The distribution of Direct Payments of the Common Agricultural Policy

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***Abstract* – Direct payments are the most important expenditure of the Common Agricultural Policy (CAP), equivalent to more than two thirds of the EU farm policy budget in 2006. They are mostly spent for decoupled direct payments (DDPs). The EU plans to further reduce direct payments for plant and animal products and to expand the volume of DDPs which are intended to be allocatively neutral. Such a move implies that distributive aspects of CAP expenditures will become more important. This contribution looks at this issue by calculating various measures of concentration based on statistics on recipients of direct payments covering a period of 2000 to 2006. The results show that direct payments are skewed towards a small number of very large holdings in a few member states.[1]**

INTRODUCTION

Until 1992, market price support and supply management policies were the major tools of the Common Agricultural Policy (CAP). To mitigate the well known weaknesses of this policy conception a process of 'decoupling' was initiated with the MacSharry reform of 1992. Since the 2003 CAP-reform fully or at least partially decoupled "*single farm payments"* (SFP) try to avoid the negative effects of both price policy and the payments based on historical areas and heads of livestock after 1992 (OECD 2006a and b).

Fully decoupled payments are considered to have minimal or no allocative effects at all and hence can be classified as pure income support, being part of a distributive policy. Such policies aim at correcting market outcomes according to politically determined objectives, usually through transferring money from richer to poorer households. If these CAP payments can be considered as a distributive policy tool in its very meaning, similar redistributive outcomes should be observable as well.

In this paper the overall distributive effect of direct payments is addressed. We compare the distribution of direct payments for farm holdings across EU member states over a period of 2000 to 2006. Using various distributional measures, among them concentration ratios and Lorenz curves we also look at the distribution within EU member states. These measures are frequently used to measure the distribution of household incomes which is not a topic of this paper. However, given that direct payments account to 26.5 percent of factor income of agriculture according to the Economic Accounts of Agriculture, direct payments are definitely an important source of farm incomes in the EU.

AN OVERVIEW OF DATA SOURCES FOR DISTRIBUTIONAL ANALYSIS

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 agricultural holdings are organized as companies. In addition, the sample of farms providing the information is considered to be not representative.
- 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 supplied by some Member States seems to be poor, these indicators are only provided at sector level. Distributional comparisons can therefore 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 Auditors, 2004). In general, IAHS allows comparing non-farm household incomes with farm-household incomes, yet not in all member states.

In preparing the 2003 CAP reform, EU Commissioner Franz Fischler infringed a hitherto off-limits information barrier. He released fairly detailed data about the distribution of direct payments to foster a political climate to limit the size of high-end CAP payments. A similar strategy was pursued by the European Commission in starting the "European Transparency Initiative" in 2005 (CEC, 2005). This initiative will gain momentum when the names of individual recipients of CAP payments will be published in 2009 as laid out in CR (EC) No 259/2008.

DATA, METHODS AND RESULTS

Aggregated data on the distribution of direct payments across EU Member States have been published regularly since they were introduced and can

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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 holdings 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 payments 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 direct payments per holding in the EU dropped from EUR 5,017 per holding to EUR 4,682 between 2000 and 2006.

We use mean, median and concentration ratios (CR) to measure the (in)equality of direct payments between Member States. High levels of CR indicate that a small number of recipients gets a large amount of payments while a low CR indicates a more equal distribution.

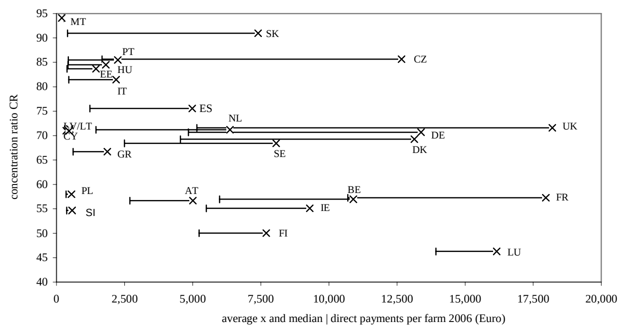

Figure. 1. Concentration Ratios (CR), medians (|) and means (x) of direct payments in 2006

In Fig. 1 an overview is presented that shows the three measures. The horizontal axis indicates the mean (indicated by x) and median (|) payment per holding in the EU 25 Member States in 2006. The vertical axis showing the CR is used to rank them according to the concentration of payments within the countries. The overview shows that even if the difference between median and mean is very large in absolute terms (like in the United Kingdom or in Germany) the CR may be relatively moderate compared to other countries (like Malta, Slovakia or Portugal). Given that the CR is relatively high in the Member States that have entered the EU in 2004, it is evident that the CR in the EU has increased between 2000 and 2006.

DISCUSSIONS

The comparison of CRs between the years 2000 and 2006 shows, that (1) the CAP reform 2003 has not improved the distribution of DDPs and (2) that there is no uniform pattern of change. The CR 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.

The distribution of direct payments within EU Member States and between them is the consequence of agricultural structures and historical developments, in particular the process of integration. CAP payments, among them direct payments, are not 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 and another purpose is to facilitate structural adjustment of farms that are exposed to freer market conditions after decades of CAP interventions in the EU-15 Member States. Given that direct payments are only granted if standards of good agricultural and environmental condition ("cross compliance") are met, direct payments have an environmental facet as well.

According to the principle of fiscal equivalence (Olson, 1969) the presumed beneficiaries of the Member State should finance the provision of public goods of national interest and the EU should finance those of interest for the EU in an appropriate way. This principle gives 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.

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