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Impact of the Amendment to the Regulation (EU) No. 1305/2013 on the Stabilization of Farmers' Incomes

*Wpływ nowelizacji rozporządzenia UE nr 1305/2013
na stabilizację dochodów rolników*

SUMMARY

This paper addresses the issues related to legal protection of farmers' incomes in the context of the need for income stabilization in view of agricultural risks. The volatility of agriculture becomes increasingly important in economic, social and political terms. This is recognized by multiple authorities, including the Union legislator, as reflected in amendments to legislative acts. Therefore, the purpose of this paper was to identify the direction in which the basic subsidized Union instruments for agricultural risk management evolve. This means in particular determining the trends followed by these instruments and assessing their attractiveness to agricultural producers. The new legal solutions seem to be more beneficial to agricultural producers as they tend to smooth over the negative impacts of production risk, in respect both to losses and incomes. However, their proper functioning continues to be hampered by the precise determination of farm incomes.

Keywords: risk management; insurance contract; farmer's income; risk in agriculture

This paper deals with issues related to legal protection of farmers' incomes in the context of the need for income stabilization in view of agricultural risks. Even though the income itself is a strictly economic term, the legislator believes that, where justified, it should be subject to special measures derived from adequate legal standards. Incomes are of interest to the legislator at both Union and national level. Though considered at the level of an individual economic operator (a farm), incomes have an overall impact on the profitability of the whole agricultural sector.

The volatility of incomes at farm level is due to multiple exogenous factors which remain beyond the farmer's control despite the ongoing progress, innovations

implemented and resources of zootechnical and agri-technical knowledge. These include the relatively long production cycle (growing season) and the impact of variable natural conditions, especially the biological, climate and weather factors which determine the amount and quality of yields. As noted by M. Soliwoda, J. Kulawik and J. Góral, these aspects give rise to problems affecting not only the stability of agricultural proceeds but also the stability of farm income¹. Based on quite detailed criteria, the authors referred to above classified the determinants of both terms into the following general groups: support instruments under the agricultural policy (i.e. direct and indirect payments); market structure; price-to-cost ratios; farm specialization and size; socio-demographic characteristics of farmers; and psychological determinants².

The classification starts with agricultural policy instruments expressed with a specific legal standard, which is a reason to believe they constitute a crucial factor. Indeed, subsidies (e.g. direct payments) allow, to a certain degree, to accept additional risks involved in decisions regarding target production mix and intensity. Also, they offset the impacts of a higher price risk. According to C. Klimkowski and W. Rembisz, they represent an income decoupled from production volumes, supply and market conditions (expressed by the level and variation of product prices)³. Therefore, they considerably reduce the volatility of income and may be thus regarded as risk management instruments.

The net farm income played a major role in formulating the Common Agricultural Policy (CAP) assumptions. It is defined as the payment for the farm's own productive inputs, i.e. labor, land and capital, engaged in its operations. Additionally, it includes the risk taken by the farmer during the accounting year⁴.

The volatility of farm incomes becomes increasingly important in economic, social and political terms. This is recognized by multiple authorities, including the Union legislator, as reflected in legislative acts. Also, it is subject to considerable debate as to the need for changing the CAP assumptions after 2020. As emphasized by the legislator, the development of the market situation makes the farmers exposed to increased economic risks which have different impacts on specific agricultural sectors. Therefore, in duly justified cases, member states should be able to provide

¹ See M. Soliwoda, J. Kulawik, J. Góral, *Stabilizacja dochodów rolniczych. Perspektywa międzynarodowa, Unii Europejskiej i Polski*, „Wieś i Rolnictwo” 2016, nr 3, p. 42.

² *Ibidem*, pp. 44–46. Cf. D. Zawadzka, R. Ardan, A. Strzelecka, *Determinanty dochodów gospodarstw rolnych w Polsce*, „Zeszyty Naukowe Szkoły Głównej Gospodarstwa Wiejskiego w Warszawie. Ekonomika i Organizacja Gospodarki Żywnościowej” 2011, nr 88, p. 71.

³ See C. Klimkowski, W. Rembisz, *Kwestie stabilizacji dochodów w rolnictwie*, „Roczniki Naukowe Ekonomii Rolnictwa i Rozwoju Obszarów Wiejskich” 2014, nr 101, p. 87.

⁴ See Z. Floriańczyk, D. Osuch, R. Płonka, *Wyniki Standardowe 2015 uzyskane przez gospodarstwa rolne uczestniczące w Polskim FADN. Część I. Wyniki Standardowe*, Warszawa 2016, p. 38.

the farmers with assistance through various income stabilization toolkits. This is particularly important for sectors affected by a considerable decline in incomes.

The purpose of this paper is to identify the direction in which the basic subsidized Union instruments for agricultural risk management evolve. This means in particular determining the trends followed by these instruments and assessing their attractiveness to agricultural producers. This paper also offers a reflection on the future of the Common Agricultural Policy in the area of risk management instruments.

There are many reasons to tackle the issues discussed in this paper. In particular, the stabilization of farm income is extremely important because of its practical implications. The emergence of adverse developments disrupting the production process affects the economic security of farmers. A drop in incomes threatens the viability of farms or, in specific cases, may result in a discontinuation of farming activities. The withdrawal of a specific producer group may also have a negative impact on national food security and perturb the entire food chain. Furthermore, it is extremely important for institutional reasons to properly define the income stabilization instruments in legal terms, too. This primarily means determining a relationship between public aid and measures taken by agricultural producers to limit negative developments which reduce their incomes⁵.

While the topic discussed in this paper is not new, it was previously addressed in broader terms from the perspective of microeconomics, agricultural policy, agricultural economics and agricultural management, both in Polish⁶ in international literature⁷. In turn, much less attention was paid to the legal aspects of this issue. Nevertheless, economic and political discussions usually take account of some legal considerations.

The stabilization of farm incomes is the reason behind the continuous search for optimum legal and economic instruments whose impacts would guarantee the

⁵ See *Z prawnej problematyki stabilizacji dochodów w rolnictwie*, „Studia Iuridica Agraria” 2015, t. 13, DOI: <https://doi.org/10.15290/sia.2015.13.14>, p. 230 ff.

⁶ For more details, see Z. Giersz, *Instrument stabilizacji dochodów – nowy instrument zarządzania ryzykiem w perspektywie Wspólnej Polityki Rolnej po 2013 r.*, Warszawa 2011; M. Soliwoda, J. Kulawik, J. Góral, *op. cit.*; C. Klimkowski, W. Rembisz, *op. cit.*, pp. 85–96; W. Rembisz, *Kwestie ryzyka, cen, rynku, interwencji i stabilności dochodów w rolnictwie*, Warszawa 2013; *Dochoły gospodarstw rolniczych a konkurencyjność systemu podatkowego i ubezpieczeniowego*, red. J. Pawłowska-Tyszko, Warszawa 2014.

⁷ For example, N. El Benni, R. Finger, M.P.M. Meuwissen, *Potential effects of the income stabilization tool (IST) in Swiss agriculture*, “European Review of Agricultural Economics” 2016, Vol. 43(3), DOI: <https://doi.org/10.1093/erae/jbv023>, pp. 475–502; R. Finger, N. El Benni, *A note on the effects of the income stabilisation tool on income inequality in agriculture*, “Journal of Agricultural Economics” 2014, Vol. 65(3), DOI: <https://doi.org/10.1111/1477-9552.12069>, pp. 739–745; *Income Stabilisation in European Agriculture: Design and Economic Impact of Risk Management Tools*, eds. M.P.M. Meuwissen, M.A.P.M. van Asseldonk, R.B.M. Huirne, Wagenigen 2008.

attainment of expected business results. This is reflected by the legislator's evolving approach to this issue and the related amendments to specific legislative acts. Examples include Regulation (EU) 2017/2393 of the European Parliament and of the Council of 13 December 2017 amending Regulations (EU) No. 1305/2013 on support for rural development by the European Agricultural Fund for Rural Development (EAFRD), (EU) No. 1306/2013 on the financing, management and monitoring of the common agricultural policy, (EU) No. 1307/2013 establishing rules for direct payments to farmers under support schemes within the framework of the common agricultural policy, (EU) No. 1308/2013 establishing a common organisation of the markets in agricultural products and (EU) No. 652/2014 laying down provisions for the management of expenditure relating to the food chain, animal health and animal welfare, and relating to plant health and plant reproductive material⁸. Note also that this is an omnibus regulation which amends a total of four legislative acts on the Common Agricultural Policy, i.e. regulations concerning direct payments, rural development, common organization of the markets and the Horizontal Regulation.

As regards the analysis of amendments to the Regulation (EU) No. 1305/2013 of the European Parliament and of the Council of 17 December 2013 on support for rural development by the European Agricultural Fund for Rural Development (EAFRD) and repealing Council Regulation (EC) No. 1698/2005⁹, note that both the catalog of risk management instruments set forth in Article 36 and the related framework solutions were amended.

Specifically, risk management support which previously covered three types of financial contribution, i.e. 1) financial contribution to the premiums for crop, animal and plant insurance; 2) financial contribution to mutual funds; and 3) financial contribution to income stabilization tools, was extended to the benefit of the latter. The income stabilization tool previously offered as financial contribution to mutual funds (whose objective was to compensate the farmers for a severe drop in incomes) was split into two support tools. The first one is an income stabilization tool in the form of financial contribution to mutual funds which provides compensation for a severe drop in incomes to farmers from all sectors. The second one is supposed to provide compensation to farmers active in a specific sector. It is very much about support for farms which, though particularly vulnerable to production risks, are highly important in economic, social or environmental terms.

The definition of farmer has also slightly changed and now means active farmer as defined in Article 9 of the Regulation (EU) No. 1307/2013, as applied in the Member State concerned. Such a solution confers on the Member States the discretion to refine the definition and abolishes the requirement for the beneficiaries

⁸ OJ L 350, 29 December 2017, pp. 15–49.

⁹ OJ L 347, 20 December 2013, pp. 487–548.

of direct payments to be (and prove they are) active farmers. Therefore, the above approach may differ from one state to another. In broad terms, an owner of agricultural land or livestock should be considered to exercise an agricultural activity and, thus, to be an active farmer¹⁰.

When it comes to principles governing the support for crop, animal and plant insurance, as set forth in Article 37 of the Regulation No. 1305/2013, the relevant legal construct was also amended. The threshold of damage covered by support was reduced from 30% to 20% of the average annual production of the farmer in the preceding three-year period or a three-year average based on the preceding five-year period, excluding the highest and lowest entry. The annual production volume of a farmer may be calculated with the use of indexes to determine the actual damage incurred by an individual farmer within a year. The measurement of damages incurred remains unchanged and may be adjusted to specific characteristics of each product type with the use of biological indexes (volume of biomass lost), equivalent indexes set for crop losses at farm, local, regional or national level, and weather indexes (including rainfall and temperature) set at local, regional or national level. Support continues to be granted only for insurance contracts which cover for loss caused by an adverse climatic event or by an animal or plant disease or a pest infestation or an environmental incident or a measure adopted in accordance with Directive 2000/29/EC to eradicate or contain a plant disease or pest¹¹.

Note that, as a major step in the procedure for the delivery of support, the adverse event which implies the right to seek support must be formally recognized by the relevant Member State pursuant to national regulations. In this case, acknowledgement of the damage by the claims adjuster (even if authorized to enter into co-financed agreements) is not enough. Also, where justified, Member States may set in advance the criteria for a formal recognition of these circumstances. Furthermore, as regards animal diseases, financial compensation available under Article 36 (1) (a) may be granted only in respect of diseases mentioned in the list of animal diseases established by the World Organization for Animal Health or in the Annex to Decision 2009/470/EC¹².

According to the legislator's assumptions, insurance payments should compensate for no more than the maximum cost of replacing the losses. At the same time, they cannot specify the type or quantity of future production and cannot impose any additional requirements in that respect. However, Member States are empowered

¹⁰ See Article 9 Reg. No. 1307/2013 in conjunction with Article 3 (3) Reg. No. 2017/2393.

¹¹ Council Directive 2000/29/EC of 8 May 2000 on protective measures against the introduction into the Community of organisms harmful to plants or plant products and against their spread within the Community (OJ L 169, 10 July 2000), pp. 1–112.

¹² Council Decision 2009/470/EC of 25 May 2009 on expenditure in the veterinary field (codified version) (OJ L 155, 18 June 2009), pp. 30–45.

to limit the amount of premium that is eligible to support by applying appropriate ceilings. In the case of this instrument, support is limited to the maximum ceiling, i.e. 70% of the insurance premium due.

Meanwhile, considering the objectives set out in the amended wording of Article 36 (1) (b) and (c), the legislator clarified the essence of the mutual fund. It is formulated as a system recognized by a member state in accordance with its national law. Its basic purpose is to enable the affiliated farmers to jointly take out insurance against adverse consequences of specific events. Its legal construct consists in paying the affiliated farmers a compensation for economic losses caused by adverse climatic events or the outbreak of animal or plant disease or pest or an environmental incident or a severe drop in incomes. As a requirement which remained unchanged, Member States shall ensure that overcompensation, as a result of the combination of this measure with other national or Union support instruments or private insurance systems, is avoided.

Essentially, the legal construct of this measure remains the same. The funds continue to be established pursuant to national regulations of Member States, shall be accredited by the competent authority in accordance with national law, have a transparent policy towards payments into and withdrawals from the fund, and have clear rules attributing responsibilities for any debts incurred. In turn, amendments were made to the principles for granting support in the form of financial contributions referred to in Article 36 (1) (b) which financially compensate the farmers for economic losses set forth in relevant regulations. The financial contribution may only relate to the administrative costs of setting up the mutual fund, spread on a degressive basis across a maximum of three years, and the amounts paid by the mutual fund as financial compensation to farmers. The contribution may also relate to interest on commercial loans taken by the mutual fund for the purpose of paying financial compensation to farmers in the event of a crisis. As a consequence of amendments to the Regulation 1305/2013, the contribution may also supplement the annual payments into the fund, and may relate to its initial capital stock.

The support discussed is limited to the maximum financing level set out in Annex II to the Regulation 2017/2393, i.e. 70% of eligible costs. Conversely, according to the new wording, support for payments to the fund as compensation for farmers shall take into account any support already provided either as a supplement to annual payments or as initial capital stock (Article 1 (17) of the Regulation 2017/2393).

The income stabilization tool shall continue to be run in the form of financial contributions to mutual funds, providing compensation to farmers who experience a severe drop in their income. The essential difference between the mutual fund and the income stabilization tool is the coverage of a partially defined “good”. In the first case, farmers are provided with a financial compensation for economic losses, whereas in the second case, support is disbursed to offset a drop in their income.

As noted above, because of the distinction between income stabilization tools provided for in Article 1 (18) in conjunction with Article 39 of the Regulation 1305/2013, the legislator implemented the demarcation for all sectors combined and for each sector individually. As regards the first case, pursuant to the new wording of Article 39, support provided for in Article 36 (1) (c) may only be granted where the drop of income exceeds 30% of the average annual income of the individual farmer in the preceding three-year period or a three-year average based on the preceding five-year period excluding the highest and lowest entry.

Income for the purposes of Article 36 (1) (c) shall refer to the sum of revenues the farmer receives from the market, including any form of public support, deducting input costs. Payments by the mutual fund to farmers shall compensate for less than 70% of the income lost in the year the producer becomes eligible to receive this assistance. Indexes may be used to calculate the annual loss of income of the farmer.

To be eligible for support, common funds (in this case, for all sectors) still must be accredited by the competent authority in accordance with national law, have a transparent policy towards payments into and withdrawals from the fund, and have clear rules attributing responsibilities for any debts incurred. Also, the Member States preserved their discretion to specify the principles for setting up and managing the funds, in particular as regards providing the farmers with compensations in the event of a crisis and managing and monitoring compliance with these principles. At the same time, Member States shall ensure that the terms and conditions for funds include penalties for negligence by farmers.

Previously applicable financial contributions, as provided for in Article 36 (1) (c) of the Regulation No. 1305/2013, may only relate to the administrative costs of setting up the fund, which may be spread on a degressive basis across a maximum of three years, and the amounts paid by the mutual fund as financial compensation to farmers. Also, financial contributions may relate to interest on commercial loans taken by the fund for the purpose of paying financial compensation to farmers in the event of a crisis; to supplementing annual payments to the fund; and to its initial capital stock.

The support discussed is limited to the maximum financing level set out in Annex II to the Regulation No. 2017/2393, i.e. 70% of eligible costs. It should take account of payments referred to above, made to supplement the annual payments into the fund or in relation to its initial capital stock.

In recital 6 of the Preamble to the Regulation concerned, the legislator emphasizes that Member States should have the possibility to help farmers by means of a sector-specific income stabilization tool, which is a considerable novelty. Therefore, while this is an instrument similar to the previous one, it provides a narrower scope of support. This applies in particular to sectors affected by a severe drop in incomes with significant economic implications for the rural area concerned.

Therefore, pursuant to Article 39 (a), as added, support under Article 36 (1) (d) shall only be granted in duly justified cases and where the drop in income exceeds a threshold of at least 20% of the average annual income of the individual farmer determined based on historical data. Just as in the general approach, indexes may be used to calculate the annual loss of income of the farmer.

Income for the purposes of Article 36 (1) (d) shall refer to the sum of revenues the farmer receives from the market, including any form of public support, deducting input costs. Payments by the mutual fund to farmers shall compensate for less than 70% of the income lost in the year the producer becomes eligible to receive this assistance. Other solutions relating to the obtaining of support remain the same for both tools.

When attempting to assess the new legal solutions for risk management instruments, attention should be paid to several matters. First of all, as regards insurance and sector-specific income stabilization instruments, an increase in the compensation (from 65% to 70%) was proposed, which is more beneficial to agricultural producers. The same is true for the change in the size of loss from over 30% to 20% of annual production (in the case of insurance) or income (in the case of the sector-specific instrument). As regards common funds and the general income stabilization tool, the maximum compensation level increased from 65% to 70%. However, the tool remains available to those who lost over 30% of their annual production or income. The objectives of this solution include encouraging the use of the most popular instruments in particular states.

In this context, note that risk management tools are run under rural development programs in each Member State. Union funds amounting to 1.7 billion euro were allocated for that purpose for the 2014–2020 period¹³. However, only a few member states have decided to introduce the whole pool of mechanisms under their national programs, which poses a significant problem. In line with the legislator's assumptions, these instruments do not become universal.

Previously offered public funds could not be allocated to initial capital stock (they could only be allocated to administrative costs related to setting up the fund and to the contribution paid to farmers), making the setting up of funds less attractive. However, this is enabled by new solutions. A precise measurement of farm incomes remains a complicated issue which still needs to be solved. As a consequence, it is difficult to encourage the producers to set up and affiliate to this instrument.

It seems that a significant role may be played by the new sector-specific income stabilization instrument. Member States have the option to include it in their rural development programs and to focus it on a specific sector. To make sure the sector-specific income stabilization tool is effective and tailored to their specific

¹³ See F. Tropea, *New income stabilization tools and price volatility in agricultural markets*, "European Parliamentary Research Services" 2016, p. 7.

situation, Member States should be able to flexibly define, as a part of their rural development programs, the income level that triggers the tool concerned. The objective is to make the tool applicable and available to the most vulnerable and deprived farmers.

By adopting the new solution which splits the income stabilization tool into general and sector-specific tools, Member States become empowered to design and implement a tailored instrument which will reflect the actual needs of an economically vulnerable market. It is particularly important to ensure that income losses incurred by the farmers are calculated by affected production types and may be compensated for even if other production types remain unaffected. According to the legislator's assumptions, the tool should provide the farmers with the best possible support during a market crisis and offset the real risks present in the sector concerned which, as a matter of fact, makes it a non-universal solution. Therefore, it seems that the tool should be more attractive to the beneficiaries and easier to use in the context of unified administrative requirements.

Legal solutions for agricultural risk management provided for in the omnibus regulation may be regarded as an indication of the path being taken by the Commission in its works on the CAP reform beyond 2020. Undoubtedly, risk management tools need to be optimized within the future CAP framework. It is indisputable that climate and market perturbations affecting the agriculture are stronger than ever. That fact should be addressed to the greatest possible extent in the Union agricultural policy, making the agricultural producer the party bearing the largest responsibility for the implementation of different legal and economic instruments. This involves an approach which is increasingly often used in many member countries and consists in classifying agricultural activities on equal footing with economic activities. As a consequence, farmers should be regarded as fully fledged entrepreneurs¹⁴.

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¹⁴ *EPP views on the future of common agriculture policy: for a strong, sustainable and innovative EU agriculture*. The European People's Party, Brussels 2017, www.politico.eu/wp-content/uploads/2017/09/CAP_FV.pdf [access: 30.06.2018].

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STRESZCZENIE

Artykuł odnosi się do problematyki związanej z prawną ochroną dochodów rolników w kontekście potrzeby stabilizacji dochodów w związku z występowaniem ryzyka w rolnictwie. Zmienność rolnictwa nabiera coraz większego znaczenia ekonomicznego, społecznego i politycznego. Dostrzegł to m.in. prawodawca unijny, co znalazło wyraz w modyfikowanych aktach normatywnych. Celem opracowania było wskazanie kierunków zmian podstawowych dotowanych ze środków unijnych

instrumentów zarządzania ryzykiem w rolnictwie. Chodzi w szczególności o określenie tendencji zmian tych instrumentów i ich ocenę w aspekcie atrakcyjności z punktu widzenia producentów rolnych. Stwierdzono, że nowe rozwiązania prawne wydają się bardziej korzystne dla producentów rolnych, ponieważ w większym stopniu niwelują negatywne skutki ryzyka w produkcji w odniesieniu zarówno do strat, jak i dochodów. Kwestią nadal niesprzyjającą ich właściwemu funkcjonowaniu jest precyzyjne ustalanie dochodów gospodarstw rolnych.

Słowa kluczowe: zarządzanie ryzykiem; umowa ubezpieczenia; dochód rolniczy; ryzyko w rolnictwie