EN

COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 29.7.2009
COM(2009) 407 final

REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL

in accordance with article 7 of Council Regulation (EC) No 378/2007 of 27 March 2007 laying down rules for voluntary modulation of direct payments

REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL

in accordance with article 7 of Council Regulation (EC) No 378/2007 of 27 March 2007 laying down rules for voluntary modulation of direct payments

The present report has been prepared pursuant to Article 7 of Council Regulation (EC) No 378/2007,[1] which provides that "before 31 December 2008, the Commission shall submit to the European Parliament and to the Council a report on the application of voluntary modulation, accompanied, if needed, by appropriate proposals."

In the meantime, the Health Check of the Common Agricultural Policy (CAP) has responded to the need to increase funding for rural development by increasing the rate of compulsory modulation. The Member States applying voluntary modulation will gradually replace voluntary modulation by compulsory modulation, thus better aligning modulation rates across the EU.

The Commission does not foresee any further initiatives on voluntary modulation in the current programming period 2007-2013.

1. Background

1.1. The concept of 'modulation'

The term 'modulation' refers to the transfer of budgetary resources from direct payments to farmers (1st pillar of the CAP) to rural development measures (2nd pillar of the CAP).

The CAP reform of 2003 introduced compulsory modulation, starting with a rate of 3% in 2005, 4% in 2006 and 5% from 2007 onwards, coupled with a franchise of EUR 5,000 below which there is no reduction of direct payments.

In addition, it was agreed in 2005 that the United Kingdom and Portugal may use further voluntary modulation under the terms of Regulation (EC) No 378/2007.

1.2. The legal framework for voluntary modulation

Regulation (EC) No 378/2007 gives the possibility to apply voluntary modulation in the period 2007-2012 to the United Kingdom where voluntary modulation already applied and to Portugal pursuant to a derogation granted in Article 70(4a) of Council Regulation (EC) No 1698/2005.[2]

Voluntary modulation takes the form of a reduction in direct payments that is additional to the reduction resulting from compulsory modulation.

A single rate of reduction per calendar year must be applied; however, the United Kingdom that applies the single payment scheme at regional level may also apply regionally differentiated rates. The maximum rate of reduction is 20%.

---

[1] Council Regulation (EC) No 378/2007 of 27 March 2007 laying down rules for voluntary modulation of direct payments provided for in Regulation (EC) No 1782/2003 establishing common rules for direct support schemes under the common agricultural policy and establishing certain support schemes for farmers, and amending Regulation (EC) No 1290/2005, OJ L 95, 5.4.2007, p. 1.

[2] Council Regulation (EC) No 1698/2005 of 20 September 2005 on support for rural development by the European Agricultural Fund for Rural Development (EAFRD), OJ L 277, 21.10.2005, p.1.

As is the case with compulsory modulation a franchise of EUR 5 000 is foreseen. However, contrary to compulsory modulation, MS are allowed to derogate and not apply it (as done by UK).

The Commission fixes the net amounts resulting from the application of voluntary modulation on the basis of the rate(s) communicated by the Member States concerned.

These additional modulated funds are used to finance rural development measures in the same Member State. There is no obligation of national co-financing, that is, the additional funds are not subject to the ceilings for the different axes set out in Article 70(3) of Regulation (EC) No 1698/2005.

The Member States concerned must provide impact assessments, in particular on the economic situation of farmers and their competitive position in the agricultural sector, taking into account the need to avoid unjustified unequal treatment of farmers. On this basis, the Commission must report to the European Parliament and the Council on the application of voluntary modulation before the end of 2008.

The implementing rules set out in Commission Regulation (EC) No 1236/2007[3] provide a) for the inclusion of the amounts resulting from voluntary modulation in the financing plan for each rural development programme (Annex II, part A, point 6.1 of Regulation (EC) No 1974/2006), and b) for repealing the old voluntary modulation regime in Regulation (EC) No 1655/2004.

1.3. Limitation of the economic impact analysis

It is still very early to draw any firm conclusions on the impact of voluntary modulation on the economic situation of farms.

In UK the first voluntary modulation budget to be spent on the UK Rural Development Programmes under Regulation (EC) No 378/2007 has only been available since October 2007. In the case of Northern Ireland the Rural Development Programme was amended to include voluntary modulation from November 2008.

In the case of Portugal it is too early to assess any impact since the amounts resulting from voluntary modulation will only be available in rural development programmes from 2010.

It is also important to acknowledge that during a particularly volatile period of change voluntary modulation deductions are only one of a wide range of factors affecting the economic situation of farms in 2007-2008. Other factors have had more impact on farm incomes, such as rising commodity prices, rising input prices, the credit crunch and, in the case of UK, the weakening of the Sterling relative to the euro, extreme weather conditions and animal health outbreaks. However, in this Member State, the overall income development was positive due to the high increase in commodity prices.

3 Commission Regulation (EC) No 1236/2007 of 22 October 2007 amending Regulation (EC) No 1974/2006 for the purpose of implementing Council Regulation No 378/2007 on voluntary modulation, OJ L 280, 24.10.2007, p. 3.

2. Application of voluntary modulation in the United Kingdom

2.1. Communication pursuant to Article 2(1) of Regulation (EC) No 378/2007

On 12.6.2007 the United Kingdom communicated to the Commission the rates of voluntary modulation for 2007-2012 together with an ex ante impact assessment.

The United Kingdom fixed the following annual rates per region, and did not foresee the application of a franchise:

YEAR	2007	2008	2009	2010	2011	2012
England	12.0 %	13.0 %	14.0 %	14.0 %	14.0 %	14.0 %
Wales	0 %	2.5 %	4.2 %	5.8 %	6.5 %	6.5 %
Scotland	5.0 %	8.0 %	8.5 %	9.0 %	9.0 %	9.0 %
Northern Ireland	4.5 %	6.0 %	7.0 %	8.0 %	9.0 %	9.0 %

As regards national co-financing, all regions provide co-funding which adds up to an additional EUR 1.6 billion. The national co-financing rates are shown below:

	AXIS 1	AXIS 2	AXIS 3	AXIS 4
England	0 %	40.00 %	0 %	0 %
N. Ireland	0 %	62.00 %	0 %	0 %
Scotland	55.21 %	55.21 %	55.21 %	65.00 %
Wales	45.00 %	45.00 %	45.00 %	0 %

According to the United Kingdom, voluntary modulation would allow for a better balance between the two pillars of the CAP, given a ratio between the 1st and the 2nd pillar for 2007-2013 before voluntary modulation of 14:1 and after modulation of 7:1.in the UK compared to an EU-15 average of 5:1.

2.2. Commission Decisions 2007/679/EC and 2007/680/EC

Commission Decision 2007/679/EC[4] fixed the net amounts resulting from the application of voluntary modulation on the basis of the regionally differentiated annual rates communicated by the United Kingdom as follows:

[4] Commission Decision of 22 October 2007 fixing the net amounts resulting from the application of voluntary modulation in the United Kingdom for the calendar years 2007 to 2012 (2007/679/EC), OJ L 280, 24.10.2007, p. 25.

YEAR	2007	2008	2009	2010	2011	2012
Total (EUR million)	362.0	424.0	464.4	475.5	481.6	481.6

Commission Decision 2007/680/EC[5] adjusted accordingly, on the one hand, the net balance available for EAFG expenditure, and on the other hand, the amounts concerning the United Kingdom and the total amounts of Community support to rural development for 2007-2013.

As a result, a total of EUR 2,689 million obtained from the application of voluntary modulation would be transferred from the 1st to the 2nd pillar in the programming period 2007-2013, more than doubling the budget for rural development in the United Kingdom (from EUR 1,910 million to EUR 4,599 million) and raising the total EU rural development budget to EUR 91.9 billion in the same period.

2.3. Report pursuant to Article 5 of Regulation (EC) No 378/2007

The report submitted by the United Kingdom in December 2008 covers the period from March 2007 to September 2008. And since the voluntary modulation receipts have only been available since October 2007, it is according to the United Kingdom too early to draw any firm conclusions.

2.3.1. Use of additional funds from voluntary modulation

The additional funds are used primarily for environmental purposes under axis 2 as shown below:

AXIS	ENGLAND	SCOTLAND	N. IRELAND	WALES
1	10.45 %	14.29 %	17.00 %	10 %
2	76.09 %	68.58 %	65.04 %	80 %
3	8.74 %	11.57 %	0.00 %	10 %
Leader	4.72 %	5.57 %	17.96 %	0 %
Total	100 %	100 %	100 %	100 %

2.3.2. Farm income

The communication states that the most recent statistics on farmers' income "would suggest that the UK agricultural industry is in a relatively healthy and competitive state even though voluntary modulation has been applied since 2001" (in the period 2000-2006 the total amount paid out was around EUR 4,500 million).

5 Commission Decision of 22 October 2007 amending Decision 2006/410/EC, setting the amounts which, pursuant to Articles 10(2), 143d and 143e of Council Regulation (EC) No 1782/2003, are made available to the EAFRD and the amounts available for EAGF expenditure, and Decision 2006/636/EC fixing the annual breakdown by Member State for Community support to rural development for the period from 1 January 2007 to 31 December 2013 (2007/680/EC), L 280, 24.10.2007, p. 27.

The first new voluntary modulation deductions were made in 2007. The analysis conducted by the United Kingdom based on data for 2007 found no direct correlation between the voluntary modulation deductions and changes to total income from farm (TIFF);

YEAR	UK REGION	VM RATE	VM DEDUCTED (£M)	TIFF (£M)	CHANGE IN VM DEDUCTIONS	CHANGE IN TIFF
2006	England	6.0 %	101.0	1555		
	N. Ireland	4.5 %	11.0	160		
	Scotland	4.5 %	19.9	537		
	Wales	0.5 %	1.2	52		
2007	England	12.0 %	218.0	1631	117.0	76.0
	N. Ireland	4.5 %	11.0	233	0	73.0
	Scotland	5.0 %	22.7	628	2.7	91.0
	Wales	0 %	0.0	46	-1.0	-6.0

Voluntary modulation should not impact significantly on the economic situation of farmers and their competitive position in the agricultural sector in 2008. Other factors have had a greater impact on total income from farming (TIFF) than voluntary modulation, not least exchange rate changes. Higher cereal prices in the first part of 2008 and higher meat and milk prices contributed to an increase in the value of output, which is expected to be only partly offset by the increased costs of fuels, fertilisers and animal feed. In real terms, total income from farming and total income from farming per person are forecast to rise slightly in 2008 following the rises seen in 2006 and 2007.

Moreover, farmers will benefit in the longer term from the economic impacts of rural development support increased by voluntary modulation; the vast majority of additional funds benefits farmers directly in the form of agri-environmental payments which provide a degree of certainty and stability in farm income.

The estimated impact on farmers' income is summarized in the following table:

	ENGLAND	NORTHERN IRELAND (NI)	SCOTLAND	WALES
Voluntary Modulation rates (min and max)	12%-14%	4.5%-9%	5%-9%	2.5% - 6.5%
Estimated impact on total income from farming	Non available	-3% / -6%	Non available	-3.9% / -10.2%
Estimated impact on cash income	Non available	non available	-0.5% / -4.3%	-1.5% / -4.4%

The competitive position of UK agriculture should not be affected, while co-financing should restrict the reduction in farm receipts. In fact, due to national co-financing of voluntary modulation, there will be a net increase in overall CAP spending in the UK (+ EUR 1 billion in the programming period 2007-2013 for England only).

2.3.3. Impact on environment

In England, 99% of voluntary modulation total public expenditure (EUR 131.5 million) was paid for agri-environment payments, mainly on the entry-level Environmental Stewardship Scheme. This scheme requires a basic level of environmental management and participants can choose from a wide range of more than 50 management options. These cover all farming types and include things such as hedgerow management, stone wall maintenance, low input grassland, buffer strips, and arable options

Since January 2007, over 10,500 new agri-environmental agreements have been signed up all funded with voluntary modulation. It would not have been possible to expand the Environment Stewardship scheme at this rate without voluntary modulation. In Scotland, all of EUR 34.9 million (total public expenditure) was used in 2008 on less favoured area payments. In Wales, which chose not to make any voluntary deduction from single payment scheme 2007 payments, the voluntary modulation, once available, will be sharply focussed on supporting agri-environmental measures at a lower scale to support farm/forestry based training and business adaptations.

In Northern Ireland, voluntary modulation will be targeted at those measures that provide direct support for farmers (training and information actions, modernisation of agricultural holdings, Less Favoured Areas compensatory payments, agri-environmental payments, forestry measures and diversification into non-agricultural activities).

A wide range of environmental benefits is expected through agro-environmental measures. These should mitigate possible negative effects of reduced direct payments, like reductions in suckler cow numbers (which could lead to under-grazing of some important habitats) and possible intensification in dairy, beef and arable sectors that might affect water quality and soil erosion.

3. Application of voluntary modulation in Portugal

3.1. Communication pursuant to Article 2(1) of Regulation (EC) No 378/2007

On 18.6.2007 Portugal communicated to the Commission the rate of voluntary modulation for 2007-2012 and the ex ante impact assessment.

The annual rate communicated was 10% starting in 2008. When the franchise is taken into account, this amounts to an effective rate of 6.1% of reduction of direct payments.

As regards the impact on farmers' income, the expected reduction should vary from a maximum of -13% for beef cattle farms and 'mixed farms' to a minimum of -2%/-3% for farms specializing in permanent crops and milk beef. The gap between the highest and lowest farm income would at the same time be reduced, with more than half of the envelope paid by farmers receiving more than EUR 50,000 in direct payments per year.

3.2. Commission Regulation (EC) No 333/2008 and Commission Decision 2008/788/EC

Regulation (EC) No 333/2008[6] fixed the national ceiling for the total amount of additional aid granted to farmers (the franchise) at EUR 20.4 million per year.

On 12.9.2008 Portugal informed the Commission that it intended to apply voluntary modulation of direct payments only as from 2009.

Commission Decision 2008/788/EC[7] of 3 October 2008 fixed the annual net amounts resulting from the application of voluntary modulation in Portugal and already took into account the decision of the Portuguese authorities by fixing the net amounts only from 2009 onwards:

Year	2009	2010	2011	2012
EUR million	41.6	40.8	40.8	40.8

As a result, EUR 164 million would be transferred from the 1st to the 2nd pillar.

3.3. Use of additional funds from voluntary modulation

According to a commitment in its Rural Development Programme for Mainland, the additional funds from voluntary modulation would be equally divided between reinforcing support for the Natura 2000 network including new additional sites (under axis 2) and projects improving farm structures (under axis 1).

As indicated before on 12.9.2008 Portugal informed the Commission that it intended to apply voluntary modulation of direct payments only as from 2009.

Portugal has confirmed that it will find alternative means to respect the above mentioned commitment in the Rural Development Programme for Mainland.

[6] Commission Regulation (EC) No 333/2008 of 11 April 2008 laying down the ceilings applicable to the additional amounts of aid to be made to Portugal as part of the voluntary modulation provided for in Council Regulation (EC) No 378/2007, OJ L 102, 12.4.2008, p. 19.

[7] OJ L271 of 11.10.2008, p. 44.

4. Impact of the Health Check

The Health Check of the CAP (Council Regulations (EC) No 72/2009, No 73/2009 and 74/2009 of 19 January 2009)[8] aims at helping farmers better respond to market signals and face new challenges.

To this end, the rate of compulsory modulation will increase in four steps reaching 10% in 2012 while the EUR 5,000 franchise is maintained. In addition, progressive modulation for a further 4% for payments over EUR 300,000 is introduced.

As a result, EUR 3.24 billion will be transferred to the 2nd pillar over 4 years. The additional funds will be used in the same Member State for 'new challenges': climate change, renewable energies, water management, biodiversity, innovation linked to these challenges and dairy accompanying measures. The co-financing rate for these operations is 90% in convergence regions and 75% in non-convergence regions.

The Member States applying voluntary modulation will reduce the rates accordingly. This means that the Health Check will reduce the importance of voluntary modulation for the United Kingdom and Portugal and have no impact on total modulation, as shown in the table below:

Table: Amounts of voluntary modulation substituted by compulsory modulation after Health Check

Million €

	2009	2010	2011	2012	Total in
United Kingdom	67.4	100.6	134.3	167.7	470.0
Portugal	8.8	11.8	15.8	19.8	56.2

In addition modulation as increased by the Health Check will narrow down the financial margin for other than new challenges.

5. Conclusions

Voluntary modulation based on Council Regulation (EC) No 378/2007 has either been used for a short period (UK) or still has not been implemented as expected under the rural development programmes (Portugal). It is therefore very early to draw any firm conclusions on the impact of voluntary modulation on the economic situation of farms and their competitive position. Other factors (e.g. rising commodity prices, rising input prices, the credit crunch) have had probably a greater impact on total income from farming than voluntary modulation.

As regard other impacts it should be noted that in UK a wide range of environmental benefits is expected mainly through agro-environmental measures where a significant increase in agri-environmental agreements has been observed.

The Health Check of the Common Agricultural Policy (CAP) has responded to the need to increase funding for rural development by increasing the rate of compulsory modulation. There is therefore no need to come forward with appropriate proposals as suggested in Article 7 of Regulation (EC) No 378/2007.

[8] OJ L 30 of 31.1.2009 p. 1.