IZABELA LIPIŃSKA

Financing risk management in agriculture in the light of the Common Agricultural Policy*

1. The paper discusses issues connected with supporting risk management instruments in agriculture. These issues are highly important as an agricultural producer is exposed to an immense amount of insecurity. Despite the progress in agricultural production owing to mechanisation, innovation and the introduction of the most beneficial plant varieties and animal breeds, an agricultural producer is not able to predict the production outcome, which is subject to factors beyond a farmer's control which he can neither predict nor prevent. The source of the risk in question may be of a production or a market character. The former relates to the level of crops, healthy growth of animals, as well as the occurrence of unexpected and often swift changes of the weather like hail, drought, and ground frosts. The latter, in turn, is a consequence of changes within the agricultural market itself, which can be exemplified by the prices fluctuation and, as a result, the production profitability.[1] Therefore, the EU legislator has noticed the necessity to establish some instruments designed to support agricultural producers in the event of risk and to secure their incomes.

The paper aims at determining the role of the EU legislator in shaping different forms of support. It also looks at the position of the State in applying

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[1] According to A. Grzelak, agriculture as an economy sector is subject to particular economic fluctuations which result both from general economic conditions and specific ones relating to connecting economic results with low inflexibility of agricultural production, in: *Koniunktura w rolnictwie w Polsce w świetle wybranych metod*, Stowarzyszenie Ekonomistów Rolnictwa i Agrobiznesu, „Roczniki Naukowe" 16(2), 2014, pp. 68–72.

the state aid. Moreover, there is an attempt to point to the changes which have been made to the legal structure of the support and to assess whether the support offered is sufficient.

The topic of the paper is not a new one. It has been researched from the economic perspective, which to a large extent is based on searching for the right management model.[2] Legal issues have so far been raised to a much smaller extent and they often accompany economic discussions which may be exemplified by the report prepared this year at the commission of the European Parliament's Committee on Agriculture and Rural Development (AGRI) supervised by T. García-Azcárate: 'Research for Agri Committee – State of Play of Risk Management Tools Implemented by Member States During the Period 2014–2020: National and European Frameworks.' The report works as a summary of risk management issues in particular Member States.

It needs to be pointed out that the last reform of the Common Agricultural Policy resulted, among other things, in a new institutional legal framework for managing production risk. Its main principle is to strike a balance between the EU objectives and the constraints of particular Member States. It justifies making some starting assumptions.

First of all, it needs to be stressed that within the European Union farmers face a very wide spectrum of events having adverse effects on production. Therefore, the Member States adopt different approaches to risk management and adapt legal instruments to their risk and agricultural policy which they have established. The instruments, however, need to be applied within the common EU legal framework.

Secondly, these instruments need to be accompanied with financial support in order to incentivise farmers to take preventive measures and to facilitate actions taken by entities designed to mitigate the adverse effects of losses, for example insurance companies or mutual funds.

Thirdly, to enhance the production security, the Member States may offer additional support for farmers the purpose of which is to mitigate losses suffered as a result of a given type of risk. Then, the support becomes *ad hoc* state aid and is applied only on an occasional basis and to a limited extent.

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[2] See: C. Szekely, P. Palinkas, *Agricultural risk management in the European Union and USA*, „Studies in Agricultural Economics" 2009, no 109, pp. 55–72; M. Hamulczak, S. Stańko (eds.), *Zarządzanie ryzykiem cenowym a możliwości stabilizowania dochodów producentów rolnych*, Warsaw 2008; OECD, *Risk Management Tools for EU Agriculture. Working Document, Agriculture Directorate-General: Economic analyses, forward studies, evaluation,* European Commission 2001.

2. The reform of the CAP has initiated a new stage in risk management in agricultural production. First of all, there has been an allocation of financing within particular pillars, namely main risk management tools, which so far were part of direct support schemes, and have been transferred to the second pillar[3] and may be included in the state Rural Development Programmes. Such a change makes it easier for them to develop within the CAP. Only the market support in the wine and the fruit and vegetables sectors has been left within the common market organisation under Regulation (EU) No 1308/2013 of the European Parliament and of the Council of 17 December 2013 establishing a common organisation of the markets in agricultural products and repealing Council Regulations (EEC) No 922/72, (EEC) No 234/79, (EC) No 1037/2001 and (EC) No 1234/2007, namely in the first pillar.[4]

The application of particular instruments at the EU level, however, is still voluntary. It has been left to the Member States to decide whether or not these instruments are of an obligatory character. At the same time it needs to be emphasised that they are limited by both the principles for financing measures and the amount of the common budget.[5]

After the reform, the risk management support was laid down by Article 36 of 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 1698/2005.[6] The legislator has set out the following:

a) financial contributions to premiums for crop, animal and plant insurance against economic losses to farmers caused by adverse climatic events, animal or plant diseases, pest infestation, or an environmental incident;

b) financial contributions to mutual funds to pay financial compensations to farmers, for economic losses caused by adverse climatic events or by the

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[3] Cf. 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 1698/2005, OJ EU L 347, 20.12.2013, pp. 487–548, and Council Regulation (EC) No 1698/2005 of 20 September 2005 on support for rural development by the European Agricultural Fund for Rural Development (EAFRD), OJ EU L 277, 21 Nov 2005, pp. 1–40.

[4] OJ EU L 347, 20 Dec 2013, pp. 671–854.

[5] More on that: T. García-Azcárate, *Research for Agri Committee – State of Play of Risk Management Tools Implemented by Member States During the Period 2014–2020: National and European Frameworks*, European Parliament's Committee on Agriculture and Rural Development, 2016 Brussels, pp. 50ff.

[6] OJ EU L 347, 20 Dec 2013, pp. 487–548.

outbreak of an animal or plant disease or pest infestation or an environmental incident;

c) an income stabilisation tool, in the form of financial contributions to mutual funds, providing compensation to farmers for a severe drop in their income.

The conditions for insuring crops, animal and plants are set out in Article 37 of the Regulation. A significant change compared with the previous legal regulations is that the suffered losses are measured based on biological indexes[7], equivalent yield loss indexes or weather indexes[8]. These indexes are established at a farm, local, regional and national level.

As for mutual funds, the financial contribution referred to in Article 36(1)(b) relates only to the administrative costs of establishing the funds which may be spread over for a maximum period of three years in a degressive manner. Moreover, the support is also designed to compensate farmers. It may relate to interest on commercial loans taken out by a mutual fund for the purpose of paying the financial compensation to farmers in the event of a crisis. At the same time, no contribution to initial capital stock can be made using public funds. As far as mutual funds are concerned, their scope can also be extended to include a loss caused by adverse climatic events. The support extended so far has related to animal or plant disease, pest infestation and environmental incidents.

As for both tools mentioned above, the aid is limited to the amount of 65 per cent of the insurance premium due and 65 per cent of eligible costs for mutual funds, if the loss amounts to 30 per cent 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 (so-called *olympic average*).[9]

Compared with the previous list of production risk management instruments, there is a new instrument, namely the possibility to implement income stabilisation tools which are given support under Article 39 of Regulation No 1305/2013. Similarly to insurances and mutual funds, the support is granted only if the drop of farmer's income exceeds 30 per cent. The income refers 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 per cent of the income lost in the

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[7] It refers to determining the quantity of biomass loss.

[8] Weather indexes include annual rainfall and temperature variation.

[9] See: G. S. Becker, *Farm program spending: what's permitted under the Uruguay Round Agreements*, in: D. Sandrino (ed.), *Farm Economic Issues*, New York 2007, p. 106.

year the producer becomes eligible to receive this assistance. The financial contributions, however, may only relate to: a) the administrative costs of setting up the mutual fund, spread over a maximum of three years in a degressive manner; b) the amount paid by the mutual fund as financial compensation to farmers. Additionally, as it is the case with mutual funds, the financial contribution may relate to interest on commercial loans taken out by the mutual fund for the purpose of paying the financial compensation to farmers in the event of a crisis. The support must not exceed 65 per cent of eligible costs. Public funds, however, must not be paid to the initial capital stock.

As it has been stressed, specific rules for support as part of risk management have also been introduced on two markets, namely the wine market and the fruit and vegetables market. Both of them are highly influenced by weather changes and market fluctuations. Additionally, as for fruit and vegetables, the market profitability is stimulated by their perishable character.

As for the wine market, it is crop insurance that has been identified by the legislator as the basic instrument designed to reduce the production risk. Article 49(1) of Regulation No 1308/2013 provides for support from the EU budget towards insurance premiums on account of concluded crop insurance contracts. Their amounts depend on the type of the negative effects which may cause the production disruptions. Under Article 49(2)(a) of the Regulation, the amount of the EU support for insurance premiums paid for insurance against losses resulting from natural disasters may not be higher than 80 per cent. In the case of not typical events or losses caused by animals, plant diseases or pests, the EU budget will cover 50 per cent of the cost of the insurance premiums. The ceiling of 80 per cent has so far been the highest support under the EU regulations. The support is granted, however, if it does not distort competition in the insurance market. Simultaneously, support for harvest insurance may be granted if the insurance payments concerned do not compensate for more than 100 per cent of the income loss suffered, taking into account any compensation the producers may have obtained from other support schemes related to the insured risk.

Another risk management measure relating to the wine market are mutual funds. As a rule, they are set up by producers and are designed to protect them from market fluctuations. They have also been provided with the EU financial support which, under Article 48(2) of Regulation No 1308/2013, may be granted in the form of temporary and degressive aid to cover the administrative costs of the funds. Legal issues for their operation and eligibility for support were left to the Member states to decide.

Some risk management measures have also been provided for the fruit and vegetables market. The legislator has established crisis management measures which are part of operational programmes. The operational programme needs to be understood as an action plan of a recognised organisation of fruit and vegetable producers. The operational programmes last from three to five years and fulfil at least two of the objectives listed in Article 152(1)(c) or Article 33(1) of Regulation No 1308/2013. One of them is crisis prevention and management, which may cover: a) investments which enable more effective management of the volumes placed on the market; b) training actions and exchange of best practices; c) promotion and prevention for the purpose of crisis prevention or during a crisis period; d) support for the administrative costs of setting up mutual funds; e) replanting of orchards where that is necessary following mandatory grubbing up for health or phytosanitary reasons on the instruction of the Member State competent authority; f) market withdrawal; g) green harvesting or non-harvesting of fruit and vegetables h) harvest insurance. Since the insurance plays a significant role on the market in question, financing them helps to safeguard the income of producers.

3. The CAP reform has also helped to establish new rules for state aid for agriculture and rural areas. The conditions and criteria have been laid down in the European Union Guidelines for State Aid in the agricultural and forestry sectors and in rural areas 2014 to 2020.[10]

All support in this respect refers only to primary agricultural production which means the production of products of the soil and of stock farming listed in Annex I to the Treaty, without performing any further operation changing the nature of such products.[11] What is important is that in that respect the aid is in line with the internal market.[12] In total, the legislator has suggested seven aid categories.[13]

The first one is the support to compensate for damage to agricultural production or damage to production means and to prevent losses. The granting of aid depends on meeting two conditions. The competent authority of the Member State needs to formally recognise the event as a natural disaster or an

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[10] OJ EU C 204, 1.7.2014, pp. 1–97.

[11] Cf. Article 38 TFUE.

[12] Cf. Article 108 TFUE.

[13] Cf. Commission Regulation (EU) No 702/2014 of 25 June 2014 declaring certain categories of aid in the agricultural and forestry sectors and in rural areas compatible with the internal market in application of Articles 107 and 108 of the Treaty on the Functioning of the European Union, OJ EU L 193, 1 July 2014, pp. 1–75.

exceptional occurrence. Moreover, there must be a direct causal link between the adverse climatic event which can be assimilated to a natural disaster and the damage suffered by the undertaking. As for the intensity of the aid, both its amount and the amount of any other payments granted to compensate the losses, including payments under insurance policies, are limited to 100 per cent of eligible costs. The latter are assessed at the level of beneficiaries. The damage may include the following: material damage to assets such as buildings, equipment, machinery, stocks and means of production and loss of income resulting from the full or partial destruction of the agricultural production and the means of the agricultural production.

Another aid category relates to compensating for damage caused by adverse climatic events which can be assimilated to natural disasters. As it was the case before, the state must recognise the event and its connection with the damage. The aid in question is limited to 80 per cent of eligible costs.[14] Its amount may be altered. The aid intensity may be increased to 90 per cent in the areas with natural constraints. It may also be lowered to 50 per cent if a beneficiary has not taken out insurance covering at least 50 per cent of their average annual production or production-related income and the statistically most frequent climatic risks in the Member State or region concerned for which insurance coverage is provided. There may be, however, exceptions to that rule provided that the Member State proves that despite all reasonable efforts, affordable insurance covering the statistically most frequent climatic risks in the Member State or region concerned was not available at the time the damage occurred.

The aid is also granted to farmers to compensate for the costs of preventing and combating animal and plant diseases as well as aid designed to compensate for the losses caused by animal diseases or pests. Aid may only be paid as part of: a) a public programme at Union, national or regional level for the prevention, control or eradication of the animal disease or the plant pest concerned; b) or emergency measures imposed by the competent public authority; or measures to eradicate or contain a plant pest implemented in accordance with 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

[14] The estimation of the amount of aid includes any other payments received to compensate for the damage, including payments under other national or Union measures or insurance policies for the damage receiving aid.

Community.[15] The aid in question, together with other payments under the support, cannot exceed 100 per cent of eligible costs.

As for animal losses, there is also support referring to fallen stock. The support covers 100 per cent of the costs for the removal of fallen stock and 75 per cent of the costs of its destruction. Full support is also granted where the aid is financed through fees or through compulsory contributions destined for the financing of the removal and destruction of such fallen stock and where there is an obligation to perform TSE tests on the fallen stock.[16]

Another form of aid is designed to compensate for the damage caused by protected animals. The protected animals mean the animals under the EU or national regulations (Article 2(49) of Regulation 702/2014). In this case the compensation is granted up to 100 per cent of eligible costs.

The most commonly applied and the most helpful risk management measure is insurance. Therefore, the eligible costs are the costs of insurance premiums for insurance to cover the damage caused by natural disasters or other exceptional occurrences, adverse climatic events which can be assimilated to a natural disaster, animal diseases and plant pests, the removal and destruction of fallen stock as well as by other adverse climatic events or damage caused by environmental incidents. The aid intensity must not exceed 65 per cent of the cost of the insurance premium, with the exception of aid for the removal and destruction of fallen stock, where the aid intensity must not exceed 100 per cent of the cost of the insurance premium as regards insurance premiums for the removal of fallen stock and 75 per cent of the cost of the insurance premium as regards insurance premiums for the destruction of such fallen stock. The Member States may limit the amount of the insurance premium that is eligible for aid by applying appropriate ceilings as has been mentioned.

The last aid category is the aid for contributions to mutual funds. Accordingly, the Commission approves the aid to funds the purpose of which is to pay compensations to farmers for the losses caused by adverse climatic events which can be assimilated to a natural disaster, animal diseases and plant pests or losses caused by environmental incidents. The aid is limited to 65 per cent of eligible costs.

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[15] 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 EU L 169, 10 July 2000, p. 1.

[16] Transmissible spongiform encephalopathies (TSE), prion diseases.

4. It needs to be stressed that supporting particular legal solutions in risk management in agriculture is connected with the need to make the EU agricultural policy more up-to-date.[17] The policy is directed towards a more effective use of public aid. Additionally, it aims at simplifying the rules and making prompt decisions relating to applied aid based on solid economic factors.[18] Such an approach was taken into consideration while drawing up the Commission Regulation (EU) No 702/2014 of 25 June 2014 declaring certain categories of aid in the agricultural and forestry sectors and in rural areas compatible with the internal market in application of Articles 107 and 108 of the Treaty on the Functioning of the European Union.[19]

The analysis of the Treaty shows that, firstly, the legislator finds it particularly important that the public aid does not incentivise beneficiaries to take an unnecessary risk. The consequences of choosing wrong production methods or products need to rest with producers themselves. Secondly, the Member States should prevent, in the form of legal regulations at the national level, excessive compensation, which refers to combining the aid with other compensations paid to beneficiaries, including insurance payments.

What needs to be emphasised is that the requirements for being granted the aid include the need to avoid distortions of competition. To do that the Commission has introduced the requirement of a minimum contribution from producers to losses or costs. Such a solution is intended to guarantee that the state aid is proportionate to suffered losses. In order to minimise the total amount of granted aid, the Commission assesses the necessity of taking appropriate preventive measures by the beneficiary. Moreover, when the conditions set out in Article 107(1) of the TFEU are met,[20] the Member States are obliged to inform the Commission about granting aid in the agricultural and the forestry sector and in rural areas under Article 108(3) of the TFEU. It is not until the final decision is issued, that the suggested support can be implemented.

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[17] See: Communication from the Commission to the European Parliament, The Council, The European Economic and Social Committee and the Committee of the Regions EU State Aid Modernization (SAM) Brussels 8 May 2012, COM(2012)209.

[18] See: point 7 of Preamble of Commission Regulation (EU) No 702/2014 of 25 June 2014 declaring certain categories of aid in the agricultural and forestry sectors and in rural areas compatible with the internal market in application of Articles 107 and 108 of the Treaty on the Functioning of the European Union, OJ EU L 193, 1 July 2014, pp. 1–75.

[19] OJ EU L 193, 1 July 2014, pp. 1–75.

[20] Pursuant to Article 107 of the TFEU (former Article 87 TEC) aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods is, in so far as it affects trade between Member States, incompatible with the internal market.

5. The list of risk management instruments suggested by the legislator uniformly lays down the rules for granting support and, simultaneously, allows the Member States to adapt them to the needs of their own agricultural market. Obviously, it needs to stay in line with adopted legal framework. These instruments are, to some extent, of a universal character. The EU regulations clearly oblige the Member States to comply with their main objective, namely to help to mitigate the adverse effects of the incident which results in a lower income from agricultural production.

All in all, the Member States play a significant role in shaping their own risk management policy based on appropriately selected measures and instruments. Due to various types of risk as well as differences among legal systems of particular Member States, it would not be possible to adopt firm legal regulations in that respect for the whole European Union.

To conclude, it needs to be emphasised that although the EU policy forbids granting the state aid to the entities engaged in a business activity, some concessions have been made for agriculture, which may be attributed both to the specificity of agriculture and its role in providing food security. Therefore, it is possible to highlight a privileged position of agricultural producers in comparison with other market participants.

There should be, however, an incentive aspect in the discussed support. The offered aid needs to modify a farmer's behaviour so that either he consciously takes actions directed at preventing risk in the future or chooses suitable instruments which provide him with a suitable income. It is difficult, however, to achieve such a situation since the State usually provides farmers with additional *ad hoc* aid, which often discourages them from taking any actions on their own. In order to avoid such an effect, the *ad hoc* support needs to depend on whether or not a farmer applied any risk management instrument under domestic regulations. Thus, generally speaking, the state aid should be preceded by preventive actions taken by agricultural producers. His, in turn, requires an appropriate legislative solution to be implemented. The *ad hoc* aid, which still is a key type of accidental support, should refer only to these events and their effects which are not covered by any production risk management tool available in the market.[21] The *ad hoc* aid is not, and should not be, an instrument itself. Therefore, as long as the application of particular instruments is replaced with *ad hoc* aid, the instruments will not be sufficient and effective.

[21] See T. García-Azcárate, op. cit., p. 108.

The above analysis justifies the claim that risk management instruments, in order to ensure a comprehensive approach, should be combined with other rural development measures. Therefore, it is necessary to try and list preventive actions aimed at preventing risk or appropriate production planning.

FINANCING RISK MANAGEMENT IN AGRICULTURE IN THE LIGHT OF THE COMMON AGRICULTURAL POLICY

Summary

The last reform of the Common Agricultural Policy has resulted, among other things, in a new institutional legal framework for production risk management. The paper discusses the issues connected with the role of the EU legislator in shaping various forms of financial support as well as the position of the State in applying the state aid. Additionally, the recent changes made to legal provisions governing the support are stressed and the sufficiency of the support offered assessed.

The applicable EU legal regulations establish a wide range of subsidised instruments and special protection for agricultural producers. They do not, however, make the producers take over the responsibility for risk management. It is thus concluded that applied *ad hoc* state aid limits the applications of risk management instruments among farmers.

IL FINANZIAMENTO DELLA GESTIONE DEI RISCHI IN AGRICOLTURA ALLA LUCE DELLA POLITICA AGRICOLA COMUNE

Riassunto

Il risultato della recente riforma della politica agricola comune è costituito tra l'altro da una determinazione di un nuovo istituzionale quadro giuridico per la gestione dei rischi in produzione agricola. L'oggetto dell'articolo è una problematica legata al ruolo del legislatore dell'Ue nel formare varie forme di sostegno finanziario, così come alla posizione dello Stato nell'accordare gli aiuti pubblici. Inoltre l'autrice cerca di indicare cambiamenti avvenuti di recente nella loro struttura giuridica e di valutare se il sostegno disponibile sia sufficiente.

Le regolazioni dell'Ue in vigore prevedono un ampio ventaglio di strumenti sovvenzionati e una tutela speciale per i produttori agricoli. Tuttavia, esse non portano a far assumere ad essi la responsabilità per la gestione del rischio. Nella parte conclusiva l'autrice sostiene che gli aiuti pubblici applicati *ad hoc* portano a limitare l'applicazione degli strumenti di gestione del rischio presso gli agricoltori.