9A. The bond scheme

Alan Swinbank and Richard Tranter

Abstract

Under the bond scheme, a pre-determined series of payments would compensate farmers for lost revenues resulting from policy change. Unlike the Single Payment Scheme, payments would be fully decoupled: recipients would not have to retain farmland, or remain in agriculture. If vested in a paper asset, the guaranteed, unencumbered, income stream would be similar to that from a government bond. Recipients could exchange this for a capital sum reflecting the net present value of future payments, and reinvest in other business ventures, either on- or off-farm. With a finite, declining flow of payments, budget expenditure would reduce, releasing funds for other uses.

9A.1 Introduction

Agricultural economists have long debated the rationale for government intervention in the agricultural sector to correct market failures and address income disparities. Many have suggested that such intervention is too pervasive, is too focused on 'income' support, and ought to be reduced. Nash (1965), having advocated such an approach, wrote:

> 'It is evident … that some method must be found of compensating those whose incomes are reduced by this abolition of the price guarantees. … It might … take the form of [a] personal annuity payable to all those at present engaged in farming for the remainder of their lives.
>
> The essential requirements are that the payments should not be related to future output and should not in any way influence future productive decisions; that they should not affect the choice of any individual whether to remain in farming or to enter an alternative occupation; that the right to participate in them should be limited to those now engaged in farming; and that the payments should have a fixed term.'

There are several reasons why governments might be willing to compensate groups adversely impacted by policy change. If the group is politically important it might be necessary to offer compensation to ‘buy’ their support. A government that reneges on its policy commitments might lose credibility, and ultimately its political authority, if it is perceived to engage in ‘unfair’ policy changes, particularly if the electorate cannot readily recognise broader economic benefits. Furthermore, radical, and rapid, policy change could have far-reaching consequences. Changes in farm support, for example, would reverberate throughout the rural economy, with bankruptcies triggered in agriculture’s ancillary industries. A compensation scheme would allow businesses time to adjust. Welfare economics can also be invoked: the weak version holds that a Pareto improvement in welfare occurs if those that gain from policy change *could* compensate the losers; the strong version is that there is a Pareto improvement only if those that gain *do* compensate those that lose.

9A.2 Characteristics of a bond scheme

Although the proposal of Nash (1965) was not quite the bond scheme later advocated by Tangermann (1991), it did contain most of the key features. As rearticulated by Swinbank and Tangermann (S&T) (2004), the scheme was unambiguously seen as a *compensation* payment for policy change, allowing the sector time to adjust. It was framed to replace the area and headage payments that had been introduced into the CAP by the Mac Sharry reforms of 1992, but the principles could be extended to other sectors benefiting from price support. It was presented as having six components. Initially, payments would be decoupled from crops grown (component one) and animals kept (component two), with future payments linked only to past entitlements. The level of compensation would be a political decision: S&T suggested that, initially, payments should reflect receipts from area and headage payments during an earlier representative period. Essentially, this is what happened when the Single Payment Scheme (SPS) was introduced by the Fischler reforms of 2003, particularly for those products, and in those regions, where so-called ‘full decoupling’ applied.

Component three was to decouple the payments from land (or the farm) and attach the entitlement to ‘farmers’ (whatever their legal form). Thus, recipients would continue to receive payments even if they left farming. Clearly the SPS is rather different in this regard: recipients have to be active farmers, there is an annual claim on farmland at the recipient’s disposal and matched by SPS entitlements denominated in hectares, and various cross-compliance conditions apply, as explained in Chapter 9. This led Swinbank and Tranter (2005) to query whether the SPS really did meet all the criteria of the WTO's green box. However, unlike the Nash scheme, under which payments would only continue during the lifetime of the original recipient, bond scheme entitlements would be inheritable.

The EU would guarantee the period over which compensation payments would be made (component four), and the future level of payments would be irrevocably fixed (component five). S&T envisaged a phased reduction in payment levels over a 15-year period, but this too would be a decision based on political expediency. Finally (component six), S&T considered that banks and other financial institutions would be willing to lend on the basis of a government-backed assurance of a future stream of decoupled payments. So they suggested the EU should go further and facilitate such transactions by issuing the entitlement as a government bond (with annual payments only, and no capital sum on maturity).

9A.3 Advantages and disadvantages

S&T stressed two important advantages of the bond scheme. First, it 'locked in' the policy reform: once the bonds had been issued, the level of compensation could not be changed without affecting the value of the bond. Second, the scheme did not adversely affect the profile of CAP budget expenditure. In year one, expenditure on compensation payments would simply replace what would have been spent on the redundant schemes, and thereafter it could decline on an annual basis, releasing funds for Pillar 2 activities or other uses. This is in marked contrast to most proposals for 'buy-out' schemes, under which government budgets are called upon to pay compensation up-front, in one lump sum. However, bond recipients *are* able to trade their future entitlement for a capital sum, reflecting the present value of a bond's future government-guaranteed income stream. This could then be used to reinvest in the farm business, to buy a retirement annuity, etc. The bond scheme is about as decoupled as is possible, but it could affect the opportunity cost of capital for farm investment purposes, it might change the recipient's perception of risk, and some farmers might use the payments to subsidise their continuation in farming.

S&T also identified potential problems. A bond scheme, unlike the SPS, cannot be used to enforce cross-compliance, as the land user is no longer, necessarily, the recipient of the annual payment. Payments might not be treated as 'farm income' for income tax purposes. And, where landowners and land users are not the same legal entity, there are potential issues over capital values. Economic theory suggests that farm income support, including the 'old' CAP's market price support mechanisms, and the area payment scheme introduced by the Mac Sharry reform, is in part capitalised into land values, to the benefit of landowners. With a bond scheme, support previously capitalised into land values switches to the bond. However, S&T envisaged that the bond would be issued to the 'farmer', who might be renting land, and who would then be free to renounce the tenancy without compensating the landowner.

Another drawback is political: politicians would prefer to prevaricate rather than announce the future date on which CAP support will end. Daugbjerg (2003) reports on the failed Danish initiative to introduce the bond scheme into the Mac Sharry reform debate, and Mac Sharry's comment that it 'would imply ending support to most Community farmers after a given period.'

One concern about decoupling schemes is that, if farmers receive payments irrespective of land use, marginal land might be abandoned, particularly in areas of extensive goat, sheep and cattle farming. Tranter *et al.* (2007) reported the findings of a survey in Germany, Portugal and the UK about how farmers might respond to various decoupling scenarios. In effect, 33% of respondents in the UK, 22% in Germany and 18% in Portugal said: 'we would carry on as before, making no changes at all to our farming systems.'

9A.4 Contrasts with the Single Payment Scheme

Table 9A.1 summarises three key differences. The purpose of the bond scheme is to *compensate* a group of stakeholders (but possibly not landlords) for policy change. The SPS, according to Regulation 1782/2003, is a form of 'income support for farmers'; although, as pointed out in Chapter 9, payments tend to be highly skewed, reflecting the size of farm business *and* past farming activities, and it is rather difficult to discern its income objectives.

The profile of payments under the bond scheme, once fixed, would be inviolable, unlike with the SPS. The Health Check, for example, increased the rate of modulation, and the Financial Discipline provisions might yet apply. The Health Check also allows, indeed encourages, Member States to switch from the historic mode of payment to a regionalised mode, involving a redistribution of payments (see Chapter 9). Bonds, once issued, would be completely guaranteed for their full term: with the SPS, there is considerable uncertainty about its availability after 2013, when the present budget settlement (the *Financial Perspective 2007-2013*) expires.

Table 9A.1. Contrasting the bond scheme with the SPS.

	Bond scheme	**SPS**
Purpose	Compensation	Income support (*and reward for multifunctionality?*)
Level of decoupling	No link to land use or farming practices	Recipients must be farmers; payments linked to farm land; cross-compliance applies
Certainty	Fixed entitlements, paid for a fixed and finite period	Entitlements can be varied, and their future (post-2013) is uncertain

9A.5 A future bond scheme?

Although the 2003 CAP reforms progressed the decoupling of EU farm support, the SPS is *not* a fully-decoupled policy, and policy-makers continue to debate the need for, and scope of, policies to secure rural livelihoods and food supplies, and to protect the environment. The bond scheme, or further elaborations of it, could yet be deployed to ease any transition towards these ends. There are similarities, for example, between the bond scheme and the ideas of Delpla and Wyplosz (2007) in France, and the buy-out schemes advocated by James and Griswold (2007) and Citigroup (Stokes, 2007) in the USA.

References

Daugbjerg, C., 2003. Policy feedback and paradigm shift in EU agricultural policy: the effects of the MacSharry reform on future reform. Journal of European Public Policy 10: 421-437.

Delpla, J. and C. Wyplosz, 2007. La fin des privilèges: Payer pour reformer. Hachette: Paris, 216 pp.

James, S. and D. Griswold, 2007. Freeing the Farm: A Farm Bill for All Americans, Trade Policy Analysis No. 34, Center for Trade Policy Studies, Washington DC, 20 pp.

Nash, E. F., 1965. Agricultural Policy in Britain. Selected Papers, edited by McCrone, G. and E.A. Attwood, University of Wales Press: Cardiff.

Stokes, B., 2007. Balance of Payments: Citi And Farm. Congress Daily, 26 April.

Swinbank, A. and S. Tangermann, 2004. A Bond Scheme to Facilitate CAP Reform. In: Swinbank, A. and R. Tranter (eds.), A Bond Scheme for Common Agricultural Policy Reform. CABI Publishing: Wallingford.

Swinbank, A. and R. Tranter, 2005. Decoupling EU Farm Support: Does the New Single Payment Scheme Fit within the Green Box? The Estey Centre Journal of International Law and Trade Policy 6: 47-61.

Tangermann, S., 1991. A bond scheme for supporting farm incomes. In: Marsh, J., B. Green, B. Kearney, L. Mahé, S. Tangermann and S. Tarditi (eds.), The Changing Role of the Common Agricultural Policy: the Future of Farming in Europe. Belhaven: London, p. 95-96.

Tranter, R.B., A. Swinbank, M.J. Wooldridge, L. Costa, T. Knapp, G.J.P. Little and M.L. Sottomayor, 2007. Implications for food production, land use and rural development of the European Union's Single Farm Payment: Indications from a survey of farmers' intentions in Germany, Portugal and the UK. Food Policy 32(4/5): 656-671.