House of Commons

Environment, Food and Rural Affairs Committee

THE MID-TERM REVIEW OF THE COMMON AGRICULTURAL POLICY

GOVERNMENT REPLY to the Third Report of Session 2002–03 from the Environment, Food and Rural Affairs Committee

Fourth Special Report of Session 2002–03

Ordered by The House of Commons *to be printed 2 April 2003*

HC 615
Published on 8 April 2003 by authority of the House of Commons
London : The Stationery Office Limited
£4.00

The Environment, Food and Rural Affairs Committee is appointed by the House of Commons to examine the expenditure, administration and policy of the Department for Environment, Food and Rural Affairs and its associated public bodies.

Powers

The Committee is one of the departmental select committees, the powers of which are set out in House of Commons Standing Orders, principally in SO No.152. These are available on the Internet via www.parliament.uk. The Committee has the power to appoint two Sub-committees.

Mr David Curry (Chairman) (*Conservative, Skipton and Ripon*)
Ms Candy Atherton (*Labour, Falmouth and Camborne*)
Mr David Borrow (*Labour, South Ribble*)
Mr Colin Breed (*Liberal Democrat, South East Cornwall*)
David Burnside (*Ulster Unionist, South Antrim*)
Mr David Drew (*Labour, Stroud*)
Patrick Hall (*Labour, Bedford*)
Mr Michael Jack (*Conservative, Fylde*)
Mr Mark Lazarowicz (*Labour/Co-op, Edinburgh North and Leith*)
Mr David Lepper (*Labour, Brighton Pavilion*)
Mr Austin Mitchell (*Labour, Great Grimsby*)
Diana Organ (*Labour, Forest of Dean*)
Mrs Gillian Shephard (*Conservative, South West Norfolk*)
Alan Simpson (*Labour, Nottingham South*)
David Taylor (*Labour, North West Leicestershire*)
Paddy Tipping (*Labour, Sherwood*)
Mr Bill Wiggin (*Conservative, Leominster*)

Publications

The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) are on the Internet on its website at:

http://www.parliament.uk/parliamentary_committees/environment__food_and_rural_affairs.cfm

Contacts

All correspondence should be addressed to The Clerk of the Environment, Food and Rural Affairs Committee, Committee Office, 7 Millbank, London SW1P 3JA. The telephone number for general inquiries is: 020 7219 3262; the Committee's e-mail address is: efracom@parliament.uk.

FOURTH SPECIAL REPORT

The Environment, Food and Rural Affairs Committee has agreed to the following Special Report:

THE MID-TERM REVIEW OF THE COMMON AGRICULTURAL POLICY: GOVERNMENT REPLY TO THE THIRD REPORT OF SESSION 2002-03 FROM THE ENVIRONMENT, FOOD AND RURAL AFFAIRS COMMITTEE

The Environment, Food and Rural Affairs Committee reported to the House on *The Mid-Term Review of the Common Agricultural Policy* in its Third Report of Session 2002–03, published on 21 January 2003 as HC 151. The Government's Reply to the Report was received on 24 March 2003 and is appended.

* * * * * * *

APPENDIX

1. We welcome the assertion that the Mid-Term Review has not been postponed or seriously damaged, though we are less confident in that assertion than Lord Whitty. Like the Government, we welcome the broad thrust of the Mid-Term Review proposals. But, as we indicated in our Report on the Future of UK Agriculture, we regret that proposals for a number of sectors are missing from the Mid-Term Review (paragraph 16).

The Government supports the Committee's view in welcoming the main body of the Commission's proposals, and also supports the above assertion that the proposals did not go as far as we would have liked. The European Commission proposals for modulation arrangements have been modified since July 2002, and some provision has been made to finance market reform (e.g. dairy and cereals).

If agreed, these reforms should ensure a sustainable future for EU agriculture and reduce the negative impact of the CAP on developing countries. The publication on 22 January of formal legislative proposals demonstrates that the reform process is still on track, but we have to maintain realistic expectations of the negotiations ahead. Securing significant reform will not be easy given the different interests of other Member States, but the Government will keep the pressure on to agree real and fundamental and affordable CAP reform.

2. We regret that the European Commission only presented options on the reform of the dairy sector rather than detailed and clearly time-tabled proposals to bring to an end the current system of milk quotas (paragraph 17).

3. We urge the Government to continue to lobby the European Commission for the earliest possible phasing out of milk quotas and we hope that the Commission brings forward such proposals when it brings forward the Mid-Term Review legal proposals (paragraph 17).

The UK Government shares the Committee's concern that the Commission's options paper for dairy reform was not more closely aligned with the conclusion of the 1999 Berlin Summit which required the Commission to review the dairy quota system with a view to allowing the current arrangements to run out after 2006. The latest Commission legal texts also do not fulfil that important requirement.

Some of the elements now proposed are welcome as a further stage in the transition to a quota-free system, such as additional, differentiated cuts in support prices over and above those agreed in Agenda 2000 together with further increases in national reference quantities. However, this approach is not taken to its logical conclusion and we do not accept the extension of milk quota. It is not clear what the Commission see as the ultimate objective for this process, or why it cannot map out a route now that would take the regime to the point where supply controls and related intervention were no longer needed.

The present dairy regime acts to the detriment of consumers, taxpayers and producers. The industry needs to have certainty so that it can plan effectively for the future. The UK Government will, therefore, continue to press for a clear end point for the quota system and an orderly progression towards it.

4. As proposals for the reform of the sugar regime are due in 2003, we hope that they come forward early in the year (paragraph 18).

The Government has consistently argued the case for early and radical reform of the EU sugar regime. When the Council agreed in May 2001 to extend the existing regime, with certain modifications, to June 2006, we did secure a commitment to a further review in 2003.

The European Commission has made clear that they see the reform proposals as providing a framework for this further examination of the sugar regime and have now said that they will be bringing forward their ideas later this year. The Government welcomes this and remains strongly committed to early progress on sugar reform.

5. We strongly support the principle of reducing CAP spending (particularly under Pillar I) (paragraph 20).

The UK Government agrees with this principle. We support the direction of the Commission's proposals on degression and modulation but we will continue to argue both for a greater transfer of funds to rural development, and further reductions in the overall level of CAP expenditure.

6. The European Commission's modulation proposal would transfer all Pillar I savings to Pillar II. We believe that there should be a very rigorous analysis of the scope and purpose of rural development measures and a procedure put in place to assess value for money. Rural development programmes should not be regarded as virtuous simply because they are <u>not</u> production aids. Funding from Pillar I should only go to well-founded schemes: if, as a result, there are total savings in expenditure so much the better. Equally, funding required under Pillar II to deliver measures which really will deliver clear measurable benefits should be provided. A proper assessment of the measures required would form a more intellectually-sustainable basis for funding (paragraph 20).

The European Commission proposals for modulation arrangements have been modified since July 2002. The original 'dynamic' modulation model would have diverted Pillar 1 direct payments into Pillar 2 at a rate of 3% in 2005 rising by 3% per year to a maximum of 20% in 2011. Under the Commission's latest proposals direct payments would be reduced by progressive percentages starting at a rate of 1% in 2006 rising to 19% in 2012. However, the percentage that would be redirected to rural development would be reduced to 1% in 2006 rising to 6% in 2012. The remainder would be used to finance market reforms (cereals and dairy).

The Government agrees that a rigorous analysis of rural development measures is required. Pillar 2 schemes must generate clear public benefit from the public funds involved. The Government is not yet convinced, for example, that the additional measures now proposed by the Commission pass this test.

All Member States are required to carry out a Mid-Term Evaluation of their rural development programmes, by the end of 2003. This will provide an opportunity for the Commission to consider the extent to which this expenditure generates real value-for-money public benefits in all Member States, and should contribute to consideration of how best to target this expenditure.

7. The agreement on CAP spending reached in Brussels in October 2002 limits Pillar I spending. Dynamic modulation, proposed in the Mid-Term Review, would transfer money from Pillar I to Pillar II. The Government should therefore seek guarantees that the Pillar I budget limit will be reduced commensurately as funds are transferred to Pillar II, otherwise the CAP budget disciplines agreed in Brussels would not be adhered to (paragraph 21).

The UK Government agrees that the budget frameworks agreed to at the Berlin Council in 1999 and the Brussels Council in 2002 should be strictly adhered to.

8. It seems likely that the modalities offer for the WTO negotiations will not point to more than minimal progress on these issues as well. The European Union and individual Member States expressed commitment to developing countries at the Johannesburg Sustainable Development Summit. It will be interesting to see if that commitment is reflected in the legal proposals emanating from the Mid-Term Review and in the subsequent debate upon them (paragraph 32).

The EU modalities proposals submitted to the WTO offer as much as is possible within existing CAP constraints. To this extent they are welcome but we have made clear that they will need to go much further, and soon; early progress on CAP reform will provide the key. Proposals for decoupling, modulation and cuts in market support, as contained within the recently published legal texts, should lead to reductions in trade barriers and subsidies, thus helping us to meet our Doha and Johannesburg summit commitments to developing countries.

9. We believe that the most appropriate response to pressure for change as a result of the WTO negotiations is to embrace it and work towards a much more liberal CAP, rather than to attempt to protect farmers from the inevitable for as long as possible (paragraph 39).

The Government fully agrees with the Committee. We have been in the vanguard of those pressing for ambitious liberalisation in both CAP and WTO negotiations. The Chairman of the WTO committee responsible for the agriculture negotiations has recently published his own modalities proposals for a new Agreement on Agriculture. We welcome the level of ambition contained therein, which will bring further pressure to bear for early reform of the CAP.

10. We believe that the proposals for decoupling and dynamic modulation would make the transition to the full CAP easier for the new Member States.

We share the Committee's view. Decoupling will minimise the distortion of market signals in the candidates when the CAP is extended to them. Many of the candidates' agricultural sectors are in need of significant restructuring. We believe enhanced rural development measures would be the best way to support this.

11. We believe that a far-reaching Mid-Term Review that ensures European agriculture is able to offer meaningful progress on trade liberalisation talks and ensure its own budgetary stability would be far better for farmers across the European Union than a continuing cycle of repeated minor reforms of the CAP (paragraph 41).

The Government agrees with the Committee's assertion that a fundamentally reformed CAP would be better for EU farmers. The Government will be negotiating hard for reform of the CAP, which will benefit farmers, consumers, the environment, the tax payer and developing countries.

12. We hope our concern (about the form of payments to new Member States) is unjustified and that this is simply an expression of the European Commission's intent to secure agreement for its proposals to decouple direct payments from production completely.

We believe that your concern that rather than specify that "subject to the outcome of the Mid-Term Review, new Member States will adopt the decoupled single income payment", the new Member States will "at the end of the transitional period, ... enter the regular system of direct income support in the form then applicable" is unfounded.

The treaty has been negotiated on the basis of the *acquis* in force - the treaty cannot pre-empt separate CAP reform discussions. However, we secured the wording "in the form then applicable" in order that changes in the CAP could be adopted by the new Member States on accession.

13. The Government should seek to ensure that the temporary permission given to new Member States to transfer money from Pillar II to Pillar I is not extended, either beyond 2006 or to existing Member States who might find it an attractive proposition.

We share the Committee's view and secured wording in the accession treaty to make clear this was a 'temporary and *sui generis* measure' for the 2004-2006 period only. Transferring money from pillar II to pillar I runs directly counter to our wishes for CAP reform.

14. During the course of our inquiry a number of issues that arise from the Mid-Term Review were identified as having a particularly disadvantageous impact on the United Kingdom. Concern stemmed from the fact that we have an average farm size larger than the European Union average, that we have already implemented a modulation scheme under the existing voluntary system, and that we currently receive a low share of European Union money under the rural development regulation. We explored issues such as the implementation of decoupling, the role of cross-compliance, the impact of modulation and the potential distortions that could arise as a result of capping and franchises with those who gave us oral evidence. We also sought evidence on the implications of the new approach to animal welfare that the Mid-Term Review signalled (paragraph 44).

The Government also agrees with the Committee, that the Commission's proposals discriminate against the UK because of its larger than average farm size. In the Commission's formal proposals released on 22 January 2003, the €300,000 ceiling on direct payments per farm has disappeared. However, the suggested mechanism for degression and modulation will still have an adverse impact on larger, efficient farms, and will impact heavily on Member States such as the UK and Germany. The Government will negotiate hard for a fairer, simpler system such as that which operates in the UK at the moment.

The UK Government also shares the Committee's concerns over the UK share of the European Union Rural Development money. The January proposals do not go far enough in redressing the imbalance and the Government will be negotiating hard for a fairer sum for the UK.

On decoupling, the Commission and the UK Government have undertaken impact studies (see the response to 15 below). The detail of implementation is currently being worked out in Working Groups in Brussels.

In regard to animal welfare, the Government welcomes these proposals, but seeks to find a flexible, and cost-effective system of cross-compliance, with the minimum of bureaucracy.

15. We welcome the fact that some economic analysis is now planned as far as the farm-level impact of the Mid-Term Review is concerned. However, both at Commission and national Government level this work should in future develop in parallel with the development of new CAP reform policies otherwise all those with an interest in these matters are going to be asked to agree proposals without having any real idea of who in the United Kingdom are going to be the winners and losers. In terms of future CAP reform the Commission should also be encouraged to provide a commentary explaining the rationale for the ideas underpinning their proposals (paragraph 71).

We agree that the Commission should explain the rationale of their proposals and we recognise the need to carry out economic analysis. Research carried out by OECD and others over a number of years shows that decoupled payments offer a more efficient means of supporting agricultural incomes. In presenting their detailed proposals in January the Commission also published a number of impact assessments. Defra has commissioned a range of research to consider the impact of decoupling and these were discussed at a seminar of stakeholders on 16 January. In addition, a Defra commissioned report on the environmental effects of CAP reform has been completed. These reports are available on the Defra website (http://www.defra.gov.uk/esg/m_decoupling.htm).

16. We welcome the proposal to decouple the vast majority of direct support payments from production (paragraph 73).

The UK Government agrees with the Committee and welcomes the decoupling of direct support payments. This would remove some of the perverse incentives to over-production in the present system and allow producers to optimise, rather than maximise, production. A reduction in production would also mean that EU surpluses would no longer need to be disposed of on world markets distorting trade and destroying opportunities for developing countries. Decoupling would therefore greatly strengthen the EU's negotiating position in the WTO Round.

Decoupling is also expected to lead to environmental benefits as damage caused by the incentive to over-produce (e.g. high stocking densities, intensive use of agro-chemicals and cultivation of marginal land) reduces.

17. We hope that the principle will be extended to any future reforms of CAP product regimes that involve the introduction of direct payments to compensate for price cuts (paragraph 73).

The Government agrees with the Committee that the principle of decoupling payments from support should be extended to the future reform of other sectors.

18. In the short term the decoupling of support will cause problems: (a) new structures for channelling support to farmers will be required, once the mechanism for attaching the single decoupled income payment is decided upon; (b) there will undoubtedly be difficult questions over entitlement, and the United Kingdom Government will have to pay particular attention to the impact of the new system on tenant farmers and on farms with a mix of previously supported and previously not supported enterprises; and (c) there will also be implications for the buying, selling and renting of land with potentially different levels of entitlement to the decoupled single income payment (paragraph 74).

(a) Defra is working closely with the Rural Payments Agency and the Devolved Administrations on implementation of a decoupled system.

(b) Under the Commission's January proposals the decoupled payment would be linked to land, but not necessarily to the same land which generated the claim. And the payment is specifically destined for 'the actual farmer'. This means that a tenant who has earned a decoupled payment entitlement through receipts in the reference period can take his entitlement with him when he leaves a farm, as long as he can find other eligible land elsewhere to farm and on which to base his claim. There are many different implications of the proposed system, which we are exploring with interested organisations.

(c) In consultation with stakeholders, the Government is examining the possible implications for land and rental values of the proposed decoupled system.

19. Receipt of a single decoupled income payment will not completely remove distortions from the agriculture sector. The payment would allow inefficient operators to remain farming, if they chose to subsidise their farming business with the decoupled support payment. Therefore we hope that the concept of dynamic modulation will be extended and lead to a year-on-year reduction in the size of the decoupled single income payment beyond 2010 (when modulation reaches 20 per cent) (paragraph 75).

In the legislative proposals for reform presented on 22 January, the Commission intends that direct aid payments should be gradually reduced over time, starting at 1% in 2006 and rising to 19% in 2012. The percentage reduction applying to any particular farm will depend on the size of its receipts and the effect of a national ceiling on total direct payments. The UK Government agrees that the degression of direct payments should continue beyond 2012, and wishes the degression to be applied in such a way that genuine budgetary savings result.

20. Payments for environmental management and improvement should come from Pillar II. Therefore, to 'green-tinge' Pillar I payments should not be necessary.

The Commission proposals envisage a considerable continuing level of pillar 1 support. In these circumstances we believe that the principle of cross-compliance should apply to these payments. It cannot be right for an EU farmer to receive public funds even if they are committing a serious breach of Community legislation on the environment, for example, or on animal welfare. By providing an additional, financial, incentive to comply with legislation, cross-compliance should have a positive effect. The main means of using CAP funds to generate environmental and rural development benefits should, however, continue to be the second pillar. The detailed implementation of cross-compliance will of course need to be proportionate, and to avoid excessive bureaucracy.

21. Rather than capping payments, we believe the best solution is a steady, staged reduction in all spending under Pillar 1 (paragraph 77).

The Government agrees. The Commission's legislative proposals announced on 22 January no longer contain the €300,000 subsidy limit per farm. This is welcome news. However, the proposed model for staged degression and modulation over time still places the burden of reform very heavily on large farms. It is framed in a way that will discourage improvements in efficiency and penalise farmers in member states where rationalisation of farm structure has already taken place. The Government would prefer all CAP payments to be subject to 'degressivity': the progressive reduction of direct payments across the board, diverting some but not all of the savings to rural development.

22. The United Kingdom Government should continue to promote its approach to modulation as a European Union-wide system (paragraph 78).

The Government will continue to do so. An EU-wide system following the UK model, where a common modulation rate applies to all payments, would be fairer, simpler to operate, and less bureaucratic than the Commission's proposals.

23. It should, if the idea of a franchise persists, seek to have it set as low as possible and to insist that the European Commission has the means to prevent farm businesses being re-engineered to get below the franchise (paragraph 78).

The UK Government will continue to argue for a fair, transparent and simple method of degression, with flat-rate, across-the-board reductions. The UK's experience of administering modulation supports this approach. The current proposal discriminates against various Member States, including the UK, on the basis of farm structures. A simpler approach would avoid these discriminatory impacts, encourage efficient restructuring in rural areas and provide a simple way of raising funds for rural development. The recent legislative proposals for reform omit the proposal, included in the July 2002 paper, to limit receipts to individual farm businesses, following discussions in the Agriculture Council when the UK Government expressed its objections.

24. The exact nature of the role to be played by farm audits is unclear. We believe that it would be beneficial for farmers to receive advice on the implications for the environment of the farming practices they use. However, it is also important that there is an efficient and effective way to monitor the huge amount of money taxpayers transfer annually to agriculture. We would like to see the Government develop the farm audit arrangements in such a way that the process can fulfil both these roles (paragraph 79).

We are currently reviewing the policies and delivery vehicles which actively support the knowledge, skills and understanding necessary to run high performing rural businesses where growth is in line with sustainable development principles. We also recognise the need to make better use of information within Defra and other Government Departments and agencies and are therefore developing the whole farm approach to improve outcomes in all areas including administration, business planning, management and enforcement. Relying upon a single assessment or audit as the basis for monitoring enforcement and making statutory payments is a long term objective of our approach. However there are a number of significant hurdles that must be overcome and which we are addressing, not least of which are issues relating to privacy and data sharing and the technology that could support that process. We are pressing to ensure that the Commission proposals are framed in such a way that they provide the flexibility necessary to achieve our objectives.

25. We also believe that all farmers in receipt of public money should be able to demonstrate that they are abiding by the cross-compliance conditions associated with the decoupled single income payment. Therefore some kind of audit process, proportionate to both the risk of misuse of funds and the size of the decoupled payment, is necessary. We request that the Government tell us how it would tailor farm-level audits to do this (paragraph 80).

We agree that appropriate conditions should be attached to receipt of public funds. In principle, therefore, the Commission's proposal to apply cross-compliance conditions to all direct payments, not just the single payment scheme, is, welcome. However, we need to consider with stakeholders whether the detailed requirements will be effective, proportionate and transparent. It is also unlikely that the same conditions could be applied to other forms of support without suitable adaptation. For example, applying 'good agricultural conditions' on the Commission model would run counter to the objective of some payments under Pillar II agri-environment schemes.

Any payments conditions which are set will need a parallel enforcement regime. In developing the whole farm approach we are trying to develop system of assessment that is proportionate and delivers the objectives we aspire to. We feel that a major plank in this approach will be the identification of core data sets and a modular approach to self assessment packages that signpost participants to additional schemes/measures or requirements as appropriate. This is the path that we hope to follow, although at present the Commission's proposals for the single payment and other direct aids rely on the traditional on-farm inspection model coupled with the equally resource intensive "farm assessment" that we are not convinced would offer the value for money that we hope to achieve. In the short term, while our work on the whole farm approach is further developed, we will be arguing for the maximum possible use to be made of existing enforcement agencies so as to minimise bureaucracy and costs for the industry and the payment authorities.

26. We recommend that the Government encourage the European Commission to assess the environmental and social objectives of Member States that fall within the ambit of Pillar II in order to obtain a clear picture of their funding requirements. The Commission would also need to determine the extent to which it is prepared to let Member States emphasise environmental aspects over social aspects (or vice versa) within the Rural Development Programmes. We hope that support would be available to non-farmers who fulfil those policy objectives in rural areas (paragraph 85).

The Government agrees with this recommendation. The Government will press for fair and objective criteria to be used to allocate rural development funds in order to redress the UK's relatively low share in EU Rural Development funds.

27. Over time funding should be directed to Pillar II. The rate at which dynamic modulation [is] used to transfer money from Pillar I should be higher [than] the rate of transfer into Pillar II in order to bring about real CAP budgetary savings (paragraph 86).

The UK Government will continue to press for market reforms and rates of degression that will generate real and substantial budgetary savings, while providing increased funding for rural development.

Department for Environment, Food and Rural Affairs
March 2003

Printed in the United Kingdom by The Stationery Office Limited
4/2003 845708 19585

Distributed by TSO (The Stationery Office)
and available from:

TSO
(Mail, telephone and fax orders only)
PO Box 29, Norwich NR3 1GN
General enquiries 0870 600 5522
Order through the Parliamentary Hotline *Lo-call* 0845 7 023474
Fax orders 0870 600 5533
Email book.orders@tso.co.uk
Internet http://www.tso.co.uk/bookshop

TSO Shops
123 Kingsway, London WC2B 6PQ
020 7242 6393 Fax 020 7242 6394
68–69 Bull Street, Birmingham B4 6AD
0121 236 9696 Fax 0121 236 9699
9–21 Princess Street, Manchester M60 8AS
0161 834 7201 Fax 0161 833 0634
16 Arthur Street, Belfast BT1 4GD
028 9023 8451 Fax 028 9023 5401
18–19 High Street, Cardiff CF1 2BZ
029 2039 5548 Fax 029 2038 4347
71 Lothian Road, Edinburgh EH3 9AZ
0870 606 5566 Fax 0870 606 5588

The Parliamentary Bookshop
12 Bridge Street, Parliament Square
London SW1A 2JX
Telephone orders 020 7219 3890
General enquiries 020 7219 3890
Fax orders 020 7219 3866

Accredited Agents
(see Yellow Pages)

and through good booksellers

ISBN 0-215-01009-4
9 780215 010094