The Political Economy of Degressivity and Capping: New evidence from Hungary

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Abstract

The debate on reforming the Common Agricultural Policy (CAP) after 2020 has already started when the European Commission published its own vision on the future of agriculture and food production in the European Union (European Commission, 2017). This Communication set the political arena. One of the key aspects of the debate relates to the revision of the system of direct payments to farmers. These payments which supplement incomes from farming have an overwhelming share in the budget assigned to Pillar I of the CAP. The fine tuning of the degressive reduction and the capping of direct payments is to be part of the new reform package. Although it has, for a long time, been a popular idea to limit payments to larger farms in one way or another, and subsidise smaller agricultural holdings instead, new evidence from Hungary suggests that placing a cap on direct payments may impact on land use structures.

In 2013, a general agreement was made by the European Council and the European Parliament on the reform of the Common Agricultural Policy (CAP) for the period 2014-2020. The agreement was a result of many years of negotiations. One of the most heavily debated issues was the degressive reduction and the capping of direct payments, aimed at a more equitable distribution of this type of European Union financial support among farms.

On the one hand, the possibility of reducing/limiting direct payments for large farms has always been a popular idea amongst liberal agricultural economists and decision makers throughout the history of the CAP. The need for 'balancing' direct payments has even been expressed in the MacSharry reform in 1992 when direct payments were introduced. On the other hand, degressivity/capping was highly opposed by countries where large farms dominate the agricultural sector.

It seems that opponents have won as original ideas on degressivity/capping have largely been watered down after the 2013 removal of modulation. This paper shows that degressivity/capping is a less effective policy tool for redistributing direct payments by analysing the issue from a political economy perspective together with recent evidence from Hungary. This paper is based on direct payments farm level data for Hungary between 2012 and 2016, provided by the Hungarian Paying Agency.

Results suggest that degressivity was applied to 568 farms in 2015 (of which capping was applied to 74 farms) and to 534 farms in 2016 (of which capping was applied to 60 farms). The average amount deduced was €144,531 in 2015, and €153,022 in 2016. The total amount 'saved' this way was €46,371,476 in 2015 €39,331,252 in 2016 (compared to €69,746,000 in 2015, and €68,961,000 in 2016 moved from the Pillar I to Pillar II).

The number of farms by physical size categories before and after degressivity/capping was implemented is also analysed in the paper. Results suggest here that degressivity/capping leads to the splitting up of farms. The number of farms with over 1200 hectares UAA (affected by capping) decreased by 26% and by 41% from 2014 to 2015 and 2016, respectively. In contrast

to this decline, the number of farms with 600-1200 hectares UAA increased by 36% from 2014 to 2016, while the number of farms with 300-600 hectares UAA also grew by 15%.

However, note that changes above are also partly due to the new Hungarian Land Transaction Act of 2013. According to this, the total area of land used by farmers cannot exceed 1,200 hectares (except for livestock and seed producers where the limit is 1,800 hectares). Hungarian land policy favours 'mid-size' 'family farms' instead of large legal entities, in line with its capping ceiling €176,000 which corresponds to 1,200 hectares.

As evident from the above, the introduction of capping, parallel the Land Transaction Act, had an impact on land use structures in Hungary, with capping contributing to the splitting of farms.