

**CHANGES TO THE SYSTEM OF DIRECT PAYMENTS
IN THE FRAMEWORK OF THE CAP REFORM
FOR THE YEARS 2014–2020**

Beata Kowalczyk

Warsaw University of Life Sciences – SGGW, Poland

INTRODUCTION

The Common Agricultural Policy (CAP) was created in 1962. Among its main aims were to improve agricultural efficiency in order to ensure consumers had a permanent food supply at affordable prices, and to guarantee European farmers appropriate wages [EC 2014]. The role of the CAP was to solve food problems in a Europe devastated by WWII, and it was therefore designed strictly as sectoral policy. The CAP functioned in its initial form until 1992, a thirty-year period of pro-supply policy. Thanks to that policy, the Union became very self-sufficient in supplying its own food [Adamowicz 2005]. However, the MacSharry reform in 1992 ushered in the era of pro-demand agricultural policy, and introduced compensation for farmers (known today as direct payments), which allowed for the gradual reduction of institutional prices and a concurrent slowing of unwanted growth in production. Further reforms and changes in EU agricultural changes introduced after 1992 are a continuation of the ideas contained in the MacSharry reforms [Poczta 2010]. The CAP is moving away from supporting production, and to a greater extent focuses on environmental and climate issues. The CAP will now have to accomplish ever more goals even as the share of funds for financing this policy in both the structure of the EU budget as well as its GDP continue to be systematically reduced. In the early 1990s the share of the CAP budget in the EU's GDP was 0.54%, but it had fallen to 0.43% by 2004 and is anticipated to fall to roughly 0.38% by 2020 [Drygas 2012].

The Common Agricultural Policy's dual complementary pillar structure is the result of successive reforms of EU agricultural policy, which were undertaken in the presence of changing goals and challenges facing agriculture. As a result, aside from supporting the productive function of agriculture, the CAP is also intended to prop up non-production functions, forming the basis for multifunctional and balanced growth – that is, it takes into account economic, social and environmental criteria [Czyżewski and Stępień 2012a].

The first proposals for a reform of CAP 2014–2020 were geared to improving the economic and environmental competitiveness of the agricultural sector, promoting innovation, eliminating the effects of climate change caused by agricultural production, increasing employment and diversifying economic activity and economic growth in rural areas. At the same time, new EU Member States expected a fairer direct payment system to be introduced [Drygas 2012, Krzyżanowski 2015].

Formal work on shaping the CAP after 2013 at the EU level began after the European Commission (EC) published, in November 2010, its communication *The CAP towards 2020: Meeting the food, natural resources and territorial challenges of the future* (<http://www.minrol.gov.pl/Wsparcie-rolnictwa-i-rybolowstwa/Platnosci-bezposrednie>, accessed: 01.02.2016). The document indicated that the reformed CAP will continue to be divided into two pillars, with the first more ecological in focus and based on a fair distribution of resources, and the second focused more on competitiveness and innovation, climate change, and the natural environment [EC Communication 2010].

Almost a year later, in October 2011, followed by discussions and public consultations, the EC prepared a draft of new regulations, including for the operation of the CAP towards 2020 with regard to direct payments (PB), as well as the development of rural areas, common agricultural market organisation and the financing, monitoring and control of the CAP. Following extensive negotiations, a common position was worked out in December 2013, and the legal basis was accepted and published for regulating the new CAP, including national budgets, the direct payments for each year of the new financial framework. Publication of the laws enabled the completion of the work on the preparation of implementing acts at the EU level, which made it possible to take a series of decisions at the national level on the possibilities left to Member States to adapt the instruments to the needs and specificities of the agricultural sector. Because so much time was required to conclude the negotiations, the new rules went into effect only in 2015. In 2014, transitional regulations were applied. They did not take into account the fundamental changes adopted in the framework of direct payments. As part of the solutions it was decided that the system of direct payments would consist of specific components, some of which would be obligatory for implementation by EU Member States.

AIM AND METHOD

The aim of this article is to present the measures some EU Member States have taken in shaping common agricultural policy after 2013 in the area of direct payments. In this context, it also considers issues pertaining to the current national budgets compared to those of the previous financial framework. Given these goals, the article takes the form of a review and looks at the solutions contained in legislation on common agricultural policy in the years 2014–2020. It is meant to help readers become familiar with the differences in the solutions adopted by EU member states in the framework of direct payments in their country.

The article makes use of scientific publications, the text of Regulations and data on the amount of particular EU Member State budgets allocated for direct payments. The horizontal (comparative level) method was used to analyse the statistical data and the results are both described and presented in charts and maps.

NATIONAL BUDGETS AND THE REDISTRIBUTION OF DIRECT PAYMENTS

From the point of view of shaping agricultural policy, direct support stabilises farm revenues. Results obtained by Poland's Farm Accountancy Data Network (FADN) on the basis of a survey of commodity farms indicate a high (nearly 70%) share of subsidies to support operational activities in 2014 farm revenues. In 2010–2014, the share ranged from approximately 55% in 2012 to approximately 69% in 2014 [Chechelski et al. 2013, FADN 2014]. Thus, the support directed to farmers significantly affects the income they generate.

Ongoing negotiations on CAP reform after 2013 produced several options for redistributing direct payments between Member States [Krzyżanowski 2015]:

- a flat rate for the whole EU: funds per 1 ha would be the same for all farmers in the EU;
- a pragmatic approach: adapting the existing rules governing the division of funds so that Member States received, for example, at least 80% of the EU average per 1 ha;
- the application of objective criteria: a flat rate for the whole of the EU but taking into account the objective criteria based on economic, physical and environmental indicators;
- a combination of the pragmatic approach and the objective criteria.

Following extensive negotiations, a convergence mechanism was worked out that seeks to transfer funds from countries whose direct payment rates per 1 ha are higher than the EU average to countries where the rates are lower. Pursuant to the provisions of CAP reform after 2013, in Member States with direct payments per 1 ha that are lower than 90% of the EU average, the difference between the current level of payment and 90% of the EU average will be reduced by a third. Ultimately, all EU Member States should achieve the minimum rate of 196 EUR per 1 ha by budget year 2020. This uniformity will be financed proportionally by all Member States, whose total direct payments exceed the EU average [Regulation 1307/2013].

As a result of convergence, 12 EU Member States will receive more funds for direct payment in the present financial framework than they did in 2007–2013. Despite the changes, including budget cuts, the leading countries with the largest budget for direct payments will remain unchanged. The countries with the largest available budgets include France (more than 52 billion EUR), Germany (nearly 36 billion EUR) and Spain (more than 34 billion EUR). With more than 21 billion EUR, Poland is sixth on the list.

In nominal value, the largest percentage growth in the total payments to be received in the years 2014–2020 over the 2007–2013 period was observed for the Baltic countries and the countries which joined the EU in 2007, i.e. Latvia (135% growth in total payments), Romania (122%), Bulgaria (108%), Estonia (102%), and Lithuania (72%). This was in large measure attributable to the fact that when a country joins the EU, the phasing-in rule is applied during the first few years of its membership with the aim of its gradually reaching the level of payments the EU-15 Member States received as of April 30, 2004 [Żmija 2011]. Direct payment funds received by Poland for the present financial framework rose 39%. Belgium (–14%), Denmark (13%), and Germany, Holland and Greece (all –12%) incurred the highest costs for the 2014–2020 financial framework (Fig. 1).

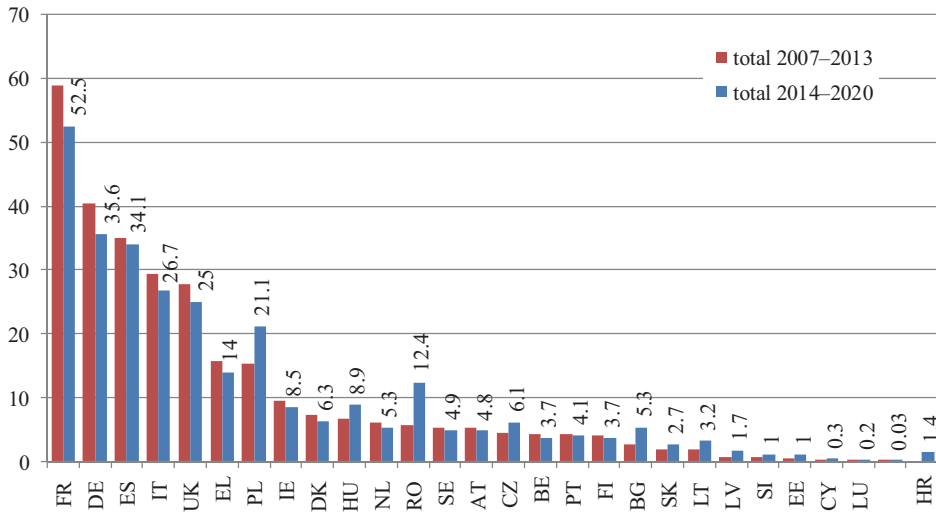


FIG. 1. A comparison of EU Member States' direct payment budgets in 2007–2013 and 2014–2020 (in billion EUR), (budgets figuring for convergence but not flexibility between pillars)

Source: the author's own calculations on the basis of Council Regulation 1782/2003, 73/2009, 994/2014 and 1307/2013 (before applying flexibility).

Pursuant to art. 14 of the Regulation of the European Parliament and of the Council (EU) 1307/2013 of 17 December 2013 Laying down rules for direct payments to farmers under support schemes under the common agricultural policy, Member States may decide to move from the pillar I to the pillar II of the CAP up to 15% of their annual national ceilings for calendar years 2014–2019. In addition, states can move to direct payments on 15% of the amount allocated to support for measures aimed at the development of rural areas for the period 2015–2020. Bulgaria, Estonia, Spain, Latvia, Lithuania, Poland, Portugal, Romania, Slovakia, Finland, Sweden and the UK can move to direct payments on 25% of the amount. These funds may be used in the first pillar in the years 2014–2019.

Ultimately, 11 UE Member States opted for a trade-off: to reduce their overall direct payment budgets in order to develop their rural areas. The group included eight EU-15 members and three that joined in 2004 (Fig. 2). The United Kingdom transferred the largest amount for developing its rural areas (more than 2.3 billion EUR). This move alone accounted for more than a third of the total funds transferred from the first to the CAP pillar II. On the other hand, five countries shifted funds from the second to the pillar I, and all of them were new EU members. Poland was responsible for the largest percentage shift in the group (25% – the largest amount possible – of the pillar II total for the years 2015–2020). In fact, this accounted for nearly 70% of the total funds transferred from the CAP II pillar for direct payment in the EU [EP 2015].

Taking into consideration the last size of the direct payment budgets (after applying convergence and budget changes as a result of transfer between the CAP pillars), the largest budget reductions between the last year from the previous financial framework and

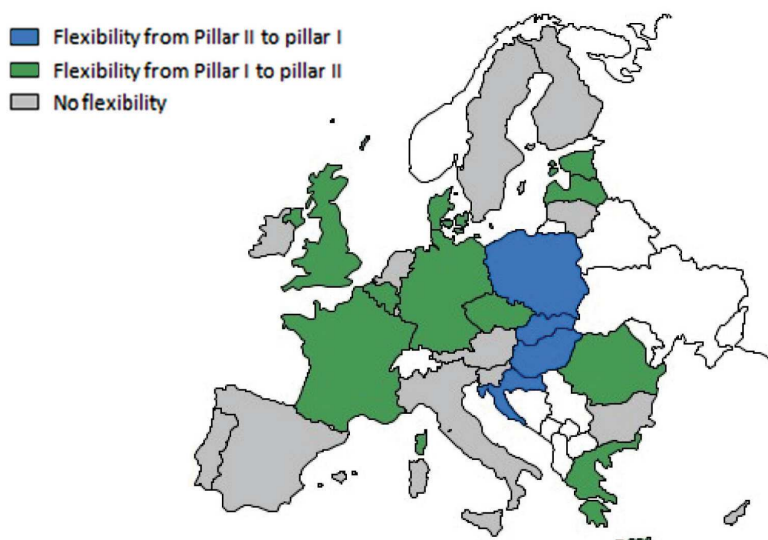


FIG. 2. How EU countries transfer funds between the CAP'S two pillars

Source: done on the basis of PE, Implementation of the pillar I of the CAP 2014–2020 in the EU Member States [2015].

the last year from the present framework – that is, between 2020 and 2013 – occurred in the following countries (Fig. 3):

- France (the budget fell by approx. 1.1 billion EUR, –13% of its 2013 budget);
- Germany (–835 million EUR, –14%),
- Italy (–666 million EUR, –15%).

At the same time, the largest percentage drops in the budget occurred in:

- Belgium (budget fell by 18% from its 2013 level, –110 million EUR);
- The Netherlands (–18%, –165 million EUR);
- Denmark (–16%, –169 million EUR).

The countries that will make the most use of the direct payment budgets in the present financial framework include:

- Romania (2020 budget grew by 639 million EUR, or 51%, over its 2013 budget);
- Bulgaria (216 million EUR, 37%);
- Latvia (156 million EUR, 107% – doubled its budget);
- Lithuania (137 million EUR, 36%);
- Estonia (68 million EUR, 67%).

The convergence and interpillar fund transfers led to changes in the conversion rate of EUR per 1 ha of potentially eligible area¹ that qualified for both the direct payment and

¹ Potentially eligible area (PEA) was used in converting DP budgets per 1 ha. It is used by the EC to distribute funds within the present financial framework based on the Council of the EU document (5715/12) Background data used in the impact assessment for the distribution of direct and rural development payments between Member States.

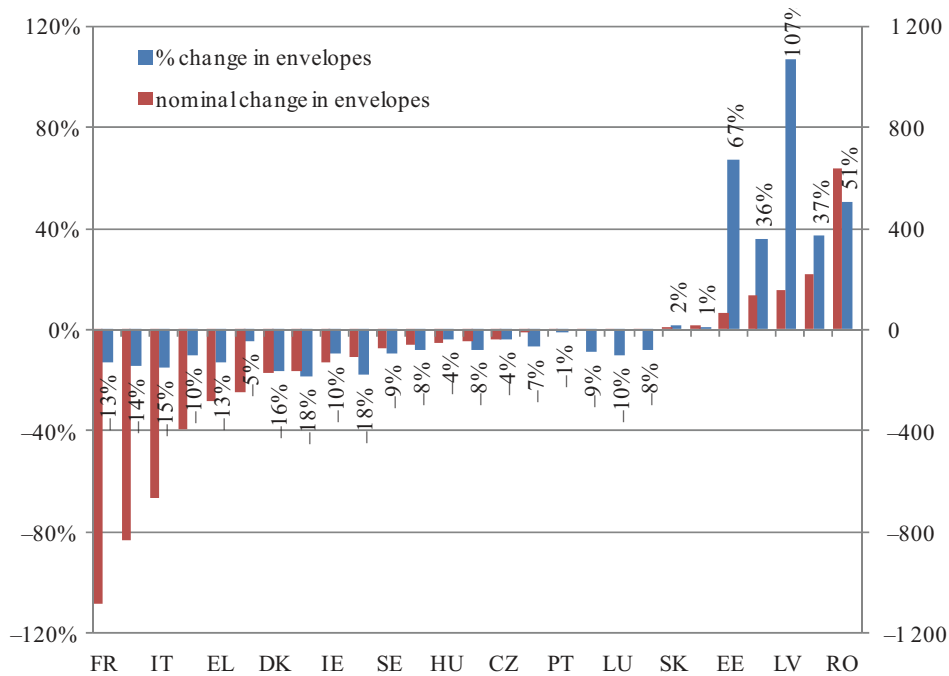


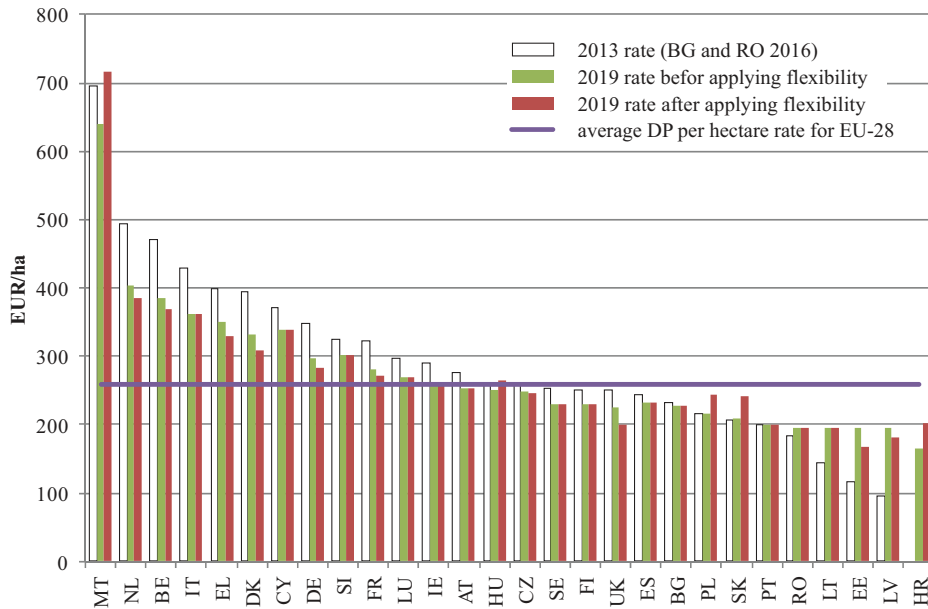
FIG. 3. Change in direct payments in 2020 over 2013 levels (after adjusting for flexibility between pillars)

Source: the author's own calculations on the basis of Council Regulation 73/2009 and 1307/2013 (after applying flexibility).

the rural area development payment. For the most part, the countries which opted to transfer part of their funds from the pillar I to the pillar II had direct payments exceeding the EU average. This group included the Netherlands, Belgium, Greece, Denmark, Germany and France. Interestingly, they were joined by Latvia and Estonia, which had among the lowest rates in the EU while at the same time observing some of the highest direct payment growth in their budget in the current financial framework.

Although Malta is to have the smallest 2019 direct payment budget (after adjusting for flexibility, it's only around 5 billion EUR), after converting it for hectare of agricultural use, the country will actually receive the highest rate among all EU Member States (around 716 EUR per 1 ha). The leaders among the countries with the highest rate after adjusting for flexibility didn't change. Malta is followed by the Netherlands (approx. 386 EUR per 1 ha), Belgium (approx. 368 EUR per 1 ha), Italy (approx. 363 EUR per 1 ha), and Greece (approx. 330 EUR per 1 ha). Rounding out the list of countries that receive an above-average rate are Cyprus, Denmark, Germany, Spain, France, Luxembourg, and Ireland (Fig. 4).

The rate of direct payments in Poland has been growing since the country joined the EU in 2004. As mentioned earlier, until 2013, the country's growth was the result of phasing-in to the full payment rate, while the growth in payments after 2013 has been attributable to convergence – that is, aligning the rate with the EU level. Furthermore, as



For Bulgaria and Romania the 2016 rates were analysed because their phasing-in period ends in that year.

FIG. 4. Comparison of direct payments in EU countries from 2013 and from 2019 before and after accounting for flexibility between the I and II CAP pillars

Source: the author's own calculations on the basis of Council Regulations 73/2009 and 1307/2013 (before and after flexibility between pillars).

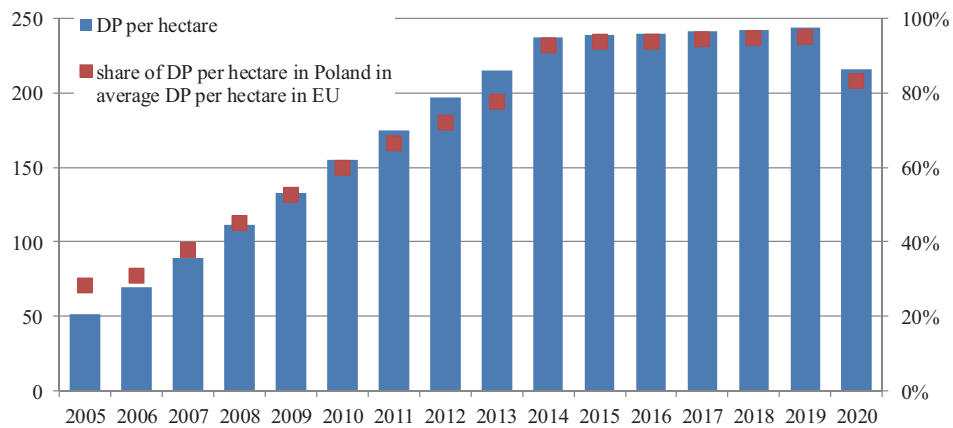


FIG. 5. Direct payments per hectare in Poland in 2005–2020 (EUR per 1 ha of potentially eligible area and as a percentage of the EU average)

Source: author's calculations on the basis of Council Regulations 1782/2003, 73/2009, 994/2014 and 1307/2013 (after flexibility between pillars).

a result of transferring 25% of its pillar II funds for the years 2015–2020, Poland's direct payment rate has grown, in the present financial framework, to approximately 95% of the EU's average rate, from around 78% in 2013. Pursuant to EU regulations as laid down in art. 14 of Regulation 1307/2013, funds transferred from the rural area development budget can be used as direct payments in 2014–2019 campaigns. This also accounts for the fall in the DP rate in 2020 (Fig. 5).

Direct payments are made to farmers after converting to Polish złoty (PLN) according to the reference rate of the ECB from the last working day of September of the year for which the payments are due. Therefore, any change in the exchange rate can have a profound effect in shaping the structure and level of farmers' income. The euro–Polish złoty exchange rate is characterised by a high annual variability – for example, 17% appreciation in 2005 (from 4.7352 to 3.9185 zł/euro) and 25% depreciation in 2009 (from 3.3967 to 4.2295 PLN per 1 EUR) [Poczta 2014].

COMPONENTS OF THE DIRECT PAYMENTS

Direct payments are a fundamental instrument in the CAP, and they play a key role in realising the programme's goals, including [Czyżewski and Stepień 2012b]:

- maintaining the incomes of agricultural producers;
- reimbursing costs related to meeting environmental requirements;
- maintaining agricultural uses in good agricultural practice;
- guaranteeing equal competitive conditions in the framework of the unified food market.

In the current financial framework, new elements have arisen in the system of direct payments. The implementation of some is obligatory, while others are done on a voluntary basis. The choice of the individual components translates directly into the amount of direct payments per 1 ha of area, as the implementation of every subsequent component will reduce the remaining funds for what is known as the basic payment. These components are aimed at specific goals, and not everyone can participate – for example, in payments for young farmers, not everyone will receive an additional payment for all of the eligible hectares of agricultural use on their farm. Figure 6 presents a detailed look at the components.

Voluntary DP components include couple support, payments to areas with natural constraint, the additional payment and payments for small farms. Payments for young farmers, green payments and the basic payments are mandatory for all countries. The basic payment (SAPS/SPS) allocation will range from 12% of Malta's budget to 68% of Luxembourg's. A total of 12 countries/regions have allocated more than 60% of their budgets for the basic payment (they include Denmark, Germany, Estonia, Ireland, Greece, Cyprus, Luxembourg, the Netherlands, Austria, and three out of four regions of the UK – England, Wales, and Northern Ireland). This could be achieved because, among other reasons, none of these countries, with the exception of Germany, opted to introduce the additional payment or, with the exception of Denmark, the LFA payment. At the same time, some spent less than the allowable threshold for the payment for young farmers (e.g. Estonia 0.3%), and couple support from 0.2% of the budget in Ireland to 7.9% in Cyprus. In addition, Denmark, Germany, Estonia, Cyprus, the Netherlands, Austria, England and

| | | | | |
|------------------------------------|---|---|------|--|
| Cross Compliance | ** Couple Support | **Payment for areas with natural constraint | } or | ** Payment for small farms ○ up to 10% ○ max 1,250 EUR ○ simplified |
| | ○ up to 10% or 15% | ○ up to 5% | | |
| | ** Redistributive Payment | | | |
| | ○ up to 30% | | | |
| | ○ max 65% of average direct payments (first ha) | | | |
| | * Young Farmers Scheme | | | |
| | ○ up to 2% | | | |
| | ○ +25% payments (max 5 years) | | | |
| * Green Payment | | | | |
| ○ mandatory 30% | | | | |
| ○ greening practices or equivalent | | | | |
| * Basic Payment Scheme | | | | |
| ○ no fixed percentage | | | | |
| ○ 5% degressivity over 150,000 EUR | | | | |

* compulsory ** voluntary

FIG. 6. The direct payment system for 2015–2020 (components and their share of the direct payment) Source: Overview of CAP Reform 2014–2020, Agricultural Policy Perspectives Brief 5, KE [2013].

Wales have implemented compensation payments on the national level (flat-rate), which means that most of the national ceiling would be distributed among all beneficiaries, who will ultimately receive individual payments at the same level. The remaining four countries have applied a partial internal convergence, so a large part of the national ceiling would be distributed among farmers maintaining partial division of the historical allocation [PE 2015].

The direct payment system implemented in Malta, Wallonia, and Lithuania is entirely different. For these regions and country, the basic payments make up the smallest share of the overall scheme (Malta 12%, Wallonia 30%, Lithuania 38%). Among other factors, this is because they allocate a large portion of overall funds to production-related payments – from 15% in Lithuania and 21% in Wallonia to as much as 57% in Malta. Moreover, Lithuania and Wallonia have also opted to use the additional payments: Lithuania allocated 15% of its portfolio while Wallonia sets aside 17%. In fact, with the exception of Germany, all EU Member States have opted for a production-related payment, and a full 24 of them support the beef industry. Eight countries have opted for an additional payment: Belgium (Wallonia only), Bulgaria, Germany, France, Croatia, Lithuania, Poland and Romania. At the same time, none of these countries have decided to allocate for this purpose the maximum ceiling of 30%, while the share of the redistributive payment

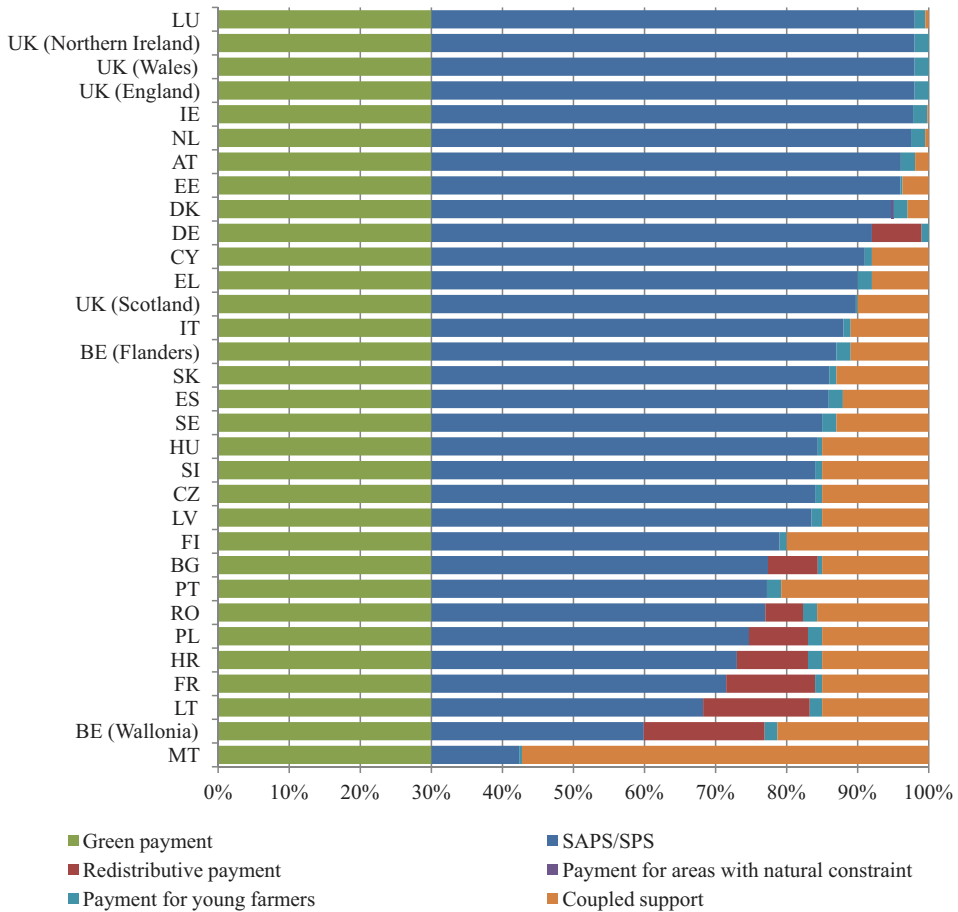


FIG. 7. The percentage share of the national budget for individual components of the direct payments (average for the 2014–2020 period)

Source: elaborated on the basis of done on the basis of PE, Implementation of the pillar I of the CAP 2014–2020 in the EU Member States [2015].

in the national budget ranged from 5% in France to 17% in Wallonia. Only Denmark allocated money for LFA support from Pillar I, and that amounted to only 0.3% of its overall portfolio [EP 2015].

CONCLUSIONS

The above considerations show that the system of direct payments has a complex structure with a tightly defined budget. The following changes made to the payment system in the present financial framework may be considered the most important:

- Negotiations carried out for the post-2013 CAP began in November 2010 and were concluded in December 2013 with the publication of the regulations to be applied.

Because discussions concerning CAP in the new financial framework lasted so long, the new regulations took effect only in 2015 (in 2014 the so-called transitional regulations, which did not include the basic changes, were applied).

- A key criterion for dividing and allocating direct payments among EU Member States is the area each uses for agriculture. The mechanism implemented increases the convergence of direct payments in countries with a rate below 90% of the EU average by a third of the difference between this level and the current rate in the country. Beyond that, in the present financial framework all of the states are to receive a minimum rate of 196 EUR per 1 ha. A mechanism for reducing direct payment rate disproportions in EU Member States was introduced.
- Thanks to the introduction of the convergence mechanism and the end of the phasing-in period, The Baltic countries, Romania and Bulgaria noted the largest increase in direct payments received. The phasing-in period consists in new Member States receiving gradually higher payments during the first years of their accession until the level of payout they are receiving is on a par with EU-15 countries. Poland's overall package grew in the present period by nearly 40% over the levels it received in 2007–2013.
- Flexibility between the CAP pillars. Five countries (all new Member States) have used their right to transfer funds from the pillar II to the pillar I, while 11 Member States moved funds in the other direction, from the pillar I to the pillar II. Poland took the most RDP funds (25% of the RDP funds for the years 2015–2020), which comprised 70% of all the funds transferred from the CAP pillar II to direct payment. Great Britain was responsible for the lion's share of transfers (around a third of all funds) moving in the other direction, from direct payment to the rural development programme.
- During the present operating period, new components have been introduced in the direct payment system, some of which are obligatory for EU Member States. These include payment for young farmers, for which a maximum of 2% of the national budget can be allocated, green payments, which can account for a 30% share of the budget, and single area payments. In addition, Member States can implement a redistribution payment (up to 30% of the budget), an LFA (less favoured areas) payment up to 5% of the budget, and coupled support (generally up to 15% of the country's budget).

In summary, EU Member States enjoy a degree of freedom both in transferring funds between the CAP's two pillars and in choosing the components they implement in their countries. They can also define, albeit within certain limits, the amount they will allocate for a given payment, and also the criteria by which particular components are made available. Thanks to this latitude, the individual countries of the European Union have the ability to fashion the system of direct payments to the needs that exist in their agricultural sector.

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Summary. The article examines the changes that have been made to the direct payments system as a result of the most recent reform of the Common Agricultural Policy (CAP) for the years 2014–2020. It presents a model division of direct payment funds taken on by the countries and institutions of the EU, as well as changes to the national budgets and payments for 1 ha of agricultural land resulting from the redistribution and the ability to transfer funds between the CAP's two pillars. It also presents solutions individual countries have used in choosing components available in the direct payment system and the division of national budgets allocated for their realisation. Results of the analysis show that the amount of direct payments in Poland has grown and that EU Member States have taken a variety of approaches to shaping the new national payment system.

Key words: direct payment system, direct payment budget and rates, CAP reform

JEL: O13, Q14, Q18

Corresponding author: Beata Kowalczyk, Warsaw University of Life Sciences – SGGW, Faculty of Economic Sciences, Department of Agricultural Economics and International Economic Relations, Nowoursynowska 166, 02-787 Warsaw, Poland, e-mail: btkowalczyk@wp.pl