hypotheses of direct aid modulation in Italy

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From the first to the second pillar of CAP:

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Roma, January 30, 2002

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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, 1997; 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

[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

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[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%.

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

	Arable crops		Olive oil		Bovines		Sheep & goats
	(000 Euros)	%	(000 Euros)	%	(000 Euros)	%	(000 Euros)
Piemonte	162 345	78,7	26	0,0	41 228	20,0	1 861
Valle d'Aosta	21	3,4	0	0,0	524	83,0	86
Lombardia	278 652	91,7	353	0,1	20 719	6,8	1 983
Trentino-Alto A.	705	17,7	144	3,6	1 989	49,9	1 147
Veneto	244 999	72,6	1 022	0,3	31 274	9,3	567
Friuli-Venezia G.	74 625	94,9	21	0,0	2 593	3,3	160
Liguria	129	1,8	5 614	79,2	969	13,7	377
Emilia Romagna	171 693	92,8	633	0,3	10 093	5,5	1 388
Toscana	138 290	73,7	17 097	9,1	5 422	2,9	8 921
Umbria	49 977	37,1	8 421	6,2	3 789	2,8	2 994
Marche	119 314	90,6	3 785	2,9	5 067	3,8	2 930
Lazio	80 388	63,2	17 838	14,0	7 051	5,5	11 086
Abruzzo	30 252	47,3	17 782	27,8	3 337	5,2	5 312
Molise	39 478	79,0	6 505	13,0	1 537	3,1	1 995
Campania	42 953	18,2	38 556	16,4	6 852	2,9	4 409
Puglia	195 456	41,9	238 001	51,1	3 484	0,7	5 595
Basilicata	80 303	79,2	9 824	9,7	3 197	3,2	7 924
Calabria	25 067	11,6	173 673	80,6	7 659	3,6	9 052
Sicilia	126 886	57,9	52 505	24,0	22 752	10,4	17 048
Sardegna	48 605	40,1	4 121	3,4	14 112	11,7	54 231
Italy	**1 910 138**	**60,1**	**595 923**	**18,8**	**193 648**	**6,1**	**139 067**

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

** 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:	____	2,600 - 5,200 Euros
		__	5,200 - 10,300 Euros
		___	10,300- 25,800 Euros
		___	25,800 - 51,700 Euros
		___	51,700 - 77,500 Euros
		___	77,500 Euros
Hypothesis B:	exemption of 5,200 Euros and a progressive reduction of:	__	5,200 - 10,300 Euros
		___	10,300- 25,800 Euros
		___	25,800 - 51,700 Euros
		___	51,700 - 77,500 Euros
		___	77,500 Euros
Hypothesis C:	reduction of:	___	51,700 - 77,500 Euros
		___	77,500 Euros
Hypothesis D:	single reduction of 3% on all farms, irrespective of the amount of		

aid

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

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

	Hypothesis A		Hypothesis B		Hypothesis C		Hypothe 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 fr modulati (000 Eur
Piemonte	9 870	18 391	8 957	10 632	1 861	232	6
Valle d'Aosta	2	35	1	8	0	0	
Lombardia	19 596	22 130	18 426	14 543	4 999	638	9
Trentino-Alto A.	160	169	152	80	63	9	
Veneto	26 605	23 230	25 550	11 298	17 186	556	10
Friuli-Venezia G.	3 874	6 932	3 567	3 251	1 588	89	2
Liguria	52	383	39	101	3	2	
Emilia Romagna	10 637	16 097	9 899	7 996	4 827	252	5
Toscana	13 262	12 418	12 645	7 401	5 429	504	5
Umbria	15 973	5 548	15 710	3 059	11 487	454	4
Marche	5 701	11 905	5 167	5 865	1 491	167	3
Lazio	7 532	8 765	7 118	4 722	3 309	229	3
Abruzzo	1 886	5 156	1 678	2 004	717	49	1
Molise	1 231	5 301	994	2 555	57	16	1
Campania	10 774	18 555	9 850	11 049	2 411	284	7
Puglia	20 847	36 279	19 192	18 392	6 493	626	13
Basilicata	3 322	9 515	2 871	5 137	174	44	3

Calabria	12 325	14 819	11 688	6 779	5 972	414	6
Sicilia	5 729	19 803	4 857	9 250	580	80	6
Sardegna	3 325	15 078	2 654	6 856	242	44	3
Italy	**172 704**	**250 509**	**161 013**	**130 978**	**68 890**	**4 689**	**95**

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

Puglia	54,2	54,2	49,9	49,9	16,9	16,9
Basilicata	13,7	13,7	11,9	11,9	0,7	0,7
Calabria	41,8	41,8	39,6	39,6	20,2	20,2
Sicilia	10,3	10,3	8,8	8,8	1,0	1,0
Sardegna	8,3	8,3	6,6	6,6	0,6	0,6
Italy	**38,2**	**29,0**	**35,6**	**27,1**	**15,2**	**11,6**

** 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