OPTIONS OF FINANCING THE CAP – CONSEQUENCES FOR THE DISTRIBUTION OF FARM PAYMENTS

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Abstract

The introduction of decoupled direct payments in the EU was a substantial change of the Common Agricultural Policy (CAP) in 2003. After decoupling direct payments from production, it has become evident, that distributional objectives are the major justification of farm payments. There are three facets: the distribution of payments among farmers within member states, the distribution of payments among member states, and the distribution of household incomes within member states. All of them will be affected if the volume and allocation of funds for the CAP will be changed in the new financial framework of the EU. The paper addresses the first distributional aspects. We provide an overview of the development of past and present research and findings on the distributional aspects of direct payments. We use the theory of federal fiscal relations to identify the policy agendas that should be handled at the EU level, at national levels, and at sub-national levels. We analyse how measures of concentration are affected if the criteria of direct payments are changed (e.g. a modified modulation scheme). This allows us to identify potential consequences after changing the way direct payments are distributed within EU member states. The summary of the paper discusses the distributional consequences of scenarios of the coming financial framework as far as agriculture is concerned.

Keywords: Direct Payments, Distribution, Common Agricultural Policy.

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Centralisation versus decentralisation

Federalism and subsidiarity – from a normative economic perspective

The theory of fiscal federalism is a normative concept that defines which government responsibilities should be transferred to the Union and which ones should remain with the member states (see, e.g., Tabellini, 2003, Breuss and Eller, 2004, Caesar, 2004, Heinemann, 2005). It is based on pioneer work by Musgrave (1959) und Oates (1972). The "optimal" political decision level for each single policy area is identified on the basis of cost-benefit considerations. Centralisation and decentralisation each have specific advantages and drawbacks that may differ from one government function to another. Wheigting relative benefits and costs of (de)centralisation of responsibilities will give guidance on the appropriate allocation of responsibilities to the different territorial authorities. Fiscal federalism tries to identify an efficient multi-level governance structure for the public sector.

Public services are viewed from the perspective of a benefit region. Public goods can be grouped whether tey are locally, regionally, nationally or supra-nationally relevant. The "principle of fiscal equivalence" (Olson, 1969) states that the responsibility for the provision of a public good should be conveyed to that territorial authority where the community of beneficiaries corresponds to that of taxpayers. If the benefits of public goods provided by one region spills over to the inhabitants of neighbouring regions, the overall supply of public goods will be sub-optimal.

External effects can be internalised and a welfare-optimal supply of public goods will be generated by centralising the responsibility. However, centralisation does not necessarily mean that the entire responsibility rests with the higher-ranking government level: The central level can provide incentives to the sub-central authorities to take into account the spill-overs of their policy decisions via financial transfers (Oates, 1972). A co-financing of public tasks and the sharing of responsibilities between different government levels in a federal state may be interpreted as intermediate steps on the way towards full centralisation. The centralisation may be meaningful for public goods and services offering substantial economies of scale in consumption.

Advantages of a centralised supply of public goods have to be weighed against their disadvantages. Decentralised responsibilities for economic policy can better adapt decisions to inter-regional differences of individual preferences. When preferences of the population concerning the quantity and quality of public goods differ across countries, a closer tie between policy making and citizens favours decentralised responsibilities. Lower information and dissatisfaction costs have to be considered as well (Oates, 1972). A general perception is that the centralisation of responsibilities tends to work in favour of uniform policies. With a view to the "optimal" allocation of responsibilities, there is thus a conflict between the supply of public goods according to popular preferences on the one hand, and the internalisation of regional external effects and the exploitation of economies of scale, on the other (Alesina Angeloni Etro, 2005).

Consequences for the division of responsibilities

EU responsibilities would be policy areas where benefits of policy action extend EU-wide and/or where economies of scale in consumption are large enough so that they can be realised only at the EU level. In other cases, the individual member states (or regional or local territorial authorities) should provide the public good in question. In situations with spill-overs and economies of scale below the EU level, the countries concerned should co-operate, in order to establish a link between beneficiaries, decision makers and the tax payers for a particular public good.

In some cases competition between countries for internationally mobile companies and taxpayers can have welfare-enhancing effects. According to supporters of a competitive solution, firms can reveal their preferences for different sets of taxes and public services by choosing where to reside or produce if decentralised political responsibilities are possible (Tiebout, 1956). Competition between the territorial authorities is expected to promote the elaboration of innovative policy approaches ("laboratory federalism", Oates, 1999), and member states' governments would have stronger incentives to align their policy proposals to people's preferences.

An alternative view stresses that the competition for mobile factors of production could induce a circle of deregulation in major policy areas. The risk of a "race to the bottom" is seen in particular for capital taxation, threatening the financing of public goods and services (e. g., Wildasin   Wilson, 2004). According to this view, such competition holds the risk of an erosion of the welfare state and of desirable regulations at the national level, such as for working conditions, environmental protection or the framework for competition (Sinn, 1997).

Spending responsibilities for the EU

Regulative policy areas for the functioning of the Internal Market

Several authors (e. g., Breuss and Eller, 2004, Caesar, 2004, Alesina, Angeloni and Schuknecht, 2005, Feld, 2005) have made suggestions on a favorable distribution of responsibilities in the EU. The consensus is that policy areas with significant economies of scale or spill-overs of benefits at the European level and homogeneous preferences should be the core competencies of the Community. EU competencies are widely recognised in the areas of:

- protection of basic freedoms,
- preservation of a competitive framework, including control of member states' subsidies policy,
- common foreign policy.

A sharing of responsibilities between the Community and the member states appears to make sense. As far as competition policy is concerned, this proposition is not without problems since views about the role of competition and the competitive framework differ to a considerable extent. Hence, homogeneous preferences can be assumed only subject to strong qualifications. Besides, not all problems of competition policy touch upon the smooth functioning of the Internal Market. In general, these policy areas mainly require intervention of a regulative and co-ordinating kind to secure the functioning of the Single Market, with only minor budgetary implications.

Policy areas with significant differences in preferences between countries

In a number of policy areas, an independent EU responsibility is contested, due to significant differences in preferences between countries which may limit or even outweigh the possible benefits from exploiting increasing returns to scale and an internalisation of regional external effects. Differences in preferences arise mainly from the welfare differential between the national economies and from differing norms and value systems. In particular, this concerns the policy areas of:

- foreign and security policy,
- enlargement and development aid policy,
- international and global (as opposed to regional and local) environmental policy,
- trans-European networks for energy and transport,
- research policy,
- education policy.

In principle, foreign and domestic security are (nearly) pure public goods with sizeable returns to scale in consumption (Samuelson, 1954). In view of the clear nature of foreign and security policy as a collective good, at least a co-ordinating role of the EU would seem appropriate (Tabellini, 2003). With the same argument, tasks of co-ordination can be justified for cross-border issues of internal security such as the fight against terrorism. Furthermore, EU responsibilities are judged in the areas of enlargement and development aid policy, based on the consideration that all member states would benefit from progress in these areas, e.g., from a reduction of poverty-driven migration flows or the opening of new markets. Adding also expenditure on humanitarian aid and emergency help, the foreign- and security-related policy areas account for some € 6.7 billion or 5.3 percent of the overall budget.

In 2007, the EU provided € 1.2 billion in funds for education and cultural policy. At present, education policy calls mainly for regulatory EU competencies in the interest of greater mobility of students and labour via mutual recognition of educational qualifications. Should the removal of barriers in this regard lead to a high degree of international labour mobility, more important responsibilities with financial implications would accrue to the EU if countries would become freeriders of educational efforts undertaken by other member states. Nevertheless, the arguments for conferring such financial responsibilities to the EU as from now are not very strong, given that (part of) the existing differences in national education systems are probably the reflection of heterogeneous preferences. Moreover, different approaches to educational policy give rise to a desirable competition for the best outcomes. In the area of cultural policy, any EU-wide returns to scale or benefit spill-overs are difficult to identify.

Generally, the view is held that industrial policy should rather not be counted among the tasks of the EU, since EU-wide spill-over effects can hardly be identified and industrial policy preferences differ significantly across member states (Alesina, Angeloni, and Schuknecht, 2005). Pelkmans (2001) invokes in support of EU competencies that competition-distorting national subsidies would be replaced by measures of support from the supra-national level. However, this argument becomes less relevant if the control of subsidies is effective. Part of the EU expenditure for industrial policy is recorded under the budget heading of "enterprises", with a total of € 524 million. But industrial policy subsidies are also included under the items of "research", "media" and "energy and transport". Overall, however, planned EU expenditure is relatively small, also because the tasks of the Community are meant to be only complementary to the measures taken by the member states.

The budget heading of "employment and social policy" provides for funds to the amount of € 11.4 billion in 2007, equivalent to 9 percent of budgetary commitments. Yet, from the fiscal federalism perspective it is not clear why the EU should be active in these areas with a sizeable amount of financial resources. Thus, it would be difficult to argue that problems of structural adjustment on national labour markets ought to be cushioned by EU-wide employment policy interventions. It is up to the member states in the first place to address the largely home-made problems by labour market measures that can be better designed according to the particular national circumstances (Berthold and Fehn, 2002). Strongly heterogeneous preferences also imply that the Union should hardly become active in the area of social policy. First, there are large differences between individual member states' level of welfare, with the consequence of diverging perceptions about the appropriate policy in favour of social equality; second, attitudes towards a policy of redistribution are shaped by socio-cultural factors and differ markedly between the member states.

Nevertheless, social policy programmes may be reasonable if labour mobility across countries is high (e. g., Wildasin, 1998). In that case, the theory of fiscal federalism recommends redistributive policy to be centralised (Oates, 1972). Thus, a responsibility for setting minimum standards could be attributed to the EU, in order to prevent a "race to the bottom" or "social dumping". Admittedly, however, there is no convincing empirical evidence in the literature for a race to the bottom actually taking place between welfare states (e. g., Hines, 2006). One should also bear in mind that setting high minimum standards would take away a competitive advantage from the less affluent member states.

The special case of agricultural policy

The expenditure block still dominating the EU budget is the Common Agricultural Policy (CAP). Overall, almost € 57 billion were planned in 2007 for agriculture (including fishery). In this regard, a distinction has to be made between market intervention and direct subsidies on the one hand, claiming a total of around € 44.5 billion (together with fishery policy), and policies for rural development on the other (some € 12.4 billion). Many economists hold the view that the arguments in favour of a policy of agricultural subsidies at the European level are not very convincing (e. g., Hoeller, Louppe, and Vergriete, 1996, Feld, 2005). However, in this regard a more nuanced look at the problem is deemed appropriate.

It is not certain that EU-wide agricultural market stability can be can be attained if internal prices levels are close to world prices. Given the income levels in the EU the possibility to buy agricultural products on world markets, the case for security of supply is rather weak. Therefore, the transition from market intervention to direct subsidies is to be welcomed from the economics perspective. However, the "first pillar" of the CAP (market-related expenditure and direct payments) is to serve primarily objectives related to the personal income distribution for which an EU responsibility can be challenged under current circumstances. Moreover, the conflict regularly arising in budget negotiations between member states with a relatively important agricultural sector vs. states with a less important agricultural sector indicates that national preferences cannot be assumed to be homogeneous across the EU. Neither can EU-wide spill-over effects or returns to scale of any significant degree be identified. Thus, from a fiscal federalism perspective, a good deal could be said in favour of a re-nationalisation of the "first pillar" of the CAP. In that case, however, agricultural subsidies would have to be subjected to strict control in order to prevent member states from outbidding each other with higher subsidies (Schweickert, 2005).

More favourable is the judgement for the programmes in support of rural development. Although economic arguments will hardly be found for permanent subsidies to a shrinking agricultural sector, temporary measures to facilitate structural adjustment may be envisaged in the context of a regional development strategy (Sapir et al., 2003), although such measures, like those of social and employment policy, are rather considered appropriate at the national level. Nevertheless, a readjustment towards an ecologically-minded agricultural policy may justify an establishment of EU responsibilities. While the direct benefits of an environmentally responsible agricultural policy are predominantly local, such policy may still create positive effects at the international level which may not be fully recognised in national decisions. EU subsidies may also be justified if there were evidence for member states engaging in a "race to the bottom" with regard to national environmental standards. Overall, a case could be made for creating an EU responsibility for selected policy areas of the "second pillar" of the CAP.

Direct Payments of the Common Agricultural Policy

During the last 15 years direct payments have become the most impor-tant fiscal policy tool in the EU. In 2006, direct payments amounted to EUR 33.1 billion, which was equivalent to 31 per cent of the EU’s total operating expenditure (EUR 106.58 billion).

Decoupled direct pay-ments (DPPs) subdivide into Single Farm Payments (SFPs, EUR 14.2 billion), and Single Area Payments (SAPs, EUR 1.7 billion). Output linked direct payments are granted for plants (EUR 12 billion) and live-stock products (EUR 5.7 billion). According to the Economic Accounts of Agriculture, the share of direct payments in the factor income of ag-riculture amounts to 26.5 percent in 2006.

Within DPs the share of decoupled payments has increased recently, because the milk quota premiums had been fully decoupled by 2007, and due to the phasing in of area payments for member states that en-tered the EU in 2004. The share of DDPs will likely further increase be-cause the Commission pledged to further reduce trade distorting inter-nal support measures (see EU offer at the G4-summit in Potsdam 2007).

Selected studies on distributional aspects in agriculture

Usually, the political rationale of distributive policies is to improve the income distribution by transferring money from richer to poorer households in order to correct market outcomes according to politically determined equity objectives. For a long time, agricultural economists (e.g. Koester and Tangermann, 1976) have advocated the introduction of decoupled direct payments as an important step to mitigate the negative effects of market price support, including the mitigation of the regressive distribution effects of output linked support.

According to Article 33 of the Treaty, one goal of the CAP is "to ensure a fair standard of living for the agricultural community, in particular by increasing the individual earnings of persons engaged in agricul-ture" while simultaneously guaranteeing adequate consumer prices. This vaguely seems to point in the direction of a fair distribution of support across farming units.

Over the last years, OECD has repeatedly looked at the various dimen-sions of the distribution of agricultural incomes. OECD (1999) analyses the distributional effects of agricultural policies in the mid-90s by com-paring the distribution of support in relation to output and income in OECD countries. The report concludes that the distribution of market price support is very similar to the one of output and that differences across regions are less than those across farm types or size classes. Moreover, the distributional patterns have shown little change over the last ten years. Kurashige and Hwan Cho (2001) examine the incidence of low income as well as the impact of social security policies of OECD countries in agriculture. Based on various indicators they find out that "low income" is higher among farm households than among non-farm households and despite generous support in many OECD countries the income distribution of farm households shows a higher degree of ine-quality than of non-farm households.

Allanson (2007 and 2008) analyses the redistributive effect of “horizontal inequity”, being the differences between the level of support received by farms of a given type and the level of pre-support income: again, the provision of support increased the average size of farm income differ-entails throughout the period 2000/01 to 2004/05. Similarly, in a recent study on Tuscany (IT), Allanson and Rocchi (2007) find that the provision of support increased absolute income inequality within the agri-cultural community because the distribution of transfers was both vertically and horizontally inequitable.

There are only a small number of studies which lead to other conclusions. One example is Keeney (2000), a study of Irish agriculture based on individual farm records. Keeney demonstrates that the direct pay-ment of the MacSharry reform induced a more equal distribution of family farm incomes in Ireland.

The territorial dimension of CAP expenditures has been analyzed by Shucksmith et al. (2005). Looking at the regional distribution of CAP payments and their contribution to cohesion objectives, the authors found that CAP payments do not support territorial cohesion, because more prosperous regions get higher levels of CAP transfers. This holds not only for market based support, but also – although somewhat less pronounced – for support through rural development programs. At a similar result with respect to the distribution of farm support between continental and Mediterranean agriculture arrive Mora and San Juan (2004).

With hardly any exceptions, studies looking at distributional effects of the CAP reveal that the current instruments of the CAP do not prevent a substantial part of farmers from being among the poorest citizens of EU member states. At the same time, direct payments to high-income farm units and regions contribute to pronounced income inequalities in this sector. This survey also shows that a cross country comparison of direct payments before and after the 2003 CAP reform has not yet been made.

Data Sources and Methods

Established information systems measuring the effects of CAP on farm incomes are hardly adequate for analyzing distributional outcomes (Court of Auditors, 2004):

- The income indicator of the farm accountancy data network (FADN) – 'farm family income' – is tricky to interpret, because many agricul-tural holdings are organized as companies. In addition, the sample of farms providing the information is considered to be not representa-tive.
- The economic accounts for agriculture (EAA) is a satellite account of the national accounts. Its main indicators are 'factor income' and 'net entrepreneurial income'. Besides the fact that the quality of data sup-plied by some Member States seems to be poor, these indicators are only provided at sector level. Distributional comparisons can there-fore only be made across countries or with other sectors, but not among farm holdings within the farming sector of a country.
- The same is true for statistics on the income of the agricultural households sectors (IAHS; see Eurostat, 2002). The methodologies of the underlying concept are not harmonized which 'cast[s] doubt on the possibility of comparing data supplied by

member states' (Court of Audi-tors, 2004). In general, IAHS allows comparing non-farm household incomes with farm-household incomes, yet not in all member states.

Aggregated data on the distribution of direct payments across EU Member States have been published regularly since they were intro-duced and can therefore be set in relation to other variables of interest like the number of farms or persons engaged in farming. The most up-to-date figures on the distribution of direct payments across farm hold-ings were published by Eurostat in 2008. In 2006, EU expenditures for the Common Agricultural Policy amounted to EUR 49.9 billion (47 per cent of the total budget). Direct payments (EUR 34 billion) had the largest share, followed by market related expenditures (EUR 8 billion) and payments for the rural development program (EUR 7.7 billion). Both, the volume and share of direct payments have increased since the CAP reform in 1992. In the year 2000 direct payments amounted to EUR 24.1 billion and EUR 32.5 billion in 2005. Given that farm pay-ments have been increasing and that structural change has taken place at an average annual rate close to 2 per cent, payments per annual working unit (AWU) have been increasing until the entry of ten new Member States in 2004.

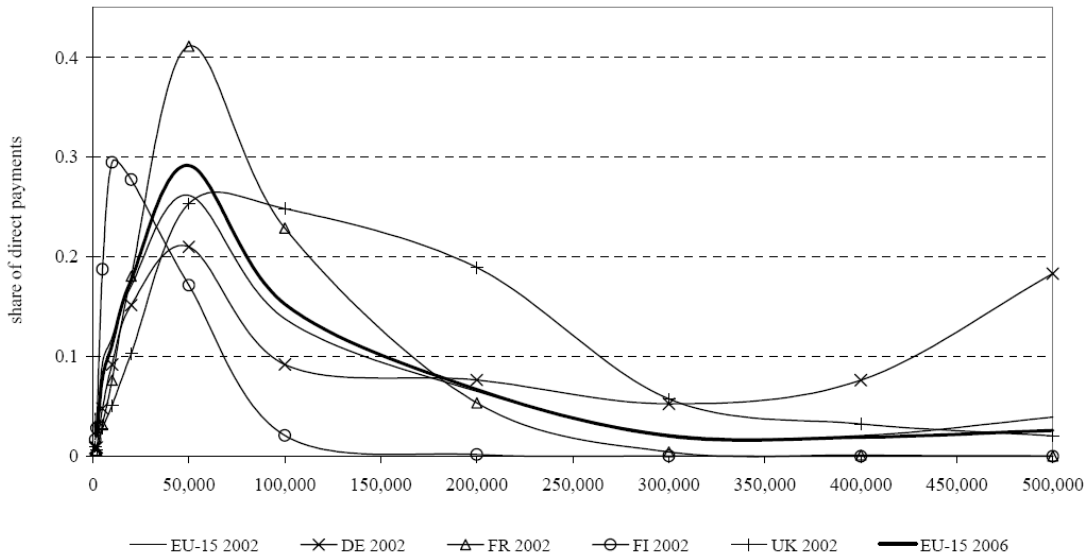
In the year 2000, the average payments per recipient were below EUR 2,000 in Portugal and Italy and were highest in Denmark (EUR 10,585) and the UK (EUR 19,272). The EU-15 average was EUR 6,331 (ranging from 1,747 in Greece and 21,429 in the United Kingdom) five years later. Direct payments per holding were considerably lower in the new Member States that entered the EU in 2004 (on average EUR 723 – from 232 in Cyprus to 11,397 in Czech Republic). Therefore the mean of di-rect payments per holding in the EU dropped from EUR 5,017 per holding to EUR 4,682 between 2000 and 2006.

In preparing the 2003 CAP reform, EU Commissioner Franz Fischler released for the first time fairly detailed data about the distribution of direct payments to foster a political climate to curb the size of high-end CAP payments. EUROSTAT publishes the number of recipients and the volume of transfers aggregated in 12 classes. Comparing the hold-ings getting less than 5,000 Euros with those getting more can be used to show that a small number of recipients got a relatively large share of all direct payments in 2000: 953,000 holdings received more than EUR 5,000, totalling EUR 15.5 billion. 21 per cent of holdings getting such support received 82 per cent of all direct payments. Until 2006 the dis-tribution has become more unequal: 1.3 million farms (18 per cent of the 7.3 million recipients) got EUR 27.9 billion (84 per cent of direct payments).

Evidence on the distribution of direct payments

The distribution of direct payments is quite different in the EU member states. Figure 1 shows a comparison of selected countries of EU15 in 2002 as well as the change in distribution for EU15 between 2002 and 2006.

Figure 1 - Distribution of direct payments in EU-15 and selected member states 2002 and 2006



Source: Commission of the EU, own calculations.

Note: Figures are truncated at 500.000 Euro, the presented volume of payments is for the open class 500.000 € and above. The graph is based on classified data with varying class sizes, therefore the real, but unknown distribution may look slightly different.

A more sophisticated measure of (in)equality is the concentration ratio (CR). It has the same interpretation as the Gini-Coefficient, but it is calculated in a slightly different way. High levels of CR (close to 100) indicate that a small number of recipients get a large amount of payments while a low CR indicates a more equal distribution. An in depth study on the development of concentration ratios of direct payments in the EU along with a technical treatment of various distribution measures is provided in Sinabell, Schmid and Hofreither (2008).We use the methodology provided in this study to analyse the consequences of policy changes on the concentration of direct payments if a scenario similar to the one proposed by the Commission of the EU in the "health check reform" is applied.

We assume that this proposal will not be endorsed by the Council of Minisers in November 2008, but the proposal to reduce transfers for those holdings that get more than 5,000 € will be on the roadmap of future reforms of the CAP. Another proposal we look at is the abandonment of payments below 500 €. Low payments entail relatively high transaction costs and therefore it would make economic sense to define a minimum payment, as the Commission has suggested (250€). Almost 50% of the recipients (3.4 Mio of 7.3) obtained less than 500 € of direct payments in 2006. Compensating them with a one time payment would allow significant future savings of administrative costs.

In Table 1 the results of various scenarios of alternative implementation schemes of the direct payments are provided. The scenarios are applied to statistics available for 2006. This implies that changes in the distribution of are not accounted for. However, given that the distribution of land is rather similar to the distribution of direct payments, one would not expect that any change from the historic model the regional model would have major implications on the distribution of direct payments.

The results in Table 1 show that the distribution of direct payments (both decoupled ones and non-decoupled ones) is very heterogeneous among Member States. In several countries like Malta, Slovakia, Czech Republic, Estonia, Italy, Hungary and Portugal it is a small number of recipients that get a relatively large share of direct payments. In countries like Luxembourg or Slovenia, the payments are relatively equally distributed.

Table 1 - Concentration ratios of all direct payments for alternative scenarios

	observed direct payments in 2006	Scenarios			
		>500 €/farm	modulation 13%	Progressive	Combination of all
BE	57.0	57.2	55.8	55.7	56.0
CZ	85.6	85.9	85.0	84.7	85.0
DK	69.3	69.6	68.4	68.3	68.6
DE	70.7	71.0	69.7	69.1	69.4
EE	83.7	89.2	82.8	82.8	88.6
GR	66.7	71.0	66.0	66.0	70.5
ES	75.6	76.7	74.5	74.4	75.7
FR	57.3	57.4	56.5	56.4	56.5
IE	55.1	55.3	53.8	53.8	53.9
IT	81.5	84.8	80.6	80.5	84.1
CY	71.0	91.8	70.9	70.9	91.8
LV	71.3	91.7	70.8	70.8	91.5
LT	71.0	92.3	70.4	70.4	92.1
LU	46.3	46.4	45.5	45.5	45.6
HU	84.5	88.9	83.5	83.3	88.0
MT	94.1	97.0	94.0	94.0	97.0
NL	71.2	71.9	70.3	70.3	71.0
AT	56.7	57.4	55.4	55.4	56.2
PL	58.0	82.4	57.6	57.6	82.3
PT	85.5	88.8	84.5	84.4	88.1
SI	54.7	77.1	54.7	54.7	77.1
SK	90.9	91.5	90.6	90.5	91.1
FI	50.0	50.2	48.6	48.6	48.8
SE	68.4	68.9	67.3	67.2	67.8
UK	71.6	71.8	71.0	70.6	70.9
EU10	77.6	90.4	76.2	76.0	89.7
EU15	78.5	79.5	77.6	77.5	78.5
EU25	82.5	83.9	81.7	81.6	83.1

Note: The figures are related to the total of direct payments (including both decoupled and not decoupled payments). In the 'scenario >500 €/farm' direct payments below 500 € per holding will be no longer paid; in the "scenario modulation 13%" amounts above 5,000 € are reduced by 13%; in the 'scenario progressive modulation' payments between 5,000 € and 99,999 € per holding are reduced by 13%, payments between 100,000 € and 199.999 € are reduced by 16%, payments between 200,000 € and 299,999 are reduced by 19%, higher payments are reduced by 22%.

If only payments above 500 € would have been paid in 2006, this would have had significant effects on the distribution of direct payments, in particular in the Member States that entered the EU in 2004: the concentration ratio would significantly increase to a level of 90 from a level that is close to that of EU-15 Member States. While such a scenario has significant consequences, the distributive effects of a more intense modulation or a progressive modulation are relatively minor at the aggregate level. But in some countries (Belgium, Austria, Sweden) the effects would be significant.

Conclusions and discussion

The economic theory of federalism is based upon the assumption that national governments consider themselves exclusively committed to the goal of maximising national welfare. An alternative view is held by political economy approaches which explicitly integrate the self-interests of the political actors. In that sense, the EU budget is interpreted as the result of compromises negotiated among national governments that act in their interest of being re-elected and therefore have to mind the specific concerns of influential interest groups. Such powerful lobbies may block progress towards closer integration, if they fear disadvantages from further market liberalisation in Europe or are uncertain about their market prospects.

The inclusion of income-maintenance elements into the EU budget, which is criticised from a fiscal federalism perspective, may serve the purpose of compensating potential losers of increasing market integration in the member states (Bhagwati - Srinivasan, 1969). Thus, a transfer of agricultural policy to the European level in the early 1960s is seen in political economy terms as a concession to the powerful French farmers' lobby in order to weaken resistance against market opening. High flows from the EU budget to agricultural producers whose interests are by tradition strongly represented at the national level, are thus intended to compensate for (actual or believed) disadvantages of the integration process.

Against this background, the centralisation of agricultural policy at the European level may be criticised from a narrow economics perspective, but may also be taken as a political precondition (a "price") for progress in integration. In a similar way, the establishment of the structural and cohesion funds is interpreted as a compensation deal. This also explains why countries like Austria or Germany, which on balance can expect additional benefits from further market liberalisation, are ready in principle to accept being a net contributor to the system.

A possible consequence of the establishment of a European responsibility is that in more recent times agricultural policy has come under somewhat lower pressure from national interests in maintaining the status quo. Since the mid-1990s, the EU is steering the CAP towards reform with the aim of price liberalisation while strengthening incentives for more environment-friendly forms of agricultural production. This shifts back the emphasis towards allocative aspects of agricultural policy. From the theoretical point of view it is not entirely clear whether status-quo interests have a greater influence at the national or the European level. Whether or not these reforms could have been achieved in a regime of exclusively national responsibilities, remains an open question.

A comparison of concentration ratios between the years 2000 and 2006 shows, that (1) the CAP reform 2003 has not improved the distribution of decoupled direct payments and (2) that there is no uniform pattern of change. The concentration ratio of EU-15 member states were 78 in both years. This is the result of two antagonistic developments: in some countries like France, Ireland, Austria the measure of inequality was lower in 2006 compared to 2000 while the opposite was true in countries like The Netherlands, Denmark, Sweden, and Italy. Given that the Single Farm Payment was introduced only recently it is too early to draw conclusions on the distributive effects of the historical versus the area based scheme. Given this observation it is evident that changing the rules on the allocation of direct payments as the Commission suggested in the 'health check' process, will affect the distribution. The interesting finding is that changes of the distribution within member states are happening 'relatively' easy while the relative ranking of concentration between member states is relatively stable. Only in a scenario of minimum payments of 500 € per holding and year the ranking of concentration between member states changes significantly.

Admittedly, CAP payments, among them direct payments, are hardly motivated by distributive considerations alone. Currently they are justified to ease the process of integration for the agricultural community of Member States that have recently entered the EU. Another purpose is to facilitate structural adjustment of farms that are exposed to freer market conditions after decades of CAP interventions. Moreover, as direct payments are only granted if standards of good agricultural and environmental condition ("cross compliance") are met, such payments have an environmental facet as well. The current debate about strengthened modulation or abandoning the historical model provides possibilities to improve the distribution of DP. At the same time, taking into account the principle of “fiscal equivalence” (Olson, 1969) could give guidance for the question which of the issues currently addressed by direct payments should be addressed at EU level or at the level of Member States.

The theory of fiscal federalism takes a sceptical view towards any sector-specific EU responsibility, including agricultural policy. It is grounded in the observation that the Common Agricultural Policy (CAP), while historically geared towards allocative objectives, has over time become an instrument of income maintenance for agricultural producers. Yet, according to the principles of fiscal equivalence and of subsidiarity, member states should be responsible for inter-personal income redistribution. Calls for a re-nationalisation of agricultural policy competences should nevertheless be treated with caution.

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