



## IEEP Policy Briefing

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Welcome to the first issue of IEEP's CAP2020 Policy Briefing. Published each month, it provides authoritative analysis on the latest developments on the road to CAP reform. In this issue, we reflect on the fate of the proposals on modulation - one of the most contested issues in the CAP Health Check negotiations.

### Making the Case for Modulation

The CAP Health Check is due to be concluded by Europe's farm ministers at the Agriculture Council to be held on November 18-19, following the delivery of the European Parliament's Plenary Opinion during the morning of November 18. The final political agreement will send an important signal as to the likely tone and ambition of the debate surrounding the reform of the CAP in the run up to 2013. This is the point at which the current EU budget expires and is the next window for the introduction of any revisions to European agricultural policy.

Of the [proposals](#) put forward by the European Commission in May 2008<sup>i</sup>, the proposal to increase the rate of compulsory modulation is perhaps the most controversial. Whilst there has been a great deal of discussion on the other elements, in particular, the loss of set-aside, the phasing out of milk quotas, Article 68/69, and revising the scope of cross compliance, the polarised nature of the modulation debate is symptomatic of the wider tensions that exist in relation to the priorities of a future CAP. On the one hand, there are those who favour an increase in focus on rural development objectives, and on the other, are those that would prefer to continue with the status quo and to maintain a significant role for broad brush support for the agricultural sector. These tensions reflect the range of different views and political stances on the role of European agricultural policy in responding to an array of concerns such as competitiveness, food security and environmental accountability.

It is widely expected that the EU's proposal to increase the rate of compulsory modulation from the current rate of 5% to 13% in 2012 (and rising as high as 22% for the farms with the largest direct payment receipts) will be diluted substantially, so as to enable an agreement on the Health

Check package to be reached. Raising the rate of modulation was predicated on a need to bolster funding for a number of pressing environmental priorities, grouped together under the banner of the 'new challenges': halting the loss of biodiversity, supporting sustainable water management, and reinforcing efforts to reduce greenhouse gas emissions and to sequester carbon. The anticipated outcome is an increase in the rate of compulsory modulation, but potentially some way below that first proposed by the Commission, and significantly reducing the additional 'progressive' element whereby recipients of larger direct payments are subject to higher modulation rates. It also seems likely that these funds will not be earmarked for the 'new challenges', but rather could be spent on any rural development measure. Co-financing requirements are another area where ground could be given. Any of these outcomes would be disappointing from an environmental perspective and would represent a missed opportunity on the part of Europe's farm ministers to prepare the CAP for the considerable environmental challenges that lie ahead.

Table 1. Rates of Modulation Agreed Following the 2003 CAP Reform.

	Current Rules		
	Compulsory Modulation	Additional Voluntary Modulation	
Member States	EU-15	UK	Portugal
Period	2005 - 2013	2005 - 2013	2008 - 2013
Rate	3% 2005 4% 2006  5% 2007-2013	0% - 3.5% 2005  9% - 14% 2013  <i>Differs by region.</i>	10%
Exempt	€5000 per farm	No exemption	€5000 per farm

Modulation reduces direct payments to farmers in the EU-15 by a set percentage each year. The amount raised is redistributed amongst the Member States, and allocated to their rural development budgets, with each receiving back at least 80% of the funds generated<sup>1</sup>. Just three Member States (France, Germany and the UK) applied modulation when it was introduced on a voluntary basis following the Agenda 2000 reform. After fierce debate, modulation eventually became mandatory following the 2003 Mid Term Review of the CAP. At this time, those Member States that were already using voluntary modulation were permitted to continue to do so alongside compulsory modulation until the end of the 2000-2006 programming period in order to meet national funding requirements for Pillar 2. The legal basis for operating voluntary modulation expired at the end of 2006, and a new legal basis was introduced in 2007 which allows only

<sup>1</sup> Germany is the exception to this and receives back 90% of the funds that it generates through modulation.

the UK and Portugal to use voluntary modulation in addition to compulsory modulation during the 2007-13 programming period. Table 1 summarises current implementation.

The European Commission's proposal ties the proposed additional rates of modulation to the size of the payment received by the farmer and increases the rate in increments of two percentage points each year from between 7% and 16% in 2009, to between 13% and 22% in 2012 (see Table 2). According to the Commission's own [impact assessment](#)<sup>ii</sup>, the higher rates of modulation would provide an additional €4.9 billion for rural development between 2010 and 2013 (excluding additional Member State co-financing, which will be of a similar order). This is in addition to the €8 billion that is already generated from the existing five per cent rate over the 2007-2013 programming period.

Table 2. The European Commission's Health Check Proposal and the European Parliament's Amended Rates.

<b>European Commission's Health Check Proposal (EU-15)</b>				
<b>Thresholds (€)</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>
1 - 5,000	0	0	0	0
5000 - 99,999	7%	9%	11%	13%*
100,000 - 199,999	10%	12%	14%	16%
200,000 - 299,999	13%	15%	17%	19%
Over 300,000	16%	18%	20%	22%
<b>European Parliament's Amendment**</b>				
<b>Thresholds (€)</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>
1 - 5,000	0	0	0	0
5000 - 99,999	6%	6%	7%	7%
100,000 - 199,999	7%	7%	8%	8%
200,000 - 299,999	8%	8%	9%	9%
Over 300,000	9%	9%	10%	10%

\* 3% for EU-10 from 2012, with Bulgaria and Romania remaining exempt.

\*\* to be voted on in Plenary on 18 November; all new Member States exempt until 2013.

With the exception of a handful of supporters, most Member States, along with the European Parliament, have disputed the proposed increase to the rate of modulation. Most Member States accept the need to address the environmental priorities expressed by the Commission, but are reluctant to reduce direct payments to the extent proposed, not least because the additional modulated funds within Pillar 2 would need to be co-funded by the Member State.

Different elements of the proposals are contentious with different Member States. For example, linking the rate of modulation to the size of direct payments received is not popular with those Member States where large farms predominate (particularly the UK and Germany, for example). In contrast to the current rules, all funds raised through the additional rates of modulation will be returned to the Member State from which they are generated. This is not popular with some Member States, particularly those

who are net beneficiaries from the current redistribution criteria (predominantly the southern Member States such as Portugal and Spain). Other Member States claim to be concerned over the increased levels of national co-financing that they would be required to source.

The European Parliament is also likely to put forward a weakened version of the Commission's proposal on modulation when the Plenary votes on the 1,020 amendments listed in the Agriculture and Rural Development Committee's [report](#) published on 21 October<sup>iii</sup>. As shown in Table 2 above, the Parliament is suggesting a progressive rate of modulation that is less than half the amount proposed by the Commission for 2012, believing that higher rates could result in too great an impact on farm structures and farm labour. Despite the more modest figures that are likely to form the Parliament's Opinion, there are a range of views within the Parliament. The Environment Committee, for example, in its Opinion, calls for the rate of modulation to be substantially higher than that proposed by the Commission, with a view to phasing out all direct payments by 2020. The Plenary vote is scheduled for the morning of November 18, so there will be little time for the Agriculture Council to reflect upon the Parliament's Opinion.

A small group of supporters, including Denmark, Sweden and the UK, are broadly in favour of a higher rate of modulation, as the proposal sits within the longer term strategic aims of these countries to shift the emphasis of the CAP toward Pillar 2. However, the UK is placed in a difficult position. Given that it already operates significant levels of voluntary modulation, and that the proposals require any increase in compulsory modulation to be accompanied by equivalent reductions in voluntary modulation, the proposals are unlikely to generate additional funds for the UK. In order to protect its rural development budget, an amendment is included within the European Parliament's report to require the agreed rate of modulation to generate funds equivalent to or greater than the funds generated through the current combination of compulsory and voluntary modulation

A modest increase in the rate of compulsory modulation, while a step in the right direction, would nonetheless be disappointing environmentally, particularly if the requirement for the additional funds to be focused on the delivery of the 'new challenges' is reneged. It would serve to perpetuate a predominant budgetary focus on untargeted support delivered through Pillar 1.

Ultimately, a defensible CAP budget is one that serves to address objectives that require a common effort, through measures that are transparent, targeted and effective. The programming approach embodied by Pillar 2 goes a long way towards meeting these requirements. It ensures that payments are targeted at the provision of specific outcomes, reflecting both the needs of local areas, and set within a broad strategic framework at the EU level. As such, it can be argued that Pillar 2 measures inherently provide greater added value than Pillar 1 support.

However, shifting the balance of funding from Pillar 1 to Pillar 2 of the CAP does raise fundamental questions about how to measure and assess the effectiveness of Pillar 2 measures, and the way in which funding can be assured in the longer term to meet the environmental priorities across the EU-27. Although implementation of Pillar 2 measures is subject to structured monitoring and evaluation requirements, greater attention needs to be paid to identifying the impacts of Pillar 2 measures if they are to be allocated higher levels of funding in the future. In addition, the continued allocation of Pillar 2 funds on predominantly historic criteria for the EU-15, rather than on more objective criteria, such as those used for the new Member States, continues to perpetuate Pillar 2 budgets that do not fully reflect the priorities and needs of the individual Member States. Both these issues need to be considered in more depth in the run up to 2013, so that future support can be based on a clear identification and quantification of need, and an assessment of the most appropriate and cost-effective form of intervention.

The [results](#) from the consultation exercise on the EU budget<sup>iv</sup> presented in Brussels on 12 November by the Budget Commissioner, Dalia Grybauskaitė, indicate that the positions on modulation expressed within the Agriculture Council and on the shape of a future CAP more generally, diverge widely from broader stakeholder opinion. If there is not a fairly swift reorientation in a more progressive direction, it is likely that the CAP budget will come under even greater pressure, as money shifts towards growing Community priorities such as combating climate change and into possible new spheres such as a common energy policy.

### *Key Dates*

November 18 - 19	Agriculture Council	The French Presidency anticipates reaching political agreement on the Health Check.
November 18	European Parliament Plenary	The Plenary will debate and vote on the Legislative Resolution drafted by the Committee on Agriculture and Rural Development.
November 18 (pm)	French Presidency	The French Presidency will issue a compromise text on the proposed legislation.
November 28	Extra Agriculture Council	The French Presidency has scheduled a second Council meeting for November in case political agreement is not reached earlier in the month.
December 17 - 19	Agriculture Council	The final Council of the year is normally dominated by issues relating to fisheries.

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- <sup>i</sup> The legislative proposals include the introduction of a new Council Regulation to replace Council Regulation 1782/2003, modifications to a range of Council Regulations on public intervention and direct aids, and amendments to the European Agricultural Fund for Rural Development (Council Regulation 1698/2005) and the Community Strategic Guidelines (Council Decision 2006/144). COM (2008) 306, 20.5.2008.
  - <sup>ii</sup> Commission Staff Working Document accompanying the Health Check proposals: Impact Assessment, SEC(2008) 1885, 20.5.2008.
  - <sup>iii</sup> Report on the proposal for a Council regulation establishing common rules for direct support schemes for farmers under the common agricultural policy and establishing certain support schemes for farmers, Committee on Agriculture and Rural Development, Rapporteur: Luis Manuel Capoulas Santos, A6-0402/2008, 21.10.2008.
  - <sup>iv</sup> Consultation Report 'Reforming the Budget, Changing Europe: Short Summary of Contributions', Working document prepared by the Secretariat-General and DG Budget, SEC(2008) 2739, 3.11.2008.