



Subsidy streams versus a CAP bond: An assessment of farmers' preferences



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ABSTRACT

Some commentators have put forward the idea of paying farmers a one-off lump sum (commonly referred to as a CAP bond), in lieu of annual single farm payments. This would bring about real reform of the CAP, but at the same time compensate farmers for the elimination of support and give them the capacity to adjust to an unsupported world. Through the development of a contingent valuation scenario, we ascertained the types of farmers who would be most likely to voluntarily switch to this reform measure at specified payment levels. We found that older farmers and those more motivated by business related objectives are relatively more attracted to a CAP bond. Those with greater household financial security and those characterised as being more risk-averse were less likely to prefer a one-off lump sum. Overall our analysis suggests there would be a general reluctance among farm operators to take up a CAP bond even at very high payment levels.

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1. Introduction

European Union agricultural policy underwent significant changes with the Mid-Term Review (MTR) of the Common Agricultural Policy (CAP) in 2003, where member states agreed to implement a system of single farm payments which were decoupled from production. Under the new agreement on CAP reform reached in 2013, a total of €362.78 billion will be spent on the CAP budget between 2014 and 2020. Of this total, €277.851 billion is foreseen for Direct Payments and market-related expenditure (Pillar 1) and €84.936 billion for Rural Development (Pillar 2) in 2011 prices (EC, 2013a). Despite the obvious importance of the single farm payment (SFP) to European farmer accounts, the justification for continued decoupled payments without considerable redesign is dubious (Jambor and Harvey, 2010; Swinnen, 2009; Bureau and Mahé, 2008). A range of environmental justifications have been articulated for continuing with the system of single farm payments, but these justifications demand well-aimed targeting of payments, and not general, sector-wide payments to all farms as is the case with the current system (Harvey and Jambor, 2011).

Moreover, as suggested by Swinnen (2009), any improvement in farm income as a result of support can be temporary, as competition in the industry leads to any revenue increase ultimately being capitalised into the value of farm assets, or being spent on increased

costs of production. Given these questions surrounding the justification of having single farm payments and the substantial pressures on the EU budget, it is unlikely that agricultural support will remain at current levels in the future. The CAP budget has shrunk from 71% in 1984 (with only 10 member states) to an expected 39% of the total EU budget in 2013 with 27 member states (EC, 2011). Under the new agreement on CAP reform, the amounts for both pillars of the CAP for 2014–2020 will be frozen at the level of 2013, which means that in real terms CAP funding will decrease compared to the current period.

The new Common Agricultural Policy post 2013 also aims to have a fairer distribution of payments, and to encourage farmers to adopt more environment-friendly farming practices. All member states with direct payments per hectare below 90% of the EU average will receive an additional allocation. It is proposed that for each of these member States, the gap between the amounts currently allocated and 90% of the EU-27 average will be reduced by one third. However, all member states should attain at least the level of €196/ha in current prices by 2020. This process will be implemented progressively over 6 years from financial year 2015 to financial year 2020 (EC, 2013b). Perhaps the most controversial change is the so called “greening” of the CAP. Specifically, thirty percent of the national ceilings for direct payments will be linked to three environmentally-friendly farming practices: crop diversification, maintaining permanent grassland and conserving areas of ecological interest. Notwithstanding these changes, the single farm payment (SFP) still remains the primary means of supporting

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the incomes of farmers and will be of vital importance to farmer accounts.

There is now a widespread view in the literature that decoupled payments should be phased out completely with any resulting funds used for the provision of public goods associated with the multifunctionality of the agricultural sector (see [Jambor and Harvey, 2010](#) for a review). Despite their inefficient nature, these payments are, however, indispensable for many farm operators. Any elimination of decoupled payments would lead to a significant decline in asset values which often constitute farmers' pension funds or their basis for future business expansion. [Vrolijk et al. \(2010\)](#) estimate that, without decoupled payments, only 18% of European farmers would continue to earn incomes over and above competitive returns to their labour and capital resources. Looking specifically at the case of the Republic of Ireland, some recent farm level research has shown that many farmers are using decoupled payments to subsidise what would otherwise be unprofitable production ([Howley et al., 2012](#)). In other words, for many cattle rearing farms, in particular, decoupled payments account for more than 100% of income, showing that many farmers would not even be able to cover the cost of their levels of production without these financial supports. While they are of central importance to farm accounts, the continuing uncertainty regarding the future of these payments adds to the difficulties faced by farmers when making their business decisions.

The aim of this study was to investigate farmers' willingness to accept (WTA) a one-off lump sum in lieu of annual single farm payments. The replacement of annual single farm payments with a one-off lump sum has been commonly referred to as a CAP bond in the literature. We do not aim to provide a detailed examination of the merits or otherwise of a CAP bond as a compelling case for their consideration has been provided elsewhere (see [Harvey and Jambor, 2011](#); [Swinbank and Tranter, 2004](#)). Rather we aim to identify the characteristics of farmers most likely to be willing to accept this reform measure. We assess WTA through an analysis of a survey in which a contingent valuation (CV) scenario was presented to farm operators. This CV scenario was designed to ascertain how much of a lump sum farmers would require to voluntarily switch from the current system of decoupled payments, to one in which they would be paid a single, once-and-for-all payment, with all rights to future payments being eliminated. To the best of our knowledge, this can be seen as a first attempt to empirically analyse farmers' WTA a one-off lump sum on a voluntary basis, and associated factors that impact those preferences. Our findings indicate a general reluctance on the part of most farm operators to choose this new reform measure even with very high lump sums. There was, however, a significant minority who would voluntarily choose a one-off lump sum at what can be seen as more cost effective levels. A wide variety of factors such as age, financial security, business motivations and risk preferences were found to be significantly associated with farmers' WTA.

2. A bond scheme

In a report for the Land Use and Food Policy Intergroup (LUFPIG) of the European Parliament, [Tangermann \(1990\)](#) recommended that farmers be issued with bonds, on which they would be paid annual payments for a certain number of years. This was suggested as a means to compensate farmers for price supports that were paid at the time. Under this scheme, farmers could decide to keep their bonds in order to receive annual payments or to sell them on the capital market for a lump-sum. Thus, the bond would compensate farmers for the removal of price support and help them adjust to a world without support, but does not seek to encourage farmers to remain in production. [Tangermann](#) suggested a 15 year life-span

for the bond. In 1993, [Poole](#) drawing on [Tangermann's](#) original plan developed the idea further and introduced a new element called an exit bond ([Poole, 1993](#)). [Poole's](#) idea was to introduce a bond scheme on a voluntary basis and offer a choice of bonds. In his proposal, a farmer could choose between an annual income bond with zero redemption value or a zero coupon without yearly income but a fixed capital sum on maturity. The Commission plans for the 1992 CAP reforms included a bond scheme but it was not adopted ([Swinbank and Tranter, 2004](#)). The Danish Government also pressed unsuccessfully for a bond scheme rather than arable area payments in the debate over the 1992 CAP reforms ([Swinbank and Tranter, 2004](#)).

A number of arguments have been put forward by various commentators in support of a bond scheme (see [Harvey and Jambor, 2011](#); [Swinbank and Tranter, 2004](#)). One of the main arguments in favour is that issuing farmers with a single lump-sum would both compensate them properly for the elimination of support, and give them a basis on which to make appropriate strategic decisions to cope in a world without continued support ([Harvey and Jambor, 2011](#)). One of the most important objectives of the CAP has been to provide stability to farmers, but uncertainty over the future of the single farm payment is detrimental for farm decision making. Such a scheme would compensate losers (farmers) and help them to adjust, while promises of continued decoupled payments for a limited period (phased elimination option) do neither.

[Swinbank and Tranter \(2004\)](#) suggest that as markets adjust to unsupported conditions, farm incomes would rise and the EU economy would be better off as a result of efficiency gains. This view was supported by [Brady et al. \(2009\)](#) who using an agent-based spatial and dynamic simulation model of agricultural structural change (AgriPolis) simulated the impacts of a bond scheme on agricultural landscapes and agricultural profitability. Under their bond scheme scenario, the SFP is not distributed as payment entitlements per hectare, but is coupled to the farmer. Their model results show that such a reform measure would speed up structural change considerably, as it would lead to a faster rate of farm exits and increase in farm size. Many farmers leave the sector if off farm jobs are available as the payment is granted to the farmer and not attached to the land. However, in most cases farm profitability increases due to a growth in farm size and lower land rental prices. Their results also show, however, significant agricultural land abandonment of between 1 and 31% depending on the region.

Few previous studies have actually assessed farmers' attitudes towards a bond scheme. One study that did examine this issue was [Tranter et al. \(2004\)](#), which assessed what farmers would do if they received a bond. This was based on a large postal survey of farmers in three European countries (Germany, Portugal and the UK). In this survey, which was done prior to the introduction of decoupled payments, farmers were told that payments would be decoupled from current land use and the number of animals kept, and that 'decoupled payments' would then be guaranteed for 15 years. After that period they would no longer be entitled to any policy support. Farmers reported a general reluctance to cash in the bond on the financial market, with around half of respondents reporting that it was 'unlikely' or they definitely would not do so. When asked whether they would consider a diversification activity, after receipt of the bond, between 5 and 12% said that they definitely would, and a further 12–15% said that it was very 'likely' they would.

3. Data collection and questionnaire design

3.1. Willingness to accept a CAP bond

The data used in this study comes from a cross-sectional survey of 364 principal farm operators in County Offaly in the Republic of

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