

entitlements from the land market. Our contention is that this will create more problems than benefits.

The reasons for this claim are explained as follows.

5. The principal argument is that the main long-term, socially-acceptable justification for continuing payments to farmers and land managers is that they are supplying a stream of environmental and cultural landscape services which society values, and which would not be supplied without the encouragement and support of appropriate rural policy. These services are highly related to land management, therefore payments for the services, naturally, should relate to the qualitative aspects of the land and its area. If this link is cut there are real dangers to resource protection and the maintenance of biodiversity and landscape.
6. We recognise that the first-best way of arranging and paying for delivery of these services is through agri-environment schemes in the second Pillar. Some Member States are already do this to a satisfactory extent, although most are not. There are real political and administrative constraints restricting the rate at which resources can be switched to pillar 2 for this purpose. In the meantime, therefore, the second best solution is to arrange measures indirectly to pay for these services through decoupled Pillar 1 payments with appropriate environmental (and other) conditions attached to the payments. We therefore view (part of) the remaining Pillar 1 decoupled payments as environmental payments in waiting.
7. To be clear, the ELO is not suggesting that all the present direct payments are beautifully calibrated and distributed payments for environmental services and should be preserved for ever. Patently the level and distribution of current payments has very little directly to do with delivering such services. They have arisen out the history of commodity support systems over many years during which the EU has successively enlarged. What we are saying is that a significant proportion of the present expenditures are justified as payment for non-market, public environmental and cultural landscape services supplied by farmers and not directly paid for. The story of the evolution of the CAP since the mid-1990s has been a struggle to overtly recognise this and change the policy in a direction which makes it explicit. Even with the proposed, radical, reform we shall still be some way from the long-run mature policy. It is important to create the structures which assist the correct policy evolution. This motivates our concern to link payment to land management which is the subject of this paper
8. It can be deduced, from the Commission's proposals and the speeches of the Commissioner for Agriculture and Rural Development, that these arguments are, at least partly, accepted. This is indicated by the nature of the conditions attaching to decoupled payments: the statutory management requirements in Article 4 and Annex III 'Statutory Management Requirements'; all aspects of Article 5 and Annex IV, 'good agricultural conditions'; the redefinition of set-aside as a long-term environmental measure¹; and the retention of permanent pasture. These are *all* directly related to environmental aspects of land management. Those statutory management requirements which are not directly land based are related mostly to treatment of animals, the processing and handling of food, and occupational safety.

¹ The ELO does not support the proposed 10 year non-rotational set aside as the way to deliver environmental benefits. In many farming systems it is important to have set aside in the rotation to provide habitat and appropriate cover for certain ground nesting farmland birds, and for uncommon arable plants.

9. ***Therefore as most of the key conditions for receipt of the Single Payment are land related, the payments should be linked directly to the land which gave right to the payments, paid to the occupier of that land, and move with the land if it is sold or leased.***
10. Beyond this issue of principle, there are a number of important practical reasons for maintaining the link between Entitlements and land. These are related to the following :
- the impact on restructuring and new entrants to farming;
 - efficient delivery of the environmental improvements
 - maintaining confidence in the leased land sector
 - administrative accountability
 - public confidence in the reforms
11. We submit that, in practice, many of the moves permitted by separating the market in entitlement and land will be counter to the desired policy direction, of paying for better environmental land management. Transfers without land will not serve to increase the incomes of active farmers, nor significantly reduce the value of land. They will not provide significant capital sums enabling restructuring and investment, and will not improve environmental performance.
12. Transfers without land will, we contend, serve to disrupt the long established division of responsibilities of land owner and tenant. In particular, the uncertainty of continuing support will threaten the future of landlord's investment in fixed equipment and environmental management on rented land. Furthermore, keeping track of entitlements and the land management subject to the compliance constraints could, over time, become a nightmare for the proper accountable administration of the supports. We fear that rights to transferable payments will come to be seen as a junk bond, having little beneficial effect on the environment, and this will lead to continued trenchant criticism of the CAP.
13. The justification for these assertions is as follows.

The impact on restructuring and new entrants

14. The experience over the last two decades in Europe is that if the administrative system makes it possible for markets in quotas to come into being, then they will. Considerable human ingenuity will be devoted to discovering how to operate with them, to the limits of the regulations, to make financial returns from the administrative instrument. In short the policy instrument itself becomes the subject of farmers' entrepreneurial attention – precisely the opposite of the outcome the current policy is trying to achieve. The administrative authorities are then faced with the task of holding the ring for quota transactions and answering for their economic, social and environmental effects. In the case of production quotas there is a strong economic logic for permitting such markets, notwithstanding some of the unanticipated effects. With scarce production rights there is a strong logic in allowing the most efficient producers to acquire the rights as they are the ones best able to bid for them. *The proposed Single Payment Entitlements*

are not a production right. They are not needed for anyone to produce anything. Indeed, as far as marketed agricultural goods are concerned, their whole raison d'être is to divorce the link to production. Therefore it is reasonable to ask what purpose is served by making them tradable?

15. Two answers have been given: that tradable Entitlements may provide some flexibility to assist farm restructuring; and the separation of land and entitlement may reduce land prices and rents as a cost of production. We argue that the entitlement market will not assist helpful restructuring and may inhibit it. We also argue that given the multiplicity of other factors which are the main determinants of land prices – especially in the population dense parts of Europe - the impact on land prices will be highly marginal, yet it may still introduce unwelcome uncertainty which retards investment by land owners in needed fixed capital on farms. In short, our argument is that the expected benefits may be outweighed by problems.
16. The idea that marketable Entitlements can help restructuring is based on the notion that it provides tenants and owners with a possible source of capital to use to develop their farms, or with which to move out of farming or to retire. The extent to which this is true will depend very heavily on the market value of the entitlements. This in turn depends on the supply and demand for entitlement. The supply is made up of the offers of entitlement by precisely this group: those wishing to capitalise the future stream of decoupled payments for investment, restructuring and retirement purposes. There may well be many who are interested in this possibility.
17. The demand for entitlement is harder to predict. Entitlement is a financial asset, available only to “active farmers” offering an annual payment in return for a list of compliance conditions including idling 10% of arable land for up to 10 years. Purchasers will require access to significant sums of capital to buy this constrained annuity. The period over which the payments are made is not clear. There is evidence that these payments might continue until 2012 given schedules to reduce the payments over this period. However in the context of recent purchasers of land who are apparently to be denied entitlements, it is currently being argued by some that there are no guarantees of these payments from one year to another. These features indicate that purchasers will insist on a large risk discount from the present value of the payment stream calculated on normal interest rates reflecting the cost of capital. That is, the buyers will only buy if, given the risk, there is a handsome return on investment in the short run. Returns of 20%-25% were sometimes achieved as the milk quota market came into existence, and are being discussed by specialist quota traders in some Member States.
18. The other factor which will strongly influence the demand for entitlement is the area of land which is bare of entitlement, or on which entitlements are so low that purchasers are willing to discard them when they buy larger entitlement per hectare. This is an empirical matter which depends on the precise rules for determining the number of eligible hectares used to calculate the entitlement per hectare. The main areas of such land are the fruit and vegetable area including potatoes, and any forage area not scooped up into livestock entitlements. The proportion of entitlement-free area will vary widely from one Member State to another, in some it may be quite small, further restricting the potential demand for entitlement.
19. If the above analysis is correct and entitlement transacts at a highly discounted price, then the volume of sales will not be great. It implies that selling payment entitlements is a highly inefficient way of raising capital for

farmers for any of the purposes suggested above. This in turn suggests that far from enabling farmers to cash-in their subsidy stream, the first group of farmers who are the recipients of the windfall may do all in their power to sit tight and receive the annual payments for as long as they last. In particular, potential retirees may consider doing just this, retiring on the job, doing the least necessary to keep the land in good agricultural condition, and returning very little to society for the support they are receiving.

20. These problems arise because the drafters of the proposal seem to have been simultaneously persuaded by two quite different motivations for decoupling payments and how they should be paid. The marketed entitlement is heavily influenced by the Tangermann Bond idea. However in Tangermann's proposal there are two vital ingredients which are not in the present proposal. The first is an explicit statement of the finite period over which the decoupled payments will be made, perhaps at a declining (degressive) rate. Second, Tangermann's bond has no linkage to land or to delivery of environmental services whatsoever. The recipients of Tangermann Bonds need not be active farmers. Quite rightly in the view of the ELO, this explicit exit strategy for support payments is not the aim of the Commission proposals. Correctly, the Commission insists that recipients must be farmers, and they must be doing something positive for society to justify payments. We applaud this approach and we have explained the non-market services that farmers are supplying. By clarifying the real motives for the payments, we can better see how they must be paid. The Commission's proposed half-way house between latent environmental payments and Tangermann Bonds is in danger of truly producing a junk bond which serves little or no useful restructuring purpose, and may not be a very effective vehicle for delivering environmental services either.
21. Another important effect of tradable entitlement on restructuring concerns future new entrants. If some tenants or owners choose to sell-off entitlement from a particular farm, subsequent new tenants or owners coming onto that farm are faced with two choices, to farm without payments (in competition with their neighbours who have payments), or to engage in the costly process of buying entitlement. A 1% National Reserve has been proposed to deal with this problem, but there is much concern that it will not have sufficient funds, and will involve a slow and bureaucratic process, and therefore provide little real remedy for the problem. Such obstacles can only discourage new entrants. This is a serious deficit in the proposals. It is vital that the 'new' policy sends a clear signal that food production and land management can provide exciting career opportunities for young people – this will be killed stone dead if new entrants are sent the message that they will be at a competitive disadvantage to established farmers.
22. The main point of the ELO counter proposal is that all these problems can be avoided by the simple act of tying the entitlements to the land which gave right to them and paying them to the bona fide occupier of that land – tenant or owner.

Efficient delivery of the environmental improvements

23. There is a real concern that one of the motivations for the sale, swapping and moving around of entitlements separately from land will become the search for land on which compliance with the conditions is least onerous. This is partly motivated by the thought that entitlements bring stronger expectation of environmental monitoring. A purchaser of entitlement buys with it a detailed

list of obligations on the management of the land, including 10% set-aside². The statutory management requirements are, of course, already applicable to all land.

24. However the farm advisory service obligation will, and compliance monitoring activities are likely to, concentrate on 'entitlement' land. To respect these requirements and the good agricultural conditions will take varying degrees of effort and cost. It is rational to expect that one of the motivating forces behind movement of entitlements without land will be to shift it from situations of difficult and costly compliance to easier compliance. Put another way, entitlements sold without land may seek to move from the arable areas or the main ruminant livestock areas to more extensively farmed land. As there could be significant differences in the value of the entitlement per hectare, this could involve both sales in which entitlement moves to entitlement free land, or entitlement swaps. In the latter the high entitlement per hectare from a farm in, say, an arable area, exchanges for low entitlement per hectare from a farm in, say, the mountains. The arable farm may then simply choose not to claim his (new, very low) entitlement to free himself from the constraints. To the extent this happens it will diminish the leverage available to raise standards in the mainstream farming areas of the Union. Such moves are not consistent with the aims of the policy change, again they arise because of the insistence of separating entitlement and the land which gave right to it.

Maintaining confidence in the leased land sector

25. The leased sector of European agriculture is a most important aspect of land ownership and management. Whilst a high proportion of European farms involved leased land, in a large proportion of these the occupier both owns and rents land. In such mixed ownership situations, the prime interest and main motivator of behaviour is the ownership aspect. In many parts of the European Union, land owners provide very significant levels of investment in fixed equipment for use by the tenant farmer. Buildings for storage and processing of crops, animal housing, water supplies, residential property and many other factors have traditionally been provided by the landowner. Continuing restructuring requires considerable capital investment in order to maintain and enhance the efficiency and profitability of tenant farmers. Enabling entitlements to be transferable will provide a disincentive to this investment, without providing anything like the necessary sums for use by tenant farmers. This is because the risk of the tenant taking the entitlement with him will be factored into the investment decisions of *all* landowners, whereas in practice only a small proportion of tenants will in fact be able to do so. Moreover, the current mechanisms which link payments to land under the Arable crops schemes have been very effective at leveraging private investment by land owners in tenanted farms. Such investment increases the efficiency of farming and the incomes of farmers.
26. Long term environmental management and investment are generally inspired by the attitudes of the landowner. An important part of the rationale for separating land ownership and its occupation is to clarify the different objectives of land management. This is especially so in situations of tenancies which do not extend beyond one generation and particularly for shorter term tenancies which have become more common as farming profitability has become more unstable and land management structures

² Although the rules for the transfer of set aside are not yet known

more fluid. In these circumstances, the tenant strives to run the most efficient farming and food production business, and devotes his investment and managerial skills to this task. We stress that good tenant farmers are also well aware of the techniques of environmentally sensitive farming practices; we also acknowledge that there are many examples of long-term multi-generation tenancies.

27. However, outside these cases, it is the land owner who has the pride of ownership, the continuity of interest, and thus the long-run sustainability of the land and its natural and built assets in mind. It is he who is highly conscious, in his investment and management, of environmental capital and amenity. It is he who is concerned with the woodland, hedgerows, ponds and parkland, and their contribution to the landscape and biodiversity; these features do not just happen, they are created by active time and commitment. This is all well-established in tenancy agreements. Building up environmental capital can be a long-term process, for example it can take many years to establish minimum thresholds for breeding of bird species. This could be put at risk if short term management decisions driven by rules for payment entitlements interfere in such processes. Thus the relationship in land management between land owner and tenant is a classic separation and specialisation of function. Within the appropriate policy and economic circumstances, it works extremely well to achieve social aims for sustainable agriculture. Allowing decoupled payments which, we have argued, are fundamentally justified as payments for public environmental goods, to be separated from the land threatens to upset this long-accepted division of responsibilities.
28. To the extent that the separation of entitlement and land allows value to be stripped from that land, then this can only result in a diminished capacity and willingness of land owners to invest in such land. We have argued above that we do not anticipate this will be a widespread and general phenomenon, but the possibility that it might happen diminishes confidence in the let sector for the owner. In cases where it actually does occur it results in land with reduced investment for the long term to the disadvantage of the local rural economy.
29. An important concern about this from the ELO perspective is that these proposals will undermine confidence in long-established tenure systems. To allow tenants, or in some countries licence holders, to remove the support the public offers for sound environmental management from the land, sends the signal to reduce the area of land available for letting. This would be a retrograde step for the balance of land management which has evolved over a long period in Europe. We look to the Commission to ensure that EU regulation does not override or undermine established national land tenure systems. These problems are also avoided if entitlements and land remain together.

Administrative accountability

30. It is our interpretation of the proposed regulations for the payment of entitlements that the recipient will have to demonstrate that he is actively managing the number of hectares for which he makes a claim. Further, we understand that this can be any actual hectares, it is the area which matters, and the fact that this tract of land is not the subject of a claim by any other party. To satisfy the latter requirement, ie to stop several entitlement claims 'piling up' on physically the same hectares, there will have to be administrative procedures in which claimants indicate the specific hectares

which are a sufficient basis for their claim. In order to facilitate the monitoring of cross compliance, it may also be necessary for claimants to indicate all the agricultural parcels under their management. In turn, with each transaction of entitlements the new claimant will presumably have to show the genesis of the entitlement amount as well as the land to which the claim has moved. As entitlement apparently will be saleable in units of one hectare, keeping track of the multiplicity of moves of entitlement, from serious land transactions to create viable farming units, to grandchildren being given entitlement birthday presents, will have to be carefully recorded and mapped by the national administrations. This seems a challenging administrative task. All claims will have to be capable of being related to specified agricultural parcels, and it will be necessary to develop software to cross check all claims with respect to each parcel. Whilst the fact that there will be no need to record individual crops and livestock categories is a simplification, the cross-checking to avoid multiple claims on the same parcel as entitlement moves around the country is a demanding task to ensure sound standards of accountability. This task is considerably simplified if the link between entitlements and land is 'sorted out' at the initial allocation and does not change thereafter.

31. This is achieved if there is a once-for-all link of the reference year payments with the land which gave right to it. Once this is done, those payments remain on that land and are paid to whoever is farming that land, the owner, his tenant – whether he is there for many years or just one season, and there the matter rests as long as the payments survive (which is a quite different question). This would be a true simplification. It would also represent the least further disturbance of the status quo given the radical change that decoupling the payments brings about. Each claimant would have to demonstrate his access to specified parcels of land. Livestock entitlements would accrue, as now, to the owners of the livestock, the owner or tenant. Land and its entitlement would be sold together – as now for area based supports.
32. The ELO recognises that there are some categories of present payment recipients which create difficulties for our proposed land-based solution for entitlements. Examples are transient graziers at the low-intensity end of the production spectrum, and feedlot producers at the other extreme, neither of which have land (or sufficient land) to create area-based entitlements. The proposed solution of 'Special Entitlements' with more restricted options for transfers seems a sensible approach.

Public confidence in the policy

33. Our concern with the next reforms of the CAP is that they should make an important step in legitimising the rather large support the public gives to its land managers and farmers. In the view of the ELO, if payment decoupling is done along the lines suggested, then it could mark a very positive step in reducing the intense criticism that the present policy has attracted. In particular, to be able to claim that the support system is not only making a large step towards removing distortions to commodity markets (reducing negative effects) but it is also recoupling the support in an important way to direct farmers' attention to improved environmental land management (increasing positive benefits) then this will enormously boost public confidence in the policy.
34. To do this we must be able to demonstrate that the new payments are indeed highly related to the improved standards of care for the natural resources of

soil, water, atmosphere, and that they will contribute to biodiversity goals and landscape and heritage management. These will be far better served if most entitlements are linked to the land, and both the land managers and authorities know to which land they relate. If the commentary on the policy in the next few years is dominated by stories of financial tricks and schemes whereby some entrepreneurial people find ways for exploiting the system to make money out of entitlements which have nothing whatsoever to do with good land management, then the policy remains doomed to be condemned by scathing criticism.

Current paralysis of the land market.

35. There is another extremely important reason for attaching the decoupled payment entitlement to the land which gave right to it and paying it to whoever farms it, which concerns the transitional arrangements until the new regulation is in place and entitlements have been satisfactorily allocated. A very large number of cases have already been notified to ELO member organisations where land transactions, and business restructuring, have occurred since the start of the reference period (January 2000) and the new owner or occupant of the land is extremely concerned about his payment rights. There will be many cases of what appear to be gross injustices where people have bought or rented land at the 'full market price' with the clear intention of both buyer *and seller* that supports will transfer with the land, to discover that if the Commission's proposals go through, they are denied payment entitlements. There is established precedent in land markets that land-based payments accrue to the occupier of the land. The sale and rental deals since summer 2000 will certainly reflect these precedents. It is certain that reasonable business expectations are that as long as public supports for farming or other forms of land management are in place they will accrue to the occupier for the land. There is a readiness to test this in courts.
36. The remedies suggested so far to deal with this problem are not adequate. To suggest that the new occupier (owner or tenant) can buy entitlement, understandably enrages those who feel they have already paid for it in their deed of sale or rental agreement. The suggestion that new entrants may be able to apply for entitlement from the National Reserves offers little comfort. There are concerns about the inadequate size of the National Reserve and delays likely before it can be allocated because of the three year window for entitlement claims. The present categories of hardship and exceptional circumstances do not include these restructuring cases, and if they did this is a poor solution. It would require an even larger reserve than proposed and the administration for the claims would be a mammoth administrative task
37. These uncertainties for current transactions have resulted in the land sale and rental market being severely disrupted. ***Transactions are now being put on ice, or set up as very short-term temporary arrangements, because buyers and new tenants are uncertain what rights they are purchasing or leasing.*** Land and rental markets cannot efficiently adapt without legal clarity about entitlement rights. Participants in these markets have real reason for doubts given that the regulations indicate that entitlements will accrue to the claimants during the reference period. It will be extremely disruptive if the land sale and leasing market is frozen for many months, there will be a long term price to be paid for this period of lost restructuring.

38. It is far preferable to avoid these misallocations of the entitlements in the first place by fixing the entitlement to land as the ELO proposes. However it is possible to separate the issue of the initial allocation of entitlement from the longer term issue of linkage to land. ***To deal with the specific issue of allocating the initial entitlements we advocate that, without prejudice to our proposal in paragraphs 4 and 8 above, that it be announced that entitlements will accrue to the occupant of the land at the commencement of the new scheme.***³
39. It is vital that early signals on the resolution of this problem are given to calm the entirely understandable nervousness which has now appeared in the land sales and leasing market.

In conclusion

40. There is a history in European agricultural policy that the rights to support have tended to be linked to land, we believe this tradition should be continued. The Commission's proposals for decoupled payments do propose that claimants of entitlements must be actively farming the area of land they are claiming. But the proposals go one stage further and suggest that there can be a market in entitlements separate from the land.
41. We have posed the question – what social purpose is served by making the proposed payment entitlements tradable without land? We have argued that in principle the evolution of the CAP for many years now has been from agricultural commodity payments towards payments for environmental services and rural development. The logic of this approach is that the annual payment part of the policy should be land-based as the environmental delivery is mostly land based. This informs our strategic approach.
42. There are substantial practical arguments too. We argue that any benefits for restructuring are likely to be outweighed by problems. The market in entitlements will be highly irregular and motivated by sheer financial gain from the subsidy system and the avoidance of environmental conditions. This will undermine the achievement of environmental goals. It will have, and indeed is already having, the side effect of undermining confidence in long-established land leasing systems. Finally, the entitlement market could turn out to be a nightmare for publicly accountable administration. In conclusion, the dangers of tradable entitlement outweigh possible benefits, and they could undermine confidence in the proposed reform. We urge the Commission to rethink this aspect of their proposals and we will be pleased to discuss these issues in greater depth.

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³ We recognise that the precise date cannot be set until we know when the scheme is to operate, also, for the benefit of tenants on grazing agreements for a certain period of the year, the date should be at a time when they can expect to be in occupation, e.g. 15th May.