



COUNTRY LAND & BUSINESS ASSOCIATION

Summary of the details of the CAP Reform 2003¹

Health warning; these notes summarise the legal text arising from the political settlement of 26th June 2003. This text, DS 228/03, was released on 7th July 2003. This is not yet an adopted regulation, therefore it may be subject to further changes. This document is intended to be shorter and clearer than the legal text and thus helpful and informative but does not claim to be legally watertight. Please refer to the legal text if in doubt. Expect new versions of this paper to appear in the coming months, indicated by the date.

This paper focuses on the horizontal regulation and not the commodity market changes

PAYMENT DECOUPLING

1. A **single payment scheme for farmers** will replace direct payments for arable crops, potato starch, grain legumes, rice, beef & veal, sheep & goats, and milk and dairy products, including set aside, grass silage payments, and de-seasonalisation and extensification payments (A1, A28, A33 and Annex VI).
2. Payment entitlements are to be **based on average payments for the Reference Period (RP) 2000, 2001 and 2002** (A37, A38). If a farmer started an activity during the reference period he need only average over the years for which he had the activity.
3. The Single Payment Scheme will **commence on 1/1/05**, although there is an 'optional transitional period' (A70) allowing up to two years grace 'where specific agricultural conditions so warrant'. **Farmers must claim their payments by 15th May in the first year or they will be forfeited and revert to the National reserve** (A34).
4. There is to be a system to deal with **hardships** (A40) which deals with cases of **force majeure** or **exceptional circumstances** in the Reference Period. This defines force majeure as: death, long-term incapacity, severe natural disaster, accidental destruction of livestock buildings, and epizootic incident (e.g. FMD). In such cases the reference period can be a smaller number of years than three, i.e. those years not affected by the cases of force majeure or exceptional circumstances. In the event that the force majeure, and exceptional circumstances affect all the reference period, then the reference amount will be calculated on the period 1997 to 1999.
5. Farmers who are in **agri-environment schemes** which affect their claims in the reference period can also exclude the affected year(s) from the averaging. In the event that claims in all three years are affected by agri-environment schemes, then Member State will establish a fair payment rate according to rules set by a **Management Committee for Direct Payments**² (A144).
6. There is a **national ceiling** (A41 and Annex VIII) on total reference amounts, which if exceeded will cause all payments to be reduced to respect the ceiling.
7. **The National Reserve** (A42) will be created by *annually* top-slicing the total decoupled payments by up to 3%. The reserve will be added to by unclaimed payments. Priority in

¹ In what follows we use the shorthand A41 etc to refer to specified Articles in the Council Regulation "establishing common rules for direct support schemes under the common agricultural policy and establishing certain support schemes for farmers" revised text.

² Management committees have representatives (officials) of the member states and are chaired by the Commission.

using the national reserve may be used for **new entrants**, ie those who commenced farming after 31/12/02. The National Reserve may also be used 'to ensure equal treatment between farmers and to avoid market and competition distortions', by establishing reference amounts for '**farmers finding themselves in a special situation**'. This refers to those in transition during or since the reference period. Rules defining these situations will be drawn up by the Management Committee on Direct Payments. In Annex 2 of the Presidency compromise there was a Commission declaration defining five such special situations. We are not sure of the status of this annex, and in particular the significance of the date 31/05/03. We suppose that this document will be taken on board by the Management Committee. The annex referred to farmers who

- a. *inherited* land from a farmer who retired or died in the Reference Period and whose land was leased in the RP;
- b. *purchased* land in the RP or up to 31/05/03³ which was leased in the RP.
- c. *entered a Multi-annual lease* of land up in the RP or up to 31/05/03 whose lease conditions may not be adjusted⁴;
- d. *made investments or purchased* land to increase production in the RP or up to 31/05/03;
- e. *participated in national programmes of reconversion* of production in the RP⁵.

Entitlements established from the National Reserve will continue to be funded from the reserve, and cannot be transferred for 5 years. Entitlements granted to those who sold land or lessors who leased it for at least six years during the reference period or up to the date of adoption for the regulation, *may* be taken back to the National Reserve. The National Reserve *may* also be 'fed' by a siphon on sales of entitlement with or without land. The reserve may also be supplemented, by further top slicing, if there is insufficient for new entrants or special situations.

8. **Entitlements based on Area** form the core of the single payment scheme. In this scheme the single payment is linked to land through the concept that entitlements are issued in one hectare units to eligible active farmers. Farmers will be **eligible** (A33) to have access to the Single Payment Scheme if:
- a. they received direct payments in the reference period
 - b. they received a holding (or part) by actual or anticipated inheritance from someone who satisfied (a).
 - c. they received a payment entitlement from the National Reserve or by transfer.

There is provision in A33 to deal with **changes in legal status or denomination** of the holding in the reference period and up to 31st December of the year preceeding the year of application of the single payment scheme, and for **mergers and divisions (scissions) in land holdings** up to the same date which ensure that the new business has access to the scheme under the same conditions as the farmer managing the original holding(s).

9. **The three key concepts** in the single payment scheme are **(1) the reference amount** (in £), **(2) the number of entitlements** (in ha) which equals the average number of hectares which gave right to the entitlements, and **(3) the entitlement per hectare** (£/ha) which is the first divided by the second.
10. **Calculation of the reference amount** (A37) is based on the three-year of the total amounts of payments claimed under relevant schemes (Annex VI) in each calendar year of the reference period. If a farmer commences agricultural activity during the reference period he may base his average on the years for which he received payments. Annex VII explains the detailed calculations. Essentially, for crops the calculation is the average claimed crop areas multiplied by the 2002 regional (i.e. for England or Wales) yield and by €63/t⁶ for cereals and oilseeds and set aside⁷. For beef and sheep the payment is based on the average animal numbers times the payment rates per head in 2002.

³ This date was in square brackets in the Presidency Compromise. As it is not in the regulation, its relevance is uncertain.

⁴ This effectively means tenancies less than three years, as all longer tenancies will be subject to possible rent review after 3 years, ie change in lease conditions.

⁵ This is a technical requirement for specific Austrian programmes.

⁶ The exchange rate of Euro to Pounds will be based on a current date. Thus the recipient bears the exchange rate risk.

- 11. Calculation of the number of entitlements (A43).** This is the three-year average number of all hectares which gave right to the direct payments. This includes area of potato starch, dried fodder and seed aid, and *all forage area* in the reference period. All forage area is 'the area of the holding that was available throughout the calendar year for rearing animals including areas in shared use and areas subject to mixed cultivation'. Throughout the calendar year has a special interpretation according to regulation 2419/2001 which means that it includes land on grazing lets less than a full year. Not included in the forage area are: buildings, woods, ponds, paths, areas used for permanent crops (orchards and vineyards), horticultural crops or other crops eligible for Community aid.
- 12. To use the entitlement (A44),** is to successfully claim it. 'Any entitlement amount accompanied by an eligible hectare shall give right to the payment of the amount fixed by the entitlement'. It is not clear if *using* entitlement involves more than successfully claiming it, e.g. whether land has actually to be managed for a period of time; there is no language to indicate this. **Eligible hectares** are 'any agricultural area taken up by arable land and permanent pasture except areas under permanent crops, forest or used for non-agricultural activities'. Farmers will have to declare in their application the parcels corresponding to the eligible area accompanying any entitlement. These parcels should have been 'at the farmer's disposal for a period of at least 10 months, starting from a date to be fixed by the Member State, but not earlier than 1st September of the calendar year preceding the lodging of the application for participation in the single payment scheme'⁸. There may be some flexibility in how the specific eligible area is declared as long as the right number of hectares is being farmed.
- 13. Payment (A28)** will be made once a year between 1st December and 30th April the following calendar year. There is provision for advances of up to 50% subject to the budgetary situation, "in regions where, due to exceptional conditions, farmers face severe financial difficulties".
- 14. Unused entitlements (A45).** If entitlements are not used for a period of three years they revert to the National Reserve (except in cases of force majeure or exceptional circumstances). Note that entitlements established from the National Reserve will revert to the reserve if not used in each year of the first five years.
- 15. Transfer of entitlements (A46).** The payments are not transferable between Member States (except when inheritance is concerned, and then they may only be claimed in the member state where the entitlements were established). **Entitlements may be transferred by sale with or without land.** Transfers in the case of leases can only be made if accompanied by an equivalent number of eligible hectares. A farmer may transfer his entitlements 'only after he has used at least 80% of his entitlements during at least one calendar year, or after he has given up to the National Reserve all the entitlements he has not used in the first year of application of the single payment scheme'.
- 16. Payment entitlements subject to special conditions (A47):** There are special considerations for some livestock entitlements⁹ and the dairy premia. These will not be included in entitlements based on area, but are to be paid as special entitlements subject to special conditions (A48, A49 and A50). These entitlements apply where the farmer has no land, or insufficient (IACS registered) land on the farm to keep the entitlements, when divided by the number of hectares, below €5000 (£3500) per hectare. These entitlements are also based on the three-year average in the Reference Period. They are paid in entitlement units of €5000 or part. They may be activated without any land at all but only if at least half of the activity is maintained. These entitlements can only be transferred *en bloc*, ie a farmer cannot transfer some of them.

⁷ See paragraph x below for the special treatment of set-aside entitlements.

⁸ Our present assumption is that DEFRA will declare the date to be, for example January 1st of the year of application. The 10 months means that short term grazing lets will have to be extended to fit this rule.

⁹ These are the deseasonalisation premium, slaughter premiums, special premia for male bovine and suckler cows where the farmer was exempt from stocking rate requirement, and certain premiums for sheep and goats

17. The dairy premium (A94 and A95). As shown in the table below, the support price for skim milk powder is to be reduced 15% over three years and for butter by 25% over three years. Compensation for these price cuts is offered in the form of a dairy premium 'granted per calendar year, per holding and per tonne of individual reference quantity eligible for premium and available on the holding'. The milk compensation is calculated in two parts, the dairy premium (A94) plus 'additional payments' (A95). For the dairy premium, the individual reference quantity for milk available on the holding on 31st March **of the calendar year concerned** expressed in tonnes is multiplied by the amounts of premium shown in the table. Quotas subject to temporary transfers (ie leased) on 31st March of the calendar year concerned shall be deemed to be available for that calendar year. Total reference quantities are subject to national ceilings and may be scaled back if necessary. The additional amounts also shown in the table are effectively added to the premia per litre (or tonne) of quota. The table shows the resulting total compensation per tonne of reference quantity. In this way we have established the **coupled** dairy payments.

Dairy support reduction and compensation payments

	2004	2005	2006	2007
Cut in intervention price for butter	7%	7%	7%	4%
Cut in intervention price for SMP	5%	5%	5%	
Dairy premium	€8.15/t	€16.31/t	€24.49/t	€24.49/t
Additional amount	€3.7/t	€7.4/t	€11.9/t	€11.9/t
Total compensation	€11.9/t	€23.7/t	€36.4/t	€36.4/t

18. Decoupling the dairy premium (A47 and A61). The dairy premia as described in the previous paragraph will give right to entitlements subject to special conditions¹⁰. These amounts *will* be included in the single payment scheme in 2007. However in the regional and optional implementation chapter 5, A61 offers Member States the option to include the dairy premia, in full or in part, in the single payment scheme from 2005¹¹. If this is done, effectively, the reference date for the decoupled milk premium becomes the quota held on 31st March 2005. The dairy premium is then consolidated with the single farm payment, and once this is issued there is presumably no necessity thereafter to produce milk. The dairy part of the SFP, based on the 2005 quota, is raised in the following year as the third and final step of the rise in dairy premium comes in.

19. Calculating the supplementary amounts for the dairy premia (A50) Dairy farmers will receive a supplementary amount per entitlement resulting by dividing his dairy premia (paragraph 16 above) by the number of entitlements he owns in 2007. The unit value of each payment entitlement he owns in 2007 shall be increased by this supplementary amount. This seems to say that the dairy premia will be added to the Single Farm Payment arising from arable crops, beef and sheep. The number of entitlements the farmer owns is described in paragraph 11 above. However, specialist dairy producers (who have never completed an IACS form) may not own any entitlement based on area. In these cases, we appear to be back to entitlement subject to special conditions (paragraph 15). However, and extraordinarily, A50(2) specifies that in these cases, "the term hectares shall mean the hectares the farmer owns in 2007". This suggests that owner occupier dairy farmers will have area based entitlements where the number of entitlements is the land area they farm. **Clarification on all this is being sought. At the time of writing DEFRA could not explain these rules.**

¹⁰ There is some ambiguity about whether all dairy premia automatically will become entitlements subject to special conditions. On farms in which arable and other livestock claims are made, the forage area used by dairy cows might be scooped into the number of entitlements (paragraph 11 above, A43). Thus both the reference amount and the number of entitlements seem capable of being treated as entitlements based on area.

¹¹ Curiously, although A61, allowing decoupling of dairy payments to be advanced to 2005 is in the Regional implementation section of Chapter 5, no reference to regionalisation of the premia is mentioned.

- 20. Land Use in the Single Payment Scheme (A53).** Farmers may use their land (on which entitlement is being claimed) for any agricultural activity except for permanent crops. No payment entitlement can be claimed with eligible land on which fruit, vegetables and table potatoes are grown. Clarification is still being sought on the position of perennial crops such as short rotation coppice and miscanthus.
- 21. Set-aside Entitlements (A53 – A57).** For farmers subject to set-aside in the RP, the three-year average amount of compulsory set-aside payments and the three-year average compulsory set-aside area will not be included in the entitlements based on area. Instead they will be given as a separate set-aside entitlement per hectare calculated as the above amount divided by the above area. So the set-aside entitlements will be the average number of compulsory set-aside hectares.
- 22. The area of compulsory set-aside** is set to continue at 10% for 2005/06, and 2006/07 (A106).
- 23. Use of set-aside entitlements.** There after, whatever set-aside area a farmer is obliged to have, he is able to claim a set-aside entitlement for each hectare involved. The area eligible to set-aside entitlement is any agricultural area of the holding (arable and permanent pasture) except areas under permanent crops, forest or used for non-agricultural activity on 31/12/02, which is set aside from production. Areas set aside in agri-environment schemes and farm woodland schemes can be counted as set-aside, and other derogations are also envisaged, details to follow. Set-aside entitlements will be claimed before other entitlements. The set-aside obligation will continue to apply to set-aside entitlements if they are transferred.
- 24. Exemption from set-aside (A55).** Farmers whose holding is managed for the totality of its production as organic are not subject to set-aside. Likewise if the set-aside land is used for non-food crops, then they are exempt from set-aside. (If this sounds odd, remember I did not write it!).
- 25. Use of set-aside land (A56).** Set-aside land must be kept in good agricultural and environmental conditions. Apart from the (A55) exception for non-food crops, set-aside land cannot be used for agricultural purpose and shall not produce any crop for commercial purposes. It may be subject to rotation. The set-aside areas must cover an area of at least 0.1 ha, and be at least 10M wide. To maximise the environmental benefits Member States may accept for duly justified environmental reasons strip width of 5M.

Regional and Optional Implementation (A57 to A70).

- 26.** The political compromise thrashed out in the Luxembourg negotiations involved a series of options on the implementation of the decoupled single farm payment scheme. Articles 58 to 62 involve the options to implement the scheme on regional basis. Articles 63 to 69 offer the possibility only to partially decouple the direct payments. Article 70 allows the Member States to delay the introduction of decoupling until January 2007 “where specific agricultural conditions so warrant”. These decisions all have to be made by 1st August 2004.

Regional implementation

- 27.** Member States can chose to implement the single payment scheme at regional level (A58). They must define their regions according to objective criteria, and they must divide the national ceiling reference amount between the regions, also based on objective criteria.
- 28.** The regionalisation can stop at the above, or it can go further to create **Regionalised Average Payments, RAP** (my name not the Commission’s). This means dividing the regional ceiling of reference amount between all the farms located in the region including those who are not eligible for the single payment. Farmers then receive entitlements whose unit value is the regional ceiling reference amount divided by the number of eligible hectares in the region (i.e. all agricultural land not used for permanent crops or non-agricultural activity). There is a further option to create these RAPs from only part of the total regional ceiling of reference amounts.

- 29. Separate forage and arable regionalised average payments.** A further variant on the Regionalised Average Payment is that Member States may fix different values of entitlement per hectare for hectares under grassland in the region from all the other eligible land. Thus there would be two regionalised average payments per hectare: one for grassland and another for the rest, i.e. arable land. The figures are the respective areas as of 31/12/02.
- 30. Bringing forward the decoupling of dairy payments.** A member State which invokes the regional implementation of the single payment scheme **may** choose to bring forward the decoupling of dairy premia to 2005. (But please see paragraphs 16 – 18 above).
- 31. Transfers of entitlements under the regional options.** If the regional option is exercised it is possible to restrict transfer of entitlements (that is the ownership of the entitlements) within the region or between regions with the same entitlement per hectare. This seems to suggest that if the Member States merely declares A58 regional implementation in the sense that it defines its regions and the allocation of the total reference amount objectively, but without invoking A59 regionalised average payments, then it can prevent the trading of entitlements over regional boundaries.
- 32.** Where the regional option is exercised, the set-aside obligation is established at regional level. Note also that the other important regionalisation of implementation of the new policy is that the good agricultural and environmental conditions may be defined regionally. Indeed as they are supposed to take account of soil, climate, and farming systems, then it is hard to see how this could not be the case.

Partial Implementation

- 33.** In the negotiations, many Member States expressed the fear that full decoupling of supports could precipitate the abandonment of land with undesirable environmental and social consequences. It was therefore agreed that Member States could choose to apply the arrangements for decoupling only to a proportion of the direct payments. If they do this, then the total amounts of coupled and decoupled payments for each sector (arable, beef sheep and dairy) cannot exceed the national ceilings established in total and for each sector. The Commission is obliged to report on the implementation of these partial implementation schemes within two years of all Member States implementing the single farm payment scheme.
- 34. Partial decoupling of arable payments (A65).** Member States may retain up to 25% of the national ceiling for arable crops area payments (excluding compulsory set-aside payment) in order to pay an additional amount up to 25% of the per hectare payments for these crops as defined in the new regulation (A99-A109). There is an alternative for Member States who grow durum wheat to allow up to 40% of the payments for this crop to continue.
- 35. Partial decoupling of sheep and goats payments (A66).** Member States may retain up to 50% of the national ceiling for sheep and goats payments in order to pay an additional amount up to 50% of the per head payments for these animals as defined in the new regulation (A110-A119).
- 36. Partial decoupling of beef and veal payments (A67).** Member States may
- either, option (a) retain**
- up to 100% of the national ceiling for suckler cow premiums in order to pay an additional amount up to **100% of the suckler cow premium** as defined in the new regulation (A120 – A140).
- and**
- Up to 40% of the national ceiling for slaughtering premium in order to pay an additional amount up to **40% of the slaughtering premium** as defined in the new regulation (A120 – A140).
- Or, option (b) retain**

Up to 100% of the national ceiling for slaughtering premium in order to pay an additional amount up to **100% of the slaughtering premium** as defined in the new regulation (A120 – A140).

Or

Up to 75% of the national ceiling for beef special premium in order to pay an additional amount up to **75% of the beef special premium** as defined in the new regulation (A120 – A140).

37. Optional implementation for specific types of farming and quality production (A68).

An alternative approach to deal with the problem of land abandonment additional payments was to allow Member states to create a fund, at national or regional level, which can be used to combat the anticipated harmful effects of decoupling. The words in the agreed regulation refer to using these funds to “grant additional payments for specific types of farming which are important for the protection or enhancement of the environment or for improving the quality and marketing of agricultural products”.

These payments shall not exceed 10% of the total national ceiling of reference amount available, nor can they be more than 10% of any specific sector to which they relate (arable, sheep, beef, dairy).

38. Optional exclusion of certain direct payments from the single farm payment (A69).

Member States can also choose not to include in the single farm payment the direct payments for drying aids; seeds and direct payments in outermost regions and Aegean islands.

39. Optional transition. (A70). Whereas the default timing of the introduction of the single farm payment system is 01/01/2005, there is an option for Member States to decide to defer this until 01/01/2006 or 01/01/2007, “where specific agricultural conditions so warrant”.

CROSS COMPLIANCE CONDITIONS

40. The conditions required for receipt of direct payments¹² (A3 – A9). To receive the single farm payment and other, coupled, direct payments farmers must respect certain statutory management requirements (Annex III) and good agricultural and environmental conditions (Annex IV).

41. The statutory management requirements (A4) are specified as (parts of) 18 existing directives which will be introduced over three years as conditions for receipt of payments as listed below. The articles involved are as implemented in the Member States (i.e. farmers cannot be held responsible for the way the directives have been transposed in to national legislation). The Commission will prepare a working document establishing indicators for each legal obligation in Annex III. This intended to guide farmers how to apply the conditions. The relevant directives are:

A Starting from 1/1/2005

- **Environment** (5 directives): wild birds; groundwater; sewage sludge; nitrates; habitats
- **Public and animal health** (3 directives): identification and registration of animals; animal passports; identification, registration and labelling of beef.

B Starting from 1/1/2006

- **Public, animal and plant health** (4 directives): plant protection products; use of hormones in stock farming; food law; TSEs
- **Notification of diseases** (3 directives): FMD; SVD; bluetongue

C Starting from 1/1/2007

¹²

Note these conditions apply both to the single farm payment and any remaining coupled direct payments.

- **Animal welfare** (3 directives): standards for calves; for pigs; protection of farm animals
- 42. The good agricultural and environmental conditions** (A5) are to ensure that all land, especially land no longer used for production purposes¹³, is maintained in good condition. The Member States will define these conditions at national or regional level on the basis of the framework provided by Annex IV (see below). In doing so, they should take into account the soil and climatic conditions, existing farming systems, land use, crop rotation, farming practices and farm structures. These conditions will apply from 1/1/2005.
- 43. The Annex IV framework for the good agricultural and environmental conditions** refers to:
- A **Soil erosion**: protect soil through appropriate measures with standards for:
Minimum soil cover; minimum land management reflecting site-specific conditions; retain terraces.
 - B **Soil organic matter**: maintain through appropriate practices, with standards for:
Crop rotations where applicable; arable stubble management.
 - C **Soil structure**: maintain through appropriate machinery use, with standards for:
Appropriate machinery use.
 - D **Minimum level of maintenance** to avoid deterioration of habitats. Standards for:
Minimum livestock stocking rates and/or appropriate regimes;
Protection of permanent pastures
Retention of landscape features
Avoiding the encroachment of unwanted vegetation on agricultural land
- 44.** Good agricultural and environmental conditions also include the requirement that **land under permanent pasture** on 31st December 2002 must be maintained. Although there is some flexibility on this for Member States provided there is no significant decrease in the total area of permanent pasture.
- 45. Reduction of, or exclusion from, payments** (A6 & A7). There are rules which reduce payments (both coupled and decoupled payments) in the event of the non-respect of the statutory management conditions and good agricultural and environmental conditions. However they only apply to actions or omissions directly attributable to individual farmers. They provide for reduction or cancellation of direct payments in the calendar year the non-compliance occurs. They only relate to agricultural activity on the farm. They relate to **all** the agricultural land (including set-aside) on the holding, i.e. not just to the area receiving payments.
- 46. The size of the penalty** depends on the severity, permanence and repetition of the non-compliance. For negligence the penalty will not exceed 10%, of if repeated 20%. For intentional non-compliance it will be between 30% and 100%. Member States may retain up to 25% of the penalties resulting from cross compliance (A9).
- 47. Review of cross compliance** (A8). The working of the whole system of cross compliance, especially on whether to extend Annex III, will be reviewed by 31/12/2007 at the latest
- 48. Farm Advisory System** (A13 to A16). To help farmers understand the cross compliance conditions there will be a farm advisory system set up in each Member State. It is voluntary for the Member state to introduce this up to 2006. It must be in place by 2007. Participation by farmers is voluntary; priority will be given to farmers receiving more than €15,000 of direct payments per year. Member States are required to ensure that the bodies performing the advisory service do not disclose personal or individual information they receive in the source of their work, with the exception that they must inform public authority if they discover irregularity or infringement. The advisory system is to be reviewed by 31/12/2010 at the latest.

¹³ This certainly refers to set-aside land which has to be kept in good agricultural and environmental condition (A57), it also presumably refers to **agricultural** production purposes.

- 49. Integrated administration and control system (A17 – A32).** The Commission proposes that the decoupled payments scheme should be computerised, with an identification system for all agricultural parcels on holdings, identification of all payment entitlements and all farmers submitting aid applications. The intention is that this system makes use of computerised geographical information system techniques including aerial or spatial 'orthoimagery' guaranteeing accuracy at least equivalent to cartography at a scale of 1:10,000. The system will embrace verification of claims, controls on cross compliance and reductions and exclusions of payment claims when conditions are not met. The Member States are obliged to carry out on-the-spot checks to verify that farmers comply with the cross compliance obligations. However they are able to use their existing administrative and control systems. The details of the sampling and approaches are not spelled out in the regulation.
- 50. Energy crops (A87-A93).** There will be available an aid of €45/ha for areas sown under energy crops. This includes products for biofuels, and electric and thermal energy produced from biomass (although the list can be extended). This is subject to a limit of 1.5m Ha, and is only payable if the farmer has a contract for his energy supplies (or he is processing it himself). The areas used for these energy crops may not be used to count towards his set-aside area. This scheme will be reviewed by 31/12/2006.

PAYMENT CUTS: MODULATION & FINANCIAL DISCIPLINE

- 51.** Existing direct payments will be cut for a number of reasons. First to expand the agri-environment and rural development programmes in the second Pillar – this fund switching process is (confusingly) called modulation. Second, cuts in existing direct payments will be made to provide the funds for reforming other commodity support regimes, and for providing part for the funds for applying direct payments and market supports in the accession countries. A third factor is that the total expenditures for all budget heading 1a, i.e. Pillar 1 measures, have to be kept within the cash limits, set up to 2012, decided in the October 2002 Brussels Council. Although this is *not* explicitly stated, this process of payment cutting follows a principle in operation that compensation for price cuts cannot be expected to last indefinitely. Hence the compensation payments which have now been in place since the MacSharry reforms are eligible for being cut to finance these other reforms.
- 52. All direct payments, coupled and decoupled, will be cut by 3% in 2005, 4% in 2006, and 5% in 2007 and onwards (A10)¹⁴.** The first €5000 of all payments will effectively be exempt from these cuts as it will be reimbursed as an additional payment (A12). There is no further modulation, ie differentiation, in the payment cuts, that is no other thresholds or ceilings.
- 53. The distribution of the funds cut from payments:** the first one percentage point of funds from these cuts remains in the Member State where they were collected. The remainder is distributed according to three criteria: agricultural area (65% weight), agricultural employment (35% weight), this is then adjusted by an index of the national prosperity, GDP/capita in purchasing power parity. However, the formula will be adjusted to ensure that no member state receives back less than 80% of the funds cut from its farmers (90% for German rye). Modulation does not apply to producers in outermost regions and Aegean islands.
- 54. Financial discipline (A11).** The previous proposal for degressivity which pre-announced a series of progressive cuts indirect payments to fund reform of un-reformed regimes and enlargement has been dropped. The arrangement agreed is an annual process of achieving the same ends, called Financial Discipline. This starts in 2007. Until then there is in place under Agenda 2000 and the Berlin agreement a plan for funding the existing policy. Under financial discipline an 'adjustment of direct support' (i.e. a rate of payment cut) will be fixed by the Council by 30th June following a proposal from the Commission no later than 31st March of the calendar year to which the adjustment applies. The

¹⁴

This fund switching does not apply to the French Overseas Territories, Azores, Madeira, the Canaries or Aegean Islands.

Commission is obliged to propose such a cut when expenditure forecasts indicate that Budget heading 1a, with a security margin of €300m, will be exceeded in a given budget year.

- 55. The payment cuts arising from financial discipline will also be modulated.** The Commission will, when the time arises, submit a proposal for a payment cut rate which also includes a franchise of €5000. In the Presidency compromise paper, the Commission included a declaration (Annex 4 of that paper) indicating that “additional franchises above €5000 with partial exemption from the adjustment might also be proposed”. This indicates that the €50,000 threshold is not dead. It is also unclear if this wording excludes the possibility of re-emergence of payment ceilings (that is thresholds above which the cut is 100%).
- 56. Transition from optional modulation to Community modulation (A155).** Rules will be established to enable Member States applying the Agenda 2000 optional modulation to continue to keep it in place up to the level necessary to fill the gap between the funds available under the mandatory modulation scheme and the financial needs resulting from accompanying measures established before 2006. All funds from voluntary modulation remain in the Member State they are collected. These are not explicitly referred to in A155, although the optional modulation, A4 of regulation 1259/99 is mentioned, but this was also part of the presidency compromise paper agreed on 26th June.
- 57.** This has particular relevance to the UK. There is expected to be a significant funding gap for several years if the current proposals to extend the Rural Development Plans in 2005 for various aspects for the Curry report, including especially the Entry Level Stewardship scheme, are implemented. These are estimated to require a modulation rate of approaching 10% in 2005, and this assumes all the funds are recycled in the UK and 100% match funded by the Treasury. The proposed 3% mandatory modulation with the redistribution formula – and a proposed reduction in member state co-financing from 50% to 40% - will clearly not provide enough. **This seems to suggest a significantly higher UK transitional modulation rate for the foreseeable future.**
- 58. Implementing rules (A145).** These are promised on 17 sets of issues, including the national reserve, the procedures for applying for aids, and the administrative rules for the cross compliance checks. Many questions arising from this agreement will not be clarified until these rules are available.
- 59. Crisis management (= safety nets?)** A new element agreed at the Luxembourg Council but not included in the new regulation is that the Commission will examine specific measures to address ‘risks, crises and national disasters in agriculture’. A report accompanied by appropriate proposals will be presented to the Council before the end of 2004. The Commission will analyse financing these measures through the one percent modulation directly re-distributed to the Member States as well as inclusion in each common market organisation an article empowering the Commission to act in the case of a Community-wide crisis, along the lines established for such cases in the common market organisation for beef.

RURAL DEVELOPMENT REGULATION

- 60. The additional Rural Development measures will be reported on at a later date.**

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