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FROM THE FIRST TO THE SECOND PILLAR OF CAP: HYPOTHESES OF DIRECT AID MODULATION IN ITALY

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From the first to the second pillar of CAP: hypotheses of direct aid modulation in Italy

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From the first to the second pillar of CAP:
hypotheses of direct aid modulation in Italy

Abstract

The paper focuses on the implementation of direct aids modulation, as provided for by Regulation 1259/99. After a critical review of the most relevant questions arisen around the effectiveness and the viability of modulation, the paper presents results about its possible application in Italy. In the first part of the paper a special attention is given to the actual distribution of direct aids in Italy, to the number of farms involved and the amount of revenues realised. In the second part four different hypotheses of modulation are tested. In order to evaluate the effectiveness of modulation revenues under the four different hypotheses are compared with the financial resources allotted in Italy to the regional Rural Development Plans (RDPs). While results of modulation are, generally speaking, quite poor in terms of re-distribution of direct aids, there is a more relevant effect in terms of additional resources destined to the RDPs. However, resources are to be destined to measures that receive the highest share of resources within the RDPs. On the contrary, other measures, more genuinely addressing Rural Development and territorial issues within the RDPs, receive a much smaller amount of resources and cannot be funded through modulation. In other words, if the main objective of the modulation is that of shifting resources from the first to the second pillar of the CAP, this is only partially realised, given the mandatory destination of financial resources on measures that are substantially financed and that do not fully address the economic diversification and the development of rural areas.

Keywords:
CAP; Direct Aids; Horizontal Regulation; Agri-environmental Measures; RDPs.

1. Introduction

The Regulation n. 1259/1999, also known as “Horizontal Regulation” since it is meant to be crosswise to Common Market Organisations (CMOs) and to Rural Development policies, can be considered as one of the most innovative elements introduced with the Common Agricultural Policy (CAP) reform in Agenda 2000 (De Filippis *et al*., 1999; INEA, 1999). It establishes a framework of rules under which Member States may intervene on matters of direct aids; such intervention provides for conditional constraints to direct aids (cross-compliance) and for limitations to their total amount according to a series of possible criteria (modulation). It also establishes that revenues obtained through the application of the Regulation have to be channelled towards the implementation of additional measures within those provided for the former “accompanying measures” (Regs. 2078/92, 2079/92 and 2080/92), introduced by the MacSharry Reform, and of allowances for the disadvantaged areas, both included in Regulation 1257/99 on Rural Development with Agenda 2000. Such obligation is to be considered an effort in the direction of the re-balancing of agricultural expenditure by shifting resources away from the traditional market support through the CMOs towards Rural Development policies, and in particular in favour of environment and disadvantaged areas (Buckwell, 1997a, 1997b and 2002; Sotte, 1997; The Countryside Agency, 2002).

The Horizontal Regulation originated as an attempt to respond to two sets of criticisms, frequently addressed to the CAP after the Mac Sharry Reform of 1992: on the one hand, there had been no correction of the imbalances in aid distribution to different types of farms; on the other, no opportunity had been taken to use direct aids to relieve the pressure on the environment caused by the farming activity.

The attempt of linking together different levels of intervention introduces a strong element of ambiguity in the Horizontal Regulation: measures such as cross-compliance and modulation, which by their very nature pursue specific aims – environmental and re-distributive – are put in relation to a wider strategy of gradually shifting resources away from market policies and towards measures for Rural Development (Henke, Sardone 2000; INEA, 2000a). That means the construction of the "second pillar" of the CAP is basically subordinated to the expenditure revenues generated by the implementation of the Horizontal Regulation, being it the main, if not the only, instrument actually implemented by Agenda 2000 with the specific aim of re-balancing resources between the two pillars of the CAP. It is important to keep in mind that modulation, as the other tools provided by Regulation 1259/99, is implemented, at the level of the single Member States. That is, on one hand, a powerful tool in the hands of national and sub-national institutions to improve financial resources available for environment and rural areas; on the other, a possible source of distortion among Member States, since each of them may decide whether, how and to what extent modulating direct aids. Moreover, as stressed later on, the additional measures implemented with the savings form modulation require national co–financing, that represents a financial burden to be charged to the national budgets.

Modulation supplies a legislative framework for the reduction of direct aids on the basis of parameters connected with employment or income, but in any case not exceeding 20% of the total amount. It may be applied on the basis of three different criteria: if the labour force employed in the farm, expressed in terms of annual work units, is below the limits established by the Member State; if the Standard Gross Income (SGI), calculated for each farm on the basis of the region where it is located, exceeds the threshold established by the Member State; if the total amount of direct aid received by a single farm is greater than the maximum fixed by the Member State (ceiling). The Regulation fixes only these basic criteria, and each Member State is allowed to choose whether, which and how to apply them (Dwyer, Bennet, 2001)[1].

After a critical review of the most relevant questions arisen in many Member States around the effectiveness and the viability of modulation, the paper presents results about the possible application of modulation in Italy, with a special attention to the actual distribution of direct aids in Italy, the number of farms involved and the amount of revenues realised. In order to evaluate the results of our exercise, we compared the amount of revenues under different hypotheses of modulation with the financial resources allotted in Italy to the regional Rural Development Plans (RDPs). It is highlighted that, while results of modulation are, generally speaking, quite poor in terms of re-distribution of direct aids both by Region and by farm involved, there is a more relevant effect of modulation in terms of additional resources destined to the RDPs. On the other hand, resources are to be destined to measures, within the RDPs, that in Italy are already those receiving the highest share of resources. On the contrary, other measures, more genuinely addressing Rural Development and territorial issues within the RDPs, receive a scant amount of resources and cannot be funded through modulation. In other words, if the main objective of the modulation was that of shifting resources from the first to the second pillar of the CAP, this is only partially realised, given the mandatory destination of financial resources on measures that are already substantially financed and that do not fully address the economic diversification and the development of rural areas (Sotte 1997; De Filippis, Storti, 2001).

2. Some questions raised by modulation

[1] The article concerning modulation has, as with the entire body of the Horizontal Regulation, undergone major rethinking since the first version of March 1998, in which only the first of the criteria had been take into consideration, while the third criterion had been intended as a measure on its own (farm ceiling) and made it compulsory to reduce the total amount of direct aid enjoyable by each farm.

Modulation, as formulated in the approved Regulation, raises a series of questions worth considering:

- firstly, consistency between tools used and objectives to be attained, both in terms of reducing the support unbalance among beneficiaries and products, and with regards to the effectiveness of creating revenues aimed at the reinforcement of Rural Development policies;
- secondly, a possible conflict between territories and agricultural products (and also between economic sectors), which are connected to the criteria of modulation and to the mechanisms regulating the destination and use of revenues generated with it;
- finally, the relationship between the institutions involved (central versus local governments) and problems associated with the management of revenues at the local level.

Modulation, in its current version within the Horizontal Regulation, is the result of a compromise between new functions assigned to agriculture in Western developed countries by society and the various positions expressed, on the one hand, by EU partners and, on the other, by agricultural interests. Such compromise had as a result the set aside of the original objective of modulation, which was to correct imbalances in the distribution of direct aids, bringing out, above all, its "fiscal" function, in terms of diverting resources from market policies to structural and agri-environmental measures[2].

About the second aspect, the arise of possible conflicts, the most debatable issue is that the Horizontal Regulation can modulate only direct aids, with no effect at all on the whole set of "indirect" support enjoyed by farmers via prices and trade control. Further conflicts may raise from the territorial re-distribution of revenues from modulation, since it would take away resources from the most productive areas and re-distribute them in the most marginal and disadvantaged ones. This can be a perfectly legitimate goal, especially from a social point of view, but probably not really welcomed by the most efficient and "entrepreneurial" part of the primary sector. Moreover, there is also a risk of creating a (false) competition between the more market-oriented part of the agricultural sector and that part of primary activity that does not enjoy any acknowledgement from the market (multifunctionality). Actually, both roles of agriculture need to be acknowledged by policy-makers, so policies need to be addressed to marketable and non-marketable goods and services produced by the primary sector.

Thirdly, modulation puts a problem of relationship among institutional levels of CAP management, which refers to the more general question of policy de-centralisation and the respect of the principle of subsidiarity. With modulation, in fact, financial resources, generated at the EU level, are managed at the national level and, at least in the case of Italy, are re-distributed on RDPs that are managed at the regional level. Furthermore, in line with the management of expenditure for the RDPs, revenues of modulation might be destined to those regions with a more developed expenditure effectiveness, increasing the gap with regions not as much efficient.

Finally, it is worth noting that direct aids do not need any financial co-financing from Member States, while agri-environmental measures and compensative allowances, like all the intervention in the RDPs, need to be co-financed. Therefore, the total amount of funds available for agri-environmental measures and disadvantaged areas subtracts resources to non–agricultural sectors, thus supporting the idea that the primary sector is clearly disproportionately sustained, certainly much more than it contributes, in terms of occupation and wealth, to the economic and social system. In this, case the conflict would be not within the primary sector and its actors, but rather between agriculture and the other sectors, involving the debated issue of the intervention of the public sector in the economy and the relationship between agricultural producers and tax-payers, already quite difficult after the "mad cow" disease and other food safety issues of the recent past.

Soon after the CAP reform in 1999, the debate on modulation within Member States started off on a low key. This was partly due to the resistance offered, above all, by producers who benefited

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[2] In other words, the EU Commission seems to be limited, in this phase, to signalling an intention and to offering an opportunity to experiment with new instruments, leaving Member States with broad discretionary powers until a new mechanism can be put in place, of which the Commission itself will probably be in charge.

considerably from direct aids, partly to the actual management difficulties. Moreover, the range of discretion conceded to Member States complicates any future debate on modulation and the problems associated with its effective implementation, given that objectives, instruments and actors affected vary considerably from country to country.

3. Direct aids modulation in Italy

3.1 Direct aids in Italy

In order to better understand the possible effects of the implementation of modulation in Italy, it is important to draw a picture of the distribution of direct aids there. The analysis refers to the situation of aids in 2000; that means payments are not effected yet by the CAP reform of Agenda 2000. Therefore, some slight change may occur starting from 2001, with the actual implementation of the reform, but not so relevant to invalidate the results of this review.

In 2000 farms enjoying direct aids were slightly more than 1.4 million, that is about the 55% of the total number of farms (INEA, 2001). The total amount of resources coming in Italy as direct aids (considering CMOs and Regulations interested by modulation) was over 3,000 million euros (tab. 1). Of the total amount, the largest share was in favour of arable crops (about 60%), followed by olive oil and tobacco, while livestock products (bovines and sheep) are at a certain distance[3]. It is also interesting to look at the regional distribution of aids, which appeared to be highly concentrated: in Northern Italy, two Regions (Lombardia and Veneto, the regions with the richest agriculture of the country) enjoyed around the 10% each of the total aids, while in the South, one single Region (Puglia, one of the most "agricultural" regions in Italy) received the 15% of the total amount. Even within Regions the distribution of aids according to the different products was rather concentrated, in some cases even more than it appeared from the national data. For example, in some Northern Regions arable crops received almost the 90% of the total aids, while in some Southern Regions about 50% of aids went to tobacco (60% in Campania) and olive oil (80% in Calabria).

Moving to the aspects more directly connected to the modulation of direct aids, it came out from available data a highly polarised distribution of aids per aid classes: Table 2 shows that the 83% of Italian farms received each less than 2,600 euros in aids, which, in total, represents the 20% of total direct aids; on the other side, just a mere 0.2% of the farms received more than 77,500 euros, that represents the 12.2% of the aids. In other words, a high number of small farms enjoyed a relatively small share of the total direct aids, while a small number of large farms receives a large share of the total direct aids[4].

Such concentration of farms in the smaller brackets of aids is common to other member States. According to the Commission, at the EU level in 1996/97 about 576,400 farms (about 23.2% of the total farms) received less than 1,000 euros, while the 42.8% received less than 2,500 euros. Aids in favour of farmers that received less than 1,000 euros totalled to 287 million euros, that is 1.4% of the total amount of direct aids[5] (European Commission, 2000). Given the high distortion between the number of farmers enjoying direct aids and the total amount of aids available for each farmer, plus the administrative burden for monitoring and procedures which is the same for all farmers no matter the amount of money received, the Commission recently proposed a change in the Horizontal

[3] It is worth underlining that direct aids vary to a certain extent form one year to the other and according to the products. In 1997, for example, olive oil and bovine meat were more relevant in the product distribution of direct aids and the total amount was 8% larger than in 2000.

[4] Within the single Regions the distribution is even more unequal: the share of farms that receive around 2,500 euros is particularly high in some Alpine Regions and in Liguria, while Piemonte, Lombardia, Veneto, Emilia Romagna, Toscana and Umbria show a larger number of farms that receive a more significant share of aids.

[5] Differences among Member States are remarkable: in Portugal, the 63% of farmers receive less than 1,000 euros, while in Denmark the share of farmers receiving less than 1,000 euros is just the 0.4%.

Regulation aimed at simplifying the access to direct aids (Reg. (CE) no. 1244/2001)[6]. Such change in the Regulation does not involve the tools offered by the Regulation itself, but modifies the criteria to supply direct aids, with the specific goal of simplifying the management of CAP policies for small farms. However, one can expect that direct aids granted through this simplified access are by definition exempted by the implementation of modulation, even in the case it will be turned into a mandatory scheme.

3.2 Four hypotheses of modulation

Of the three criteria indicated in the Horizontal Regulation, the application in Italy of the farm SGI (Standard Gross Income) seems to be scarcely operative, because of the abstract nature of such indicator, which would not necessarily make it applicable to single farms, and because of its inaccurate and slow updating. All the same, considering that the amount of direct aid received appears to be closely linked with the economic dimension, any progressive criterion ensures that modulation have a greater effect on more "prosperous" farms, overcoming the difficulties connected with the explicit use of the SGI.

The second criterion, farm labour intensity, aimed at reducing advantages in rent gained in aid distribution and thus favouring labour-intensive farms, also raises doubts with regards to the management of its application, given the difficult task of identifying the actual labour force occupied in farms (family labour, seasonal workers, part-time farmers, and so on). Like the previous criterion, the intensity of labour is inversely correlated to the total aids received, that means a progressive rate of modulation would have the effect of diverting aid from the land factor to the labour factor.

The third criterion indicated in the Regulation, the ceiling to the total amount of aids, if applied progressively, corresponds itself to a criterion of modulation which is directly correlated to the "prosperity" of farms and inversely correlated to the quantity of labour employed. Such statement is supported by information coming from the Italian FADN sample: there is clear evidence that the total amounts of direct aids received by a single farm is directly correlated to the economic dimension of the farm and inversely correlated to the labour intensity in the farm (INEA, 2000a).

On the basis of this last criterion, four different hypotheses of modulation have been tested (Table 3). All of them are of a mere exemplifying nature, though they offer interesting cues for a first evaluation of the application of modulation in Italy. In the first two simulations (A and B), the reduction of direct aids is applied progressively on the basis of brackets of direct aids (as a sort of progressive taxation). The difference between the two simulations is in the threshold of exempted farms (franchise), in the former case fixed at about 2,600 euros, in the latter at about 5,200 euros[7].

The latter two hypotheses have been treated as "borderline cases" of the former ones. In hypothesis C a threshold has been set at about 52,000 euros of total direct aids by farm: only farms with a total amount of aids over the threshold have been modulated. The rationale in this case is that of amplifying the re-distributive character of modulation, that is applied only to "prosperous farms". In hypothesis D modulation is applied to all farms, independently from quantity of financial aids received. Modulation, in this case, is considered as a "fiscal" tool, with no re-distributive ends. For this reason, simulation D is quite different from all the others, for both the administrative burden – quite lighter compared to the other simulations, since it applies the same rate of modulation to all farms – and for the possibility of frauds. In fact, only under hypothesis D it would be impossible to avoid modulation by creating "smaller" farms, with a lesser total amount of aids received, thus increasing the problem of farm parcelling.

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[6] The simplified scheme is based on a single payment that is proportional to the aids received in the past three years and cannot exceed 1,250 euros. The scheme is reserved to all the farmers that, on a voluntary basis, join it for a period of at least three years. It is applicable only to some of the direct aids granted by the EU: to those provided for arable crops, rice, pulses, special premium and suckler cows premium, sheep.

[7] The franchise is aimed at exempting form modulation small farms, which are considered to be those more depending on EU direct aids for their income.

3.3 Possible effects of modulation

Given the Italian farm structure, the number of farms involved by modulation, as well as the amount of revenues, vary significantly according to the different scenarios simulated. More in details, in hypotheses A and B, though revenues are quite similar, the number of farms involved are rather different. In hypotheses C and D revenues are significantly lower than in A and B, but in case C the number of farms is also very small, that is an easier management of the modulation, dealing with a smaller number of farms, while in hypothesis D the whole Italian farms receiving direct aids would be involved.

Comparing the effects of modulation at the regional level, Table 4 shows that there are no significant effects on the results of the four hypotheses with regards to the regions most involved by modulation. First in the regional ranking is Veneto in the North and Puglia in the South, followed by Lombardia, Umbria, Toscana, Calabria, Campania and Emilia Romagna. It is just worth noting that in case C Umbria, a relatively small Region, ranks second in terms of yields from modulation; moreover, in case D, where there is no changing in the distribution of aids, the role of Southern regions to revenues from modulation is relatively more important, while it is reduced the contribution of the richest regions, such as Veneto, Lombardia and Toscana.

The Horizontal Regulation maintains that the total amount of revenues generated by modulation of direct aids is to be used to support additional measures within the former "accompanying measures" of the 1992 reform - early retirement, agri–environmental measures and forestation of agricultural land, plus compensation allowances for disadvantaged areas and for areas with environmental constraints. That means a very specific set of measures within the new RDPs as they were designed by the Agenda 2000 reform for the 2000-2006 planning.

The four hypotheses analysed generate very different amounts of revenues that need to be compared with the actual financial resources available for Rural Development policies, and especially for measures mentioned in the Regulation, in 2000–2006 RDPs (Table 5). The former two scenarios (A and B) would cause an increase equal to more than a third of the total amount of resources that can be financed through modulation and slightly less than 30% of the average yearly resources available for the whole RDPs, while under hypotheses C and D modulation would shift a lower amount of resources towards either the total RDPs and the specific measures considered by the Horizontal Regulation.

It is important to keep in mind that both the agri-environmental measures and the compensation allowances represent, in terms of financial resources, about 40% of the total amount of resources destined to RDPs, while for Objective 1 Regions such measures coincide with the total financial allotment for RDPs. Therefore, for Objective 1 Regions, modulation revenues can actually be destined only to additional agri-environmental measures, while in other Regions there can be an indirect "re-distributive" effect of resources among agri-environmental measures (and compensation allowances) and other measures in RDPs.

However, it is worth noting that with revenues from modulation the distribution of financial resources for Rural Development policies at the regional level would be significantly altered. That means criteria of resource allotment fixed in the planning phase would be, by no means, attended, involving, furthermore, new institutional actors in the decision process.

3.4 Distribution of financial resources in Italian RDPs

In this section we look at the distribution of financial resources for Rural Development policies in Italian RDPs. As underlined in the introduction, this is crucial to highlight the binding constraints to the allotment of revenues from modulation, especially if one keeps in mind that modulation was conceived to supply Member States with a tool to address the shift of resources form the first to the second pillar of the CAP. In Table 6 is reported the public expenditure provided for the 2000-2006 programming period by main typology of intervention within the RDPs approved by the EU for the Italian Regions (INEA, 2000b).

As can be observed in the table, the most substantial share of resources is assigned to measures addressing the protection and improvement of the environment. In fact, almost half the entire amount of resources for Rural Development in Italy is assigned to them (a full 6.5 billions of euros for the new seven-year programming period). Within this typology agri-environmental measures prevail: slightly less than 30% of public spending is assigned to them (Gatto, Henke, Velazquez, 2002).

Most environmental intervention regard biological and integrated production, introduction or improvement of grass cover, restoration and conservation of natural areas, the safeguarding of biodiversity and the reduction of pollution-causing input[8]. A lesser share of resources goes to the remaining measures for environmental protection, equal to 17% of overall programmed public spending, including forestry measures. Agri–environmental measures include intervention fostering the production, processing and marketing of wood (to some degree coupled to production) and incentives for land afforestation based on differentiated premiums, that take into account the profitability of the farming carried on prior to afforestation and of the area where the intervention takes place.

Overall, measures for environmental protection, while in many instances "sector-oriented" and partially "de-coupled", present clear goals and potential impact aimed at obtaining environmental benefits (positive externalities) and, therefore, the achievement of objectives not purely commercial.

Paradoxically, types of intervention aimed at the promotion of Rural Development absorb a share of expenditures equal to only 18% of the entire amount. In particular, measures aimed at increasing the stock of services and infrastructures receive 14% of programmed public expenditure, while intervention aimed at the economic diversification is assigned only a residual share of available resources (4%).

Among the former, those for the funding of intervention pertaining to rural roads, aqueducts and power lines are of some importance. Il is worth pointing out the public, collective nature of the infrastructures even when they are located on farms; this confers the characteristic of common property resources on them. Other measures in this category regard village renewal and protection of the rural heritage – clearly linked to the safeguarding of the inherited cultural values of the rural areas – as well as the promotion of services in favour of the economy and the rural population – directly related to the defence of the territory and to the increase in the well-being of the residents. Despite the pronounced consistency of the objectives of these types of intervention *vis-à-vis* the roles assigned to agriculture in the European Model of Agriculture (Comitato Economico e Sociale, 1999), an absolutely marginal portion of resources is allotted to them (approximately 2% overall).

The second set of measures included in the "promotion of Rural Development" typology is constituted by intervention in favour of economic diversification in rural areas. The most important measure in this category in terms of financial resources is the diversification of agricultural activities, which provides for intervention on farms in order to promote activity pertaining to agri-tourism and the providing of business services related thereto.

To a much lesser extent resources are destined to actions of an extra-farm nature, such as the creation of networks for agri-tourism, "wine-paths", "food-paths", the realisation of information booths; the realisation of structures aimed at qualifying and diversifying the supply of products and services. The finalities and intended effects of this latter type of intervention, while focusing attention on farms, aim at the supply of services that do not always find adequate remuneration on the market.

[8] It needs to be specified that the expenditure provided for these measures is conditioned by the commitments covering many years assumed in the previous programming phase, and assumed in within a less binding normative framework as compared to the new regulations (which now provide for the respect of sound agricultural practice, new modalities for the calculation of premiums and the measurability of effects).

Finally it is worth pointing out the extra-sector character of the measure for incentives to tourism and handcrafts which provides for aid to enterprises in the tourist and handcraft sector, and for intervention for territorial promotion and for structures and services of a collective nature. This measure has positive implications above all in terms of employment, rather than with respect to the obtaining of non-marketable goods, considering that it provides incentives for economic activities. However, also in this case the skimpy funding (less than 1% of public spending) leads to foresee a modest impact.

4. Concluding remarks

In the first part of the paper it is highlighted that the Horizontal Regulation can be rightfully considered as a "signal" launched in the direction of the expenditure re-balancing in favour of structural and environmental intervention, in order to better qualify the multifunctional role of European agriculture. However, the link imposed among the objective and the instruments supplied (cross−compliance and modulation) binds an important strategy of the CAP, the reinforcement of the second pillar, to the possible revenues of specific measures, whose implementation is left to the Member States.

As for modulation itself, as actually introduced with the Regulation, it is the result of a compromise among different positions and needs within the Member States that have shifted its main goal from the issue of a distorted distribution of direct aids as a consequence of the implementation of the 1992 CAP reform, to the increasing need of the construction of the second pillar, based on Rural Development policy (De Filippis, Storti, 2001; Lowe, Buller, Ward, 2002). As a consequence, many relevant questions arise:

- the scarce consistency between instrument (very constrained) and objectives (very ambitious);
- the possible opening of a series of conflicts, either within the primary sector (between territories and producers) and between agriculture and the other sectors of the economic system (competition among additional resources to co−finance the revenues shifted to the RDPs);
- the complexity of modulation, especially in terms of institutional levels involved in its implementation. This is particularly true in Italy, where the de-centralisation of agricultural and rural policies is rather high, and where the distribution of duties among the central government and the Regions created in the past quite a number of conflicts;
- last, but not least, the need for additional financial support at the national level, given that revenues coming from modulation must be co−financed. This means "more money for the primary sector" and thus a (relevant) problem of relationship among tax−payers (consumers) and institutions, especially in a time when the agricultural performance in terms of consumer trust and reliance has been quite weakened.

These questions make the debate on modulation rather complex and not over yet, both at the national and at the EU level. As a consequence, further discussion on this matter would be necessary and desirable, with special regards to guidelines from EU Commission on implementation, aimed at reducing as much as possible the different criteria of application in Member States.

The proposal of "dynamic modulation" in the mid-term review (MTR) of Agenda 2000 reform of the CAP partially address some of the issues raised in this paper. First of all, the proposal is in favour of the compulsory character of modulation. This means all Member States will be involved and will pursue the reduction of direct aids up to 20%. Secondly, there are two different ways of modulation aids: by the annual reduction of 3% and by capping the total amount of payments that each farm can receive for EU. In the first case, revenues go back to the EU budget and subsequently return to Member States according to "objective criteria"; in the second case, revenues return to the

Member States where they were drained[9]. In both cases revenues are added to the "second pillar" financial resources, however not necessarily to the "accompanying measures", but to any of the measures included in the RDPs. Such mechanism ensures, certainly more than the current modulation, a potential for relevant redistribution of resources at the Member State level. Moreover, the franchise has been proposed at 5,000 euros up to two labour units fully employed on-farm, so to prevent small farms to be modulated. This can have a particularly effective result in countries like Italy, where small farms receive, altogether, a quite significant share of total direct aids. Besides, according to the MTR proposal, the threshold can be raised on the basis of the labour intensity of farms, so to exclude the labour-intensive farms from the modulation, or at least reduce the modulation rate for them[10]. Of course this is just a proposal that will be submitted to debate within the EU both at the Commission and at the Member State level; however, it reflects the main arguments pointed out about the current modulation and it is supported by many experts and policy makers.

In the second part of the paper some examples of application in Italy are shown, given the direct aids distribution which results highly distorted in favour of few large farms that receive the largest share of support. The results of modulation differ according to the scenarios presented, but all the hypotheses tested show that modulation has a scant effect on direct aid distribution and a more relevant effect on the shift of resources from one pillar (market policies) to the other (Rural Development policies). This leads to the issue of the destination of revenues: additional resources for agri–environmental measures and for compensation allowances in Italy not only can create a problem of conflict among Regions (contributors *versus* beneficiaries), but can distort, to a different extent according to the criterion of modulation, the financial plans which are the result of a long and often difficult process of negotiation between Regions, State and EU.

Finally, as stressed in the paper, the additional amount of support will be added to measures that already are highly financed, especially if one compares their share of resources with those of more innovative and truly territorial measures, such as the Rural development and the income diversification measures. Encouraging this type of intervention would be, in our opinion, a much clearer signal in favour of the shift of resources from the first to the second pillar of the CAP.

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[9] The objective criteria are not explicitily indicated in the MTR proposal, but they should be connected to the contribution of the single member State to the EU agricultural GDP and to the final output in agricolture.

[10] The single Member States may decide to rise the franchise of 3,000 Euros per each labour unit over the basic two required for the franchise of 5,000 euros.

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Table 1 - Direct aid by type of agriculture in Italy (2000)

	Arable crops		**Olive oil**		**Bovines**		**Sheep & goats**		**Tobacco**		**Total**	
	(000 Euros)	%	(000 Euros)	%	(000 Euros)	%	(000 Euros)	%	(000 Euros)	%	(000 Euros)	%
Piemonte	162.345	78,7	26	0,0	41.228	20,0	1.861	0,9	836	0,4	206.296	100
Valle d'Aosta	21	3,4	0	0,0	524	83,0	86	13,6	0	0,0	631	100
Lombardia	278.652	91,7	353	0,1	20.719	6,8	1.983	0,7	2.044	0,7	303.750	100
Trentino-Alto A.	705	17,7	144	3,6	1.989	49,9	1.147	28,8	0	0,0	3.985	100
Veneto	244.999	72,6	1.022	0,3	31.274	9,3	567	0,2	59.818	17,7	337.680	100
Friuli-Venezia G.	74.625	94,9	21	0,0	2.593	3,3	160	0,2	1.230	1,6	78.630	100
Liguria	129	1,8	5.614	79,2	969	13,7	377	5,3	0	0,0	7.089	100
Emilia Romagna	171.693	92,8	633	0,3	10.093	5,5	1.388	0,7	1.296	0,7	185.104	100
Toscana	138.290	73,7	17.097	9,1	5.422	2,9	8.921	4,8	17.819	9,5	187.547	100
Umbria	49.977	37,1	8.421	6,2	3.789	2,8	2.994	2,2	69.585	51,6	134.766	100
Marche	119.314	90,6	3.785	2,9	5.067	3,8	2.930	2,2	524	0,4	131.620	100
Lazio	80.388	63,2	17.838	14,0	7.051	5,5	11.086	8,7	10.813	8,5	127.176	100
Abruzzo	30.252	47,3	17.782	27,8	3.337	5,2	5.312	8,3	7.219	11,3	63.903	100
Molise	39.478	79,0	6.505	13,0	1.537	3,1	1.995	4,0	481	1,0	49.997	100
Campania	42.953	18,2	38.556	16,4	6.852	2,9	4.409	1,9	142.649	60,6	235.418	100
Puglia	195.456	41,9	238.001	51,1	3.484	0,7	5.595	1,2	23.409	5,0	465.945	100
Basilicata	80.303	79,2	9.824	9,7	3.197	3,2	7.924	7,8	176	0,2	101.425	100
Calabria	25.067	11,6	173.673	80,6	7.659	3,6	9.052	4,2	0	0,0	215.451	100
Sicilia	126.886	57,9	52.505	24,0	22.752	10,4	17.048	7,8	0	0,0	219.191	100
Sardegna	48.605	40,1	4.121	3,4	14.112	11,7	54.231	44,8	0	0,0	121.070	100
Italy	**1.910.138**	**60,1**	**595.923**	**18,8**	**193.648**	**6,1**	**139.067**	**4,4**	**337.900**	**10,6**	**3.176.676**	**100**

Source: calculations by INEA based on AGEA data

Table 2 - Direct aid distributed, by class and by farms in class* (%), 2000

	up to 2,600 Euros		2,600 - 5,200 Euros		5,200 - 10,300 Euros		10,300- 25,800 Euros		25,800 - 51,700 Euros		51,700 - 77,500 Euros		over 77,500 Euros	
	aid %	farms %	aid %	farms %	aid %	farms %	aid %	farms %	aid %	farms %	aid %	farms %	aid %	farms %
Piemonte	12,5	59,6	14,1	17,1	20,1	12,7	27,9	8,1	15,6	2,1	4,3	0,3	5,4	0,2
Valle d'Aosta	75,9	97,8	14,8	1,7	7,7	0,4	1,7	0,1	0,0	0,0	0,0	0,0	0,0	0,0
Lombardia	6,7	51,0	9,5	16,8	15,5	14,6	28,8	12,1	21,3	4,1	7,9	0,9	10,2	0,6
Trentino-Alto A.	50,4	97,0	7,9	1,6	6,9	0,7	10,7	0,5	5,4	0,1	9,5	0,1	9,2	0,1
Veneto	19,8	78,2	13,0	11,2	13,6	6,2	15,2	3,1	9,0	0,8	4,1	0,2	25,4	0,3
Friuli-Venezia G.	22,0	71,9	17,1	14,9	17,5	7,9	19,9	4,1	9,2	0,8	3,1	0,2	11,2	0,2
Liguria	71,6	97,2	14,1	2,0	7,4	0,6	5,1	0,2	0,0	0,0	1,7	0,0	0,0	0,0
Emilia Romagna	17,4	70,9	16,1	14,6	18,0	8,6	19,6	4,3	11,0	1,0	4,2	0,2	13,8	0,2
Toscana	13,6	80,9	9,9	7,7	14,0	5,6	20,8	3,8	15,3	1,2	8,5	0,4	17,9	0,4
Umbria	12,9	86,0	6,7	6,3	7,3	3,4	10,2	2,2	9,9	1,0	6,7	0,4	46,2	0,8
Marche	21,0	76,2	16,6	12,1	18,8	6,9	20,4	3,6	11,7	0,9	4,6	0,2	6,9	0,1
Lazio	22,7	90,5	11,6	4,4	14,1	2,7	19,1	1,7	12,0	0,5	5,1	0,1	15,3	0,1
Abruzzo	42,3	92,7	17,7	4,5	14,9	1,9	11,9	0,7	4,5	0,1	2,5	0,0	6,2	0,0
Molise	26,5	81,5	20,0	9,6	23,9	5,8	23,1	2,8	4,3	0,2	1,4	0,0	0,8	0,0
Campania	20,2	84,9	11,8	6,1	18,2	4,7	27,1	3,3	12,0	0,7	4,4	0,1	6,4	0,1
Puglia	26,6	86,5	13,9	6,6	15,7	3,8	20,8	2,3	9,9	0,5	4,4	0,1	8,6	0,1
Basilicata	22,1	82,0	15,8	8,3	21,0	5,5	29,4	3,6	8,7	0,5	1,9	0,1	1,1	0,0
Calabria	28,1	87,6	13,3	6,7	12,3	3,1	15,5	1,8	9,0	0,5	5,9	0,2	15,8	0,2
Sicilia	33,3	89,1	17,4	5,8	18,7	3,2	21,1	1,7	6,4	0,2	1,4	0,0	1,7	0,0
Sardegna	16,9	67,7	25,1	17,6	28,4	10,5	21,0	3,7	5,9	0,5	1,4	0,1	1,4	0,0
Italy	**20,7**	**82,6**	**13,8**	**8,3**	**16,4**	**5,1**	**21,0**	**3,0**	**11,2**	**0,7**	**4,6**	**0,2**	**12,2**	**0,2**

** The classes have been established in Lire, then transformed and rounded off in Euros*

Source: calculations by INEA based on AGEA data

Table 3 - Hypotheses of the modulation of direct aid used in simulations*

	Details		
Hypothesis A:	exemption of 2,600 Euros and a progressive reduction of:	2.5%	2,600 - 5,200 Euros
		5%	5,200 - 10,300 Euros
		10%	10,300- 25,800 Euros
		15%	25,800 - 51,700 Euros
		20%	51,700 - 77,500 Euros
		25%	77,500 Euros
Hypothesis B:	exemption of 5,200 Euros and a progressive reduction of:	5%	5,200 - 10,300 Euros
		10%	10,300- 25,800 Euros
		15%	25,800 - 51,700 Euros
		20%	51,700 - 77,500 Euros
		25%	77,500 Euros
Hypothesis C:	reduction of:	20%	51,700 - 77,500 Euros
		25%	77,500 Euros
Hypothesis D:	single reduction of 3% on all farms, irrespective of the amount of aid		

Table 4 - Hypotheses of modulation based on region (2000)

	Hypothesis A		Hypothesis B		Hypothesis C		Hypothesis D	
	Yield from modulation (000 Euros)	Farms involved (n.)	Yield from modulation (000 Euros)	Farms involved (n.)	Yield from modulation (000 Euros)	Farms involved (n.)	Yield from modulation (000 Euros)	Farms involved (n.)
Piemonte	9.870	18.391	8.957	10.632	1.861	232	6.189	45.468
Valle d'Aosta	2	35	1	8	0	0	19	1.564
Lombardia	19.596	22.130	18.426	14.543	4.999	638	9.113	45.157
Trentino-Alto A.	160	169	152	80	63	9	120	5.543
Veneto	26.605	23.230	25.550	11.298	17.186	556	10.130	106.415
Friuli-Venezia G.	3.874	6.932	3.567	3.251	1.588	89	2.359	24.648
Liguria	52	383	39	101	3	2	213	13.759
Emilia Romagna	10.637	16.097	9.899	7.996	4.827	252	5.553	55.400
Toscana	13.262	12.418	12.645	7.401	5.429	504	5.626	65.120
Umbria	15.973	5.548	15.710	3.059	11.487	454	4.043	39.769
Marche	5.701	11.905	5.167	5.865	1.491	167	3.949	50.027
Lazio	7.532	8.765	7.118	4.722	3.309	229	3.815	92.252
Abruzzo	1.886	5.156	1.678	2.004	717	49	1.917	70.165
Molise	1.231	5.301	994	2.555	57	16	1.500	28.692
Campania	10.774	18.555	9.850	11.049	2.411	284	7.063	123.174
Puglia	20.847	36.279	19.192	18.392	6.493	626	13.978	269.463
Basilicata	3.322	9.515	2.871	5.137	174	44	3.043	52.836
Calabria	12.325	14.819	11.688	6.779	5.972	414	6.464	119.688
Sicilia	5.729	19.803	4.857	9.250	580	80	6.576	181.123
Sardegna	3.325	15.078	2.654	6.856	242	44	3.632	46.679
Italy	**172.704**	**250.509**	**161.013**	**130.978**	**68.890**	**4.689**	**95.300**	**1.436.942**

Source: calculations by INEA based on AGEA data

Table 5 - Yield as a % of annual average capital generated by RDP by region, for period 2000-2006*

	Hypothesis A		Hypothesis B		Hypothesis C		Hypothesis D	
	Horizontal Reg.	RDP	Horizontal Reg.	RDP	Horizontal Reg.	RDP	Horizontal Reg.	RDP
Piemonte	35,1	20,6	31,8	18,7	6,6	3,9	22,0	12,9
Valle d'Aosta	0,0	0,0	0,0	0,0	0,0	0,0	0,4	0,3
Lombardia	56,4	44,1	53,0	41,5	14,4	11,3	26,2	20,5
Trentino-Alto A.**	1,1	0,6	1,1	0,6	0,4	0,2	0,8	0,4
Veneto	140,3	67,9	134,7	65,2	90,6	43,9	53,4	25,9
Friuli-Venezia G.	40,2	29,4	37,0	27,1	16,5	12,1	24,5	17,9
Liguria	1,7	0,5	1,3	0,3	0,1	0,0	6,9	1,9
Emilia Romagna	37,0	20,9	34,4	19,4	16,8	9,5	19,3	10,9
Toscana	31,1	30,6	29,7	29,1	12,7	12,5	13,2	13,0
Umbria	113,1	67,4	111,2	66,3	81,3	48,5	28,6	17,1
Marche	49,4	23,3	44,8	21,1	12,9	6,1	34,2	16,1
Lazio	38,0	22,4	35,9	21,1	16,7	9,8	19,3	11,3
Abruzzo	19,3	10,8	17,2	9,6	7,3	4,1	19,6	10,9
Molise	28,0	28,0	22,6	22,6	1,3	1,3	34,1	34,1
Campania	54,1	54,1	49,5	49,5	12,1	12,1	35,5	35,5
Puglia	54,2	54,2	49,9	49,9	16,9	16,9	36,3	36,3
Basilicata	13,7	13,7	11,9	11,9	0,7	0,7	12,6	12,6
Calabria	41,8	41,8	39,6	39,6	20,2	20,2	21,9	21,9
Sicilia	10,3	10,3	8,8	8,8	1,0	1,0	11,9	11,9
Sardegna	8,3	8,3	6,6	6,6	0,6	0,6	9,1	9,1
Italy	**38,2**	**29,0**	**35,6**	**27,1**	**15,2**	**11,6**	**21,1**	**16,0**

** The first column shows the effect of yield on measures financeable by modulation; the second the effect in proportion to RDP*

*** For Trentino-Alto Adige, financial assets are the sum of the assets of the two Autonomous Provinces of Trento eBolzano*

Source: calculations by INEA based on AGEA data

Table 6 - Typologies of intervention provided for in Italian RDPs and allocation of financial resources for the 2000-2006 programming period

	Programmed public spending (million Euros)	% of total
Modernisation of production structures	**4.618,6**	**33,6**
Investments in farms	*2.379,9*	*17,3*
Processing and commercialisation	*1.224,6*	*8,9*
Setting up of young farmers	*694,4*	*5,1*
Early retirement	*41,7*	*0,3*
Land improvement	*41,9*	*0,3*
Land recomposition	*236,2*	*1,7*
Training	**118,8**	**0,9**
Promotion of rural development	**2.427,3**	**17,7**
Diversification (of which:)	***590,6***	***4,3***
Commercialisation of quality products	*137,1*	*1,0*
Diversification of activities in the agricultural sector	*359,9*	*2,6*
Incentives for tourist and handcraft activities	*93,6*	*0,7*
Infrastructures and services (of which:)	***1.890,1***	***13,8***
Services for replacement of and assistance to management	*109,4*	*0,8*
Essential services for the economy and population	*167,5*	*1,2*
Village renewal and protection of rural heritage	*157,2*	*1,1*
Water resources management	*654,0*	*4,8*
Development and improvement of rural infrastructures	*643,9*	*4,7*
Rebuilding of damaged agricultural potential	*104,5*	*0,8*
Financial engineering	*53,5*	*0,4*
Environment	**6.509,3**	**47,4**
Agri-environmental measures	*4.021,9*	*29,3*
Afforestation of agricultural areas	*804,1*	*5,9*
Other forestry measures	*675,0*	*4,9*
Environmental protection	*453,8*	*3,3*
Compensatory allowances	*554,5*	*4,0*
Total	**13.727,5**	**100,0**

** Not included in the total are resources for evaluation and for certain previous measures.*

Source: elaboration of Italian RDP and ROP financial plans