

THE IMPACT OF PAYMENT REALLOCATION IN CASE OF DIRECT AGRICULTURAL SUBSIDIES IN 2012

MIKLÓS VÁSÁRY¹, CSABA DOMÁN², ZOLTÁN KOVÁCS³, ZSOLT BARANYAI¹

¹Szent István University, Faculty of Economics and Social Sciences, 1 Páter K. str., 2013 Gödöllő, vasary.miklos@gtk.szie.hu, baranyai.zsolt@gtk.szie.hu,

²Hungarian Research Institute of Agricultural Economics 3-5 Zsil str., 1093 Budapest, doman.csaba@aki.gov.hu

³University of Szeged, Faculty of Engineering 7, Mars square, 6724 Szeged, zoltan.kovacs@mailbox.hu

ABSTRACT

In the grant year of 2012, the reallocation of payment in the frames of modulation was a new element in the national agricultural subsidy system. The procedure means that when the total amount of first-pillar direct subsidies are above 5000 EUR which is, 10% payment reduction, when it is above 300 000 EUR, an additional 4% payment reduction should be applied.

The implementation in Hungary – according to the principles of the European Union - included the development of a system, which enabled to decrease substantially the actual volume of grant reallocation owing to modulation. In the course of this, the national supplementary titles which were not actually announced and the “unused” items of some titles are also included in the calculation. The present paper introduces and analyses the impacts of reduction in case of enterprises concerned are quantified on the basis of the databases belonging to the Research Institute of Agricultural Economics.

Keywords: common agricultural policy, agricultural payments, modulation, profitability

INTRODUCTION

The reform of Common Agricultural Policy (CAP) in 2003 has restructured the basic operation of aid system and in this regard the key objective was to expand the funds of rural development (2nd pillar) reinforced in the frames of CAP reform in 2003. Rural development policy should handle new challenges (climate change etc.) emerging due to the gradually increasing expectations on behalf of society and member states. During the period between 2007 and 2013 the considerable part of required financial funds can be collected through modulation by gradually increasing the pace of reduction of direct payments. The measures aim to create better balance between special policies and to reinforce sustainable agriculture and rural development. The disproportion is concerning the allocation of direct subsidies - which means that considerable part of payments are given to relatively few beneficiaries who get rather large amounts - was to be eased by the measure which was observed in Hungary for the first time in the course of transferring the direct subsidies requested in 2012, on the basis of decree no. 73/2009/CE. On the basis of the Health Check of 2008 which corrected the reform policy of 2003, 10% reallocation had to be provided in case of any 5000 euros allotted in the given calendar year, in the first year of its domestic implementation. The volume of reduction grows by a further 4% if the amount of aid for which the farmer is entitled exceeds 300.000 euro. (VM, 2012) In case of implementation in Hungary it means that the total amount of direct subsidies (SAPS, separated special grants and restructuring programs) and complementary national direct payments (top-ups) shall be reduced above 5000 euro. (EB, 2012) In the course of domestic implementation, quite a few title groups should be distinguished when the aid reallocation is calculated. The aim is that those elements of grants which cannot be paid or

only partly due to lack of budget sources could also be considered. The groups considered in the calculation are the following: (1) Not announced (inactive) top up titles: these titles are not announced due to the national budget sources (Cereals, oilseeds and protein crops – COP top up, rice and sucker cow premium) (2) In case of some titles, the difference between the actually transferred grant and the maximum amount of grant that can be paid. These items (e.g. premium for beef cattle breeding) which could be operated with larger grants according to the approval of the Committee but, due to the limited national budget, the maximum amount cannot be paid. In the course of modulation, these unpaid items should also be considered. (3) Actually transferred grants: In those cases when the above two items are exhausted or are not available at all, the withdrawal shall be made from the amount to be paid. If the actually payable grants should be reduced, it is made in a specific order. (VM, 2012; VÁSÁRY, 2013)

MATERIAL AND METHOD

Before the examination it should be noted that only one aspect of payment reallocation is outlined in the present study. The aim of the paper is to quantify the main impacts observed in case of the producers concerned and the consequences in respect to profitability. The conclusions concerning the first-pillar measures are made on the basis of the payment data about approximately 174.000 producers, processed by the Agricultural and Rural Development Agency (MVH) in the grant year of 2012. The analysis was made by using a database updated in 2013, containing data for each producer, without personal details. The database included the result of former appeals and approvals. Another support for the main objective of the paper was provided by the database of the National Tax and Customs Administration (NAV), including balance sheet and profit-and-loss statements compiled by the Institute of Agricultural Economics. Due to the nature of the database, information is available only about the enterprises performing double entry book-keeping, thus the analysis is narrowed to them. The research is based on the data of 2012, but – due to lack of data – information from the year 2011 was used in 13 cases.

RESULTS

According to the expectations (VÁSÁRY, 2013), the payment reallocation in the frames of modulation did not concern too many producers. As the result of the actually occurring withdrawal process, the MVH made the withdrawal in regard to 6 national and 8 community titles, altogether in 3685 cases (*Table 1*). On the basis of the data it can be concluded that withdrawal at the expense of community funds was made altogether in 871 cases. The most significant item was the SAPS title, because an amount of 1.09 billion HUF was withdrawn in case of 414 producers. The highest per producer reduction was made in this regard: it amounted to 33.7 million HUF. In addition to this, there was high number of reductions in case of separated sugar subsidy (147 clients) and special milk subsidy (120 clients). Since some producers can be concerned in respect to more titles, in fact only 2473 farmers were hit by the payment reduction. It is 1.4% of the total number of beneficiaries. Clustering according to the number of titles can be a reference point concerning the impact of reduction. It is obvious from the aggregated data of enterprises analysed in the frames of the study that in case of the 594 producers concerned, those with one title are still in the highest number, (*Table 2*) although their ratio is hardly 20% compared to the total number of beneficiaries, and only 24% on average. In contrary to

this, in case of enterprises related to more titles, this ratio is gradually increasing. By examining the amounts affected by reduction, it can be seen that it covers 74.4% of the total reduction. This classification represents the total population to a much larger extent than the number of those concerned. Thus, those concerned only with one title make up for about 20%, they represent two-third of the total reduction. In case of producers connected with three titles, this value increases to 91%. The above correlations well demonstrate that the specific value of reduction was multiplied in the categories concerned. In respect to the average, the rise is threefold.

**Table 1. Distribution of modulation according to titles concerned
(2012, pics, 1000 HUF)**

Categories	Number of concerned by modulation	Amount withdrawn due to modulation	Average amount withdrawn due to mod.	Max. amount withdrawn due to modulation
Single Area Payment Scheme - SAPS	414	1 097 778	2 652	33 731
separated sugar payment	147	258 829	1 761	12 115
separated fruit and vegetable payment	9	17 992	1 999	8 356
special rice payment	4	9 795	2 449	3 908
special milk payment	120	158 794	1 323	7 378
ruminant restructuring payment	109	73 982	679	3 806
fruit, vegetables and tobacco restructuring payment	24	70 808	2 950	32 782
insurance fee support form EAGF*	44	8 784	200	1 209
total form EAGF	871	1 696 761	14 012	103 286
milk payment (decoupled)	76	13 759	181	10 258
suckler cows payment	666	311 324	467	13 359
bovine extensification payment (decoupled)	116	52 505	453	15 673
male bovine payment (decoupled)	199	26 188	132	4 973
ewe payment	1 350	185 542	137	6 686
ewe kept on unfavorable areas (decoupled)	407	118 432	291	9 968
total from national budget	2 814	707 750	1 661	60 917
Sumtotal	3 685	2 404 511	15 673	164 203

Source: own calculation on the basis of ARDA 2013 *:European Agricultural Guarantee Fund

Table 2. Distribution of titles concerned by modulation (2012)

Number of titles concerned by reduction (pcs)(A)	Number of those concerned and examined (pcs)(B)	Ratio compared to the total number of concerned (%)	Total amount withdrawn from the concerned and examined (HUF)(C)	Ratio compared to the total number of concerned (%)	Specific value reduced from the examined (HUF)(C/B)	Ratio of withdrawal from the examined compared to total subsidies (%)
1	304	19.49	417 824 910	66.17	1 374 424	0.88
2	175	25.33	506 393 003	68.75	2 893 674	0.61
3	83	52.53	507 864 395	91.40	6 118 848	0.33
4	28	53.85	304 697 994	83.42	10 882 071	0.14
5	4	36.36	52 211 474	68.25	13 052 869	0.02
6	0	0.00	0	0.00	0	0.00
Total	594	24.02	1 788 991 777	74.40	3 011 771	-

Source: own calculation on the basis of ARDA 2013

It is obvious from *Table 3* that in case of funds withdrawn by the examined enterprise the payment reallocation due to modulation concerned hardly 1% of the subsidies. It was mostly due to the calculation scheme and the great proportion of EU funds which were not reduced until the 300 000 euro limit. In case of the analysed enterprises the EU sources amounted to 73 billion HUF, while the national funds gave 5 billion HUF. In respect to the examined farms it could be stated that out of them 131 could be regarded as micro farms, 268 small-scale farms, 186 medium and 9 large-scale farms. Fifty-six % operated as limited liability companies (Ltd), further 28% as joint-stock companies. In addition to them, about 10% is the ratio of cooperatives, the remaining 5% operates in five other types of corporations. As regards their scope of activity, field crop farming is strongly determinant. Altogether 310 farms, 52% of the examined sample deal with this activity. Besides, dairy farms (79 pc, 13%) and grazing livestock farms (72 pc, 12%) are also significant. In case of the remaining 22%, further eight activities emerge, like for example enterprises performing pig farming, poultry raising, fruit and vegetable farming or forest management.

In respect to enterprises, the paper also aimed to examine the ratio expressed to the basic indicator which serves for the evaluation of farming and can be recorded in the balance sheet report. The size properties are clearly reflected in *Table 3*, where the values are classified according to the enterprise categories. The ratio of total payment and modulation is the greatest in case of micro and large-scale enterprises, the former one emerges owing to the lower ratio of EU grants, the latter is due to the threshold of 300 thousand euro. It is obvious that payment reduction means harder load to micro-farms compared to equity, as well as the net price income of sale (7.77%) and other income (3.24%). Parallel with this, when the size is growing the impact of modulation is gradually decreasing, or in some cases, e.g. in regards to other income it is increasing at large-scale enterprises. In respect to the earnings before tax, the value of ratio is considerable in all the four categories. Although it is obvious that the profitability of micro-enterprises is still affected the worst: the impact of reduction was 30.55% on the earnings before tax.

Table 3. Impact of modulation on the examined enterprises according to size categories (2012 %)

Categories	Total payment/modulation	Equity/modulation	Net sales revenue/modulation	Other income/modulation	Earning before tax/modulation
micro	1.67	3.18	7.77	3.24	30.55
small	0.61	0.46	0.44	0.94	11.21
medium sized	0.91	0.29	0.48	1.23	4.21
large	1.35	0.37	0.29	1.51	6.12

Source: own calculation on the basis of ARDA 2013

As regards the form of business - limited liability company - which appears in the highest ratio it can be seen that the modulation value compared to the total payment is average considering the 0.95% value of the examined companies. It is also obvious that this value is much higher in case of private ventures (4.2%) or non-profit limited liability companies (2.5%). Although representativity cannot be stated in their case because 2 farms belonged to the former category and one to the latter category. By analysing the corporate forms largely representing the total examined population, it is clear that joint stock companies and cooperatives farming on bigger areas are less exposed to the effect of modulation, than limited liability companies.

On the basis of the values of all the enterprises in the sample it can be concluded that the

ratio of equity and modulation is 1%, while this value is 2.1% in case of net sales revenue and 1.5% in case of other income. In respect to the earnings before tax, the degree is 13.2% unlike the former lower values. In case of limited liability company, the earnings before tax exceeds the average value: it amounts to 20%. It should be noted, however, that - also referring to the high values in *Table 4*, observed in case of micro and small-scale enterprises - it often occurred in case of Ltd. that the earnings before tax were extremely low. It may refer to the low profitability of farming in the given year, due to which - the low value of earnings before tax - the value of the index increases substantially. The high value may also indicate the farming difficulties generally observed in the course of business, but also to the practical presence of tax optimization.

Table 4. Effect of modulation on the examined enterprises, according to the form of corporation, 2013 (%)

Categories	Total payment/modulation	Equity/modulation	Net sales revenue/modulation	Other income/modulation	Earnings before tax/modulation
Limited Liability Company	1.012	1.47	2.71	1.76	20.24
Joint Stock Company	0.82	0.27	0.32	1.08	3.40
Agricultural Cooperative	0.59	0.29	0.76	1.06	3.42
Other cooperative	0.61	0.25	0.26	0.92	2.15
Unlimited liability company	1.36	1.86	6.15	1.89	3.38
Limited partnership	1.43	1.27	7.17	2.24	9.51
Private venture	4.20	2.28	8.76	11.55	26.08
Nonprofit limited liability company	2.51	2.04	9.13	2.34	5.07
Nonprofit public limited company	0.83	0.48	8.28	0.56	2.10

Source: own calculation on the basis of ARDA 2013

By examining not only the form of corporation but also the major business activities, it is obvious that there are significant differences in respect to the activities. Although it must be underlined that the main scope of activities, in most cases, does not mean exclusivity, however many farms have diversified business activities which may substantially affect values and thus only limited conclusions can be drawn. The outcomes can also be distorted by the delay in converting business activities and that in some cases the main activity (e.g. regarding forestry) does not but marginally belong to the scope of direct subsidy system and, consequently, modulation.

As regards the scope of activities, crop production is dominant with its share of 52%, due to the single area payment scheme. In their case - on the basis of *Table 5* - it is obvious that the impact of modulation is much lower compared to the average values.

In case of farms dealing mostly with forest management, the ratio of modulation is significant compared to the total payments, just like in respect to equity or income. In case of pig and poultry sectors regulated indirectly by CAP, the narrow funding possibilities (mostly SAPS) resulted in low values. By reviewing the sensitive sectors, however, there are outstanding values in regard to ruminant livestock breeding by grazing, which gives 12% of the total base population. Even in case of total payments, the value of modulation exceeds the average level, but peak values appear in case of the net sales income (10.89%) and the earnings before tax (21.31%). The impact is very significant in case of ruminant sector, partly owing to the payment scheme, partly to the consequent narrow room for maneuver resulted by the payment reallocation calculations. Presumably, in case of mixed-profile farms which give 9% of the examined enterprises, the presence of livestock farming and its impact on farming activities may cause the extreme values. In this latter row, there

is a high value, 65% in ratio of the earnings before tax and payment reduction.

Table 5. Impact of modulation on the examined enterprises according to the main profile, 2013 (%)

Categories	Total payment/modulation	Equity/modulation	Net sales revenue/modulation	Other income/modulation	Earnings before tax/modulation
poultry farm	1.02	0.25	0.56	1.16	5.54
other	1.43	5.21	4.26	2.45	14.65
forestry	1.88	6.45	1.74	2.02	4.26
fruit farm	0.89	0.64	0.65	0.74	8.75
ruminant farm	1.72	2.25	10.89	3.78	21.31
corn farm	0.75	0.53	0.60	1.09	4.98
pig farm	0.82	0.39	0.68	1.07	6.68
dairy farm	0.71	0.55	0.68	0.97	4.95
mixed farm	1.05	1.27	0.80	1.83	65.04
vegetable farm	1.17	0.67	2.49	1.85	3.55

Source: own calculation on the basis of ARDA 2013

CONCLUSIONS

On the basis of the research made in the frames of the study it can be concluded that the payment reallocation in respect to modulation has not had any significant impact. Our research has proved that hardly 1% of the total payment was reallocated in case of some farms performing double entry book-keeping. Considering this and also using the database of the Hungarian Taxation and Customs Administration we have examined the trends observed in respect to some outcome indicators selected according to certain ways of classification. On the basis of these it can be concluded that there is a significant correlation in regard to micro- and small-scale enterprises. In close relation with this, the analysis was carried out in respect to the form of enterprise, too, and it was revealed that the modulation value was very significant concerning the earnings before tax in case of the dominant form of enterprising, namely the limited liability company. It refers rather to the profitability of farming and not to the impact of modulation. Considering the quantifiable impacts in regard to the main scope of activities, grazing activity - which indicates ruminant livestock management - can be highlighted. In this case, the impact of modulation is very substantial, referring primarily to the low earning capacity and the specialties of the payment scheme. In total, it can be declared that the payment reallocation in the frames of modulation in respect to year 2012 - although it has not concerned any significant amounts and in general it has not meant any considerable impacts - has caused difficulties in case of farms, the profitability of which is behind the average of the sector.

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