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**SINGLE PAYMENT SCHEME (SPS):  
ISSUES TO BE ADDRESSED TO IMPROVE  
ITS SOUND FINANCIAL MANAGEMENT**



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# SINGLE PAYMENT SCHEME (SPS): ISSUES TO BE ADDRESSED TO IMPROVE ITS SOUND FINANCIAL MANAGEMENT

(pursuant to Article 287(4), second subparagraph, TFEU)

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## REPLY OF THE COMMISSION

# ABBREVIATIONS

**CAP:** common agricultural policy

**CATS:** Clearance Audit Trail System (database collecting information related to European agricultural funds payments)

**EAGF:** European Agricultural Guarantee Fund

**EAFRD:** European Agricultural Fund for Rural Development

**Eurostat:** statistical office of the European Union

**GAEC:** good agricultural and environmental condition

**LFA:** less-favoured area

**LSU:** livestock units

**SMR:** statutory management requirements

**SAPS:** Single Area Payment Scheme

**SPS:** Single Payment Scheme

**URAA:** Uruguay Round Agreement on Agriculture

**WTO:** World Trade Organisation (Geneva)

# GLOSSARY

**1992 reform:** The first major reform of the CAP ('MacSharry reform') in which intervention prices in the arable and the beef sectors were reduced. As a compensation for expected losses of income the reform introduced direct payments to arable crop producers and for land to be taken out of production (set-aside).

**WTO Agreement on Agriculture:** Result of negotiations in the 1986–94 Uruguay Round where WTO member countries agreed to improve market access and reduce trade-distorting subsidies in agriculture.

**Agenda 2000:** This reform put the CAP on two main pillars which the Community budget finances through two European agricultural funds. The first pillar (European Agricultural Guarantee Fund (EAGF)) provides for market measures and income support in the form of direct payments. The second pillar (European Agricultural Fund for Rural Development (EAFRD)) co-finances rural development measures in areas such as agri-environment, the promotion of food quality, higher technical standards and animal welfare.

**2003 reform:** CAP reform ('Mid-Term Review') which aimed to reduce price support and compensate for this reduction by direct income aid continuing a process that had begun in 1992 (MacSharry reform), and confirmed in 1999 (Agenda 2000 reform). The 2003 reform introduced the decoupling of aid and cross-compliance while reinforcing rural development assistance

**Health Check:** 2008 review of the 2003 CAP reform. Adoption of Commission proposals for further decoupling of direct aids and additional flexibility for the SPS, higher transfers of expenditure to rural development measures, modifications to the intervention system, increase of milk quotas and other sector-specific measures.

**Agricultural factor income:** Indicates the net value added of agricultural activities (as well as inseparable non-agricultural, secondary activities) at factor cost. It is calculated by subtracting the value of intermediate consumption, the consumption of fixed capital and production taxes from the value of agricultural output at basic prices and adding the value of (other) subsidies on production. Households often receive income from other sources (non-agricultural activities, salaries, social benefits, income from property) so that agricultural income is not necessarily identical with the actual income of agricultural households.

**Agricultural entrepreneurial income:** Income generated by farming activities which is used to reward own production factors (work and/or enterprise, own capital and owned land). It corresponds to factor income minus costs linked to borrowing capital and hiring labour.

**Decoupling:** Process of separation of direct aid payments from the actual agricultural production.



# EXECUTIVE SUMMARY

## I.

The Single Payment Scheme (SPS) is a key feature of the 2003 reform of the common agricultural policy. Its objectives are to encourage farmers to better respond to market demand and to support their income. The SPS is currently applied in 17 of the 27 EU Member States and expenditure on the scheme amounted to some 28,8 billion euro in 2009.

## II.

The Court's audit of the implementation of the SPS focused on the following:

- the beneficiaries of the policy, the access to single payments and the definition of eligible land;
- the contribution of the scheme to the objectives of supporting farmers' income and maintaining land in good agricultural and environmental condition;
- the specific effects arising from the various implementing models of the scheme.

## III.

The beneficiaries of the SPS are 'farmers' engaged in an 'agricultural activity' and having 'eligible land' at their 'disposal'. However, a lack of precision in the definition of these terms and the manner in which the related provisions were subsequently applied permitted persons or entities having no or only marginal agricultural activity to benefit from SPS payments.

## EXECUTIVE SUMMARY

### IV.

In 2008, the Commission and the Council undertook a review of the CAP, known as the 'Health Check', which led to the acknowledgement that SPS aid should not go to 'natural or legal persons whose agricultural activities form only an insignificant part of their overall economic activities or whose principal business or company objects do not consist of exercising an agricultural activity'. However, no Member State has yet made use of this option to better target the beneficiaries of SPS aid.

### V.

Access of new entrants to the SPS was sometimes limited. Furthermore, the criteria for eligibility of land were not clear enough and the required minimal agricultural activity was sometimes reduced to no activity at all.

### VI.

Direct payments, comprising SPS and coupled aid, represent an important share of farm income. The major part of the aid goes to a small number of large beneficiaries while the large majority of beneficiaries each receive only a small amount of aid.

### VII.

The receipt of SPS aid is conditional upon respecting cross-compliance obligations. However, the Court noted that there is no direct link between SPS aid and the costs incurred by farmers for complying with such obligations. Similarly, it is not possible to establish a direct link between SPS aid and the positive public externalities that agricultural activities generate.

### VIII.

Several options ('models') were made available to Member States for the implementation of the SPS. The choice between the available models significantly influenced the distribution of aid within Member States (among farmers). This means that, currently, the SPS is a poorly targeted method to support farmers' income.

### IX.

Most Member States that have so far introduced the SPS have retained the historic model where the amounts of aid are essentially based on parameters set in 2000 to 2002 which no longer correspond to current activity. Where the Member States authorities have not set up proper restrictions, this model can also be associated with speculative transfers and accumulation of payment entitlements by beneficiaries.

### X.

The regional model favours a more equal distribution of aid. However, it has been shown that it aggravates the 'capitalisation' of the aid in land prices and land leases. Such capitalisation exists in all aid systems based on the surface of land farmed, but more so in the regional form of implementation of the SPS.

### XI.

Overall, while the SPS has contributed to the objectives of the CAP, notably by encouraging farmers to better respond to market demand and by supporting the income of the agricultural sector as a whole, the Court invites the Commission to consider whether such features should be reviewed along the lines set out in the recommendations below.

## EXECUTIVE SUMMARY

### **XII.**

The Court recommends that;

- the present legislation should be amended to ensure that SPS aid is directed to active farmers, in particular by excluding beneficiaries who have no or only insignificant agricultural activities;
- eligible land and agricultural activities should be more clearly defined with a view to excluding from the benefit of SPS aid non-agricultural parcels and activities that do not contribute to increasing agricultural productivity (Article 39 of the Treaty, see footnote 5) or actively maintaining the environmental value of the land;
- the calculation of SPS aid should be modified to better reflect the cost of environmental and other externalities;
- GAEC standards should require concrete and regular activities to be carried out by farmers for them to receive the full amount of the aid. Payment reductions for failure to respect cross-compliance obligations should be made more dissuasive;
- a more balanced distribution of aid between farmers should be sought either by further modulation of payments, or by capping higher individual payments, or by taking into consideration the specific circumstances of farms;
- the calculation of entitlements should be based on current farming conditions in the different regions.

# INTRODUCTION

## BACKGROUND

1. Until its reform in 1992, the CAP relied on a price support system in most agricultural sectors combined with public intervention in agricultural markets as well as border protection<sup>1</sup>. Price support came to generate almost permanent surpluses of the major farm commodities and market stabilisation could only be achieved, at a high budgetary cost, through measures such as private storage, disposal measures, export subsidies or even destruction of agricultural products. In addition, price support had been systematically criticised in multilateral trade negotiations.
  
2. The 1992 reform of the CAP reduced intervention prices for cereals and beef and obliged larger farms to set aside part of their land. In parallel, the reform introduced accompanying measures for the protection of the environment, early retirement for farmers and afforestation measures. In compensation for the expected income losses that followed the decrease of cereal and beef prices, producers received direct payments which were coupled to areas sown or animal numbers. The overall amounts of these payments were restricted by sector-specific regional or national ceilings.

<sup>1</sup> In some agricultural sectors direct aid payments had been introduced to improve producer incomes. An example is Council Regulation No 136/66/EEC of 22 September 1966 on the establishment of a common organisation of the market in oils and fat (OJ 172, 30.9.1966, p. 3 025–66) that introduced an aid to the production of olive oil and table olives. In the case of cotton, producers were supported, indirectly, via an aid to the ginners.

### BOX 1

#### FARM INCOME SUPPORT AND THE EUROPEAN UNION'S INTERNATIONAL COMMITMENTS

In 1994, the European Union and the member countries of the World Trade Organisation signed the Uruguay Round Agreement on Agriculture (URAA). This agreement classifies the various forms of farm support according to their impact on the distortion of international trade. Direct price support is considered as particularly distorting and the WTO member countries committed themselves to reduce this form of support. Direct payments 'decoupled' from production are considered not to distort trade and are therefore permitted<sup>2</sup>.

<sup>2</sup> The Agreement on Agriculture (OJ L 336, 23.12.1994, p. 22) allows public farm support under specific conditions. According to Annex 2 to the agreement the eligibility for income support payments must be determined on the basis of criteria such as income level, status as a producer or landowner, factor use or production level in a reference period. The amount of such payments in any given year shall not be related to the type or volume of production (including livestock) after the reference period nor to the prices of any such production. Also, payments must not be based on the factors of production employed in any year after the reference period nor should farmers be obliged to produce in order to be entitled to the support.

3. In 1999, the European Council in Berlin agreed upon a further reform of the CAP. Support to agriculture was organised around two main 'pillars' that the Community budget finances through two funds. The European Agricultural Guarantee Fund (EAGF) continues to provide for the financing of market measures and includes income support in the form of direct payments coupled to production. The European Agricultural Fund for Rural Development (EAFRD) co-finances rural development measures such as protection of the environment and sustainable agriculture, promotion of food quality, and higher technical and animal welfare standards.

#### THE 2003 REFORM OF THE CAP INTRODUCED THE SINGLE PAYMENT SCHEME

4. Implementation of the URAA and changing political priorities led to the 2003 reform of the CAP. This reform was designed to encourage farmers to respond to market demand and to promote agricultural practices considered to be protective of the environment.
5. As regards the first pillar of the CAP (EAGF) which finances market and direct aids, the 2003 reform was based on four key elements:
- Introduction of the [Single Payment Scheme \(SPS\)](#). This scheme replaces most existing direct aid payments. Under the SPS, aid is 'decoupled' from any obligation to produce.
  - Full payment of direct aid is subject to the condition that farmers keep all their land in good agricultural and environmental condition (GAEC) and respect statutory management requirements (SMRs). This is called '[cross-compliance](#)'. GAEC and SMRs prescribe or prohibit practices related to the protection of the productive potential of agricultural land, the environment, animal health and welfare, plants and food safety.
  - Introduction of a compulsory mechanism to reduce all direct payments exceeding 5 000 euro per calendar year by a fixed percentage ('[modulation](#)')<sup>3</sup>. The funds resulting from the modulation are transferred to the EAFRD.

<sup>3</sup> Direct payments were reduced by 3 % in 2005, 4 % in 2006 and 5 % from 2007 onwards. As from 2009, annual reductions for modulation will be further increased from 7 % in 2009 to 10 % in 2012. The Agenda 2000 reform had already introduced a voluntary modulation mechanism allowing Member States to modulate up to 20 % of the total amount of direct payments. Only the United Kingdom, France, Germany and Spain had chosen to apply these voluntary modulation measures. Under the 2003 CAP reform Member States may apply such a voluntary modulation mechanism in addition to the mandatory modulation. Currently, this is the case in the United Kingdom and in Portugal.

- A **financial discipline mechanism** to ensure that the amounts agreed upon for the financing of Pillar I of the CAP are not exceeded in any year<sup>4</sup>. This mechanism came into effect in 2007 but has not so far been triggered.

<sup>4</sup> Article 12 of Council Regulation (EC) No 1290/2005 of 21 June 2005 on the financing of the common agricultural policy (OJ L 209, 11.8.2005, p. 1).

6. The SPS is designed to be consistent with the overall objectives of the common agricultural policy aiming to 'increase agricultural productivity' and 'thus ensure a fair standard of living for the agricultural community, in particular by increasing the individual earnings of persons engaged in agriculture'<sup>5</sup>. Hence, the income of farmers, which had been one of the principal concerns of the CAP since its introduction, remained a major policy concern.
  
7. For the application year 2008 (financial year 2009), the national ceilings available for distributing payment entitlements in the 17 Member States that have introduced the SPS so far amounted to a total of 31,5 billion euro<sup>6</sup>. In the 2009 budget the SPS accounted for 72,1 % of the EU direct support payments and 49,8 % of the budget for agriculture and rural development.

<sup>5</sup> Article 39 of the Treaty on the functioning of the European Union (Treaty of Lisbon):

'1. The objectives of the common agricultural policy shall be:

- (a) to increase agricultural productivity by promoting technical progress and by ensuring the rational development of agricultural production and the optimum utilisation of the factors of production, in particular labour;
- (b) thus to ensure a fair standard of living for the agricultural community, in particular by increasing the individual earnings of persons engaged in agriculture;
- (c) to stabilise markets;
- (d) to assure the availability of supplies;
- (e) to ensure that supplies reach consumers at reasonable prices.

2. In working out the common agricultural policy and the special methods for its application, account shall be taken of:

- (a) the particular nature of agricultural activity, which results from the social structure of agriculture and from structural and natural disparities between the various agricultural regions;
- (b) the need to effect the appropriate adjustments by degrees;
- (c) the fact that in the Member States agriculture constitutes a sector closely linked with the economy as a whole.'

<sup>6</sup> Article 41 and Annex VIII to Council Regulation (EC) No 1782/2003 (until 31.12.2008) (OJ L 270, 21.10.2003, p. 1) and Annex VIII to Council Regulation (EC) No 73/2009 (as from 1.1.2009) (OJ L 30, 31.1.2009, p. 16). Amounts in Annex VIII are calculated on the basis of a full decoupling of all direct payments. If a Member State opted for partial decoupling only, the ceiling for SPS is reduced and the ceiling for the appropriations available for coupled payment is increased accordingly (see for example Annex III to Commission Regulation (EC) No 674/2008 (OJ L 189, 17.7.2008, p. 5) modifying Annex VIII to Council Regulation (EC) No 1782/2003 and establishing budgetary ceilings for the partial or optional implementation).

TABLE 1

## ANNUAL BUDGETARY CEILINGS FOR THE SINGLE PAYMENT SCHEME

(1 000 euro)

Member State	Application year		
	2006	2007	2008
Belgium	475 641	488 660	502 200
Denmark	981 539	987 356	993 338
Germany	5 644 898	5 693 330	5 741 963
Ireland	1 335 311	1 337 919	1 340 752
Greece	2 041 887	2 069 049	2 234 039
Spain	3 529 453	3 542 583	3 600 357
France	6 060 555	6 107 448	6 159 613
Italy	3 593 132	3 612 988	3 827 342
Luxembourg	36 602	37 051	37 051
Malta		1 668	3 017
Netherlands	325 103	730 632	743 163
Austria	540 440	643 956	649 473
Portugal	365 645	413 774	434 232
Slovenia		50 454	62 902
Finland	519 628	521 285	523 362
Sweden	630 000	714 201	719 414
United Kingdom	3 914 945	3 931 186	3 947 375
<b>Total</b>	<b>29 994 779</b>	<b>30 883 540</b>	<b>31 519 593</b>

## KEY ELEMENTS OF THE SPS AND MODELS OF IMPLEMENTATION

- 8.** As indicated above, the SPS was the cornerstone of the 2003 reform of the CAP and replaced most existing direct aid payments<sup>7</sup>. Only farmers are eligible for SPS. A farmer is a person who carries out an agricultural activity. An agricultural activity is defined as the production of plants, the rearing of animals or the maintenance of land in good agricultural and environmental condition (GAEC)<sup>8</sup>.
- 9.** To benefit from SPS aid, a farmer must hold 'payment entitlements' and have eligible agricultural land at his disposal. Every payment entitlement declared together with one hectare of eligible land gives right to an SPS payment equal to the unit value of the payment entitlement declared<sup>9</sup>. Payment entitlements are, in essence, a conditional right to being paid EU income support, i.e. an asset. They may be separated from land and traded independently.
- 10.** Payment entitlements are granted by the national authorities. The national ceilings correspond to the value of all payment entitlements available that farmers can activate with eligible land within the territory of the same Member State. This value is higher than the amounts actually paid, because all direct payments to farmers, including SPS payments, are reduced as a result of modulation (for example 5 % in 2008), Member States have not fully allocated all available amounts, farmers have not used ('activated') all payment entitlements (for example, because in a given year they farm fewer hectares than the number of entitlements they possess) or payments were reduced as a result of administrative sanctions (for example in the case of late presentation of the aid application). Thus, total payments made under the scheme amounted to 28,8 billion euro in financial year 2009<sup>10</sup>.

<sup>7</sup> For details on the support schemes integrated into the SPS see Annex VI to Regulation (EC) No 1782/2003.

<sup>8</sup> See Article 1 and Article 2 (a) and (c) of Council Regulation (EC) No 1782/2003.

<sup>9</sup> Exceptions apply only for certain producers of beef, milk and sheep and goat without land. These producers receive income support under the condition that they maintain a minimum level of their historical animal production. Arable crop farmers received specific entitlements for their set-aside obligations.

<sup>10</sup> For details on income support payments effectively made under the SPS see *Annex II*.



**11.** Belgium, Denmark, Germany, Ireland, Italy, Luxembourg, Austria, Portugal, Sweden and the United Kingdom introduced the SPS in 2005. Spain, France, the Netherlands, Finland and Greece used a transitional period and introduced the SPS one year later, in 2006.

<sup>11</sup> Article 122 of Regulation (EC) No 73/2009.

<sup>12</sup> Article 43 of Council Regulation (EC) No 1782/2003.

<sup>13</sup> Specific provisions applied in the sector of olive oil where the reference period comprised the marketing years 1999/2000, 2000/01, 2001/02 and 2002/03.

**12.** Specific rules apply for the new Member States that joined the EU in 2004 or 2007. They could, in principle, introduce the SPS like other Member States but so far only Malta and Slovenia have done so in 2007. Bulgaria, the Czech Republic, Estonia, Cyprus, Latvia, Lithuania, Hungary, Romania, Poland and Slovakia availed themselves of an option that allows them to postpone the introduction of the SPS until 2013. In the meantime, they apply a simplified area-based support scheme (SAPS)<sup>11</sup>. SAPS was not included within the scope of the audit reported in the present report.

**13.** Several implementing options were opened as regards the calculation and allocation of payment entitlements, thus defining a number of 'models' among which Member States could choose: the historic model; the regional (flat-rate) model; and mixed models, which are a combination of both:

- (a) **The historic model**<sup>12</sup>: Each farmer is granted payment entitlements which are as a rule based on the average amount of aid payments received during the three-year (2000, 2001 and 2002) reference period (the historical reference amount) and the average number of hectares farmed during that period under any of the former coupled support schemes (the reference area)<sup>13</sup>. Thus the unit value of a payment entitlement is equal to the reference amount divided by the number of entitlements. This mode of calculation results in significant differences in the unit value of payment entitlements that arise from the disparity of support to specific agricultural sectors during the reference period.

- (b) The **regional (flat-rate) model**<sup>14</sup>: Under the regional model, all payment entitlements allocated to the farmers of a defined region/sub-region have the same value ('flat-rate') and each farmer is allocated a payment entitlement for every eligible hectare declared in the first year of application or, alternatively, in the last year preceding the year of introduction of the SPS.
- (c) **Mixed ('hybrid')** models: These models combine elements of the historic and the regional models. Farmers receive a basic flat rate amount per eligible hectare plus a fixed percentage of the aid payments that they had received in the reference period. **Hybrid** models may be **static** or **dynamic**, i.e. the combination of historic and flat rate values may remain unchanged or it may vary over time and evolve towards a full regional, flat-rate, model. The models chosen by the 17 Member States that apply SPS for the calculation and allocation of payment entitlements are shown in **Annex I**.

<sup>14</sup> Articles 58 and 59 of Regulation (EC) No 1782/2003.

<sup>15</sup> Member States which, since 2005, had only partially introduced the SPS were however authorised to keep premiums for suckler cows and sheep and goat coupled to production.

- 14.** Member States were entitled to allocate part of the historical payments to a **national reserve** which could be used to grant payment entitlements to new farmers who had started their activities after the reference period, farmers in special situations or farmers affected by restructuring or development programmes.

#### **MODIFICATIONS INTRODUCED BY THE 2008 'HEALTH CHECK' OF THE COMMON AGRICULTURAL POLICY**

- 15.** In 2008, the Commission and the Council undertook a review of the CAP known as the '**Health Check**'. The Council accepted the Commission proposals to further decouple direct support schemes that were still coupled to production<sup>15</sup>. Remaining coupled aid schemes for dried fodder, starch, flax and hemp will also be decoupled and incorporated into the SPS by 2013. Also, the Health Check further simplified the rules and abolished the obligation for farmers to keep part of their land fallow (compulsory set-aside).

- 16.** The Council also authorised Member States to revise their original decision to opt for a particular model of implementation of the SPS. Member States that had chosen the historic model may either decide to narrow the gap between the unit values of payment entitlements or to change over to a (full or hybrid) regional model. Member States which had already introduced a hybrid regional model may decide to reduce the historical component of the value of the payment entitlements and thus adjust them closer to the regional value. Member States may also revise the composition of the regions<sup>16</sup>. Finally, Member States were also authorised to use up to 10 % of their 'national ceilings' for supporting specific issues<sup>17</sup>.

<sup>16</sup> Articles 45 to 48 of Regulation (EC) No 73/2009.

<sup>17</sup> Article 68 of Council Regulation (EC) No 73/2009. For further analysis of these issues see *Annex I*.

## AUDIT SCOPE, OBJECTIVES AND APPROACH

- 17.** The Court has already audited the implementation of the SPS in the 17 Member States applying the system since 2006. The results of these audits were reported in the respective Annual Reports.
- 18.** The Court also decided to carry out supplementary audit work in 2009 and 2010 for the purpose of the present report. This included further audit visits to the European Commission and three Member States (France, United Kingdom, Italy) as well as documentary analysis and review of studies and evaluations.
- 19.** This report focuses on the following:
  - the definition of the beneficiaries of the policy, the conditions of access to single payments and the definition of eligible land;
  - the contribution of the scheme to the objectives of supporting farmers' income and maintaining agricultural land in good agricultural and environmental condition;
  - the specific effects arising from the various implementing models of the scheme;
  - the errors linked to the complicated calculations required for the establishment of the payment entitlements.

## OBSERVATIONS

### THE BENEFICIARIES OF THE POLICY, THE CONDITIONS OF ACCESS TO SINGLE PAYMENTS AND THE SETTING UP OF KEY ELEMENTS OF THE SCHEME

- 20.** The audit identified a lack of precision in the definition of the beneficiaries of the SPS, of eligible activities and eligible land as well as significant discretion in the setting up and implementation of key elements of the scheme by Member States.

<sup>18</sup> Article 2 of Regulation (EC) No 1782/2003 and Article 2 of Commission Regulation (EC) No 795/2004 (OJ L 141, 30.4.2004, p. 1).

### DEFINITIONS OF 'HOLDING', 'AGRICULTURAL ACTIVITY' AND 'LAND AT THE FARMER'S DISPOSAL'

- 21.** The beneficiaries of the SPS are 'farmers' engaged in an 'agricultural activity' and having 'eligible land' at their 'disposal'. However, the lack of precision in the definition of these elements (farmer, agricultural activity etc.) and the manner in which they were subsequently applied permitted persons or entities having no or only marginal agricultural activity to benefit from the SPS payments.
- 22.** Legal provisions<sup>18</sup> define a **holding** as the totality of the production units which the farmer manages within the territory of the same Member State. A production unit is a plot of agricultural land (including forage areas) or an animal which has given right to direct payments in the reference period. **Agricultural activity** is the production, rearing or growing of agricultural products including harvesting, milking, breeding animals and keeping animals for farming purposes **or** maintaining the land in GAEC.
- 23.** The legal framework therefore does not require beneficiaries:
- (a) to own land or any other means of agricultural production,
  - (b) to be a producer of agricultural goods; and
  - (c) to earn one's income from the selling of the product of one's agricultural activity on a market.

- 24.** With respect to the availability of land, the initial legal framework for the SPS required applicants to have had at their disposal, for a period of at least 10 months<sup>19</sup>, eligible land corresponding to the number of payment entitlements they had in their possession. The provision, which was considered to be too restrictive, was replaced in 2008 by the obligation that land be **at the farmer's disposal on a fixed date**<sup>20</sup>. However, the legal provisions do not define the term 'at the farmer's disposal' or 'management of production units'. As a result, the declared land may be at the disposal of any other person for any period of time outside of this fixed date during the same calendar year, without this affecting the qualification of the claimant as a 'farmer'.
- 25.** Certain Member States have endeavoured to target SPS aid to specific categories of farmers. As an example, Luxembourg requires applicants to have the necessary agricultural machinery or equipment. In France, the authorities consider that a farmer is the person who bears the economic risks of the agricultural activities which he conducts on the land declared for SPS. This is the person who takes the economic decisions i.e. who acquires input factors (such as land, machinery, seeds, etc.) and derives his income from selling the produce of the farm.
- 26.** A beneficiary who carries out the agricultural activity required through salaried workers is considered to be a farmer. However, when the land is leased and the tenant bears the economic risk of the agricultural activity, he does not receive the SPS aid if the provisions of the lease agreement specify that the landowner remains the economic beneficiary of the activity carried out. The audit revealed a number of cases of this kind<sup>21</sup>. In such cases, SPS aid was paid to landowners on condition that the tenants maintain the land in GAEC on their behalf.

<sup>19</sup> Article 44(3) of Regulation (EC) No 1782/2003.

<sup>20</sup> Article 1(3) of Council Regulation (EC) No 146/2008 (OJ L 46, 21.2.2008, p. 1). Except in case of *force majeure* or exceptional circumstances, the parcels shall be at the farmer's disposal on the date fixed by the Member State which shall be no later than the date fixed in that Member State for amending the application for single payment.

<sup>21</sup> The Court had already reported on this practice in its Annual Report for the financial year 2006, paragraph 5.21.

## BOX 2

### BENEFICIARIES OF SPS AID WHO DO NOT BEAR THE ECONOMIC RISK OF FARMING

The Court's audit revealed a number of cases where a tenant farmer had been paid under a support scheme for less-favoured areas but where the single payment attached to this same parcel was paid to another beneficiary (the landowner). Such cases were frequent under the regional (hybrid) model because, in the year of introduction of the scheme, payment entitlements were allocated to every person who declared eligible land, regardless of whether he was or had been an agricultural producer.

### PAYMENT TO RETIRED FARMERS FOR MEETING MINIMAL GAEC OBLIGATIONS

- 27.** Prior to the SPS, i.e. under the former coupled payment schemes, when a farmer retired, he was no longer entitled to direct aid as he had ceased agricultural production. With the introduction of SPS, farmers who had disposed of their original holding could keep their entitlements and activate them on rented land on which they had no activity by entering into complex constructs designed to meet the requirements of the regulations. In such cases, those who took over the original holding could receive new entitlements from the national reserve.
- 28.** According to a study contracted by the Commission<sup>22</sup>, the introduction of the SPS delayed actual retirement of farmers, because the scheme allows them to keep their payment entitlements and holdings (which may only consist of low value rented land with minimal GAEC obligations). However, the national authorities could not provide the Court with reliable information about the scale of such cases. The Court found that in one Member State (France), in order to avoid such cases, the legislation provides that access to the national farmer pension scheme is only permitted if farmers transfer all their payment entitlements and land, with the possible exception of a subsistence parcel. In general, however, there is a risk that delayed exit from farming, encouraged by the introduction of the SPS, negatively impacts on the restructuring of the agricultural sector.

<sup>22</sup> Swinnen, J., Ciaian, P. and Kancs, D., 'Study on the functioning of land markets in the EU Member States under the influence of measures applied under the common agricultural policy', Brussels 2008, pp. 149–150. Evidence from several country studies (e.g. Belgium, Finland, Ireland, Sweden, United Kingdom) indicates that the SPS may constrain farm exit. In the United Kingdom many farmers' exit decisions appear to have been delayed until 2012 as they know the SPS will run at least until then. The study also suggests that this effect of the SPS works in combination with imperfect tradability of entitlements.

#### BOX 3

### BENEFICIARIES OF SPS WHO DISPOSED OF THEIR ORIGINAL HOLDINGS

In Italy, the Court found former producers of cereals and tobacco holding high-value payment entitlements who had transferred all their land to other farmers and rented at low cost poor pasture land in mountain regions considerably distant from their original holdings as well as from their residence. In practice, local farmers were allowed to graze their animals on that land free of charge which was considered adequate to maintain it in GAEC. In another case, a retired farmer had transferred his holding to family members and declared public land for the sole purpose of activating his entitlements without having any right of use of the declared land<sup>23</sup>.

<sup>23</sup> See paragraph 3.21 of the Annual Report concerning financial year 2009.

## NEW BENEFICIARIES

- 29.** Following the introduction of the SPS, the Court has identified a number of new beneficiaries whose agricultural activities form only an insignificant part of their overall economic activities or whose principal business does not consist of exercising an agricultural activity. Cases in point include recreational and sports clubs, railway companies, nature reserves, airports and city councils, hunting and sporting estates, government bodies, schools and camping sites.
- 30.** Among these new beneficiaries, the audit identified investors who purchased payment entitlements (sometimes of high value) which they activated on low-value land, thus making very attractive guaranteed returns on their investments (see paragraphs 66 and 67).
- 31.** During the Health Check, it was acknowledged that agricultural income support should not be allocated to 'natural or legal persons whose agricultural activities form only an insignificant part of their overall economic activities or whose principal business or company objects do not consist of exercising an agricultural activity'<sup>24</sup>. However, the regulation left it to the Member States to exclude such beneficiaries through appropriate legal provisions. No Member State has yet made use of this option and SPS aid is still paid to these beneficiaries. Neither the Member States visited nor the Commission have precise information on the number of such beneficiaries and the amount of SPS aid they received. Given that the national ceilings are fixed, the acceptance of such new beneficiaries reduces the amount of aid available for the principal target beneficiaries of SPS aid.

<sup>24</sup> Article 28(2) of Regulation (EC) No 73/2009.



## MEMBER STATES SET UP IN VERY DIFFERENT WAYS KEY ELEMENTS OF THE SPS SCHEME

- 32.** The detailed implementation of a number of key elements of the SPS is left to the Member States. Cases in point include the access of new entrants, the definition of the minimum agricultural activities that have to be carried out on the land declared or the conditions for benefiting from the consolidation of payment entitlements.

### ACCESS OF NEW ENTRANTS TO THE SPS IS LARGELY DEPENDENT ON MEMBER STATES' IMPLEMENTATION POLICIES

- 33.** Persons who wish to take up farming activities have in principle no right to aid under the SPS, unless they acquire an eligible agricultural holding together with the attached payment entitlements, or buy such entitlements on the market. Member States are also authorised to use their national reserves to grant payment entitlements to new farmers who commence their agricultural activity. This is under condition that they had no agricultural activities in their own name or at their own risk in the five years preceding the start of their agricultural activity<sup>25</sup>.
- 34.** The audit found that some Member States used the reserve as a policy instrument to promote entry into the agricultural sector by providing new farmers with payment entitlements.
- 35.** In other Member States, however, in spite of a demand for payment entitlements by new farmers, there is no specific policy and there are no appropriations available in the national reserve. Hence, new entrants have to acquire payment entitlements which may entail substantial investments and place significant barriers to entry. With the passage of time, more and more new farmers may experience difficulty in obtaining payment entitlements. Meanwhile, 57,5 % of farmers in the European Union are over 55 years and one in three is over 65 years old<sup>26</sup>. It is therefore in the interest of a dynamic and innovative farming sector to facilitate the establishment of new active farmers.

<sup>25</sup> Article 41(2) of Regulation (EC) No 73/2009 and Article 2(l) of Commission Regulation (EC) No 1120/2009 of 29 October 2009 laying down detailed rules for the implementation of the single payment scheme provided for in Title III of Council Regulation (EC) No 73/2009 (OJ L 316, 2.12.2009, p. 1).

<sup>26</sup> Eurostat pocketbooks — Agricultural statistics — Main results 2007–2008 (2009 edition).

### ELIGIBLE LAND AND MINIMUM AGRICULTURAL ACTIVITIES REQUIRED HAVE NOT ALWAYS BEEN CLEARLY DEFINED

- 36.** There are three types of eligible land — arable land, permanent pastures and permanent crops<sup>27</sup>. However, the detailed specifications as to what constitutes an eligible parcel are left to Member States. In some Member States marginal land and wooded areas traditionally used for occasional grazing are accepted as being eligible while, in other Member States, such land is excluded from SPS aid. Such marginal land can quickly become overgrown with shrubs and forest, making it unsuitable for agricultural purposes.
- 37.** As regards the definition of the concrete activities farmers have to carry out to maintain their land in GAEC, the EU legislation sets out only general objectives with respect to soil erosion, soil organic matter, soil structure and the minimum level of maintenance required. This latter aspect is of particular importance for land that is no longer used for production purposes. The definition of the minimum standards to be observed is left to the discretion of Member States, which adapt them to the specific characteristics of the regions. As a consequence farmers may receive annual payments without having to carry out any specific maintenance activity or only minimal infrequent activity, such as combating encroachment of unwanted vegetation or cutting grass once every three or five years. Where farmers fail to do even the minimum stipulated, they risk a moderate reduction of SPS payments under the cross-compliance rules<sup>28</sup>.

<sup>27</sup> Article 2(h) of Regulation (EC) No 73/2009.

<sup>28</sup> The Court has already observed that the sanction system for cross-compliance is weak both in its conception and its application: Special Report No 8/2008: 'Is cross-compliance an effective policy?' (<http://eca.europa.eu/portal/page/portal/publications/auditreportsandopinions/specialreports>).

## BOX 4

## BROAD DEFINITION OF ELIGIBLE LAND AND MINIMUM AGRICULTURAL ACTIVITIES

The provisions concerning GAEC have a considerable impact in the United Kingdom (Scotland), where the major part of agricultural land is rough grazing land, nearly half of which is declared under the SPS<sup>29</sup>. Most of this land is situated in less-favoured areas. The applicable national rules for less-favoured areas require that the land be actively farmed. In contrast, under the SPS the same land is eligible on the sole condition that claimants commit themselves **not to carry out** specific activities that would change the natural state of the land e.g. drainage works or ploughing. The Court identified individual beneficiaries in receipt of between several hundred thousand and up to more than 1 million euro per year in SPS aid without having any agricultural activity on such land, including a nature reserve which for decades has not been used for farming. It is estimated that SPS aid is currently paid in relation to approximately 150 000 hectares of such parcels.



Source: European Court of Auditors.



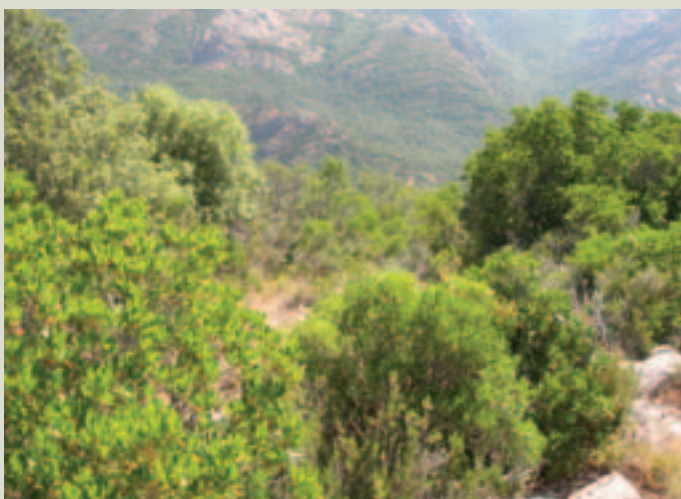
In Spain, partially wooded and rocky mountain grazing land was considered eligible even though farmers were not required to carry out any particular maintenance. Stocking density requirements to ensure the maintenance of permanent pastures at an appropriate level were only optional.

Source: European Court of Auditors.

<sup>29</sup> In 2008, some 2,375 million ha of the 4,557 million ha of agricultural land declared under the SPS were rough grazing land. This land — of which, according to statistical information, there are some 4,027 million ha — can be found on mountains, hills, moors and heaths. Rough grazing land is for the most part covered with heather and bracken and relatively unproductive. Traditional farmers use it usually only for extensive grazing of sheep.

## BOX 4

In Italy, permanent pasture has to be mowed or grazed by animals. This obligation applies also to wooded or mountain areas used for grazing. The national authorities introduced a system of reduction coefficients to identify ineligible areas devoid of grass vegetation. As the Court has already pointed out in its Annual Report for the financial year 2007, the reduction coefficients underestimated such areas.



Source: European Court of Auditors.

The Court also found that, in Italy, beneficiaries are still paid on the basis of incorrect land use information, although the parcels declared have reverted to their natural state and can no longer be used for grazing farm animals.

In France, the national rules oblige farmers to maintain land in GAEC through the grazing of animals or annual mowing of the land, but specific standards can be adopted at local level. This has resulted in a situation where, in certain regions, full payment of the SPS aid can be obtained for parcels that contain up to 30 % of ineligible areas, such as rocks, bushes and trees.



Source: European Court of Auditors.

### TEMPORARY USE OF LAND FOR NON-AGRICULTURAL ACTIVITIES

- 38.** When the SPS was introduced, the legislation did not allow the payment of aid when parcels were used for non-agricultural activities. As a result of the Health Check<sup>30</sup>, such land is now considered as eligible as long as the agricultural activity can be exercised without being significantly hampered by the intensity, nature, duration and timing of the non-agricultural activity<sup>31</sup>. However, the precise definition of such situations is left to the Member States. The Court found cases where the national authorities had allocated payment entitlements which were activated for parcels of land used primarily for recreational activities.

### ADVERSE EFFECTS OF THE CONSOLIDATION OF PAYMENT ENTITLEMENTS

- 39.** The payment of SPS aid is associated with the objective of avoiding the abandonment of agricultural land<sup>32</sup>. Under the historical model, to obtain the full theoretical amount of payments, farmers must continue to farm the same number of hectares which they farmed during the reference period<sup>33</sup>. The legislation<sup>34</sup> provides for exceptions for farmers who were affected by restructuring and development programmes. Farmers affected by such measures could have their historical payment entitlements exchanged for a smaller number of entitlements with a higher unit value. This procedure is called 'consolidation'. Farmers need less land to activate their payment entitlements while they maintain their historical level of aid. Cases in point include agricultural land that was afforested under a public programme or farmers who had lost some of their parcels due to the reorganisation of agricultural land in the framework of re-parcelling.

<sup>30</sup> Article 34(2)(a) of Regulation (EC) No 73/2009.

<sup>31</sup> Article 9 of Regulation (EC) No 1120/2009.

<sup>32</sup> See recitals 2 and 3 of the preamble to Regulation (EC) No 1782/2003.

<sup>33</sup> These were as a general rule the average number of hectares on which they had cultivated subsidised crops or the forage areas that had been available throughout the year for the animals that had been subject to premium payments.

<sup>34</sup> Article 42(5) of Regulation (EC) No 1782/2003. This measure is continued for the direct aids that are still (partly) coupled to production and that will be integrated into the SPS by 2012.

40. The Court found that consolidation of payment entitlements occurred in circumstances other than those foreseen by the legislation.
41. As farmers who benefited from such consolidation need less land to receive the same amount of aid, the remaining land can be taken up by any other farmer who can activate his own payment entitlements on it or by a new farmer who receives payment entitlements from the national reserve. As a result, more aid is paid in relation to the same area. Alternatively, there is a risk that the excess land is abandoned and no longer maintained in GAEC.

**BOX 5****CONSOLIDATION IN CIRCUMSTANCES NOT PROVIDED FOR BY THE REGULATIONS**

In France, the Court found that the authorities did not take into account the totality of agricultural land which certain milk producers had in their possession when the dairy premium was decoupled in 2006 and apportioned the amount of this premium to a much smaller surface of land. In one case the farmer who had previously used 70 ha had his entitlements apportioned to only 2 ha. By the same token, common pasture land which beneficiaries of extensification payments had used in the reference period as forage areas was also not taken into account. This effectively allowed beneficiaries to consolidate their payment entitlements on smaller land areas in circumstances not provided for by the regulations.

## A HIGH PROPORTION OF SPS AID GOES TO LARGER FARMS AND THE SCHEME'S CONTRIBUTION TO ENVIRONMENTALLY FRIENDLY AGRICULTURE IS LIMITED

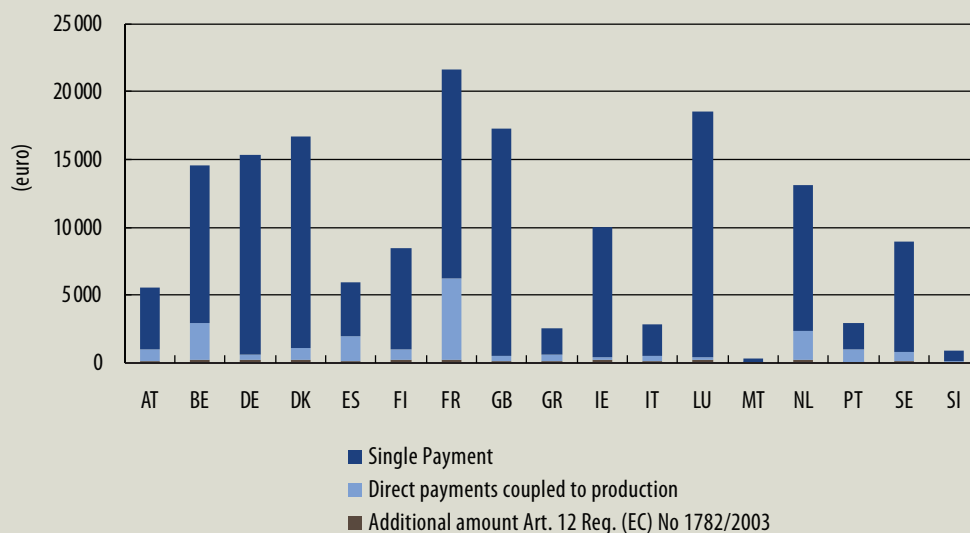
### SPS AID REPRESENTS AN IMPORTANT SHARE OF FARMERS' INCOME BUT NO DISTINCTION IS MADE BETWEEN LOW AND HIGH-INCOME FARMERS

42. In 2008, there were 4,49 million beneficiaries of SPS aid while total payments under the scheme amounted to 28,7 billion euro for application year 2008<sup>35</sup>. However the level of income support varies significantly between Member States and between farmers. The distribution of SPS between Member States largely depends on their size and on the importance of their agricultural sectors as reflected in the national ceilings. The distribution between individual beneficiaries depends on the implementation model chosen by the Member State, the surface of the agricultural land farmed during the reference period, the level of subsidy in the sector in which the farmers were engaged in the reference period and the number of hectares they currently farm.

<sup>35</sup> For details on payments made under the SPS see *Annex II*.

GRAPH 1

### DIRECT PAYMENTS PER HOLDING IN 2008



Source: European Court of Auditors on the basis of payment data from the European Commission.

- 43.** Direct payments, comprising SPS and coupled aid, represent an important share of farm income<sup>36</sup>, which indicates the high dependency of the farm sector as a whole on EU support. The Court notes, however, that across the EU 74,4 % of farmers work part-time i.e. they do not earn their full income from agriculture<sup>37</sup>.
- 44.** While the SPS appears to meet its objective of contributing significantly to farmers' income, the distribution of subsidies to individual farmers remains essentially based on the surface of land farmed and thus a high proportion of SPS aid still goes to large farms, as was the case under the previous system. There is a contradiction in the design of the SPS which is on the one hand intended as a support to individual income and the fact that its distribution takes little account of the specific circumstances of the recipient.

#### **ANALYSIS OF DISTRIBUTION: THE SPS PRIMARILY BENEFITS FEW BUT LARGE BENEFICIARIES**

- 45.** The 2003 CAP reform retained the concept of compensation payments, meaning that the new SPS should result in maintaining approximately the amount of subsidies a farmer formerly received under the previous direct aid scheme. In all models, large farms have a higher level of income support<sup>38</sup>.

<sup>36</sup> According to Eurostat, between 2005 and 2008 in the EU-15 the share of direct payments represented 30 % of the factor incomes and between 52 and 56 % of the entrepreneurial income. The agricultural factor income is the net value added at factor cost and is calculated by subtracting from the value of agricultural output at basic prices [= producer price + product related subsidies – product related taxes] the value of intermediate consumption, the consumption of fixed capital and production taxes, and adding the value of other subsidies on production. The agricultural entrepreneurial income represents the share of the income generated by the farming activities which is used to reward its own production factors (work and/or enterprise, own capital and owned land).

<sup>37</sup> According to Eurostat, in 2007, the share of part-time farmers varied from 33 % in Belgium to 90 % in Malta.

<sup>38</sup> Thus, in the historical model farms with a historically high level of direct payments still receive a high level of income support, provided they farm a similar number of hectares. In the hybrid and the regional models entitlements were allocated in the first year on a strict per hectare basis. Even though this has led to certain redistribution effects between farmers in various sectors (for example there could be income support losses for intensive dairy farms and income support gains for farms with extensive cattle and sheep production), the close association of entitlements with agricultural land resulted again in significant payments being made to the larger farms.



46. At farmer level, the historic and, to a certain extent, the hybrid models conserve the significant sector-specific individual differences of past support levels. The Commission's analysis of the distribution of payment entitlements in terms of value per hectare shows that this has resulted in significant differences between Member States having opted for the historical model and those which introduced a hybrid model<sup>39</sup>. This is particularly evident in Member States with sectors that benefited from high support levels per hectare such as olive oil, cotton or raw tobacco, even though the size of the individual holdings could be relatively small. In Member States with intensive animal production, such as the Netherlands, SPS aid per hectare can also be high where farms have little land in relation to their animal production activities while, in areas with extensive farming, payments per hectare can be very low. Only in Denmark, Germany and the United Kingdom (England) is this situation going to gradually disappear by 2013, because these Member States have decided to reduce the historical component in favour of a uniform value of each payment entitlement.

<sup>39</sup>The Commission analysed the distribution of payment entitlements in context of the 2008 Health Check of the CAP. See Annex I, Figure 3 of 'Health Check — Impact Assessment Note No 1' dated 20.5.2008, document D (2008) AH/15325CAP.

## BOX 6

### DIFFERENCES IN UNIT VALUES OF ENTITLEMENTS UNDER THE HISTORIC MODEL

Depending on the intensity of production, in the olive oil sector, aid to production varied between several hundred and several thousand euro per hectare. In the tobacco sector, aid amounted to several thousand euro per hectare. In the cotton sector, coupled aid included in the reference amount was between 966 euro per hectare in Greece and 1 202 euro per hectare in Portugal. Payment entitlements for animal premiums can have unit values per hectare of up to 5 000 euro in cases of intensive production. On the other hand the unit value of payment entitlements in areas with extensive farming of sheep and goats can have negligible value.

47. The analysis of the distribution of SPS aid among beneficiaries highlights the concentration of support on a small number of farmers. In 2009 (for the application year 2008), 84 % of beneficiaries received less than 10 000 euro, representing 25 % of the total value of payments. Conversely, 0,41 % of beneficiaries received over 100 000 euro, representing 12,78 % of the total value of payments<sup>40</sup>. This is illustrated by **Table 2** and **Graph 2**.

<sup>40</sup> For more details see *Annex III*.

<sup>41</sup> Article 7(2) of Regulation (EC) No 73/2009.

48. In the framework of the Health Check of the CAP, the Commission considered capping direct payments to individual beneficiaries. The Council finally decided<sup>41</sup> to marginally increase the compulsory modulation for very large beneficiaries and to subject payments in excess of 300 000 euro to an additional modulation of 4 %. This additional adjustment which affects a very limited number of beneficiaries (approximately 2 500) does not significantly impact the overall distribution of the aid.

TABLE 2

DISTRIBUTION OF SPS PAYMENTS (APPLICATION YEAR 2008)

Annual payment of SPS support (euro)	Number of beneficiaries	% out of total beneficiaries	% of amount received out of total payments
< 500	1 395 721	31,08 %	1,18 %
≥ 500 and < 5 000	1 912 824	42,60 %	12,48 %
≥ 5 000 and < 10 000	458 464	10,21 %	11,43 %
≥ 10 000 and < 50 000	642 954	14,32 %	47,67 %
≥ 50 000 and < 100 000	62 210	1,39 %	14,46 %
≥ 100 000 and < 300 000	15 927	0,35 %	8,30 %
≥ 300 000 and < 500 000	1 500	0,03 %	1,99 %
≥ 500 000 and < 1 000 000	783	0,02 %	1,81 %
≥ 1 000 000	144	0,00 %	0,68 %
<b>Grand total</b>	<b>4 490 527</b>		

Source: European Court of Auditors based on European Commission payment data (CATS).

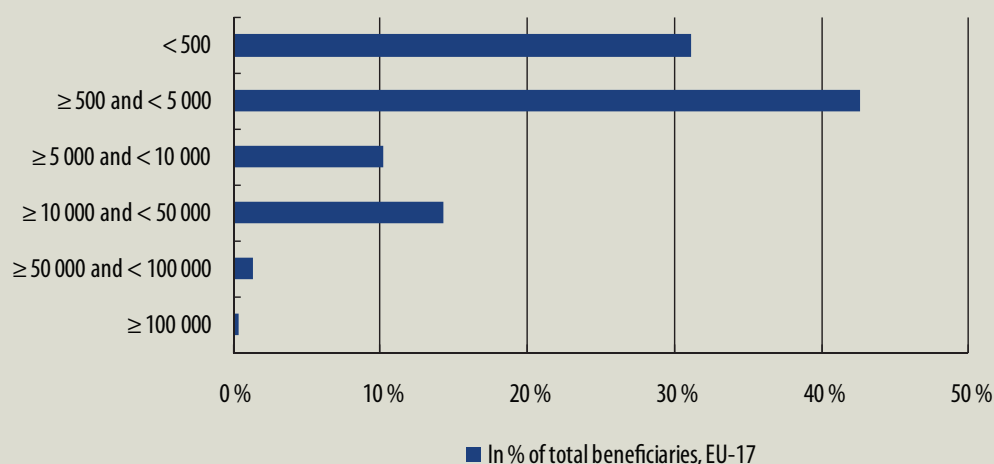
### THE SPS SUPPORT REFLECTS NEITHER THE COSTS OF MAINTENANCE OF LAND NOR THE POSITIVE PUBLIC EXTERNALITIES

- 49.** The 2003 reform made full payment of SPS aid to farmers conditional upon complying with environmental and sustainable farming obligations (so-called cross-compliance obligations) introduced by that reform. Cross-compliance has, thus, become an important argument in justifying payments to farmers. These standards, most of which already existed before the 2003 reform, are considered to 'entail ... an increase in the costs of production for agricultural holdings in the Community'<sup>42</sup>.
- 50.** Maintenance of land in GAEC is of public interest, because the production potential of the land is conserved and because of other positive effects that can result from regular maintenance, for example protection of water against pollution, prevention of fire or preservation of landscape features and habitats.

<sup>42</sup> Recital 24 of Regulation (EC) No 1782/2003.

GRAPH 2

#### DISTRIBUTION OF SPS INCOME SUPPORT IN 2008 (EURO PER YEAR)



Source: European Court of Auditors based on European Commission payment data (CATS).

- 51.** There is no direct link between SPS aid and the costs incurred by farmers for complying with compulsory standards for farming practices under cross-compliance nor have such costs been quantified. It is therefore possible that farms in high-yield areas receive a high level of aid without particularly exacting GAEC obligations while, on the other hand, a farm in a low-yield area with heavy GAEC obligations will receive only a low level of aid.
- 52.** Failure to comply with cross-compliance obligations, as a rule, only results in a reduction of the full amount of SPS and other aid paid to the non-compliant farmer. The Court has noted that in practice such reduction is negligible for the most part and seldom applied (if only because it often goes undetected, as the number of farmers annually checked for cross-compliance is very low)<sup>43</sup>.
- 53.** It is also not possible, at present, to establish a direct link between SPS aid and the positive public externalities resulting from agricultural activities, i.e. the services beneficiaries of SPS aid render to the public at large in respecting environmental requirements in the operation of their farm and in maintaining agricultural land in GAEC.

<sup>43</sup>Special Report No 8/2008 'Is cross-compliance an effective policy?'

## **SPECIFIC EFFECTS ARISING FROM THE DESIGN OF THE SCHEME AND MEMBER STATES' IMPLEMENTATION POLICIES**

### **A PATCHWORK OF MODELS, VARIANTS AND IMPLEMENTATION POLICIES ACROSS MEMBER STATES**

- 54.** As mentioned above, numerous implementing options are opened to Member States, each model involving complicated calculations of individual entitlements to aid.

- 55.** Most Member States of the EU-17 opted for the historic model. Only Malta and Slovenia opted for immediate transition to a regional flat-rate model. In Denmark, Germany and one region of the United Kingdom (England), after a transitory period for farmers to adjust to new conditions, the dynamic hybrid model will result in a full regional model so that farmers in the same region will hold payment entitlements of a uniform value per hectare.
- 56.** For specific sectors, Member States could opt for **either partial or full decoupling**. They could also introduce new specific aids that were linked to quality production in specific farm sectors<sup>44</sup>.
- 57.** As a consequence of the wide gamut of options, each of the 17 Member States has implemented the scheme in its own way. Currently, 20 different models and variants are applied<sup>45</sup>. This situation has not allowed for the intended simplification of the income support system to produce its full effect, particularly in Member States where part of direct payments remains coupled to production. The new options opened to Member States within the framework of the Health Check, whereby they could move towards a 'flatter' rate system, have not substantially changed the situation.
- 58.** The wide gamut of implementing options has important consequences on the distribution of SPS among farmers across Member States. This distribution varies depending largely on the model adopted. This means that the SPS is currently a poorly targeted method to provide income support.

<sup>44</sup> Article 69 of Regulation (EC) No 1782/2003.

<sup>45</sup> See *Annex I*.

## **OVER TIME, THE HISTORIC MODEL HAS BECOME DIVORCED FROM PRODUCTION ...**

### **SPS AID IS NOT BASED ON CURRENT ACTIVITY**

- 59.** In the historic model, the level of SPS aid depends on whether the farmer's activity benefited from direct aid in the reference period (as a rule years 2000, 2001 and 2002). Similarly, in the hybrid model, the historical component of the value of the payment entitlement still reflects the level of the sector-specific aid received by each farmer. As mentioned earlier, the concept of 'compensation' in the context of reducing intervention prices was the guiding principle. However, there is only a tenuous link between historical support levels and current market demand, the agricultural potential of the land farmed, farm structures and environmental criteria.
- 60.** Farmers who did not receive payment entitlements, because in the reference period their activity was not eligible for direct aid to production, do not benefit from SPS aid, even if they have in the meantime changed production. In order to benefit from such aid, they must purchase payment entitlements on the market.
- 61.** This can lead to situations whereby two farmers, currently growing the same crop on surfaces of the same size in the same region, are treated very differently depending on what they produced in the reference period and on whether as a consequence they received payment entitlements.
- 62.** As a result of the Health Check, the Council recognised that, with the passage of time, it was becoming increasingly difficult to justify significant individual differences in support levels which were only based on past activities. In this regard, it was the Commission's intention to introduce a 'flatter' system, i.e. levelling out the wide divergences in individual payment entitlements. However, no Member State has yet decided to apply any of the options made available to them under the Health Check reforms and to revise the model chosen.

**UNDER THE HISTORIC MODEL, TRADING OF PAYMENT ENTITLEMENTS  
ALLOWED SPECULATIVE<sup>46</sup> TRANSFERS AND ACCUMULATION OF PAYMENT  
ENTITLEMENTS TO OCCUR**

- 63.** With the introduction of the SPS, entitlement to payment was separated from the land: payment entitlements may be traded independently of the transfer of the land on which they were generated and they can be activated on whatever type of eligible land, whatever the agricultural activity carried out on this land. This paved the way for the emergence of markets for payment entitlements which are traded in and outside the regions of their establishment.
- 64.** A market for payment entitlements was considered as a means of increasing the efficiency of the support scheme. The economic reasoning behind this assumption is that, once payment entitlements have been allocated, farmers can only increase their level of aid by acquiring additional payment entitlements from other holders, either with or without land. It is anticipated that, in an open and transparent market, payments entitlements will go to those farmers who are willing to pay the most for them, which contributes to an efficient allocation of support.
- 65.** EU legislation provides for several options regarding the transfer of payment entitlements<sup>47</sup>. Certain Member States restricted the trading of payment entitlements without land by limiting the activation of such entitlements to the regions where they had been generated (France, United Kingdom (England)) or by applying 'retentions' to certain transfers of entitlements with or without land (e.g. France). In this latter case, the value of each payment entitlement transferred is reduced by a certain percentage. Other Member States did not consider restricting transfers of entitlements (United Kingdom (Scotland)) or even abolished the application of retentions to encourage trading<sup>48</sup>. The latter choice was motivated by concerns that farmers wishing to sell payment entitlements were hesitating to do so, because the retentions would have significantly reduced the value of the future payments and therefore the sale price of each payment entitlement.

<sup>46</sup> Speculative is used in this section in the sense of 'transfer and accumulation of payment entitlements without a corresponding agricultural basis'. Recital 28 of Regulation (EC) No 73/2009 and recital 30 of Regulation (EC) No 1782/2003 refer.

<sup>47</sup> Article 46 of Regulation (EC) No 1782/2003; Article 43 of Regulation (EC) No 73/2009.

<sup>48</sup> Since 2005, Italy had applied 'retentions' of up to 50% on the value of payment entitlements sold without land (as permitted by Article 9 of Regulation (EC) No 795/2004). In 2007, these restrictions were abolished. As a consequence, the value of payment entitlements transferred without land increased from 1,3 million euro in 2006 to 65,2 million euro in 2009.

- 66.** The Court found that the absence of regulation of such transfers and the heterogeneous agricultural potential of land resulted in adverse effects: the possibility to lease marginal land with low opportunity costs and for which beneficiaries do not have to respect particularly exacting GAEC obligations helped pave the way for speculative acquisitions and the accumulation of payment entitlements without land by investors who activate these entitlements on parcels of land not requiring any 'real' agricultural activity.
- 67.** The Court's audit confirmed cases of investors who had acquired high-value payment entitlements which had been generated in fertile regions and in intensive production sectors but which the investor activated on marginal land of little market value, distant from their own holding or residence and requiring no or minimal agricultural activity. As underlined above, this has already resulted in the creation of a category of beneficiaries complying with minimal GAEC obligations but receiving substantial guaranteed income.

**BOX 7****EXAMPLES OF INVESTMENT CASES**

In its Annual Report concerning the financial year 2008, the Court reported cases of claimants in the United Kingdom (Scotland) who purchased high-value payment entitlements and rented at very low rates large tracts of land requiring only minimal or even no maintenance activity. In 2007 and 2008 40 % of the payment entitlements transferred without land had been activated on rough grazing land. Almost all the additional land that has been declared in Scotland for SPS since 2007 (ca. 58 000 ha) was rough grazing land (ca. 50 000 ha), even though the number of sheep in Scotland has been declining for a number of years.

In Italy, where the GAEC standards require that the land be mowed or grazed, the Court identified beneficiaries who had acquired payment entitlements and leased pasture land in marginal areas. For example, one beneficiary acquired payment entitlements without land in 2008 at almost their face value of ca. 197 000 euro. After modulation, the payment entitlements under current conditions would provide the beneficiary, until 2013, total income support of ca. 1 088 000 euro. The beneficiary activated almost all of these payment entitlements on 45 ha of leased poor pasture land located 400 km away from his permanent residence. The annual lease price for the land was 7 650 euro. The beneficiary does not carry out any agricultural activity on this land while grazing rights are assigned to a local farmer, free of charge, to respect the GAEC obligations of the beneficiary.



- 68.** The EU legislation opened to Member States the possibility to adopt appropriate rules to avoid speculative transfers leading to the accumulation of payment entitlements by beneficiaries without a corresponding agricultural basis<sup>49</sup>. However, such provisions are optional.

<sup>49</sup> See recital 30 of Regulation (EC) No 1782/2003 and recital 28 of Regulation (EC) No 73/2009.

<sup>50</sup> Article 42(9) of Regulation (EC) No 1782/2003 and Article 10 of Regulation (EC) No 795/2004.

<sup>51</sup> Annual Report concerning the financial year 2006, paragraphs 5.33 and 5.34.

#### **INEFFECTIVE CORRECTION MECHANISMS TO DEAL WITH WINDFALL PROFITS**

- 69.** Under the historic and regional (hybrid) models, farmers who had ceased or reduced their activity after the reference period could be subjected to the 'windfall profit clause'<sup>50</sup>. This provided for their entitlements based on their activity during the reference period to be reduced by up to 90 %. The proceeds of these reductions are credited to the national reserve. The windfall profit clause however only applied to transfers that occurred up to 15 May 2004.
- 70.** Belgium, France, Denmark, Italy, Luxembourg, Greece and Sweden chose to apply this clause, although limiting it to farmers in certain sectors. In the other Member States, farmers were allowed to keep all of their historical entitlements.
- 71.** In Italy and France, the Court found cases where farmers had transferred tobacco premium rights after 15 May 2004 and thus received the high-value payment entitlements deriving from their former production of tobacco without the authorities being entitled to 'claw back' a part of the corresponding amounts.
- 72.** Another case was disclosed in the Court's 2006 Annual Report<sup>51</sup>: 'Payment entitlements from the national reserve may be allocated to farmers who made investments in production capacity or purchased land. In the United Kingdom a 10 % increase in income was considered sufficient evidence of an investment. Paradoxically by increasing the number of cattle slaughtered during 2002 (i.e. destocking) farmers could meet this investment criterion. Consequently there was a general run on cattle premiums'. As a result, farmers who slaughtered all cattle on the holding before the end of the reference period were entitled to keep all their historic reference amounts for the duration of the SPS.

- 73.** In 2009, the Council adopted the Commission's proposal to modify the windfall profit rules and open an option for Member States to claw back up to 100 % of the reference amounts on windfall profits that farmers may realise in the sectors where the remaining coupled support will be integrated into the SPS by 2012<sup>52</sup>. However, such provisions are optional and do not correct any of the old cases in which the clause had not been applied.

### **... BUT THE REGIONAL MODEL GENERATES OTHER ADVERSE EFFECTS**

#### **ALTHOUGH REGIONALISATION LEADS TO A MORE EQUAL DISTRIBUTION OF AID, IT STILL FAVOURS LARGER FARMS**

- 74.** The regional model is associated with uniform unit values of payment entitlements across the region concerned, irrespective of the type of agricultural activity carried out before the introduction of the SPS. In the dynamic hybrid version, where the regional model is gradually introduced and that is currently applied in Denmark, Germany and the United Kingdom (England), the historical component is being gradually reduced and redistributed across all payment entitlements in the region. The Court already highlighted in its Annual Report 2006 that 'there will be a significant redistribution effect on EU direct aid away from those actually farming and towards landowners, who will see the value of their entitlements multiplied by four in Denmark and Germany and tenfold in England'<sup>53</sup>. This applies, in particular, to new beneficiaries who did not receive direct payments under the former coupled scheme.
- 75.** Notwithstanding this specific redistribution effect, payment entitlements under the regional or hybrid model are allocated in the first year on a strict per hectare basis so that large farms remain the main beneficiaries of the aid. Consequently, farmers using a smaller surface of land, for example intensive bovine farmers, see their income support reduced compared to their historical level of coupled payments. Moreover, according to the Commission, sectors that currently face economic difficulties, such as milk production, would suffer losses in the amount of aid they receive if the Member States in which they operate were moving towards regionalisation, because they farm on average less agricultural land than farmers in other sectors<sup>54</sup>.

<sup>52</sup> Article 41(6) of Regulation (EC) No 73/2009 as amended by Regulation (EC) No 1250/2009 (OJ L 338, 19.12.2009, p. 1).

<sup>53</sup> Annual Report concerning the financial year 2006, paragraph 5.28.

<sup>54</sup> 'CAP Health Check — Impact Assessment — Impact of a change towards flatter rates of direct payments', European Commission, December 2007.

#### REGIONALISATION AND POSSIBLE CAPITALISATION OF SUPPORT IN LAND PRICES

**76.** Under the regional (and hybrid) models, the number of payment entitlements is very close to the overall number of hectares of eligible agricultural land<sup>55</sup>. This situation had an important effect on land prices, because farmers with more payment entitlements than land were prompted to lease land for the purpose of activating the largest part possible of their payment entitlements. This pushes up the overall demand for leased land and results in higher land lease prices.

**77.** While ‘capitalisation’ of the aid in land prices could be observed under the former area-related aid schemes, several studies concluded, independently from one another, that the introduction of the SPS has not reduced and sometimes aggravated this effect, particularly in Member States that opted for the regional model and where there is a high dependence on leased agricultural land. This reduces the efficiency of the support payments, because farmers have to pay more for agricultural land than before the reform. The impact of SPS on land rents is considered to be stronger than on land sale prices and the ‘capitalisation’ depends on the percentage of leased farmland available. The Court sees in this situation a risk that the extension of regionalisation to other Member States, as envisaged in the framework of the Health Check, could significantly affect the profitability of farms<sup>56</sup>.

#### ADJUSTMENT TO REGIONAL DIVISION AND REVISION OF UNIT VALUES OF ENTITLEMENTS ARE OPTIONAL

**78.** When the SPS was introduced, Member States which preferred a regional form of implementation had to define the perimeter of the regions on the basis of objective criteria. They justified their decisions on this matter on the basis of their administrative structure<sup>57</sup>, the agricultural potential of the regions defined<sup>58</sup> or specific farming patterns<sup>59</sup>.

<sup>55</sup> This is due to the fact that the regional and the hybrid model included nearly all eligible land into the SPS, whereas in the historical model only the land farmed under a coupled aid scheme and forage areas were included into the number of payment entitlements.

<sup>56</sup> Swinnen, J., Ciaian, P., and Kancs, D., ‘Study on the functioning of land markets in the EU Member States under the influence of measures applied under the common agricultural policy’, Brussels 2008, pp. 141–145; Salhofer, K., Röder, N., Kilian, S., Henter, S. and Zirnbauer, M., ‘Märkte für Zahlungsansprüche’, Endbericht zum Forschungsauftrag 05HS041 des Bundesministeriums für Ernährung, Landwirtschaft und Verbraucherschutz, Bonn, 2009; von Witzke, H., Noleppa, S. and Kennedy, P. L., ‘Effects of the EU common agricultural policy and US farm policy on agricultural land markets’, Washington DC, 2007.

<sup>57</sup> Germany, United Kingdom.

<sup>58</sup> In Sweden and Finland the design of regions was based on reference yields. In the United Kingdom (England) the decision for a regional form of implementation was primarily motivated by national strategies for sustainable farming. Support levels in England were however differentiated between severely disadvantaged areas (e.g. moorland) and normal land which indirectly takes account of the agricultural potential of the land.

<sup>59</sup> United Kingdom (Northern Ireland). In Denmark, a regional implementation was chosen that initially entailed the lowest redistribution among aid recipients.

- 79.** As a result of the Health Check, the Council adopted a Commission proposal which allowed Member States applying the historic model to bring the unit values of payment entitlements closer to one another or to change over to a (full or hybrid) regional model. Member States that had opted for a regional model may review their decisions, revise the design of the regions and bring the value of the entitlements across regions closer to one another. These decisions have to be taken 'on the basis of the objectives laid down in Article 33 of the Treaty' (now Article 39) and on the basis of objective and non-discriminatory criteria such as the agricultural potential and environmental considerations. These measures are intended to give Member States an increased flexibility to target direct support. To date, no Member State has decided to revise its model.

#### THE INTRODUCTION OF THE SPS REQUIRED COMPLICATED CALCULATIONS AND RESULTED IN CASES OF ERRORS

- 80.** The Court's audit established that, in general, national authorities calculated the value of payment entitlements in accordance with the EU legislation. However, errors were noted as a result of erroneous or missing historical reference data, of failure to update such data where changes in holdings or status had occurred, of defective treatment of applications for payment entitlements from the national reserve. To date such errors have not yet been completely corrected.
- 81.** In its Annual Reports for financial years 2006, 2007 and 2008, the Court reported shortcomings in the calculation of payment entitlements and in the application of rules governing the operations of national reserves<sup>60</sup>.

<sup>60</sup>In France, the authorities had adopted several ineligible programmes under which farmers had received payment entitlements, had accepted short-term rented equipment as investments and had failed to systematically apply mandatory provisions to new farmers who commenced farming during the reference period. The undue allocations of payment entitlements materialised since 2006 in annual payments amounting to some 60 million euro (Annual Report concerning the financial year 2007, paragraphs 5.21 to 5.25). In Italy, irregular allocations of entitlements for new olive oil trees planted after the stipulated deadline and not covered by a specific programme and the generous recognition of hardship cases and for ineligible areas have not been corrected at the time of the audit (Annual Report concerning the financial year 2007, paragraph 5.14). In the United Kingdom (England), the authorities were still working, at the end of 2009, on the correction of entitlements that had been wrongly allocated in 2005 (Annual Report concerning the financial year 2006).

- 82.** The Court reviewed the follow-up work that the Commission had carried out on the errors that occurred during the implementation of the SPS. At the time of the audit, procedures were still under way and only one formal conformity clearance decision had been taken and published<sup>61</sup>.
- 83.** The Court notes that the Council decided<sup>62</sup> that all payment entitlements allocated before 1 January 2009 be deemed legal and regular as from 1 January 2010 unless they had been allocated on the basis of factually incorrect applications. While this gives legal certainty to farmers, it means that financial corrections decided pursuant to the conformity clearance procedure will not apply to payments posterior to 2009<sup>63</sup>. As a result of this decision, erroneous payment entitlements will be 'legalised' and rendered definitive, resulting in annual payments being made on such bases in future years.

<sup>61</sup> Commission Decision 2009/721/EC of 24 September 2009 excluding from Community financing certain expenditure incurred by the Member States under the Guarantee Section of the European Agricultural Guidance and Guarantee Fund (EAGGF), under the European Agricultural Guarantee Fund (EAGF) and under the European Agricultural Fund for Rural Development (EAFRD) (OJ L 257, 24.9.2009, p. 28).

<sup>62</sup> Article 137 of Regulation (EC) No 73/2009.

<sup>63</sup> See Article 137(3) of Regulation (EC) No 73/2009.

## CONCLUSIONS AND RECOMMENDATIONS

- 84.** The SPS has contributed to the achievement of two main objectives of the common agricultural policy: encouraging farmers to better respond to market demand and supporting the income of the agricultural sector as a whole. However, the overall conclusion of the present report is that the implementation of the scheme resulted in a number of questionable features relating to the definition of the beneficiaries of the policy, the nature of eligible parcels and activities, the environmental impact of the scheme, the distribution of aid across and within Member States and the specific effects of the historic and regional models. Therefore, the Court invites the Commission to consider whether such features should be reviewed along the lines set out in the recommendations below.

### BENEFICIARIES, ELIGIBLE LAND AND AGRICULTURAL ACTIVITIES

- 85.** The definition of the beneficiaries of the scheme was formulated, and subsequently applied, in a way that permitted persons or entities not or only marginally engaged in an agricultural activity to benefit from SPS payments.
- 86.** The Court previously reported on this situation in its annual reports and this was recognised during the 'Health Check' examination of the CAP, in 2008. The legislator then allowed Member States to exclude such beneficiaries from SPS aid. However, at the time of the audit, no Member State had made use of this option and the situation described above persists.
- 87.** Where Member States failed to put up effective restrictions, the complete separation of payment entitlements from the land on which they were originally generated encouraged investments by operators who have little interest in farming as an activity but who exploit the guaranteed returns that SPS provides.
- 88.** The entrance of new farmers into the agricultural sector is often hampered by present conditions of access to payment entitlements.

- 89.** The specifications as to what makes a parcel of land eligible for SPS aid and what constitutes an eligible agricultural activity are loosely defined and do not contribute to focusing such aid on activities and land that ‘increase agricultural productivity’.

<sup>64</sup> See footnote 5.

#### RECOMMENDATION 1

The present legislation and its implementing rules should be amended to ensure that SPS aid is directed to active farmers and excludes beneficiaries who have no or only insignificant agricultural activities.

#### RECOMMENDATION 2

Eligible land and agricultural activities need to be more clearly defined with a view to excluding from the benefit of SPS aid non-agricultural parcels and activities that do not contribute to increasing agricultural productivity<sup>64</sup> or to actively maintaining the environmental value of the land.

## ENVIRONMENTAL IMPACT

- 90.** With the introduction of cross-compliance, at the same time as the SPS, the full payment of aid was made conditional upon criteria based on environmental and other good agricultural practices. Cross-compliance thus became a key justification for the SPS payments. However, SPS aid is only indirectly linked to environmental obligations.
- 91.** Firstly, the Court noted that there is no direct link between the level of SPS aid and the costs incurred by farmers to maintain land in GAEC or to comply with the specific statutory management requirements (SMR) applicable. Neither does it reflect the value of the positive externalities that agricultural activities generate.
- 92.** Secondly, often the maintenance of land in GAEC does not require any or only sporadic actions.

**RECOMMENDATION 3**

The calculation of SPS aid should be modified to better reflect the cost of environmental and other externalities.

**RECOMMENDATION 4**

GAEC standards should require concrete and regular activities to be carried out by farmers for them to receive the full amount of the aid. Payment reductions for failure to respect cross-compliance obligations should be made more dissuasive.

**DISTRIBUTION OF SPS AID**

- 93.** The determination of SPS payments to individual farmers remains based (a) on the number of hectares farmed and (b), in the historical model, on the amounts paid in the past (reference years from 2000 to 2002). It follows that this aid continues to benefit primarily larger farms.
- 94.** The distribution of SPS aid is characterised by the fact that the major part goes to a small number of large beneficiaries while the large majority of beneficiaries each receive only a limited amount of aid. The modulation mechanism that reduces the amount paid to the largest farmers concerns a very limited number of recipients. Furthermore, it does not contribute to correcting the present distribution as its primary objective is to shift funds from direct aid to the rural development pillar of the CAP.

**RECOMMENDATION 5**

A more balanced distribution of SPS aid between farmers should be sought either by further modulation of payments, or by capping higher individual payments, or by taking into consideration the specific circumstances of farms.



## SPECIFIC EFFECTS OF IMPLEMENTATION MODELS

95. Currently some 20 different variants of SPS are applied across the EU. This situation explains in large part the wide disparity in the levels of aid per hectare across Member States as well as in the distribution patterns within a Member State.
96. Two main models are implemented. On the one hand, the historic model has, over time, become divorced from present conditions of production.
97. On the other hand, the regional model is associated with uniform unit values of payment entitlements across the region concerned. However, the transition to this latter model may, in certain regions, negatively affect certain sectors of agricultural production and may result in an increase in the market price of agricultural land and land leases which would reduce the effectiveness of the aid.

### RECOMMENDATION 6

The calculation of entitlements should be based on current farming conditions in the different regions. However, such a transition should ensure that undesirable effects, such as an increase in the price of leases and land, are limited.

This report was adopted by Chamber I, headed by Mr Olavi ALA-NISSILÄ, Member of the Court of Auditors, in Luxembourg at its meeting of 6 April 2011.

*For the Court of Auditors*



Vitor Manuel da SILVA CALDEIRA  
*President*

## IMPLEMENTATION OF SINGLE PAYMENT MODELS, FUTURE INTEGRATION OF COUPLED SUPPORT AND SPECIFIC AID

Member State	Start	Region	Model	Sectors remaining coupled	Year of decoupling	Optional implementation for specific types of farming and quality production 2005–09 (Art. 69 of Reg. (EC) No 1782/2003)	Optional implementation of specific support after 2009 (Art. 68 of Reg. (EC) No 73/2009)
Belgium	2005	Flanders + Brussels	Historical	Nuts and seeds (some species)	2010		Quality production
				Slaughter premium calves 100 %	2012		
				Protein	2012		
				Suckler cow premium 100 %	—		
Denmark	2005	Wallonia	Historical	Nuts and seeds (some species)	2010		Grassland premium (breeding)
				Protein	2012		
				Suckler cow premium 100 %	—		
				Protein	2010		Agri-environmental measures
				Special male bovine premium 75 %	2012		
				Sheep and goat premium 50 %	2012		
				Potato starch	2012		
Germany	2005	Bundesländer (Berlin included in Brandenburg, Bremen in Lower Saxony and Hamburg in Schleswig-Holstein)	Dynamic hybrid moving to nearly full regional model	Hops payments 25 %	2009		Grassland premium (dairy sector)
				Tobacco 60 %	2009		
				Protein	2012		
Ireland	2005	—	Historical	Protein	2012		Grassland sheep scheme, grassland dairy programme, conservation in the Burren

Greece	2006	—	Historical	Seeds Protein Rice Nuts Fruit and vegetables: other than annual crops Fruit and vegetable: processing of citrus fruits 60% Fruit and vegetable: tomatoes 30% Cotton 35 %	2010 2010 2010 2010 2010 2013 2011 —	Tobacco, olive oil, sugar, arable crops, bovine sector, sheep and goats	Olive oil, durum wheat, sugar, beef sector (heifers and suckler cows), sheep and goats, dairy sector, new entitlements in LFA, crop insurance
Spain	2006	—	Historical	Sheep and goat premiums 50 % Tobacco 60 % Olive oil Fruit and vegetables: processing of citrus fruits Fruit and vegetable: tomatoes Seeds 100 % Arable crops 25 % Slaughter premium calves 100 % Slaughter premium bovine adults 40 % Protein Rice Nuts Potato starch Suckler cow premium 100 % Outermost regions 100 % Cotton 35 %	2010 2010 2010 2010 2011 2012 2012 2012 2012 2012 2012 2012 2012 2012 — — —	Tobacco, cotton, sugar, bovine sector, dairy payments	Tobacco, legumes, sheep and goats, crop rotation, milk sector (quality and LFA)
France	2006	—	Historical	Hops payments 25 % Tobacco 60 % Sheep and goat premium 50 % Suckler cow premium 100 % Slaughter premium calves 100 % Slaughter premium bovine adults Fruit and vegetable: tomatoes Arable crops 25 % Protein Rice Seeds (some species) 100 % Nuts Potato starch Outermost regions 100 % 98 % of respective national ceiling for orchards producing prunes, peaches, and pears intended for processing 75 % of respective national ceiling for orchards producing prunes, peaches, and pears intended for processing	2010 2010 2010 25 % in 2010 2010 2010 2012 2012 2012 2012 2012 2012 2012 2012 — until end 2010 from 2011 until end 2012	Protein crops, durum wheat, organic farming, crop rotation, calves, sheep and goats, milk producers in mountain areas, crop harvest insurance, mutual funds in case of diseases	

Member State	Start	Region	Model	Sectors remaining coupled	Year of decoupling	Optional implementation for specific types of farming and quality production (Art. 69 of Reg. (EC) No 1782/2003)	Optional implementation of specific support after 2009 (Art. 68 of Reg. (EC) No 73/2009)
Italy	2005	—	Historical	Tobacco	2010		Beef and veal sector, sheep and goat meat, olive oil, dairy products, tobacco, sugar, floricultural products, crop rotation, crop insurance
				Fruit and vegetable tomatoes 50% Fruit and vegetable pears, peaches and prunes intended for processing 100% Fruit and vegetable prunes 75% Seeds Protein Rice Nuts	2011 25 % in 2011 25 % in 2011 2012 2012 2012 2012	Sugar, arable sector, bovine sector, sheep and goats	
Luxembourg	2005	One region	Static hybrid	Protein Nuts	2010 2010		
Malta	2007	One region	Regional model	None	None		
Netherlands	2006	—	Historical	Protein and nuts	2010		Animal welfare, crop insurance, sheep and goats, water transport allowance
				Slaughter premium calves 100 % Slaughter premium bovine adults 100 % Seeds for fibre flax 100 % Potato starch	2010 2010 2010 2012 2012		
Austria	2005	—	Historical	Slaughter premium calves 100 % Slaughter premium bovine adults 40 % Hops payment 25 % Protein Nuts Potato starch Suckler cow premium 100 %	2010 2010 2010 2010 2011 2012 —		Dairy cow premium

Portugal	2005	—	Historical	Tobacco Fruit and vegetable: tomatoes Protein Nuts Seeds 100 % Suckler cow premium 100 % Slaughter premium calves 100 % Slaughter premium bovine adults 40 % Sheep and goat premium 50 % Outermost regions 100 % Cotton 35 %	2010 2011 2012 2012 2012 — — — — — —	Arable crops, rice, bovine and ovine sectors, olive oil, sugar	Extensive handling systems for autochthonous breeds, quality (crops and animals), milk and sheep sectors, agroenvironmental measures
Slovenia	2007	One region	Regional model	Sheep and goat premium 50 % Hops payment 25 % Protein Nuts Special male bovine premium 75 %	2010 2010 2012 2012 2012	Bovine sector	Extensive rearing of female bovine animals, dairy payment, animal rearing on permanent pastures
Finland	2006	Three regions (based on reference yield)	Dynamic hybrid moving to full regional model	Special male bovine premium 75 % Protein Potato starch Seeds (timothy seed) 100 % Sheep and goat premium 50 %	2010 2011 2012 2012 —	Arable crops, bovine sector	Protein and oil seed crops, potato starch, slaughtered lambs, beef and veal production, dairy cow premium
Sweden	2005	Five regions (based on reference yield)	Static hybrid regional model	Protein Potato starch Special male bovine premium 74,55%	2010 2012 2012	Quality and marketing measures	Quality and marketing measures
United Kingdom	2005	England — normal areas	Dynamic hybrid moving to full regional model	Protein Nuts	2012 2012	Quality and marketing measures	
	2005	England — moorland					
	2005	England — severely disadvantaged areas (without moorland)					
2005	Scotland	Historical	Protein Nuts	2010 2010	Bovine sector		
2005	Wales	Historical	Protein Nuts	2010 2010			
2005	Northern Ireland	Static hybrid regional model	Protein Nuts	2010 2010			

**PAYMENTS UNDER THE SINGLE PAYMENT SCHEME (APPLICATION YEARS 2006 TO 2008 — FINANCIAL YEARS 2007 TO 2009) IN MILLION EURO**

Budget Item 05 03 01 01 Single Payment Scheme — Regulation (EC) No 1782/2003 Title III												
Application year	2006			2007			2008			2009		
	2007	2008	2009	Total	2008	2009	Total	2008	2009	Total	2008	2009
Belgium	444,9	0,1		445,0	453,4	0,4	453,8	467,3				
Denmark	927,9	0,1	-0,1	927,9	917,8	0,5	918,3	922,9				
Germany	5 358,1	4,4	0,7	5 363,2	5 339,0	1,4	5 340,4	5 390,6				
Ireland	1 242,7	7,4	1,1	1 251,2	1 240,8	4,7	1 245,5	1 246,8				
Greece	1 905,0	7,3	4,3	1 916,6	1 886,8	16,2	1 903,0	2 056,6				
Spain	3 294,0	30,0	14,8	3 338,8	3 246,5	29,6	3 276,1	3 342,8				
France	5 722,1		0,4	5 722,5	5 695,6	1,1	5 696,7	5 745,3				
Italy	3 195,8	17,9	5,2	3 218,9	3 185,5	16,1	3 201,6	3 371,7				
Luxembourg	34,6			34,6	34,2		34,2	34,1				
Malta				0,0	1,6		1,6	2,7				
Netherlands	293,8	1,7	0,6	296,1	659,2	7,0	666,2	682,0				
Austria	508,5	0,3	0,1	508,9	598,9	-0,1	598,8	604,0				
Portugal	307,0	1,8	0,3	309,1	341,6	4,2	345,8	356,6				
Slovenia				0,0	48,9	0,1	49,0	60,6				
Finland	493,9			493,9	488,9		488,9	490,8				
Sweden	595,0	0,5		595,5	661,3	0,2	661,5	661,5				
United Kingdom	3 681,4	28,8	-6,2	3 704,0	3 316,2	7,4	3 323,6	3 263,3				
<b>Total</b>	<b>28 004,7</b>	<b>100,3</b>	<b>21,2</b>	<b>28 126,2</b>	<b>28 116,2</b>	<b>88,8</b>	<b>28 205,0</b>	<b>28 699,6</b>				

Budget Item 05 03 03 00 Additional amounts of aid - Article 12 of Regulation (EC) No 1782/2003										
Application year	2006			2007			2008		2009	
	2007	2008	2009	Total	2008	2009	Total	2009	Total	2009
Belgium	6,2			6,2	7,6		7,6		7,6	7,4
Denmark	8,0			8,0	9,6		9,6		9,6	9,3
Germany	49,3			49,3	60,4		60,4		60,4	59,6
Ireland	19,3	0,2		19,5	24,3	0,1	24,4		24,4	24,2
Greece	60,2	-0,1		60,1	73,7	-0,1	73,6		73,6	74,9
Spain	74,4	0,6	0,2	75,2	91,3	1,1	92,4		92,4	94,9
France	66,5	1,0		67,5	83,7	0,3	84,0		84,0	84,4
Italy	72,8	0,3	0,1	73,2	89,8	0,3	90,1		90,1	92,2
Luxembourg	0,3			0,3	0,4		0,4		0,4	0,4
Malta				0,0			0,0		0,0	
Netherlands	8,9			8,9	10,5	0,1	10,6		10,6	10,4
Austria	15,7			15,7	19,1		19,1		19,1	18,8
Portugal	8,2			8,2	9,5		9,5		9,5	9,4
Slovenia				0,0			0,0		0,0	
Finland	10,2			10,2	12,5		12,5		12,5	12,2
Sweden	8,8			8,8	10,9		10,9		10,9	10,8
United Kingdom	22,5	0,6	0,1	23,2	26,0	3,1	29,1		29,1	27,7
<b>Total</b>	<b>431,3</b>	<b>2,6</b>	<b>0,4</b>	<b>434,3</b>	<b>529,3</b>	<b>4,9</b>	<b>534,2</b>		<b>534,2</b>	<b>536,6</b>

Source: European Commission, Directorate-General for Agriculture and Rural Development.

#### Comment

Total expenditure per financial year corresponds to the sum of the amounts paid in that financial year (in respect of the different application years). For instance, the expenditure on SPS amounted to 28 809 million euro in financial year 2009.

The additional amount of aid is equal to the amount resulting from the application of the modulation to the first 5 000 euro or less of all direct payments (SPS and payments coupled to production). This amount is reimbursed to farmers. For technical reasons the part relating to SPS cannot be displayed separately.

## DISTRIBUTION OF INCOME SUPPORT UNDER THE SPS (APPLICATION YEAR 2008)

Annual payments of SPS support (euro)	Total EU-17	Belgium	Denmark	Germany	Ireland	Greece	Spain	France	Italy
< 500	1 395 721	2 491	8 013	49 594	4 571	277 817	274 088	28 667	553 801
≥ 500 and < 5 000	1 912 824	12 940	20 648	123 480	49 347	399 590	367 149	100 144	546 431
≥ 5 000 and < 10 000	458 464	6 276	7 398	53 612	29 810	76 355	75 198	55 969	70 478
≥ 10 000 and < 50 000	642 954	15 280	13 984	108 532	38 059	38 787	78 126	156 466	58 074
≥ 50 000 and < 100 000	62 210	808	4 192	10 844	1 906	406	4 493	18 706	5 003
≥ 100 000 and < 300 000	15 927	106	1 281	3 972	267	26	1 420	1 869	1 781
≥ 300 000 and < 500 000	1 500	1	38	960	3	1	90	12	138
≥ 500 000 and < 1 000 000	783		8	616	1		28	3	56
≥ 1 000 000	144			108			6		16
<b>Grand total</b>	<b>4 490 527</b>	<b>37 902</b>	<b>55 562</b>	<b>351 718</b>	<b>123 964</b>	<b>792 982</b>	<b>800 598</b>	<b>361 836</b>	<b>1 235 778</b>

Annual Payments of SPS support (euro)	Luxembourg	Malta	Netherlands	Austria	Portugal	Slovenia	Finland	Sweden	United Kingdom
< 500	85	4 018	8 493	20 851	101 840	30 000	1 261	11 265	18 866
≥ 500 and < 5 000	345	612	20 066	62 813	47 209	28 038	31 072	40 311	62 629
≥ 5 000 and < 10 000	220	66	7 234	20 296	4 882	1 092	16 100	9 961	23 517
≥ 10 000 and < 50 000	1 091	53	22 357	16 576	5 881	302	16 074	15 796	57 516
≥ 50 000 and < 100 000	85		1 036	261	829	8	234	1 644	11 755
≥ 100 000 and < 300 000	7		142	63	302	7	18	365	4 301
≥ 300 000 and < 500 000			6	3	15	1	1	14	217
≥ 500 000 and < 1 000 000				3	2	2		4	60
≥ 1 000 000									14
<b>Grand total</b>	<b>1 833</b>	<b>4 749</b>	<b>59 334</b>	<b>120 866</b>	<b>160 960</b>	<b>59 450</b>	<b>64 760</b>	<b>79 360</b>	<b>178 875</b>



# REPLY OF THE COMMISSION

## EXECUTIVE SUMMARY

### II. Second indent

The objective of the Single Payment Scheme (SPS) is to grant basic income support and contribute to the provision of basic public goods **while** encouraging farmers to better respond to market demand.

### III.–IV.

The SPS is a decoupled scheme, and hence there is no production requirement. In this context, a farmer should not be considered having no agricultural activity simply because he does not maintain a certain production level.

Any farmer receiving support must however perform an agricultural activity. Following Council Regulation (EC) No 73/2009, this implies that he should at least maintain his land in good agricultural and environmental condition (GAEC).

The Commission is committed to examine how to further strengthen that support is granted only to active farmers as stated in the communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions 'The CAP towards 2020: meeting the food, natural resources and territorial challenges of the future'<sup>1</sup>, hereafter referred to as the 'communication on the future CAP'.

<sup>1</sup> COM(2010) 672 final, adopted on 18 November 2010.

## REPLY OF THE COMMISSION

### V.

Access of new farmers to support under the SPS is not the same as the opportunity to start out as a new farmer.

Twelve out of 17 Member States grant payment entitlements from the national reserve to commencing farmers. In other Member States farmers can buy or lease payment entitlements in the free market, which functions well.

An in-depth examination by the Commission and the Member States showed that in the vast majority of cases, the assessment of the eligibility of the area is beyond doubt. The Commission intends nevertheless to examine the possibility of further refining the definition of eligible land in order to better target the aid, as it is advanced in the communication on the future CAP.

However, a decoupled support like the SPS cannot be linked to the performance of the beneficiary or of the land, for which payment entitlements have been activated, in terms of production. Such a requirement would not comply with paragraphs 1 and 6(e) of Annex 2 to the WTO Agreement on Agriculture<sup>2</sup>.

### VI.

The communication on the future CAP includes the possible introduction of an element of capping which would allow a limitation of the payments made. The number of hectares and the number of entitlements would however continue to reflect the size of farms and to a certain extent their contribution to the objectives of the common agricultural policy (CAP).

<sup>2</sup> [http://www.wto.org/english/docs\\_e/legal\\_e/14-ag\\_01\\_e.htm](http://www.wto.org/english/docs_e/legal_e/14-ag_01_e.htm)

### VII.

There is no quantified link between SPS support and costs incurred in respecting good agricultural and environmental conditions. Historical references have thus been used to determine the level of aid. SPS is an area-based payment whose main objective is to provide basic income support. Through the obligation to keep land in GAEC, SPS contributes to the protection of natural resources, thus providing the basis for the delivery of public goods through agriculture. This has been noted in particular in the study on public goods of the Institute for European Environmental Policy (IEEP)<sup>3</sup>.

The issue of costs for farmers of compliance with legislation on environment, food safety and animal welfare is often raised, and a study assessing these costs has been requested by the European Parliament and is under way. However, the level of SPS is independent of these costs as it should not compensate farmers for respecting the law and must remain 'green box' compatible.

The communication on the future CAP outlines the intention of the Commission to assess possibilities for a further 'greening' of the first pillar.

<sup>3</sup> Cooper, T., Hart, K. and Baldock, D., 'The provision of public goods through agriculture in the European Union', Report for the Agriculture and Rural Development DG, Contract No 30-CE-0233091/00-28, Institute for European Environmental Policy, London, 2009.

## REPLY OF THE COMMISSION

### VIII.

The Commission does not agree that SPS is a poorly targeted method to provide income support. The issue of targeting is not linked to the different implementing options.

The level of decoupled direct support that farmers receive is based on production and support levels during a historic reference period or, in the case of the regional model, on the areas on a historical reference date. Hence, the current distribution of direct payments between farms is simply a reflection of the fact that agricultural land and agricultural production are not shared equally among the farms in the EU. This situation does not change the fact that the SPS has already proven its effectiveness as a method to provide basic income support to farmers.

Nevertheless, the issue of redistribution of support between farmers and Member States is considered in the communication on the future CAP, and should also lead to improved targeting of the SPS aid.

### IX.

In a decoupled support system there is no possibility to adjust the support level to current production levels. Such an adjustment would not only be non-compliant with the WTO 'green box' rules but also run counter to the objective of increasing the market orientation of farmers.

However, the communication on the future CAP acknowledged that the justification of the different support levels is getting weaker as the reference periods are getting more distant. The redistribution of support between Member States and farmers is therefore a core issue for the future of the CAP and reflections regarding relevant and feasible criteria for such reallocation are ongoing. An impact assessment is currently being carried out on these issues.

Under the current rules as well as in the future, it is a clear requirement that payment entitlements only be activated with the declaration of a corresponding number of eligible hectares.

### X.

The historical model was firstly proposed by the Commission in 2003 with a view to facilitating a smooth transition towards decoupling. The regional model was added at the request of Member States to match some particular national objectives for direct support. The capitalisation of support in a regional model may be higher than in a historic model. Nevertheless, among factors influencing land prices, CAP subsidies have a rather modest impact. In addition it does not necessarily mean an increase in capitalisation as compared to former coupled forms of support.

The impact of the regional model is currently being assessed together with all social, economic and environmental effects, in the impact assessment following the communication on the future CAP.

## REPLY OF THE COMMISSION

### **XI.**

The communication on the future CAP includes a number of issues relating to the direct payments which are currently being examined and reviewed by the Commission.

### **XII. first indent**

In order to increase the effectiveness and efficiency of the support, one of the elements mentioned in the communication on the future CAP is to better target the support to active farmers. However any such targeting would have to respect the decoupled nature of the SPS payments.

### **XII. second indent**

Non-agricultural parcels are already excluded from the SPS support. Farmers can only 'activate' an entitlement to receive support with eligible land and they have to respect the rules and conditions set by existing legislation.

A decoupled support like the SPS cannot however be linked to the performance of the beneficiary or of the land in terms of increasing agricultural productivity. Excluding activities that do not contribute to increasing agricultural productivity from the benefit of SPS would establish a link to current production and, as a consequence, the conditions of the WTO Agreement on Agriculture ('green box') would no longer be met.

As regards the active maintenance of the 'environmental value of agricultural areas' mentioned by the Court, the Commission committed itself in its communication on the future CAP to assess ways of enhancing environmental performance of the CAP. This could be done by supporting simple, generalised, non contractual and annual environmental actions within the direct payment scheme and/or enhancing certain elements of GAEC standards.

### **XII. third indent**

As set out in the communication on the future CAP, the environmental performance of farmers as a counterpart for support will be further considered by the Commission

### **XII. fourth indent**

The Commission has proposed in its communication on the future CAP to assess how cross-compliance rules could be simpler and more comprehensive and, for GAEC, to analyse how certain of its elements could be enhanced.

The EU framework for payment reductions under cross-compliance is dissuasive since the reduction can be as high as 100 % of CAP payments received by the farmer. Where weaknesses in the implementation by Member States of the cross-compliance system are observed, these are followed up under the clearance of accounts procedure.

### **XII. fifth indent**

The redistribution of aid, the capping of payments and the support to farmers in areas with specific natural constraints are elements included in the communication on the future CAP.

### **XII. sixth indent**

The communication on the future CAP foresees a new design for direct payments. Several options are currently being assessed in an impact assessment, among them one which would imply a basic support rate complemented with payments for farmers in areas with natural constraints, as well as a greening component.

## REPLY OF THE COMMISSION

### AUDIT SCOPE, OBJECTIVES AND APPROACH

#### 19. Second indent

The main objective of the SPS is to grant a basic income support to farmers while contributing to the provision of basic public goods.

In this context, situations of farmers who just fulfil the GAEC thus having only limited agricultural activity can arise. This issue has been raised in the communication on the future CAP and the possibility of further targeting of the support should be examined.

### OBSERVATIONS

#### 20.

Concerning the lack of precision of the definition, see Commission reply to point 21.

The margin of discretion left to Member States is related to the existence of differences between the Member States such as in the agricultural structures.

#### 22.

The definition of agricultural activity reflects the objective of promoting farmers' market orientation while ensuring compliance with WTO 'green box' rules.

#### 21.

The definition of farmers under the current rules is clear and only farmers within the definition laid down in Council Regulation (EC) No 73/2009 qualify for support<sup>4</sup>. The definition reflects the decoupled nature of the scheme and the objective of promoting farmers' market orientation while ensuring compliance with WTO 'green box' rules. Production obligations or links to production factors may not be imposed as eligibility criteria.

In this context the option for farmers to decide to 'maintain the land in GAEC', instead of producing a given agricultural product, reflects the fact that the aid is decoupled.

#### 23.

The SPS is decoupled from production. In order to be compliant with the WTO 'green box' rules, production obligations or links to production factors may not be imposed as eligibility criteria. Furthermore, the issue of ownership of land is not a decisive criterion for exercising farming activities, as this, for instance, can also be done by tenants of land.

<sup>4</sup> See Article 2(a) of Regulation 73/2009: 'farmer' means a natural or legal person, or a group of natural or legal persons, whatever legal status is granted to the group and its members by national law, whose holding is situated within Community territory, as defined in Article 299 of the Treaty, and who exercises an agricultural activity. The latter is defined in Article 2(c) of the same regulation as production, rearing or growing of agricultural products including harvesting, milking, breeding animals and keeping animals for farming purposes, or maintaining the land in good agricultural and environmental condition.

See also Commission reply to point 21.

## REPLY OF THE COMMISSION

### 24.

The Commission underlines that the area declared has to be eligible throughout the calendar year and double declarations from several farmers are normally detected in the administrative checks. The rule providing that areas should be at the farmers' disposal at a given day serves the purpose of avoiding double payment of the same area.

In addition, the replacement of the 10-month period with a single date which may be determined by the Member State is linked to the simplification efforts of the common agricultural policy. Farmers gain greater flexibility in their farm management and in responding to market developments.

The abolition of the 10-month period reduces the time spent by farmers on retrieving relevant information for the single payment application. It is expected to lead to a reduction in administrative burden for farms which is estimated at around 21,5 million euro<sup>5</sup>.

### 26.

According to the rules for activation of entitlements, Member States have to decide who was farming the land bearing the management risk. This issue has and will continue to be followed up in the context of the clearance of accounts.

The economic conditions of the contractual arrangements reflect the diversity of the situations in the field. However, in any case, the terms negotiated in the contract between landowners and tenants are expected to reflect the economic interests of both parties.

<sup>5</sup> See Commission Communication COM (2009) 544.

### Box 2

The current legislation for the first pillar direct support schemes does not exclude that a parcel can be claimed for aid under different schemes by more than one single farmer, as long as the eligibility criteria for each scheme concerned are fulfilled throughout the year.

Generally, when first pillar and less-favoured areas (LFA) payments are claimed by two different beneficiaries for the same area, the beneficiary should be the one exercising the agricultural activity.

Special cases, when first pillar and specific agri-environment measures (AEM) like stonewalls, hedgerows, landscape features or catchment areas and ponds are claimed by two different beneficiaries, should be handled on an individual basis.

The Commission has also found cases such as those referred to by the Court during its audits and these are followed up in the context of the clearance of accounts.

In the regional model, following the Council regulation, it was the eligible area declared and the historic support level which determined the number and value of the entitlement. It remains however that the rules provide that support should only be granted to farmers disposing of eligible areas.

## REPLY OF THE COMMISSION

### 27.

As explained under point 21, only farmers fulfilling the legal definition and at least maintaining the areas in GAEC are eligible for support. The eligibility does not depend on the age of the farmer.

In Member States where early retirement schemes are applied under rural development, farmers are not allowed to continue receiving SPS payments.

See also reply to point 28.

### Box 3

The activation of high-value entitlements on low-value areas is allowed by Council Regulation (EC) No 73/2009.

Member States do however have the option to set rules at national level which could, for example, limit the transfer of payment entitlements between regions.

One of the issues taken up in the communication on the future CAP is the redistribution and targeting of support and the possible move towards a more uniform level of basic support.

### 28.

The study mentioned by the Court on the functioning of land markets in the EU Member States under the influence of measures applied under the CAP<sup>6</sup> states that, as for all public support, there are also other contextual factors than the SPS which influence the decisions of farmers in terms of staying in farming or retiring, the capitalisation of support in the level of land prices and more generally the restructuring of the agricultural sector. Those factors are in particular output and input prices, the institutional context at national and regional levels, national or regional land policy, social and cultural habits, etc. Compared to those factors and compared to other types of public support (coupled aid to production quantity, coupled aid to livestock or crop, intervention prices), decoupled payments have a much lower impact.

The main objective of decoupling is market orientation and, in general, farmers, as entrepreneurs, are actively farming in order to generate an income from the selling of their products and possibly other activities.

The weight of decoupled payments in the production choices of farmers is such that farmers will produce as long as it is profitable. The decision not to produce is also a market-oriented behaviour if variable production costs are not covered.

<sup>6</sup> Swinnen, J., Ciaian, P. and Kancs, D., 'Study on the functioning of land markets in the EU Member States under the influence of measures applied under the common agricultural policy', Brussels, 2008.

## REPLY OF THE COMMISSION

### 29.

The spirit of the reform was to decouple aids from production. Beneficiaries have the right for payment of their entitlements as long as the land is at least kept in GAEC and not based on production obligations.

If the land is predominantly used for non-agricultural activities, it is, however, not eligible and cannot be used for the activation of payment entitlements.

Cases of support to land where the predominant activity was non-agricultural have been subject to financial correction.

As mentioned in the communication on the future CAP, the definition of eligible farmers is currently under scrutiny to achieve a better targeting of SPS aid.

### 30.

Generally, the tradability of entitlements is an important feature of the SPS and with regard to activation no link is imposed between the value of the payment entitlements and the value of the land. However, Member States have the possibility to limit the transfer of entitlements between regions where they see it as necessary.

In addition, whereas the different values of entitlements under the historical model are linked to the aid paid in the reference period, the transactions that take place will normally reflect the economic value of the land and the entitlements.

### 31.

It is within the principles of the SPS that the beneficiaries exercise an agricultural activity which means at least keeping the land in GAEC, as it is defined in the regulations. There is no measurement of the degree or intensity of such activity as long as the GAEC have been respected.

However, when discussing further targeting during the Health Check, the Council considered that flexibility should be given to Member States to consider, in accordance with the principle of subsidiarity and according to their specific economic realities, which are the right parameters to be taken into account for the application of this possibility (to exclude from direct payments 'natural or legal persons whose agricultural activities form only an insignificant part of their overall economic activities or whose principal business or company objects do not consist of exercising an agricultural activity').

Member States did not make use of the option to exclude beneficiaries provided for by Article 28.2 of Council Regulation (EC) No 73/2009.

The question of effective targeting is taken up in the communication on the future CAP, where the Commission is seeking a solution in close dialogue with the Member States. Possible criteria are being assessed with a view to achieving the targeting intended while respecting the objective of the aid scheme.



## REPLY OF THE COMMISSION

### 32.

The EU territory covers a wide range of different agricultural structures and different conditions for farming. In the light of this, Member States insisted on retaining a certain discretionary margin as regards the implementation of the SPS in order to take measures which can mitigate possible adverse effects from the decoupling.

Moreover, the various options provided allow Member States to adapt to their own specificities.

### 35.

Though all Member States with SPS shall operate a national reserve, the amount available (within limits) and the use of the national reserve for new farmers are, in the spirit of subsidiarity, better decided at the level of the Member States.

Even if it is an option, the fact that 12 out of the 17 Member States applying the SPS have made use of the provisions regarding the use of the national reserve in favour of newcomers shows that the objective to integrate new farmers into the system was successfully implemented. This is a logical consequence of Member States' intention of assuring the relay of new generations into their agricultural sectors.

The other option for new farmers who wish to receive SPS payments is to buy or lease payment entitlements, with or without land. Transfer of entitlements is a basic principle of the functioning of the SPS.

Access to the market for payment entitlements is in general good. A transparent market for payment entitlements ensures an efficient allocation of entitlements among farmers.

### 36.

The implementing rules for the SPS provide detailed and precise definitions of arable land, permanent pastures and permanent crops which must be respected. There are also legal provisions laying down rules as regards areas with trees or with landscape features. Furthermore, the Commission services have issued guidelines for each claim year (WikiCap) which can help Member States defining clear and understandable methods to deal with areas which are more marginal in order to ensure that payments are only made for the eligible part and not for areas with forest.

Moreover, farmers claiming for direct payments are always obliged to respect cross-compliance and the GAEC on the entire holding.

### 37.

The responsibility for defining the standards for GAEC rests with the Member State since the specific characteristics of the areas concerned need to be taken into account. Consequently, whether the land is in GAEC or not depends of the definition set up by the Member State and does not necessarily entail an intensive activity from the farmer.

When farmers are not respecting the rules, for example not carrying out the minimum activity required, the eligibility for an SPS payment on the concerned parcel is questioned and where appropriate Member States must apply reductions or exclusion on this parcel. Moreover the breach of GAEC rules entails, where appropriate, reductions and exclusions of all CAP payments received by the farmer subject to cross-compliance. The risk for the farmer is therefore not moderate but significant.

## REPLY OF THE COMMISSION

### Box 4

Both objectives of agricultural condition and environmental condition underlie the GAEC concept. Therefore, the definition of national standards by Member States does not necessarily entail that an activity aiming at maintaining or increasing the agricultural production is expected from the farmer. National GAEC standards may solely foresee prohibitions of certain practices detrimental for the purpose of the GAEC.

The Court links also the question of eligible areas to the question of 'active farmer'. In the discussion on the future of the CAP it is considered to define the active farmer with a view to achieve a better targeting of the aid.

### Box 4 — Spanish example

Questions concerning eligibility of wooded and rocky mountain grazing land are pursued in the context of the clearance of accounts.

### Joint reply to the two Italian examples

The Italian authorities have undertaken to update their LPIS and to review the pro-rata distribution. Furthermore, it is foreseen that undue payments will be recovered in accordance with Article 80 of Commission Regulation (EC) No 1122/2009. Similar cases have been identified during Commission audits and are followed up in the context of the clearance of accounts.

### Box 4 — French example

The eligibility issues referred to by the Court are pursued in the context of the clearance of accounts.

### 38.

Certain activities falling outside the direct scope of 'agricultural activities' are fully compatible with agriculture and should not lead to the ineligibility of the area. This concerns for instance temporary sporting activities. The implementing rules in Article 9 of Commission Regulation (EC) No 1120/2009 set clear objectives and give guidance to the Member States on how to define the detailed criteria for this rule.

### 39.

The principle of consolidation, as described in Article 7 and recital 6 of Commission Regulation (EC) No 795/2004 and currently in Article 18 and recital 8 of Commission Regulation (EC) No 1120/2009, states that when a farmer has fewer hectares than entitlements he can apply, under certain conditions, for consolidation. In that case he has to return all his entitlements to the national reserve and will get in return entitlements from the national reserve that correspond to the total value. The farmer has to declare all hectares at the time of the request, which he will have to keep in GAEC.

The cases mentioned by the Court suit the objectives of consolidation for those farmers undergoing the effects of any intervention, namely to protect their income level.

### 40.

The Commission has only accepted cases of consolidation covered by the legislation. This issue is pursued in the context of the clearance of accounts.

## REPLY OF THE COMMISSION

### Box 5

See Commission reply to point 40.

#### 41.

In general the consolidation provisions are applicable to situations where the farmer has lost land due to various justified reasons (a restructuring or a development programme) and which would in case of no consolidation affect his income support negatively. The tool to maintain the support level of the farmer is the consolidation of the payment entitlements since the support is paid in respect of the payment entitlements and not for the area as such.

The consolidation should not affect the possibility of neighbouring farmers to receive and activate entitlements following the rules applicable in a given Member State.

It remains however the responsibility of the Member States to ensure the right application of the rules.

For holdings receiving CAP payments, the area which is not used for activating payment entitlements is also in any case covered by GAEC obligations, therefore preventing land abandonment.

Issues of consolidation (other than the one referred to in Article 7 of Commission Regulation (EC) No 795/2004 and currently in Article 18 of Commission Regulation (EC) No 1120/2009) during the allocation of payment entitlements have been audited and are followed up in the clearance of accounts procedure. Financial corrections are proposed.

#### 42.

The individual level of decoupled direct support that farmers receive in the EU is based on production and support levels during a historic reference period. Hence, the current distribution of direct payments between farms is a reflection of the fact that agricultural land and agricultural production are not shared equally among the farms in the EU.

However, as the reference period for current support is getting more distant, it becomes more difficult to justify and a redistribution of support between Member States and between farmers should be considered. This has been acknowledged in the communication on the future CAP and will be further examined, as well as the possibility of introducing a specific scheme for small farmers.

#### 43.

One of the aims of direct payments is to provide a basic income support to farms (SPS represents about 45 % of farmers' agricultural income) and thus to keep sustainable farming in place throughout the EU. Indeed the entrepreneurial income per worker employed in agriculture in the EU-27 was estimated to be around 58 % of the EU average wage in 2008.

The Court notes that SPS is paid to part-time farmers, part of whose income does not come from farming activity. More precisely, the SPS is linked to farming and not to the level of household income. Diversification of activities is a valuable alternative to limited growth opportunities within the farm sector and contributes to maintaining farming in areas where agriculture is socially and environmentally valuable.

## REPLY OF THE COMMISSION

### 44.

The need for basic income support of 'large farms' should not be considered to be systematically lower than those of other farms as income in general depends strongly on types of production, input and output costs, farm labour, etc.

In addition, SPS is paid on the basis of **entitlements** associated with the equivalent number of eligible hectares. Their value and number were calculated, using historical references of production and surfaces (for the latter in the historic model only) so as to ensure a smooth transition towards decoupling.

Nevertheless, the issue of distribution between largest and smallest farms has been raised several times and it was assessed during the Health Check in 2008<sup>7</sup>. The Commission proposed a progressive modulation of direct payments which would have reduced payments below 100 000 euro by 8 %, payments below 200 000 euro by 11%, payments below 300 000 euro by 13 % and payments above 300 000 euro by 17 % (figures for 2012). The Council finally opted for a reduction of 10 % in all payments and an additional reduction of 4 % for support above 300 000 euro. In the communication on the future CAP the Commission announced that it will assess the possibility of introducing a specific scheme for small farmers and the capping of payments of largest beneficiaries.

<sup>7</sup> Communication from the Commission to the European Parliament and the Council 'Preparing for the 'Health Check' of the CAP reform' of 20.11.2007, COM(2007) 722 final, p. 5: '(...) if a solution is to be found, it would be in a model where the support level is gradually reduced as overall payments to the individual farmer increase, while retaining some support even at high overall payment levels (by way of example: payments above 100 000 euro reduced by 10 %, above 200 000 euro reduced by 25 %, and above 300 000 by 45 %)'.

### 45.

The individual level of decoupled direct support that farmers receive in the EU is based on production and support levels during a historic reference period. This was crucial for being able to move to almost full decoupling of direct support within only a few years. Hence, the current distribution of direct payments between farms is a reflection of the fact that agricultural land and agricultural production are not shared equally among the farms in the EU.

The issue of redistribution of direct support between farmers and Member States — according to its objectives of basic income support and basic support to provision of public goods — will be addressed in the considerations on the future CAP. This implies also reflections on a possible capping of high support amounts as well as the possibility of granting a specific support to small farmers.

### 46.

The current distribution of direct payments among farms is simply a reflection of the fact that agricultural land and agricultural production are not shared equally among the farms in the EU. This fact obviously does not change with the introduction of a flat-rate per hectare model which, in addition, does not mirror the fact that farms face very different economic and natural conditions across the EU.

The only way to have an equal share of direct payments among farms would be to give the same direct payment to each farm (in this case a farm of 2 hectares would receive the same payment as a farm of 400 hectares whatever the labour, types of production, farm income, etc.).

## REPLY OF THE COMMISSION

It is however acknowledged that, as adjustments of all sectors have taken place and as 12 more Member States have joined the European Union with a substantially different production and support history, the differences in support levels cannot be justified in the long term. This is one of the reasons why the issue of redistribution is a core issue for the future of the CAP.

### Box 6

See Commission replies to points 45 and 46.

### 47.–48.

The Court notes that there is a concentration of support on a small number of farmers. As already mentioned in the Commission reply to point 44, this issue was assessed during the Health Check in 2008. The Commission has announced in the communication on the future CAP that it will assess once again the capping of payments of largest beneficiaries and the introduction of a specific scheme for small farmers.

### 51.

There is no quantified link between SPS support and costs incurred in respecting good agricultural and environmental conditions. Historical references have thus been used to determine the level of aid. The SPS is an area-based payment whose main objective is to provide basic income support. Through the obligation to keep land in GAEC, the SPS contributes to the protection of natural resources thus providing the basis for the delivery of public goods through agriculture. This has been noted in particular in the study on public goods of the Institute for European Environmental Policy (IEEP)<sup>8</sup>.

<sup>8</sup> See footnote 3.

The issue of costs for farmers of compliance with legislation on environment, food safety and animal welfare is often raised, and a study assessing these costs has been requested by the European Parliament and is under way. However, the level of the SPS is independent of these costs as it should not compensate farmers for respecting the law and must remain 'green box' compatible.

The communication on the future CAP outlines the intention of the Commission to assess possibilities for a further 'greening' of the first pillar.

### 52.

The reductions laid down in the EU legislation for the cross-compliance system range in principle from 1% to 100%, which is not negligible. The farms are selected for checking on a risk basis, which increases the efficiency of the sampling. The Commission audits the implementation of the cross-compliance system by the Member States and follows up weaknesses found, such as incorrect application of reductions, under the clearance of accounts procedure.

### 53.

The link between direct payments and cross-compliance conditions contributes to the provision of basic public goods by agriculture. SPS income support also contributes to the maintenance of a vibrant agricultural sector throughout the EU. Indeed this is particularly shown in the study on public goods of the IEEP<sup>9</sup>.

<sup>9</sup> See footnote 3.

## REPLY OF THE COMMISSION

### 54.

The basic principle of all SPS models is the same: decoupling. The level of discretion given to Member States as regards the allocation of entitlements is justified by the diversity of national or regional specificities and by the necessity to facilitate the way forward towards decoupling. Member States have assessed the specific situation in their agricultural sector and selected the SPS model they deem appropriate to better implement decoupling in view of a viable agriculture.

This being said, the number of models is actually limited. As a result of choices made in the Council by Member States which wanted to have a large choice of options and exceptions in particular as regards degree of decoupling, there is a variety in implementation, but this concerns variations and not different models. Council Regulation (EC) No 73/2009 concerning the Health Check has introduced further decoupling of practically all schemes and has given the possibility to Member States to steer towards flatter rates and a more regionalised system. The communication on the future CAP announced that the Commission will assess further changes towards a flatter rate of payment.

### 57.

The choice of implementing model and the scope for partial decoupling are two different issues. The choice of implementing model is less significant for simplification than the rate of decoupling.

The discretion with regard to implementation given to the Member States by the Council regulation does not complicate the implementation in a given Member State but on the contrary gives that Member State the flexibility to choose the most appropriate model.

Simplification obtained by decoupling should be compared against the situation which existed before the introduction of the SPS. The fact that most schemes were decoupled and merged into the SPS, meaning claims are now made in a single application, is in itself a simplification.

Further decoupling and other elements of simplification have been pursued with the Health Check and the process of simplifying the CAP will be continued in the framework of the discussion on the CAP post-2013.

### 58.

The Commission does not agree that SPS is a poorly targeted method to provide income support. The issue of targeting is not linked to the different implementing options.

The level of decoupled direct support that farmers receive in the EU is based on production and support levels during a historic reference period or in the case of the regional model on the areas on a historical reference date. Hence, the current distribution of direct payments between farms is simply a reflection of the fact that agricultural land and agricultural production are not shared equally among the farms in the EU. This situation does not change the fact that the SPS has already proven its effectiveness as a method to provide basic income support.

## REPLY OF THE COMMISSION

Nevertheless, as regards the issue of redistribution of support between farmers and Member States, it is considered that an improved distribution should be achieved in the future CAP, thus also improving the targeting.

### 59.–62.

It is the principle of the SPS that payments are based on historic references. This was a crucial element for being able to move to almost full decoupling of direct support within only a few years. The basic income support in a decoupled system contributes to stabilise the farmers' income while allowing them to make production decisions on the basis of the market demand. This market orientation means that production choices reply to the demand of the consumers.

To maintain the market orientation of farmers it is not possible to go back to previous support schemes based on market and production support.

The EU Member States and the Commission committed themselves during the adoption of the Health Check to review the allocation and levels of support.

This has been taken up in the communication on the future CAP: it is acknowledged that the justification for the different support levels is getting weaker as the reference periods are getting more distant. The redistribution of support between Member States and farmers is therefore a core issue for the future of the CAP and reflections regarding relevant criteria for such reallocation are ongoing. An impact assessment is currently being carried out on these issues.

### 63.

Tradability of entitlements is a key element of the SPS. Furthermore, to reflect the decoupled character of the scheme, there is no requirement to link the entitlements to certain areas. Regional restriction of the transfer of entitlements is therefore not a compulsory provision even if Member States have the possibility to make use of it.

### 64.

Farmers can acquire additional payment entitlements from other farmers. However, to increase their level of aid, they must have additional parcels of eligible agricultural areas in order to get the payment from the additional entitlements.

### 66.

See Commission replies to points 63 and 64.

Payment entitlements can only be activated on eligible hectares. This implies as a minimum that the farmer activating the entitlements maintain the area in GAEC. The decision of the farmer on whether to continue agricultural production on the eligible hectares or simply maintain the area in GAEC should be a result of the conditions of the market and not of the support.

For decoupling to be WTO 'green box' compatible support must not be linked to production factors.

## REPLY OF THE COMMISSION

### 67.

As mentioned above it is not possible in a decoupled system to link the support to production factors.

The eligibility rules of SPS should in any event be respected (in particular those referred to GAEC).

### Box 7

Rough grazing constitutes a considerable part of the total area in Scotland. However, the described situation in Scotland is to a large extent the result of the choice made by the Scottish authorities not to limit the transfer of entitlements between regions.

Furthermore, the number of sheep does not affect support and is also not an eligibility criterion for the areas. It could simply affect density of animals on the pastures used for these animals and thus the maintenance of land in GAEC.

In general, the conditions set out in the transfer/lease contracts for both areas and payment entitlements are expected to reflect the economic value of the land and the entitlements and hence the interests of the persons involved in the transactions.

As regards the definition of national standards for GAEC these should reflect the local characteristics (see reply to point 37).

The Commission is looking into this situation in the context of the future CAP.

As regards the Italian example, the Commission considers that the calculation is based on assumptions which may not occur. Furthermore the beneficiary will have to meet the payment requirements on a yearly basis.

### 68.

The Council considered that flexibility should be given to Member States to consider, in accordance with the principle of subsidiarity and their specific economic realities, which are the right parameters to be taken into account for the application of the possibility referred to by the Court.

Under the current rules it is a clear requirement that payment entitlements only be activated with the declaration of a corresponding number of eligible hectares.

### 69.

The so-called windfall profit clause targeted the specific situation where sale or lease took place after the reference period when the reform was still not known, and where a seller of a holding could therefore potentially benefit from selling production units at a price set without the buyer being aware of the decoupling of the support.

Once the decoupling was known, the conditions and prices could be adapted accordingly.

Often farmers dealt with this situation directly through the private contract clause, thus avoiding administrative burden. Sellers/lessors could not use the entitlements without land and had hence an incentive for such contracts.

### 71.

There is no legal basis to withdraw entitlements from farmers who reduced their activity after 15 May 2004. After this date it has been considered that the parties could have already known the conditions of the new system and could therefore be expected to reflect the decoupling in the market.



## REPLY OF THE COMMISSION

### 72.

The situation referred to by the Court results from the implementing conditions set up at national level linked with Member States' specificities.

However the conditions of the new SPS were not known in 2002 and thus farmers' decisions at that time were not influenced by the introduction of the new SPS.

A Commission audit enquiry has already resulted in financial corrections addressing the issue of weaknesses related to national reserve allocations<sup>10</sup>.

### 73.

See Commission reply to point 69.

The intention of the windfall profit clause is not to update the support to current production levels. If such an update was made possible the support scheme would not be decoupled.

### 74.

In a decoupled support scheme, the support level cannot be linked to specific sectors or specific current production levels. This would not be WTO 'green box' compliant and it would reduce the effectiveness of the scheme as an income support mechanism. This also applies to the regional model.

<sup>10</sup> Commission Decision 2010/399/EC of 15 July 2010 excluding from European Union financing certain expenditure incurred by the Member States under the Guarantee Section of the European Agricultural Guidance and Guarantee Fund (EAGGF), under the European Agricultural Guarantee Fund (EAGF) and under the European Agricultural Fund for Rural Development (EAFRD) (OJ L 184, 17.7.2010, p. 6).

Under the SPS and in particular in the historic model, the individual support level is based on past production and support levels and this is also partly the case in the hybrid model.

As regards the redistribution effect mentioned by the Court 'from those actually farming and towards landowners', it has to be stressed again that landowners without agricultural activity and non-farmers are not eligible to receive the payments.

It is however recognised that justification of the current distribution is getting weaker as the reference period gets more distant. Therefore, the distribution should be reviewed as proposed in the communication on the future CAP.

### 75.

See Commission reply to points 44 and 74.

The example used by the Court of intensive bovine farmers who would receive a reduced support compared to previous coupled payments has to be balanced against the fact that within the same region more extensive livestock farms with a large share of grassland benefited from the regional model. Those two types of farms contribute to a different extent to the CAP objectives.

However among EU-15 Member States having chosen the regional model, all of them applied some part of historical individual references for the calculation of the value of entitlements.

Regional and historic models had different implications for each kind of farms. However this subsidiarity element in the choice of the implementing models was deemed necessary for being able to pass within a short time-lapse from coupled to decoupled payments.

## REPLY OF THE COMMISSION

### 76.–77.

See Commission reply to point 28.

The study on the functioning of land markets in the EU Member States under the influence of measures applied under the CAP<sup>11</sup> indicates that in theory full capitalisation of support into land prices is to be expected in the SPS model (higher in the regional model, lower in the historical model, especially if there is a lot of eligible land without correspondent entitlements). The same study indicates as well that among factors influencing land prices, CAP subsidies have a more modest impact than other factors.

This does not necessarily mean that the increase in capitalisation is higher than under former coupled forms of support.

As regards the likely impacts on profitability of farms of 'extension of regionalisation to other Member States', they have to be assessed together with all social, economic and environmental impacts. This has been started in the Health Check impact assessment and will be continued in the impact assessment following the communication on the future CAP.

### 80.–81.

The allocation of payment entitlements has been subject to Commission audits and shortcomings are pursued in the context of the clearance of accounts.

<sup>11</sup> Swinnen, J., Ciaian, P. and Kancs, D., 'Study on the functioning of land markets in the EU Member States under the influence of measures applied under the common agricultural policy', Brussels, 2008.

### 82.

Enquiries were instigated in all 17 Member States applying the SPS in 2007. So far, two Member States have been subject to a formal conformity clearance decision<sup>12</sup>, while the enquiries concerning three others have been closed without correction. In the other 12 Member States the normal clearance of accounts procedures are ongoing.

### 83.

One of the main purposes of the article in question (Article 137 of Council Regulation (EC) No 73/2009) is to reduce the long-standing burden for administrations and farmers, as well as providing legal certainty for farmers, as the Court notes. However, paragraph 2 of the same article sets limits to the application of this provision. In addition, paragraph 3 ensures that non-conformities for the period before 2009 may still lead to financial corrections.

<sup>12</sup> Commission Decision 2009/721/EC of 24 September 2009 excluding from Community financing certain expenditure incurred by the Member States under the Guarantee Section of the European Agricultural Guidance and Guarantee Fund (EAGGF), under the European Agricultural Guarantee Fund (EAGF) and under the European Agricultural Fund for Rural Development (EAFRD) (OJ L 257, 24.9.2009, p. 28); and Commission Decision 2010/399/EC of 15 July 2010 excluding from European Union financing certain expenditure incurred by the Member States under the Guarantee Section of the European Agricultural Guidance and Guarantee Fund (EAGGF), under the European Agricultural Guarantee Fund (EAGF) and under the European Agricultural Fund for Rural Development (EAFRD) (OJ L 184, 17.7.2010, p. 6).

## REPLY OF THE COMMISSION

### CONCLUSIONS AND RECOMMENDATIONS

#### 84.

The SPS has proven to be a very effective tool to grant basic income support while allowing the farmer to make production decisions on the basis of market signals. This is because payments are decoupled from production and do not interfere with production decisions. To be eligible for payments, beneficiaries, parcels and activities must match clear conditions set up in Council regulations that are compatible with WTO rules, i.e. not linked with production factors.

Subsidiarity in choosing implementing models as well as the use to a certain extent of historic distribution of payments was deemed necessary for better adapting the scheme to national/regional conditions and to be able to pass within a few years from coupled to decoupled support.

The SPS also contributes to the provision of basic public goods. As regards environmental public goods, the link between the SPS and cross-compliance is of crucial importance. Even if the SPS and cross-compliance do not replace existing EU and national environmental legislation which applies to farmers, it is clear that they help farmers to better integrate environmental concerns in their everyday management.

The Commission intends to review and improve certain elements of the support scheme to add value and quality in spending as highlighted in the communication on the future CAP which covers some of the issues mentioned by the Court: redistribution of funds between and within Member States, redesign (e.g. by enhancing the environmental performance of the CAP) and better targeting of support.

#### 85.

The SPS is a decoupled scheme, and hence there is no production requirement. Consequently, a farmer should not be considered as having no agricultural activity simply because he does not maintain a certain production level.

#### 86.

The definition of eligible farmers is currently under scrutiny, as mentioned in the communication on the future CAP, so as to achieve a better targeting of the SPS support.

#### 87.

Tradability of entitlements is a key element of the SPS. Furthermore, to reflect the decoupled character of the scheme, there is no requirement to link the entitlements to certain areas. Beneficiaries should however always respect the eligibility criteria.

#### 88.

New farmers who wish to receive SPS payments can either request entitlements from the national reserve or buy or lease payment entitlements, with or without land.

Transfer of entitlements is a basic principle of the functioning of the SPS. Farmers who are entering the agricultural sector can therefore buy entitlements in the free market.

The market for transfer of payment entitlements is well-functioning. A transparent market for payment entitlements ensures an efficient allocation of entitlements among farmers.

## REPLY OF THE COMMISSION

### 89.

The Commission intends to further refine the definition of eligible land in order to better target the aid, as it is stated in the communication on the future CAP.

In order to maintain the SPS as decoupled support in the WTO 'green box' and therefore not counting against the EU's support reduction commitment, the SPS cannot be linked to the performance of the beneficiary or of the land, for which payment entitlements have been activated, in terms of production. Such a requirement would not comply with paragraphs 1 and 6(e) of Annex 2 to the WTO Agreement on Agriculture<sup>13</sup>.

#### Recommendation 1

In order to increase the effectiveness and efficiency of the support, one of the elements mentioned in the communication on the future CAP is to better target the support to active farmers.

#### Recommendation 2

Non-agricultural land is not eligible and eligible farming activities may not be tied to production of agricultural commodities. WTO 'green box' rules mean that a decoupled support like the SPS cannot be linked to the performance of the beneficiary or of the land in terms of production levels or productivity.

As regards the active maintenance of 'environmental value of agricultural areas' mentioned by the Court, the Commission committed itself in its communication on the future CAP to assess ways of enhancing environmental performance of the CAP. This could be done by supporting simple, generalised, non-contractual and annual environmental actions within the direct payment scheme and/or enhancing certain elements of GAEC standards.

<sup>13</sup> See footnote 2

### 90.

See Commission reply to point 89.

Environmental obligations exist on their own and farmers must implement them independently from the CAP subsidies. Farmers are not remunerated for implementing the law. However, within the CAP, cross-compliance creates a link between those obligations, to which are added other requirements to maintain all the lands of the farm in GAEC, and the full payment of first pillar (and certain second pillar) subsidies.

The intention of the Commission to further 'green' the CAP is outlined in the communication on the future CAP. As regards the SPS, an enhancement of the environmental performances could be achieved through a greening component of the direct payments and an enhancement of GAEC.

### 91.

There is no quantified link between SPS support and costs incurred in respecting good agricultural and environmental conditions. Historical references have thus been used to determine the level of aid. SPS is an area-based payment whose main objective is to provide basic income support. Through the obligation to keep land in GAEC, SPS contributes to the protection of natural resources, thus providing the basis for the delivery of public goods through agriculture. This has been noted in particular in the study on public goods of the Institute for European Environmental Policy (IEEP)<sup>14</sup>.

<sup>14</sup> See footnote 3 above.

## REPLY OF THE COMMISSION

The issue of costs for farmers of compliance with legislation on environment, food safety and animal welfare is often raised, and a study assessing these costs has been requested by the European Parliament and is under way. However, the level of SPS is independent of these costs as it should not compensate farmers for respecting the law and must remain 'green box' compatible.

The communication on the future CAP outlines the intention of the Commission to assess possibilities for a further 'greening' of the first pillar.

### 92.

A margin of appreciation is given to Member States to define the national standards for the GAEC so as to take into account the characteristics of the area. This does not necessarily entail that a production activity is expected from the farmer. National GAEC standards may solely foresee prohibitions of certain practices detrimental for the agricultural or environmental purposes of the GAEC tool while in other cases certain activities are imposed to the farmer.

### Recommendation 3

As set out in the communication on the future CAP, the environmental performance of farmers as a counterpart for support will be further considered by the Commission.

### Recommendation 4

The Commission has proposed in its communication on the future CAP to assess how cross-compliance rules could be simpler and more comprehensive and, for GAEC, to analyse how certain of its elements could be enhanced.

The EU framework for payment reductions under cross-compliance is dissuasive since the reduction can be as high as 100 % of CAP payments received by the farmer. Where weaknesses in the implementation by Member States of the cross-compliance system are observed, these are followed up under the clearance of accounts procedure.

### 93.

The variation in support amongst farmers reflects the farm structure and thus also the fact that there are big variations in the sizes of farms.

In the communication on the future CAP the Commission provides different options to adapt the system of direct payments, in particular in view of addressing the distribution of payments at farm level and between smaller and larger farms. Work is currently ongoing on this issue in the framework of the Commission impact assessment.

### 94.

The communication on the future CAP includes the possible introduction of an element of capping which would allow a limitation of the payments made. The number of hectares and the number of entitlements would however continue to reflect the size of farms and to a certain extent their contribution to the objectives of the common agricultural policy (CAP).

### Recommendation 5

Redistribution of SPS aid as well as capping of payments are options included in the communication on the future CAP.

## REPLY OF THE COMMISSION

**95.**

The historical model was first proposed by the Commission in 2003 with a view to facilitating a smooth transition towards decoupling. The regional model was added at the request of Member States to match some particular national objectives for direct support.

Despite the different implementation, it remains that the level of decoupled direct support that farmers receive in the EU is based on production and support levels during a historic reference period or in the case of the regional model on the areas on a historical reference date. Hence, the current distribution of direct payments between farms is simply a reflection of the fact that agricultural land and agricultural production are not shared equally among the farms in the EU.

**96.**

It is acknowledged that the reference period is getting more distant, but the decoupled character of the scheme does not allow linking it to current production.

**97.**

The capitalisation of support in a regional model may indeed be higher than in a historic model but among factors influencing land prices, CAP subsidies have a more modest impact than other factors. In addition it does not necessarily mean an increase in capitalisation as compared to former coupled forms of support. As regards the likely negative impacts of the regional model, they have to be assessed together with all social, economic and environmental impacts. This will be done in the impact assessment following the communication on the future CAP.

**Recommendation 6**

The communication on the future CAP foresees a new design for direct payments. One of the options currently under consideration would imply a basic support rate complemented with payments for farmers in areas with natural constraints as well as a greening component.

European Court of Auditors

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THE SINGLE PAYMENT SCHEME (SPS) IS A KEY FEATURE OF THE 2003 REFORM OF THE COMMON AGRICULTURAL POLICY. ITS OBJECTIVES ARE TO ENCOURAGE FARMERS TO BETTER RESPOND TO MARKET DEMAND AND TO SUPPORT THEIR INCOME. THE COURT CONDUCTED AN AUDIT OF THE IMPLEMENTATION OF THE SPS.

THE COURT OBSERVES THAT THE LEGISLATION PERMITTED PERSONS OR ENTITIES NOT OR ONLY marginally ENGAGED IN AGRICULTURE TO BENEFIT FROM SPS PAYMENTS. IT RECOMMENDS THAT THE LEGISLATION BE AMENDED TO ENSURE THAT SPS AID IS DIRECTED TO ACTIVE FARMERS. THE CALCULATION OF SPS AID SHOULD BETTER REFLECT THE COSTS FOR ENVIRONMENTAL EXTERNALITIES AND SHOULD BE BASED ON CURRENT FARMING CONDITIONS IN THE DIFFERENT REGIONS. FINALLY, A MORE BALANCED DISTRIBUTION OF SPS AID BETWEEN FARMERS SHOULD BE SOUGHT.



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