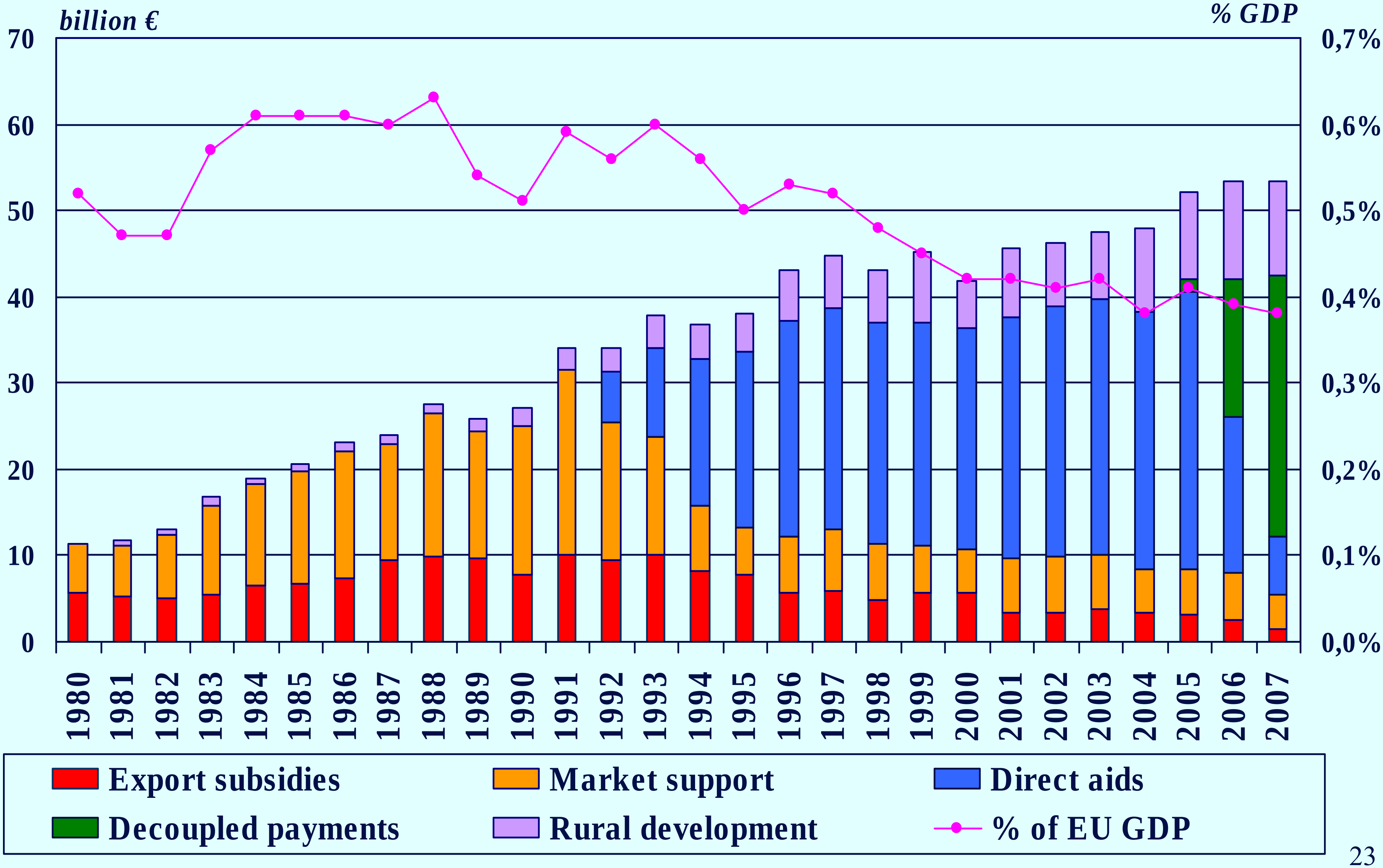
– First, the share of agricultural expenditure has decreased
– Secondly, the relative importance of the most distorsive measures has been significantly reduced
– Moreover, differently than in the past, in the enlarged EU-27 several member states that are net contributors to the budget may realize that their financial deficit due to the CAP is less than the deficit due to other more redistributive policies (cohesion)
– Last but not least, the recent world price crisis is convincing public opinion and policy makers to consider agriculture not more as a *residual* component of the economy and society but as a *strategic* sector

Budget share of CAP and other policies



The CAP share is substantially dropping, from 60% of 1988 to 33% expected in 2013, when it will be lower that the share of Cohesion policy

CAP reform path and related expenditure



Conclusions: which CAP after 2013?

- In the policy debate, the increase of agricultural prices is used as a "strong" argument to support opposite positions…
  - calling for a return to the past protectionism and coupled support, in order to boost food supply…
  - or for a pure dismantling of the CAP, taking the opportunity of high agricultural prices and farm incomes
- These are both wrong approaches: the challenge is to consider either food price increase or the new political centrality of agriculture as opportunities to design good policies for the future, ***combining market orientation and public support***
  - In this approach, ***a system of direct payments almost fully decoupled, flat, declining and more selective towards targets and beneficiaries*** is something more than a legacy of the past or a compensation for dismantling the 'old' policy
  - Rather, it might be considered also as an ***insurance against the risk of adverse global downturns***

- More generally, one can say that the future CAP should finance (probably with less resources than in the past) what can be defined the "***option value"*** of European agriculture:
  - to ensure ***environmental cross-compliance*** and the ***public services and goods*** related to agricultural activity
  - but also to keep an adequate productive capacity to face ***food emergencies***
- These are costly objectives, which only few countries can afford. However, for those that have the financial capacity and the political will to support their agriculture (and which in the past adopted indiscriminate and expensive policies) this may be a viable approach to design future policies
- ***The current CAP is still largely backward oriented, and the transition will be long and difficult***; but if the Health check will be approved without major mutilations, it may be considered an important step in the right direction…