SPICe Briefing
CAP Reform: Proposals for 2014-20

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This briefing has been prepared for Members of the Rural Affairs and Environment Committee. It looks at the historical background to the Common Agricultural Policy and recent reforms; summarises proposals for the forthcoming reforms in three contributions to the debate – a report by the European Parliament; the Pack Report on the future of agricultural support in Scotland; and a Communication published by the European Commission. It considers reaction to these proposals, the position of the UK Government, and a joint position published by the Devolved Administrations.
## CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>EXECUTIVE SUMMARY</td>
<td>3</td>
</tr>
<tr>
<td>HISTORICAL EVOLUTION OF THE CAP</td>
<td>6</td>
</tr>
<tr>
<td>CURRENT SYSTEM OF SUPPORT IN SCOTLAND</td>
<td>9</td>
</tr>
<tr>
<td>PILLAR 1 – PAYMENTS ENTIRELY FUNDED BY THE EU</td>
<td>9</td>
</tr>
<tr>
<td>PILLAR 2 – THE SCOTLAND RURAL DEVELOPMENT PROGRAMME</td>
<td>9</td>
</tr>
<tr>
<td>PUBLICATION OF DATA ON SUBSIDY RECEIPTS</td>
<td>10</td>
</tr>
<tr>
<td>EUROPEAN PARLIAMENT AGRICULTURE COMMITTEE REPORT</td>
<td>10</td>
</tr>
<tr>
<td>THE PACK REPORT</td>
<td>11</td>
</tr>
<tr>
<td>OBJECTIVE OF AGRICULTURAL SUPPORT</td>
<td>11</td>
</tr>
<tr>
<td>FUTURE OF SINGLE FARM PAYMENT</td>
<td>12</td>
</tr>
<tr>
<td>LFA SUPPORT</td>
<td>14</td>
</tr>
<tr>
<td>RURAL DEVELOPMENT</td>
<td>14</td>
</tr>
<tr>
<td>ALTERNATIVE PROPOSALS FROM THE NFUS AND OTHER REACTIONS</td>
<td>14</td>
</tr>
<tr>
<td>EUROPEAN COMMISSION’S COMMUNICATION</td>
<td>15</td>
</tr>
<tr>
<td>CHANGES TO DIRECT PAYMENTS</td>
<td>16</td>
</tr>
<tr>
<td>CHANGES TO MARKET SUPPORT</td>
<td>16</td>
</tr>
<tr>
<td>OPTIONS FOR REFORM</td>
<td>17</td>
</tr>
<tr>
<td>REACTION TO COMMISSION PROPOSALS</td>
<td>17</td>
</tr>
<tr>
<td>COMMON FEATURES OF EUROPEAN PARLIAMENT, PACK AND COMMISSION PROPOSALS</td>
<td>19</td>
</tr>
<tr>
<td>UK GOVERNMENT’S POSITION AND REACTION</td>
<td>19</td>
</tr>
<tr>
<td>JOINT POSITION OF DEVOLVED ADMINISTRATIONS</td>
<td>20</td>
</tr>
<tr>
<td>HOUSE OF COMMONS EFRA COMMITTEE INQUIRY</td>
<td>21</td>
</tr>
<tr>
<td>WHAT HAPPENS NEXT?</td>
<td>22</td>
</tr>
<tr>
<td>ANNEX – IMPLEMENTATION OF THE SINGLE FARM PAYMENT</td>
<td>22</td>
</tr>
<tr>
<td>SOURCES</td>
<td>23</td>
</tr>
<tr>
<td>RELATED BRIEFINGS</td>
<td>28</td>
</tr>
</tbody>
</table>
EXECUTIVE SUMMARY

Initially, the goal of the Common Agricultural Policy (CAP) was to boost food production to alleviate post-war shortages. It did this by managing supply to keep prices high. Success in achieving this led to overproduction. The need to curtail spending on the CAP budget, and pressure for the EU to reform its protectionist stance on agriculture in trade negotiations have been the main drivers of reform of the policy since the 1990s. The policy has also evolved in response to EU citizens’ concerns about the need to protect the environment, and to improve animal welfare. Support has been shifted from price to producer, and direct payments to farmers now make up three quarters of the CAP budget of c. €57 billion per annum. These direct payments were intended to compensate farmers for lower prices, and were linked to the number of animals kept or the area of crops grown. Further reforms in 2003 have “decoupled” payments from production, and farmers receive an annual Single Farm Payment, for which they are required to keep their land in Good Agricultural and Environmental Condition (GAEC) and comply with a set of Statutory Management Requirements (existing legislative standards relating to public health, animal and plant health, environmental protection and animal welfare). Direct payments and remaining price support mechanisms are known as “Pillar 1” of the CAP. Rural development measures, which include support for farmers in Less Favoured Areas (LFA) and agri-environment schemes are known as “Pillar 2” of the CAP.

Member States were given an unprecedented amount of discretion in implementing the 2003 reforms. Scotland chose to introduce a fully decoupled Single Farm Payment in 2005, and establish a Scottish Beef Calf Scheme. Single Farm Payments are an average amount per hectare based on the amounts farmers received in a 2000-02 reference period. These two schemes are the main elements of support from Pillar 1 of the CAP in Scotland. In 2009, c.£510m was been paid out under the Single Farm Payment Scheme to over 19,000 applicants and £23m has been paid out to c.7,700 applicants under the Scottish Beef Calf Scheme. Pillar 2 in Scotland is implemented by the Scotland Rural Development Programme. This has 3 main elements – the Less Favoured Area Support Scheme, worth £62m to 12,000 farmers in the LFA, which covers 85% of Scotland; Land Managers Options – a non-competitive scheme which offers 21 options with a budget of c. £15m p.a.; and Rural Priorities, a competitive scheme which offers 75 different options to farmers and land managers. £378 million funding has been approved for 4,850 applications under Rural Priorities since the scheme opened in July 2008.

The current CAP agreement expires at the end of 2013, and a debate has begun on a new agreement for the period 2014-20. Three important contributions to this debate are a report from the European Parliament published in July 2010; the Pack Report and a Communication from the European Commission both published in November 2010. There are clear areas of consensus between these positions.

The European Parliament’s own initiative report on the future of the CAP identifies food security; rising energy prices; climate change; environmental protection; land abandonment; and the economic crisis as challenges to which the CAP must respond. The report argues that the existing CAP budget must be maintained up to 2020. The report suggests the CAP budget should be allocated to Member States based on objective criteria, and that the period up to
2020 should be a transitional period for moving from the historic to the area basis for Single Farm Payments in all Member States.

In Scotland, the “Pack Report” was published in November 2010, and contains advice to the Scottish Government on the priorities for Scotland in the forthcoming negotiations, and recommendations about how support should be delivered. The report argues that the CAP budget should be maintained and that the CAP should maintain its two pillar structure. Scotland has one of the lowest rate of Pillar 1 support per hectare and lower Pillar 2 support per hectare than the average of any Member State. Pack recommends that Scotland should seek a better share of the Pillar 1 budget from within the UK’s allocation, and the UK should seek a fairer allocation of the Pillar 2 budget. It suggests Single Farm Payments should be made on an area basis, with a top-up element to encourage agriculture to respond to the challenges of food security, energy shortages, climate change and environmental protection, and that there be some coupled payments in the LFA to stabilise cow and ewe numbers.

The report suggests that a different regime should apply to LFA and non-LFA land when the reform is implemented in Scotland. Farmers outwith the LFA should receive an area payment, with a top up payment per hectare. Farmers in the LFA would receive an area payment, significantly lower than non-LFA land; a top up payment linked to farm labour use; and headage payments for the beef calves and lambs they rear. Support under the present LFA scheme should be separated with c.£40m being paid out in Pillar 1 and added to the top-up payment for LFA farmers, and c.£20m retained in Pillar 2 and targeted at the parts of the LFA which are most difficult to farm. The National Farmers Union of Scotland has welcomed the general thrust of the proposals but has expressed some reservations about the detail. It is consulting its members on alternative models for delivering support. Scottish Environment LINK has criticised the lack of environmental focus of the proposals. In particular, they have expressed concern about the assumption that the most productive businesses should receive the highest payments and the suggestion to divert funds from Pillar 2 to Pillar 1 in order to fund the LFA top-up.

The European Commission published a Communication with its initial proposals on CAP reform on the 17 November 2010. The Communication highlights similar challenges facing European agriculture as the European Parliament and Pack and argues that a common policy is the best way to respond to them. It suggests a future direct payments regime would be composed of an area payment, which would be capped at a maximum per farmer; additional payments for non-obligatory measures designed to “green” Pillar 1; and an additional support payment for farmers in the LFA (who would also continue to receive support from Pillar 2). The option of retaining limited coupled payments to encourage production in sensitive sectors, such as the Scottish Beef Calf Scheme, would remain. The Communication suggests three options for reform, of which commentators have suggested the second option - a significant reform of the policy to make it more sustainable, and a fairer distribution of the budget between Member States - is the only horse in the race. The Commission’s proposals were criticized by Stefan Tangermann, a noted commentator on agricultural policy as being for a conservative review rather than a reform, and argued that more of the budget should be shifted to Pillar 2, and used to pay farmers for producing non-market goods, such as reducing greenhouse gas emissions and protecting biodiversity and landscapes.

Reaction to the Commission’s proposals in an initial discussion by the Council of Ministers was broadly favourable, although the UK and Germany said that there was a need to restrain spending on the CAP post 2013. This call was repeated by the UK Secretary of State, Caroline Spelman MP in a speech at the Oxford Farming Conference. She said that the prospect of rising food prices meant that it was possible to phase out direct payments, and that they should be cut from 2014-20, and that more money should be shifted to Pillar 2. These views attracted critical comment in Scotland.
The Scottish Government, Welsh Assembly Government and Northern Ireland Executive have published a joint position on CAP reform, and have written to the Secretary of State setting out their three priorities which they want the UK to adopt in its negotiating line. These are: securing a fair share of the budget; flexibility to respond to local needs in implementing the policy; and simplification.

The House of Commons Environment, Food and Rural Affairs Committee is currently conducting an inquiry into the implications of CAP reform for the UK.

The European Commission will take into account the reaction of Member State Governments and the European Parliament to its proposals. It aims to publish legislative proposals mid-2011 and achieve a political agreement on these by the end of 2012. In 2013 the Commission will develop detailed implementing rules, so that the new CAP can be implemented in 2014.
HISTORICAL EVOLUTION OF THE CAP

The 1957 Treaty of Rome made provision for there to be a Common Agricultural Policy (CAP). Europe had suffered food shortages during and after the Second World War, and the initial objective of the CAP was to increase food production. The CAP sought to do this by offering farmers guaranteed prices for their produce by managing supply. Surplus grain, milk, wine, olive oil and meat was removed from the market and held in intervention storage to keep prices above a target level. Tariffs were set to restrict competition, and exports of surplus produce were subsidised. The policy was successful at increasing internal production, so much so that by the end of the 1970s and the early 1980s the problem for policymakers was how to deal with grain mountains and wine and milk lakes. This saw the introduction of supply management measures such as milk quotas and set aside. The 1970s also saw the introduction of specific supports for farmers in Less Favoured Areas.

The next phase in the history of the CAP is marked by the EU’s response to the outcome of international trade negotiations in the General Agreement on Tariffs and Trade (GATT) and then the World Trade Organisation (WTO), to make the CAP less trade distorting. The policy has also evolved in response to EU citizens concerns about the need to protect the environment, and to improve animal welfare. The response to the requirement to reduce trade distorting subsidies was to reduce support for prices, allowing prices on the internal EU market to fall closer to the world market price, and to compensate farmers with direct payments paid per hectare of crops, and per head of livestock. This approach was begun by the “Macsharry” reforms of 1992, agreed under the Irish Commissioner for Agriculture, Ray Macsharry, and continued with the Agenda 2000 reforms, agreed in 1999 under the Austrian Commissioner Franz Fischler. The Agenda 2000 reforms also sought to reform the CAP to accommodate the accession of ten new Member States from Central and Eastern Europe in 2004. Direct payments to farmers and remaining market support are described as “Pillar 1” of the CAP. Another important change in the Agenda 2000 reforms was to bring together agri-environment schemes, support for farming in Less Favoured Areas with other rural development measures in a rural development regulation. This rural development policy is commonly described as “Pillar 2” of the CAP. In 2009 EU spending on Pillar 1 was €43 billion (76%) and €14 billion on Pillar 2 (24%) (Scottish Government 2010a).

In the WTO terminology subsidies which are trade distorting are known as “amber box” payments, and the WTO agreement limits the amount signatories can spend on this type of payment. Subsidies which have no effect on trade are known as green box, and are not subject to limits. The headage\(^1\) and area payments used by the EU were categorised as “Blue box” and were not subject to payment limits (WTO).

The next major change in the policy was agreed in the “Fischler” reforms of 2003. The reform was meant to be a mid-term review of the Agenda 2000 deal which was to run until 2006, but the reforms ended up being the most radical since the inception of the policy. The scene was set for the reform with an agreement between France and Germany (later adopted by the then EU15, although opposed by the then UK Government), which set the CAP budget up to 2013. The Commission successfully argued that rather than a mid-term review, more radical reform was needed in order to strengthen the EU’s hand in the forthcoming Doha round of WTO negotiations. In previous negotiations the Commission had spent much of its time defending the CAP, so reform would allow the Commission to push for a better deal on access to other markets, which would benefit the EU. The centrepiece of the reform was to combine previously separate subsidy schemes into a Single Farm Payment which would be ‘decoupled’ from

\[^1\] i.e. payments made according to the head of livestock of certain kinds kept on a farm
production, as it would be either paid as a flat rate area payment, or based on historic production levels, which farmers would not be obliged to maintain in order to continue to receive the payment. As it was not linked to production, the EU argues that Single Farm Payments are not trade distorting, and are therefore “green box”.

To receive the payments farmers must keep their land in Good Agricultural and Environmental Condition, and respect EU laws on biodiversity, animal welfare, and the water environment – criteria known as “cross compliance”. Member States were given an unprecedented level of choice in how to implement the reforms. The table shows the main choices which could be made and the decisions made in Scotland. Single Farm Payments in the 10 Central and Eastern European Countries which joined the EU in 2004, and in Romania and Bulgaria which joined in 2007 have been made as a flat rate area payment, with rates increasing in steps to reach equivalent levels in the other Member States by 2013.

Table 1 – Decisions implementing CAP reform in Scotland in 2004

<table>
<thead>
<tr>
<th>Choice</th>
<th>Decision made in Scotland in February 2004</th>
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<tbody>
<tr>
<td>Implement Single Farm Payment in 2005, 2006 or 2007</td>
<td>2005</td>
</tr>
<tr>
<td>Reforms to be implemented ‘regionally’</td>
<td>Yes. Different regimes implemented in Scotland, England, Wales and NI. UK ceiling limiting Single Farm Payments divided regionally.</td>
</tr>
<tr>
<td>Flat rate area payment or historic payment based on average amounts paid out between 2000 and 2002 (or a ‘hybrid’ of the two, which could be either static – proportion of historic and area payments fixed over time, or dynamic – shift towards area payment over time)</td>
<td>Historic payment. England opted for a dynamic hybrid, Wales historic basis, NI a static hybrid.</td>
</tr>
<tr>
<td>Retain a proportion of previous schemes as coupled subsidies</td>
<td>No</td>
</tr>
<tr>
<td>Introduce a national envelope of up to 10% of payments to all sectors or an individual sector. Payments must contribute to the environment or to quality food production.</td>
<td>Yes. National envelope of 10% of payments granted to beef sector used to set up a Scottish Beef Calf Scheme</td>
</tr>
<tr>
<td>Option specific to UK – retain national ‘modulation’ of payments to transfer funds to rural development schemes. This would be in addition to compulsory modulation for all Member States that was introduced in the reforms.</td>
<td>Yes</td>
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A table in the annex shows the way the Single Farm Payment has been implemented in the different EU Member States.

The most recent changes to the policy were agreed as part of a ‘Health Check’ in 2008. The reforms made a number of changes such as abolishing set-aside, and increasing the transfer of
resources from Pillar 1 to Pillar 2 of the CAP (modulation), but the fundamental features of the policy agreed in 2003 and the decoupled Single Farm Payment remain (European Commission). The evolution of the CAP from its inception to date is summarised in the figure below. The bar chart below the figure gives a graphical illustration of the way CAP reforms over the last 30 years have changed from supporting prices to supporting producers.

**Fig 1 – Historical development of the CAP**

![Image of historical development of the CAP](Source: Scottish Government (2010a))

**Figure 2 – Evolution of CAP expenditure 1980-2008**

![Image of evolution of CAP expenditure](Source: Lyon (2011))
CURRENT SYSTEM OF SUPPORT IN SCOTLAND

PILLAR 1 – PAYMENTS ENTIRELY FUNDED BY THE EU

Single Farm Payment Scheme (SFPS) – payments are made annually to farmers based on the amounts they received historically between 2000 and 2002. The average area farmed in those years and the average amount received creates an entitlement per hectare. To receive their full entitlement farmers must continue to manage the same area, but not necessarily the same hectares. There is no obligation to continue to grow crops or keep animals to receive the payment, but land must be kept in Good Agricultural and Environmental Condition. Scotland has a ceiling for Single Farm Payments of €647 million, of which €82 million is deducted through modulation and used to fund the Scotland Rural Development Programme (€27.9 million in compulsory modulation which is applied EU wide, and €54.2 million of voluntary modulation, additional modulation which applies in Scotland). This leaves a total of €565 million. The amount paid out depends on the €:£ exchange rate$^2$, in the 2009 scheme year c.£510m has been paid out under the scheme to over 19,000 applicants.

Scottish Beef Calf Scheme (SBCS) – a payment paid once per beef calf. To be eligible, calves must be three-quarters beef bred$^3$. The payment varies from year to year depending on the total number of calves claimed in Scotland. To help smaller producers there is a higher payment for the first ten calves claimed. For the 2009 scheme year the payments were £114.38 for the first 10 calves, and £57.19 for the remainder (Scottish Government 2010b). The budget for the scheme is formed out of a “national envelope” of 10% of the total subsidies formerly paid to the beef sector, and has an annual budget of £29.8m. In the 2009 scheme year £23m has been paid out to c.7,700 applicants (Scottish Government a).

PILLAR 2 – THE SCOTLAND RURAL DEVELOPMENT PROGRAMME

The Scotland Rural Development Programme is funded by the EU and the Scottish Government. It has four main elements: the Less Favoured Area Support Scheme; Land Managers Options; Rural Priorities and LEADER.

Less Favoured Area Support Scheme (LFASS) – is an area payment paid per hectare of eligible land in the Less Favoured Area (LFA). The rate per hectare depends on whether the farm is in the “very fragile”, “fragile” or “standard” LFA, and on whether the land is more or less disadvantaged. 85% of Scotland is classified as LFA. The scheme has been reviewed to target payments at more active farmers, and payments for farmers in the fragile and very fragile area are increasing by 38% in two steps in the 2010 and 2011 scheme years, and increasing by 38% for farmers with land in grazing categories A & B in the “standard” LFA in 2011, and by 5% for other farmers in the Standard LFA in 2011. In the 2009 scheme year £62m has been paid out to over 12,000 applicants (Scottish Government a).

Land Managers Options – 21 options available to all farmers and land managers. The scheme is non-competitive. Following the structure of the EC Rural Development Regulation which governs support under the SRDP the options are listed under three axes – improving

$^2$ Farmers can elect to receive their payment in Euros
$^3$ The scheme rules list a number of dairy breeds which are not eligible for payment. Male animals in livestock farming are invariably pure-bred. Many beef cows “sucklers” are the progyny of a beef bull and a dairy cow. The offspring of a pure-bred beef bull and a half-bred beef cow is thus 75% beef bred, which is the minimum requirement of the scheme.
competitiveness (axis 1); improving the environment (axis 2), and improving rural life (axis 3). £15 million was paid out under the scheme in 2009 (Scottish Government a).

Rural Priorities – a competitive scheme which offers 75 different options to farmers and land managers. The options are organised under the same three axes as Land Managers Options. As at November 2010 a total of £378 million has been approved for 4,850 applications under Rural Priorities since the scheme opened in July 2008 (Scottish Government b).

The other elements of the SRDP are the LEADER programme, which supports rural development projects by Local Action Groups; the Crofting Counties Agricultural Grant Scheme; and two forestry Challenge Funds.

**PUBLICATION OF DATA ON SUBSIDY RECEIPTS**

Prior to November 2010 the Scottish Government published details of the amounts received by individual recipients of agricultural subsidies. On 9 November, the European Court of Justice (2010) issued a ruling on two cases involving the publication of subsidies paid to individuals. The ruling makes invalid the European legislation that places an obligation on Member States to publish the data on beneficiaries of agricultural funds. As a result, and with immediate effect, all member states have been asked to suspend the publication of data on individual beneficiaries affected by the ruling. Data on subsidies received by Scottish farmers on the Scottish Government and DEFRA websites has been taken down.

**EUROPEAN PARLIAMENT AGRICULTURE COMMITTEE REPORT**

The current CAP agreement expires at the end of 2013, and negotiations are beginning on a new agreement for the period 2014-20. The entry into force of the Lisbon Treaty in December 2009 has changed the European Parliament’s role in CAP reform negotiations. Previously, the Parliament has been consulted by the Commission and Council of Ministers on CAP reform. The Treaty gives the European Parliament co-decision powers over agriculture, which means the Parliament and Council have equal weight in deciding on the final outcome.

The European Parliament’s Committee on Agriculture produced an own-initiative report on the future of the CAP which was adopted at the July 2010 plenary session of the Parliament. The rapporteur who drafted the report for the Committee was the Scottish Liberal Democrat George Lyon MEP.

The report identifies a number of challenges facing EU agriculture to which the CAP must respond: food security and the need for the EU to contribute to world food supplies; rising energy prices which will increase costs of production; the need to continue to reduce greenhouse gas emissions from agriculture; the need to use water efficiently and protect soils and biodiversity; the risk of land abandonment; and the effects of the economic crisis on agriculture.

The report argues that a common policy with a balanced and fair system of support and common objectives and rules is needed to address these challenges, and that the existing CAP budget must at least be maintained up to 2020.
Key points made about the future of the CAP in the report are:

- Direct payments must be fairly distributed between old and new Member States. A simple flat rate per hectare is not the solution. The European Commission should devise objective criteria on which to base the allocation of CAP funds to Member States for both Pillar 1 and Pillar 2.

- Reducing or removing direct payments would have “devastating consequences” for farmers and the countryside. The CAP should not be renationalised and Pillar 1 payments should continue to be entirely funded from the EU budget. The period up to 2020 should be a transitional period for moving from the historic to the area basis for Single Farm Payments throughout the EU.

- Direct payments should have a common basic area component, with top up payments for reducing greenhouse gas emissions. Cross compliance conditions should include a minimum activity requirement.

- Farming should be maintained in all areas of the EU. Support for farmers in the LFA should be maintained. The flexibility to grant coupled payments in certain sectors should remain.

- The market does not reward farmers for producing public goods and delivering ecosystem services. Therefore the CAP should incentivise the provision of these services.

- The vast majority of farm land should be able to be entered into agri-environment schemes. Promoting green growth should be the focus of rural development funding (European Parliament 2010).

THE PACK REPORT

The Inquiry into Future Support for Agriculture and Rural Development in Scotland was commissioned by Richard Lochhead MSP, Cabinet Secretary for Rural Affairs and the Environment in June 2009. It was established to provide advice to the Scottish Government on how support to agriculture and rural development should be delivered in the future, and to inform the Scottish Government’s position in negotiations on CAP reform. The Inquiry was chaired by Brian Pack OBE, former Chief Executive of Aberdeen and Northern Marts Group Ltd. An interim report was published in January 2010, a set of short term recommendations were published in June 2010, and the final report of the Inquiry, “the Pack Report” was published on the 3 November 2010 (Scottish Government 2010a).

It contains 18 negotiating points – advice to the Scottish Government on the priorities for Scotland in the forthcoming negotiations on CAP reform, and 22 recommendations on matters over which the Inquiry expects the Scottish Government will have discretion in implementing CAP reform.

OBJECTIVE OF AGRICULTURAL SUPPORT

Farming is increasingly seen as having a role in addressing global challenges that society faces. The Pack report identifies five key challenges: food security, climate change, water supply, energy use and biodiversity, and says that it is critical that future support regimes recognise the important and increasing role of the industry in addressing these global challenges.
The report uses the term 'a sustainable agriculture' to describe an industry that is moving towards meeting these challenges. This, it says, means an agricultural sector that is innovative and competitive, with food production as its primary purpose, but which is also delivering a range of other benefits helping to address these global challenges.

The report identifies a number of concerns about the current support regime. The main one is that using an historic approach to distributing payments makes the payments hard to justify. Pillar 1 payments are very unevenly distributed across Scotland and there is an asymmetry between Pillars 1 and 2, again raising the question of whether Pillar 1 should be reformed so as to deliver greater benefits, given its greater share of the budget. The final concern relates to Scotland's small share of the overall CAP budget and the strong argument for this to be increased in future.

The Pack report states that the goal of agricultural support should be a more sustainable Scottish agriculture, contributing to sustainable economic growth. It says that to achieve this goal a future support system will: have agricultural production at its heart; be tailored to meet the needs of different areas; and be simple to administer. The system should be designed to work towards clear objectives, whilst being compliant with WTO requirements.

Key negotiating points in the Pack report are that:

- Agriculture has a pivotal role in tackling the global challenges, and the CAP budget must be adequate for this purpose.
- The UK receives an average Single Farm Payment per hectare that is close to the EU average. Therefore, although the UK CAP budget would be unlikely to change significantly, Scotland should receive a larger share of the future UK Pillar 1 (Single Farm Payment Scheme) budget. Scotland receives a lower allocation per hectare from the Pillar 2 budget than any Member State, and the UK’s allocation is the lowest of all Member States. The UK should argue for an increased share of the EU Pillar 2 (rural development) budget which in turn would lead to an increase for Scotland.
- The current CAP structure of two Pillars should be maintained.
- The direct payments budget should be maintained at its current level, but Pillar 1 payments must more clearly deliver public benefits by delivering against the global challenges.

The report also makes recommendations for changes to agricultural support if there are cuts to the CAP budget.

**FUTURE OF SINGLE FARM PAYMENT**

The Pack report proposes to distinguish between LFA and non-LFA land in delivering Single Farm Payments in future. This is a change from the proposals in the Inquiry’s interim report, which proposed to use the Land Capability Classification as a basis for determining area payments. Responses to the interim report highlighted a number of concerns with the proposed approach, including the payment rates set and the use of the LCA classification to allocate area payments. Work done by the Macaulay Land Use Research Institute (included in the Annex to the Pack report) showed that allocating support based on the LFA would result in less change to Farm Business Income, across a range of farm types.
In the LFA, farmers would receive an area payment; a top up payment; and headage payments for beef cattle and lambs. The top up payment would be set according to the Standard Labour Requirements of the farm, and the payments would be designed to make the farm more sustainable, for example, be linked to measures to reduce greenhouse gas emissions. The detailed proposals for the top up payments are not set out in the Pack Report, and are still to be worked up. The Government announced a group to consider this on 17 November 2010 (Scottish Government 2010c).

Non-LFA farmers would receive an area payment, and a top up payment. Outside the LFA the proposal is that the top up payment is area based, rather than linked to farm labour. Some LFA farms are cropping farms and similar in character to non-LFA farms. The report recommends that such farmers should be able to elect to be treated as non-LFA farms.

The report contains some indicative figures for the levels of these payments, and also shows how the budget for single farm payments would be shared between LFA and non-LFA land – around €200m for non-LFA and €350m for the LFA. The payment rates suggested in the report assume that Scotland continues to receive the existing envelope for Single Farm Payments. The suggested payment rates are as follows:

**Non- LFA land**

<table>
<thead>
<tr>
<th>Area Payments:</th>
<th>€200 per eligible hectare</th>
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<tr>
<td>Top Up Fund:</td>
<td>€100 per eligible hectare</td>
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**LFA land**

<table>
<thead>
<tr>
<th>Area Payments:</th>
<th>€30 per eligible hectare</th>
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<tbody>
<tr>
<td>Top Up Fund:</td>
<td>€6400 per Standard Labour Requirement</td>
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**Headage Payments:**

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<tr>
<th></th>
<th>Numbers</th>
<th>€ per head</th>
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<tbody>
<tr>
<td>Scottish Beef Calf Scheme</td>
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<td></td>
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<tr>
<td>(SBCS )</td>
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<tr>
<td>At least 75% beef genetics:</td>
<td></td>
<td></td>
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<tr>
<td>1-5</td>
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<td>220</td>
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<tr>
<td>6-15</td>
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<td>190</td>
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<td>16-40</td>
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<td>165</td>
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<tr>
<td>40+</td>
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<td>135</td>
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<tr>
<td>50% beef genetics:</td>
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<td></td>
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<tr>
<td>All</td>
<td>135</td>
<td></td>
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<tr>
<td>Scottish Lamb Scheme (SLS)</td>
<td></td>
<td>8</td>
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</tbody>
</table>

Source: Scottish Government (2010a)

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4 This is a standardised measure of the amount of labour needed to look after a certain number of animals or cultivate a certain area of crops.
LFA SUPPORT

The funds Scottish farmers receive from Pillar 1 are “modulated” i.e. a proportion is transferred to Pillar 2 to fund the Scotland Rural Development Programme. The Pack Report argues that since a proportion of the LFASS budget is funded from Pillar 1, in future budget periods money should be allocated to the purpose intended, i.e. to pillars, instead of using modulation to finance Pillar 2.

The report recommends that €45 million of the current LFASS budget should be moved to Pillar 1 and paid out as an increase to the top up payment for LFA farms. This would mean an additional €1,800 to the existing €6,400 per SLR mentioned above.

The report recommends that the remaining €25 million in the LFASS budget should be retained in Pillar 2, and be directed at the areas with most handicap which are at greatest risk of land abandonment, which the Inquiry refers to as the “Vulnerable Area”. This area will be defined as all of the existing “Very Fragile” area – the islands, and part of the existing “Fragile” area, according to an objective definition based on bio-physical criteria such as soil; rainfall, slope and altitude.

RURAL DEVELOPMENT

The Pack report does not make detailed recommendations for the future of rural development support. It points out that rural development schemes have been reviewed by Peter Cook, and that there is a mid-term review of the Scotland Rural Development Programme being conducted. The report does make some observations about the future of rural development support.

It suggests there is a need for greater flexibility in the EU rural development regulation, for example, the way it lists measures under axes, and limits spending per axis. The number of options available in Scotland does mean there are some options with low take-up rates – there should be fewer options, with a higher minimum payment rate per option (perhaps £1,500).

If the inquiry’s proposals to use Pillar 1 payments for more sustainable food production are adopted, it says there will be a need to think about how these payments complement those under Pillar 2.

The capital grants for investment and diversification are important, particularly in the context of reducing Pillar 1 support. The report suggests that a much-wider take up of agri-environment schemes should be encouraged e.g. with an entry-level “broad and shallow” scheme.

ALTERNATIVE PROPOSALS FROM THE NFUS AND OTHER REACTIONS

Responding to the Pack Report, the National Farmers Union of Scotland (NFUS 2010a) said that the main principles of the report were “about right” but that “whilst the specific model outlined in the report helps illustrate how support could be delivered, it still remains one option in the Union’s view.” The NFUS also expressed concerns about the proposal to distinguish between LFA and non-LFA farms in determining support, which it said could “risk locking people into particular production systems” and about the proposal to shift part of the LFASS scheme budget into Pillar 1, which it said was “trying to fix a problem that doesn’t exist with that scheme”.

14
The NFUS (2010b) has produced a paper with alternative options for delivering CAP support, on which it is consulting its members. These are:

1. Maintaining the historic basis for payments, but updating the reference period on which they are based so they better reflect current activity

2. Adopting the Pack report proposals of a flat-rate area payment for support outwith the LFA, but basing payments in the LFA on the grazing category, stocking density and fragility marker of LFA farms, so payments reflected the productive capacity and the activity on the farm.

3. A low basic area payment, with the remainder of support delivered through sector-specific “pots”, and paid out based on hectares grown or animals reared.

4. An area payment based on land type, with rates set for crops, grassland, and rough grazing.

Scottish Environment LINK (2010) has criticised the lack of environmental focus of the proposals. In particular, they have expressed concern about the assumption that the most productive businesses should receive the highest payments and the suggestion to diverted funds from Pillar 2 to Pillar 1 in order to fund the LFA top-up. LINK’s (2008) vision for the CAP states that:

“all public funding for land management should be directed towards providing public goods. Our vision is for a well-funded support system for all land managers willing to provide basic environmental benefits above what is required by legislation. There should be higher payments for more specifically targeted environmental management. More support should be directed towards High Nature Value (HNV) farming systems to pay for the environmental benefits they currently provide.”

EUROPEAN COMMISSION’S COMMUNICATION

The European Commission is responsible for developing and initiating proposals for the reform of the CAP. The Commission (2010) published a Communication on CAP reform on the 18 November 2010. The Communication identifies a number of challenges which face the CAP, which make further reform of the policy necessary:

- to address rising concerns regarding both EU and global food security
- to enhance the sustainable management of natural resources such as water, air, biodiversity and soil
- to deal with both the effect of climate change on agriculture, as well as the need for farmers to reduce their contribution to GHG emissions, play an active role in mitigation and provide renewable energy
- to retain and enhance competitiveness in a world characterized by increasing globalisation, and rising price volatility while maintaining agricultural production across the whole European Union
• to make CAP support equitable and balanced between Member States and farmers by reducing disparities between Member States taking into account that a flat rate\(^5\) is not a feasible solution, and better targeted to active farmers

• to simplify the policy and reduce the administrative burden on farmers

**CHANGES TO DIRECT PAYMENTS**

The Communication suggests a future direct payments system would be composed of the following elements:

• A basic area payment to support farm incomes providing a uniform level of support to all farmers in a Member State (or region), subject to cross compliance requirements. This payment would be capped, though the level of the cap is not specified. \(^6\)

• “Greening” of Pillar 1 through the introduction of mandatory environmental measures, with priority given to measures addressing climate and environmental policy goals. Examples given are of annual, non-contractual measures which go beyond cross-compliance requirements such as retaining permanent pasture, maintaining green cover, crop rotation and set-aside for environmental purposes.

• Additional support payment for farmers in areas with specific natural constraints (i.e. LFA) as a complement to support under Pillar 2

• In areas where particular types of farming are important coupled support payments (such as the Scottish Beef Calf Scheme) can be maintained, subject to specific limits

The Communication also suggests a specific scheme for small farmers, and the simplification and revision of current cross compliance rules.

**CHANGES TO MARKET SUPPORT**

Market measures should only be used as a safety net in times of price crises to avoid market disruption. Dairy quotas will be removed in 2015, as agreed in the CAP health check.

The share of the farm gate value of production as a proportion of total value added by the food sector has decreased from 29\% in 2000 to 24\% in 2005. The functioning of the supply chain should be improved by addressing: the current imbalance of bargaining power along the chain; the level of competition at each stage in the chain; and the need for restructuring and consolidation of the farm sector. The Communication is not specific about how this should be addressed.

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\(^5\) This is understood to mean a single, flat-rate area payment throughout the EU

\(^6\) Capping of payments was proposed by the Commission in CAP reforms in 1999 and 2003 but was not agreed in the final settlement.
OPTIONS FOR REFORM

The Communication suggests three broad options for reform. The Commission says that all three options would retain a two-pillar structure for the CAP, with a different balance between pillars:

Option 1 – limited changes to the existing framework, focussing on the most common criticism of the current system which is the inequality in distribution of direct payments between Member States

Option 2 – significant reform of the policy to make it more sustainable, as well as addressing the distribution of payments between farmers and Member States. Measures would be better targeted and also more understandable to citizens.

Option 3 – a more far reaching reform focussed on environmental and climate change objectives through Pillar 2, with a phased removal of direct payments and most market measures.

Comment has suggested that it is implicit that the Commission’s preferred option is option 2, in an article on the Commission’s proposals Farmers Weekly (2010) said it was clear that option 2 “was the only horse in a one horse race”.

REACTION TO COMMISSION PROPOSALS

Initial reactions of farm ministers were given at the Agriculture Council of the 29 November 2010, and reported by Agra Europe (2010a):

“The basic principles in the paper appeared to have won broad backing, and not just from traditional CAP beneficiaries such as France, Italy and Spain. The paper also received a broadly positive welcome from free market enthusiasts such as the Netherlands and Denmark, who welcomed new green requirements in P1. Eastern European heavyweights Poland and Hungary also backed the thrust of the paper.

Ministers from France, Spain, Portugal, Poland, Austria, Bulgaria and elsewhere called for an ambitious budget to back the new policy and its objectives - and French Farm Minister Bruno Le Maire trumpeted Paris’ own success in leading the Commission away from the CAP-cutting ideas first mulled last year towards the "balanced" paper which emerged this month.

However, the UK and Germany sounded a sombre warning that financial restraint must govern all EU spending post 2013.

UK Farm Minister Jim Paice also poured water on any ambitious CAP plans at this stage, stating: "The overall budget will be set by Heads of Government so our duty is to devise an agricultural policy within that financial framework."

He reiterated the UK position that the CAP budget "must fall very materially during the next financial perspective", within a declining overall EU budget."

The proposals were discussed again at the December Agriculture Council, and Agra Europe (2010b) reported on a new CAP reform alliance:
"In the margins of the Council, news emerged of a new CAP reform alliance forming around a position paper signed this week in Brussels.

The paper carries the support of nine new member states (NMS) Bulgaria, Cyprus, the Czech Republic, Estonia, Latvia, Lithuania, Poland, Romania and Slovakia, and the curious addition of two EU15 countries: Sweden and Portugal.

It calls for a "real reform" whereby the second pillar is strengthened, cross-compliance is overhauled, state support options in P1 are severely limited, and prevention financing is brought in."

The Commission's proposals were criticised by Stefan Tangermann, director of Trade and Agriculture at the OECD, who described the proposals as a conservative revision, rather than a reform:

In its core it is an attempt at constructing political justifications for maintaining as much as possible from current subsidy benefits for Europe's farmers. Where has all the courage and vision gone that animated the Commission's CAP reform drive in the past?

[...] Implicitly, its focus is on the future of direct payments. [...] When the payments were first introduced in the CAP they had an entirely respectable purpose, namely to compensate farmers for the sudden cut in support prices. The flip side of that coin is that the justification of compensation fades over time. Payments originally introduced in 1992 can hardly be said, twenty or thirty years down the road, to still be necessary to allow farmers time to adjust to the reformed policy framework.

The Commission is obviously fully aware of this problem, and its communication comes across as a desperate endeavour to cleanse the current direct payments regime from its most controversial features and to construct a new justification that, it is hoped, could create the political base for maintaining as much as possible of the payments as a permanent feature of the CAP.

The cleansing part of the job deals primarily with the equity concerns so frequently raised by critics of the current regime. [..]

The justification endeavour of the Communication focuses on objectives which can supposedly be attained only with a continuation of direct payments. Food security, in Europe and globally, is one of them. In times of volatile international commodity markets and sudden price explosions for food this might appear to make perfect sense. However, it is not as if Europe is not producing enough food to save its citizens from starvation, nor would we have to fear such consequences if the direct payments were abandoned. [..]

When the market demands more food, then prices will signal that clearly to the farming community. And Europe's farmers have shown how well they can respond to rising prices, when they produced butter mountains and wine lakes in the 1970s and 1980s. There is no need for the CAP to tell farmers they should produce more. [..]

Another attempt at justification is the argument that farming will be abandoned in significant areas if support is withdrawn. Irrespective of the empirical accuracy of this argument, simple logic suggests that it is not necessary to make direct payments to everyone within EU agriculture in order to keep specific regional areas from falling idle. It would make much more sense to (i) identify where in the union there is a threat of area no longer being farmed in the absence of payments, (ii) determine where in these areas there is a need or desire to
maintain farming, and on that base (iii) make specific payments to these areas, conditional on farming activities of the nature desired.

The most important argument for continued direct payments, both explicit and implicit in the Communication, is farm income support. The Commission makes the point that farm income per working unit is considerably lower (supposedly by 40%) than in the rest of the economy. That is a highly questionable argument for income support: if governments were to try and make income per working unit (or per unit of capital) equal across all sectors through support payments, then we could give up on the market economy in the first place. Income support must be based not on a comparison of factor incomes but on social criteria, i.e. on family income relative to a socially accepted threshold. But that is precisely what direct payments cannot achieve as they are granted on a flat rate per hectare basis, irrespective of the actual income situation of the recipient (Agra Europe 2010c).

Tangermann argues that instead the CAP should be reformed so that payments are targeted at the services agriculture can provide to society which are not remunerated by the market, such as protecting biodiversity and reducing greenhouse gas emissions. Required amounts of such services should be determined, and then farmers paid for delivering them on a contractual basis. This should be done by moving money from Pillar 1 to Pillar 2, though without an increase in national match funding that such transfers usually require. This shift should occur gradually over time.

COMMON FEATURES OF EUROPEAN PARLIAMENT, PACK AND COMMISSION PROPOSALS

There are a number of clear areas of consensus between the proposals in the European Parliament’s report; the Pack report and the European Commission’s Communication. They all identify a similar set of challenges facing EU agriculture, all of which include food security; the need to reduce greenhouse gas emissions; and the need to protect biodiversity. They all argue that these challenges justify the maintenance of a common policy, and that the CAP budget should be maintained at current levels. None of them propose a departure from the current two-pillar structure to the CAP. All three suggest a move towards an area payment; with a top-up component and all three foresee the possibility of maintaining coupled payments. All three propose strengthening the link between activity and receipt of payments; and all three recognise the importance of maintaining support for farming in Less Favoured Areas.

UK GOVERNMENT’S POSITION AND REACTION

The Secretary of State’s speech to the Oxford Farming Conference on the 5 January 2011 set out her position on CAP reform:

“To continue as we are threatens to prevent the transition we need towards a market that can sustain EU agriculture in the future. And there has to be change, because the new member states will demand a fairer allocation – with which I have considerable sympathy. There won’t be a deal, frankly, without this.

We now need to make the new CAP fundamentally different. Its strategic approach must change; as well as its detail. It must be re-positioned so that we can tackle the new challenges of achieving global food security and tackling and adapting to a changing climate.
The Commission recently published its plans for CAP reform. Although they set out the challenges for the sector they did little to create a dynamic strategy that would usefully contribute to President Barroso’s 2020 vision. So, while I welcome their proposals for further moves towards market orientation and international competitiveness I believe we can be more ambitious.

We can be more positive. More confident. Now is the time to make very significant progress towards reducing our reliance on direct payments – it’s certainly something the farmers I know want to see happen. Rising global demand for food and rising food prices make it possible to reduce subsidies and plan for their abolition.

Furthermore we should encourage innovation in the industry. Provide help with environmental measures and combating climate change. Our taxpayers have every right to expect other public goods for the subsidies they pay. I’m wary of the proposal to ‘green’ Pillar 1. What is proposed is nothing like as ambitious as British farmers have shown themselves to be. That’s why we want to see Pillar 2 taking a greater share of limited resources.” (DEFRA 2011)

The Secretary of State’s views on the need to reduce direct payments attracted critical comment in Scotland. The Scottish Farmer (2011) reported them under the headline “DEFRA ambition to scrap the SFP”:

Commenting, Scotland’s current CAP reform visionary, Brian Pack, declared that Mrs Spelman’s views were “fundamentally flawed”. “Direct support is justified to help pay for the costs of the higher standards in food production and animal welfare and also cope with volatility” said Mr Pack. “They are also flawed because she only wants to pay for the elements that are seen as public benefits. That is an impossible position to maintain and an expensive road to go down. If you do not have a vibrant agriculture, how do you deliver these wider benefits?”.

[…] NFU Scotland’s Chief Executive James Withers was equally scornful of Mrs Spelman’s New Year resolutions, describing her vision as “naïve”. “The view of the CAP outlined by the Secretary of State still smacks of the infamous Treasury vision articulated a few years ago, where cost saving was the sole driver” said Mr Withers. “That was divorced from the reality of what the CAP was delivering for consumers on the ground when it was first published, and it remains so now. To suggest that rising food prices are paving the way for a quick move towards support removal is naïve. In a world where global food, energy and water systems are increasingly insecure, calling for removal of direct agricultural support because we have seen some spikes in food prices is poor policy-making”.

**JOINT POSITION OF DEVOLVED ADMINISTRATIONS**

The Scottish Government, Welsh Assembly Government and the Northern Ireland Executive have developed a joint position on CAP reform. In a news release of 19 January 2011 the Scottish Government (2011) said that the devolved administrations had written to Defra setting out three priorities they want the UK Government to pursue in the negotiations:

1. Securing a fair and proportionate share of the budget
2. Flexibility to respond to specific local needs
3. Simplification
The main points of the joint position, published in full in the news release, are that:

- Adequate funding is critically important for the DAs to ensure that the objectives of the CAP can be delivered. Therefore, the UK must set as a primary goal the securing of a fair and proportionate share of the overall CAP budget, in particular the UK must secure a significantly improved share of the rural development budget.

- There is an ongoing justification for Pillar 1 Direct Payments, which must, therefore, remain in place and the UK should not adopt a negotiating position seeking to phase them out. However, they should be reformed so as to phase out the historic basis for payments and to define more clearly the links with the delivery of public benefits and with farming activity.

- The design of both Pillar 1 and Pillar 2 must contain sufficient regional flexibility to enable all parts of the UK to tailor measures to meet their specific needs, including the needs of the Less Favoured Areas.

- The Market Support elements of the CAP must remain sufficiently strong and flexible to provide a genuine market safety net.

- The future Rural Development regime must continue to support sustainable economic growth, competitiveness and diversification as well as agri-environment and community projects. The balance between these objectives should be at regional discretion and reflect regional priorities.

- The CAP must be simplified in order to keep administrative costs for farmers and Governments to the minimum necessary to deliver the policy objectives. There must be an explicit recognition of the true costs and benefits of control mechanisms and an acknowledgement that eliminating all error involves disproportionate administrative costs and represents poor value for money. Penalties for errors must be proportionate.

**HOUSE OF COMMONS EFRA COMMITTEE INQUIRY**

The House of Commons Environment Food and Rural Affairs Committee has begun an inquiry into the impact of CAP reform on UK agriculture. The Committee announced its inquiry on the 23 November 2010. The Inquiry seeks to address the following questions:

- How will the Commission’s proposals affect the ability of UK agriculture to be competitive in a global market?

- Do the proposals ensure fair competition for British agricultural products within the European Union?

- Will the proposals achieve the correct balance between productivity and sustainability? Do the proposals place the UK in a good position to help meet future food supply challenges?

- Will the proposals redress the imbalance in support to different sectors created by the historic basis of payments?

- What aspects of the proposals should be made a common policy, and which are best left to Member States?
• Can the proposals be implemented simply and cost-effectively, within a short time-scale?

The Committee received 25 written submissions, and has so far scheduled 3 oral evidence sessions. The Secretary of State for Environment, Food and Rural Affairs, the Rt. Hon Caroline Spelman MP will give evidence to the Committee on the 2 February 2010.

WHAT HAPPENS NEXT?

The European Commission will take into account the reaction of Member State Governments and the European Parliament to its proposals. It aims to publish legislative proposals mid-2011 and achieve a political agreement on these by the end of 2012. In 2013 the Commission will develop detailed implementing rules, so that the new CAP can be implemented in 2014.

ANNEX – IMPLEMENTATION OF THE SINGLE FARM PAYMENT

<table>
<thead>
<tr>
<th>Model</th>
<th>Regionalisation</th>
<th>Member States and Regions</th>
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<tbody>
<tr>
<td>Single Farm Payment Scheme - Historical</td>
<td>non-regionalised</td>
<td>Greece; Spain; France; Ireland; Italy; Netherlands; Austria; Portugal</td>
</tr>
<tr>
<td></td>
<td>regionalised</td>
<td>Belgium (Flanders; Brussels and Wallonia); UK (Scotland and Wales)</td>
</tr>
<tr>
<td>Single Farm Payment Scheme - Area</td>
<td>non-regionalised</td>
<td>Malta</td>
</tr>
<tr>
<td></td>
<td>regionalised</td>
<td>Germany (by Lander); Finland (3 regions based on soil type); Sweden (5 regions based on reference yields); UK (England – 3 regions based on soil)</td>
</tr>
<tr>
<td>Single Farm Payment Scheme – hybrid between historic and area</td>
<td>non-regionalised</td>
<td>Luxembourg, Slovenia</td>
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<td></td>
<td>regionalised</td>
<td>UK (Northern Ireland)</td>
</tr>
<tr>
<td>Single Area Payment Scheme</td>
<td>One region</td>
<td>Bulgaria; Czech Republic; Estonia; Cyprus; Latvia; Lithuania; Hungary; Romania; Poland; Slovakia</td>
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SOURCES


NFUS. (2010b) *Personal Communication.* [Unpublished]
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