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THE FORTUNE OF MODULATION IN THE PROCESS OF CAP REFORM

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Rete di informazione
della Commissione Europea

Paper prepared for the 109th EAAE Seminar " THE CAP AFTER THE FISCHLER REFORM: NATIONAL IMPLEMENTATIONS, IMPACT ASSESSMENT AND THE AGENDA FOR FUTURE REFORMS".

Viterbo, Italy, November 20-21st, 2008.

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Abstract

Direct payments have progressively become the largest and most visible form of support in the CAP tool-box. Analyses on direct payments have always highlighted a large inequality in their distribution, both between Member States and, within them, among farmers and territories where, on one side, a relevant amount of payments is concentrated in the hands of a few beneficiaries; on the other, a small share of support is divided among many heads. The European Commission has faced the problem of the volume and the distribution of the direct payments with two main instruments: the modulation and the capping.

Modulation was originally conceived as a temporary tool aimed at filling the gap between pillars, but in the last years it has changed shape and rules alongside with the CAP process path and it has become one of the milestones of the CAP tool-box. The capping has received high attention during each step of the recent CAP reform process, however, it has been never implemented so far. Both the instruments have relevant implications about the total amount of payments received by farms and by the Member States and about their distribution; however, the way they are implemented and combined together is crucial to fully evaluate their effects.

The main goal of this paper is to reconstruct the evolution of modulation in the process of CAP reform, from the voluntary one launched by Agenda 2000 till the most recent proposal of the CAP Health Check, that combines in one single tool modulation and direct payments' capping.

Simulations of the most recent proposal of modulation show that the goal of Pillar 2 reinforcement has prevailed over the distributional one, through the creation of a sort of national envelope that shifts resources from Pillar 1 to Pillar 2, even though it is not very clear so far how and for what that envelope will be spent. Moreover, the capping goal within the progressive modulation is not very effective and only affects to some limited extent direct payments in few Member States.

Keywords: CAP Budget, CAP Pillars, Health Check, Rural Development Policies

JEL Classification: Q18

Introduction

With the circulation of the review proposals of the common agricultural policy (CAP) designed by the Fischler reform in 2003 – the so called Health Check – an overall picture of the adjustment process is highlighted (European Commission, 2008 and 2007). The path to be followed is quite long and complex, however it is rather clear, even at this stage, that the Health Check represents the predictable conclusion of a process started in 2003, although the rationale and the consequences of the approach proposed are something more than a simple “technical adjustment” of the CAP (Cooper *et al.*, 2007).

Looking at pillar 1 of the CAP, the proposal outlines the path of the ongoing process of decoupling of direct payments, together with the increasing dismantling of the traditional market policies. In a nutshell, Pillar 1 reform proposals go into the direction of turning the single payment, decoupled on a historical base, into a flat-rate regionalised payment, addressing more and more the remuneration of environmental and social services through the conditionality. In this way, direct payments become, at least in the intentions of the policy makers, the rewards for providing goods and services to the whole community rather than a compensation offered to farmers for the progressive dismantling of the specific supports granted to agricultural products.

As for the Pillar 2, the Health Check draws a picture that apparently seems to reinforce the role and the objectives of the rural development policies. However, at a deeper analysis one could argue that Pillar 2 has been rather considered as a sort of “black box” where to place new functions and measures that are a consequence of the progressive revision of the pillar 1 support: possible measures of land management due to the elimination of the set aside; a “soft landing” for the milk quota regime elimination, providing specific measures for the production in mountain and marginal areas; measures aimed at the management of risk coming from further decoupling and the increasing dismantling of market policies; finally, the reinforcement of measures concerning with climatic change and the management of the natural resources. It is not clear at the moment what and to what extent these new functions will be included in pillar 2 among all the others, but it can be maintained that it is the sector-based family of measures that tend to be enhanced, in contrast with the emphasis put on the territory-based approach of the pillar 2.

Given this as a more general picture, the debate around the financial resources available for the two pillars of the CAP is mainly focused on the unbalance still existing between them, with pillar 1 still representing about 75% of the total expenditure for the CAP, and that in spite of the fact that the uneven distribution of resources was highlighted firstly at the Conference of Cork in 1996 and then during the debate developed around Agenda 2000. Since then, many instruments have been discussed, all concerning the reduction of direct payments: degressivity, capping and modulation. Degressivity is simply a progressive reduction of the total amount of direct payments enjoyed by farms, never really taken into consideration so far. Capping was originally conceived as a cut to the higher brackets of direct payments that was supposed to reinforce pillar 1 of the CAP, but it was then set aside. Only

recently it popped out again in the Health Check as “upper and lower limits to support levels”. Modulation was launched with Agenda 2000 as a voluntary instrument and since then it became one of the backbones of the CAP, being the only tool that actively shifts resources from the first to the second pillar of the CAP and that redistribute resources among Member States.

The aim of this paper is to reconstruct the fortune of the modulation of direct payments in the CAP, tracing its evolution from its first appearance on the CAP scene with Agenda 2000 in 1999 up to the recent proposal of the Health Check of the Fischler reform of June 2003. The continuous change in the rationale and implementation of the modulation underlines on the one hand the “experimental” feature of the modulation, on the other the deep conflict between its supporters, that are in favour of the reinforcement of pillar 1 at the expenses of pillar 2, and those who still are in favour of a larger first pillar, although reformed and addressing the secondary functions of agriculture through conditionality.

More in details, specific attention will be paid to the following aspects: the shift from a State-based voluntary modulation to a mandatory one (passing by a new voluntary version); the analysis of the most recent proposal of modulation coming with the Health Check proposal (May 2008¹); the theoretical and actual reinforcement of pillar 2 of the CAP, given also the financial decisions adopted in 2006; finally, the redistributive effects of modulation among Member States.

Modulation from Agenda 2000 to the Health Check

Modulation was introduced in the CAP tool box with Agenda 2000, in the framework of the so called “horizontal regulation” (Reg. 1259/1999) and it featured for the first time a voluntary cut in the direct payments (DP) granted to farmers and conceived as a compensation for the decrease in the institutional prices. The horizontal regulation supplied with the voluntary modulation a legislative framework for the reduction of DP on the basis of parameters connected with farm employment, total farm income and total amount of DP received by a single farmer, but in any case not exceeding 20% of the total amount: the Regulation fixed these basic criteria, but each Member State was allowed to choose whether to apply modulation and how (Dwyer and Bennet, 2001; Lowe *et al.*, 2002). The same regulation also established that revenues obtained through the application of modulation had to be channelled towards the implementation of additional measures within the former “accompanying measures” (Regs. 2078/92, 2079/92 and 2080/92), and allowances for the disadvantaged areas, all included in Regulation 1257/99 on rural development with Agenda 2000. It is, in fact, with Agenda 2000 that pillar 2 of the CAP took its current shape, and modulation became the tool with which a shift of resources from the first to the second pillar was assured (Dwyer and Bennet, 2001).

At the time of Agenda 2000 the debate arisen around modulation became quite intense, shading light on pros and cons of the instrument: on one side, it was considered the first clear

¹ COM(2008) 306/4.

signal of the need to balance financial resources between the two pillars of the CAP and to limit the expenditure for direct payments. On the other side, most experts were dubious about its effectiveness being based on a voluntary approach and having effects only on DP, in a stage of the CAP life when other forms of support were quite relevant and CMOs were rather heterogeneous in terms of tools implemented (INEA, 2000). It is interesting to stress how such debate was somehow based on the underlying idea that modulation was a temporary measure aimed at launching a signal in favour of the rebalancing of the CAP expenditure, from a sector-based dominant criterion to a territory-based one.

Not surprisingly, after almost ten years and two deep CAP reforms, modulation is not only still present in the tool box, but it is still the only active instrument that shifts resources from the first to the second pillar, and it is actually considered as a milestone of the new CAP.

Coming to the mid term review of Agenda 2000 (MTR), modulation became mandatory and was originally conceived as drastically drawing on the direct payments (20% cut) together with the proposal of capping (Henke and Sardone, 2004). However, the resistance of pillar 1 support ended up in a sensible reduction of the cut, reduced to a percentage that went from 3% in 2005 up to 5% in 2012, whereas the capping was abandoned. It is worth noting that the actual rate of modulation would have been lower than the theoretical 5% (which, in turn, was considered much lower than the proposed 20%), given the franchise established at 5.000 euro, according to which the amount of direct payments under that threshold would have not been interested by the cut of modulation. Moreover, the franchise, as it will be shown more in detail later, makes the actual cut also different among Member States, and especially between Mediterranean partners and North European ones, given the different farm structure and payments' distribution (Henke and Sardone, 2004; Osterburg, 2006).

During the 2007 another proposal of a voluntary modulation to put beside the mandatory one was discussed, but it was strongly opposed by the European Parliament, that considered it an inappropriate instrument to counterbalance the cut that resources for rural development policy had borne during the financial decisions in 2006 (Osterburg, 2006). Eventually, voluntary modulation was approved, but it has been implemented only by two Member States: UK and Portugal².

Moving to the latest proposal, the Health Check stresses the importance of modulation as a financial instrument for the valorisation of pillar 2, also with a specific reference to the new functions generally ascribed to rural development policies in the discussion paper released in November 2007³. However, so far both in this paper and in the following regulation proposals

² According to the new voluntary modulation, Member States have been allowed to raise the rate of modulation up to 20%, as originally proposed by the MTR. UK set its modulation at different rates according to Regions (from 9 to 14%), while Portugal at 10%.

³ This document, released on November 20, 2007 to open the discussion about the Health Check proposals, explicitly quotes: "With the CAP budget now fixed until 2013, strengthening rural development funds can only be achieved through increased co-financed compulsory modulation" (Commission of the EC, 2007, p. 9). In the first proposal launched by the Commission, modulation was proposed together with a rather heavy capping of the DP, but that specific proposal was then deleted, while the progressive component of modulation was proposed.

there is no clear evidence of how the possible resources coming for the modulation would combine with the rural development funds.

It is well known that, with the 2005 financial decision, resources for pillar 2 for the planning period 2007-2013 were cut down from the expected 88.7 million to 69.7 million euro, which were to be topped up by about 8 million euro coming from modulation set up at 5%, according to the decisions of the Fischler reform, so that the resources available amounted to about 77.7 million euro (Mantino, 2006). This is to say that, in some way, modulation is counted on in the balance between the first and second pillar, so it becomes relevant the mechanism of modulation itself to know the amount of resources shifted from one pillar to the other.

Table 1 - Progressive modulation according to the Health Check proposal

Thresholds (in €)	2008	2009*	2010*	2011*	2012*
0-5.000	0%	0%	0%	0%	0%
5.000-99.999	5%	7% (2%)	9% (4%)	11% (6%)	13% (8%)
100.000-199.999	5%	10% (5%)	12% (7%)	14% (9%)	16% (11%)
200.000-299.999	5%	13% (8%)	15% (10%)	17% (12%)	20% (15%)
> 300.000	5%	16% (11%)	18% (13%)	20% (15%)	22% (17%)

* Values in brackets are the progressive rates that are to be added to the basic rate of modulation (5%)

Source: COM(2008) 306/.

In the most recent proposal of modulation (May 2008), the “old” idea of the capping and the modulation are combined together in what is called the “progressive modulation”⁴. Such proposal is based on a growth of the mandatory modulation rate from 5% up to 13%, gradually reached through a annual increase of 2%. Moreover, a progressive rate of modulation needs to be added to the “basic” one, according to different levels of direct payments, featured as a progressive taxation system (table 1). Progressive modulation addresses two relevant issues maintained by Commissioner Fischer Boel (Rural Europe, 2007): expanding EU funding for rural development support and cut direct payments received by large farms. This would make the CAP more equitable and socially accepted.

It is interesting to note that the raise of the modulation rate, as it will be shown later, will bring the actual amount of available resources for rural development policies back at the level expected at the time of the financial debate in 2006.

⁴ See the proposal for a council regulation COM(2008) 306/4 “establishing common rules for direct support schemes for farmers under the common agricultural policy and establishing certain support schemes for farmers”, chapter 2, Art. 7.

The modulation in the CAP Health Check

The implementation of the cut

In this section a simulation of the effects of modulation as designed by the new regulation proposal is provided. In order to calculate the cuts on direct payments, the 2006 data base organised by the DG-Agri has been used⁵. The original data set has been re-organised according to the specific topic of modulation, that is calculating all the direct payments below the threshold of 5.000 euro (the franchise proposed by the Commission) that are not hit by the modulation, and subsequently organised according to the progressive elements introduced through the thresholds set at 100.000, 200.000 and 300.000 euro.

Table 2 shows farms and payments submitted to modulation per country for the EU-15. On average, in the EU-15 75% of the farms enjoy payments below the franchise set up at 5.000 euro, while only 13.4% of the payments is below the same threshold. Such shares hide a high variability among the Fifteens: the Northern partners show a much lower rate of both farms and payments under the 5.000 euro franchise, (France 34% of farms and only 3.2% of payments; Germany 51% and 6.5% respectively; United Kingdom 49.4% and 3.4%) while the Mediterranean countries show a reversed situation (Greece 90.6% and 51%; Portugal 92.5% and 28.7%; Italy 91.3% and 31.6%) and Spain in an intermediate position.

Table 2 - Farms and payments per thresholds in the EU-15

	Farms per threshold ('000)					Payments per threshold (Meuro)				
	Franchise	Thr. I	Thr. II	Thr. III	Thr. IV	Franchise	Thr. I	Thr. II	Thr. III	Thr. IV
Belgium	19,4	24,3	0,1	0,0	0,0	34,5	421,4	7,5	2,1	1,5
Denmark	37,1	32,8	0,7	0,1	0,0	54,4	755,7	83,7	18,0	12,2
Germany	192,5	180,1	2,5	0,9	1,6	329,3	3.285,3	345,5	229,8	860,3
Greece	786,8	81,3	0,0	0,0	0,0	830,7	780,5	3,4	1,2	0,8
Spain	693,3	201,2	2,1	0,4	0,3	822,0	3.138,6	277,5	84,0	140,7
France	145,1	278,1	3,4	0,2	0,1	242,3	6.863,9	417,4	34,2	57,9
Ireland	59,5	69,7	0,2	0,0	0,0	134,1	1.034,7	30,1	2,3	1,5
Italy	1.442,4	135,7	1,6	0,3	0,3	1.093,0	1.945,9	208,3	68,9	139,8
Luxemburg	0,5	1,5	0,0	0,0	0,0	0,9	30,9	0,6	0,0	0,0
Netherlands	68,2	33,8	0,1	0,0	0,0	70,2	555,4	16,1	3,9	3,3
Austria	88,9	44,0	0,0	0,0	0,0	166,1	486,1	5,7	2,2	4,6
Portugal	221,5	17,5	0,4	0,1	0,0	154,5	297,0	58,3	15,3	13,2
Finland	31,1	33,9	0,0	0,0	0,0	74,3	422,1	3,2	0,5	0,5
Sweden	52,3	30,4	0,3	0,0	0,0	83,5	538,5	33,4	8,4	5,2
United Kingdom	96,4	93,1	4,6	0,7	0,4	118,6	2.457,1	611,5	169,0	167,4
EU-15	3.934,9	1.257,4	15,9	2,7	2,6	4.208,3	23.013,1	2.102,1	639,8	1.409,0

Legenda:

Franchise = < 5.000 euro payments

Thr. I = 5.000 - 99.999 euro payments

Thr. II = 100.000 - 199.999 euro payments

Thr. III = 200.000 - 299.999 payments

thr. IV = > 300.000 euro payments

Source: elaborations on EU data set (2006)

Given the figures in table 2, the results of modulation as proposed in the Health Check document are presented in table 3, while in table 4 the shares of the modulation cut in 2012 (full implementation) per payment thresholds is reported. As it could be expected, the cut originating in the first payment bracket is the highest in all the Fifteen, although some

⁵ The data set is available on the following web page: <http://ec.europa.eu/agriculture/fin/directaid>.

sensible differences are featured for the highest threshold (300.000 euro), with Germany at 32.4% and Italy at 13.2%, both well above the EU average (10.8%).

In table 5 the percent distribution of the amounts originated by the basic modulation and the additional progressive modulation is highlighted. It is worth noting that, on the whole, the distribution is rather homogeneous between the two components of modulation, even if the absolute amounts change.

Table 3 - Modulation according to the new proposed regulation (Meuro)

	Basic Modulation	Additional progressive modulation				Total Modulation			
	(5%) 2009-2012	2009	2010	2011	2012	2009	2010	2011	2012
Belgium	15,5	6,3	12,5	18,8	25,0	21,9	28,1	34,3	40,5
Denmark	35,1	15,4	29,4	43,5	57,5	50,5	64,5	78,6	92,6
Germany	189,8	131,6	207,5	283,4	359,3	321,3	397,2	473,1	549,0
Greece	19,0	7,6	15,2	22,8	30,4	26,6	34,2	41,8	49,3
Spain	131,1	63,9	116,3	168,7	221,2	195,0	247,4	299,8	352,3
France	298,3	126,1	245,4	364,7	484,0	424,4	543,7	663,0	782,3
Ireland	35,9	14,6	29,0	43,4	57,7	50,6	64,9	79,3	93,7
Italy	83,7	44,2	77,7	111,2	144,6	127,9	161,4	194,9	228,4
Luxemburg	1,2	0,5	0,9	1,4	1,9	1,7	2,1	2,6	3,1
Netherlands	20,4	8,5	16,7	24,9	33,1	29,0	37,2	45,3	53,5
Austria	13,9	5,9	11,4	17,0	22,6	19,8	25,3	30,9	36,5
Portugal	14,7	7,0	12,8	18,7	24,6	21,7	27,5	33,4	39,3
Finland	12,8	5,2	10,3	15,4	20,6	18,0	23,2	28,3	33,4
Sweden	21,6	9,2	17,9	26,5	35,1	30,8	39,5	48,1	56,7
United Kingdom	145,6	74,2	132,4	190,6	248,9	219,7	278,0	336,2	394,4
EU-15	1038,5	520,2	935,6	1351,0	1766,4	1558,7	1974,1	2389,5	2805,0

Source: elaborations on UE data set (2006)

Tab. 4 - Shares of modulation cut per payment thresholds 2012 (%)

	Thr. I	Thr. II	Thr. III	Thr. IV	Tot
Belgium	96,1	2,4	0,8	0,7	100,0
Denmark	82,3	12,0	3,0	2,6	100,0
Germany	53,1	8,1	6,4	32,4	100,0
Greece	98,6	0,9	0,2	0,3	100,0
Spain	77,1	10,5	3,8	8,6	100,0
France	90,5	7,0	0,7	1,8	100,0
Ireland	95,0	4,2	0,4	0,3	100,0
Italy	70,1	12,0	4,7	13,2	100,0
Luxemburg	98,3	1,7	0,0	0,0	100,0
Netherlands	93,4	4,1	1,1	1,4	100,0
Austria	94,3	2,1	0,9	2,6	100,0
Portugal	68,1	19,9	5,9	6,1	100,0
Finland	98,2	1,2	0,3	0,3	100,0
Sweden	87,9	7,8	2,2	2,0	100,0
United Kingdom	64,0	20,5	6,7	8,7	100,0
EU-15	75,8	9,9	3,6	10,8	100,0

Legenda:

Thr. I = 5.000 - 99.999 euro payments

Thr. II = 100.000 - 199.999 euro payments

Thr. III = 200.000 - 299.999 payments

thr. IV = > 300.000 euro payments

Source: elaborations on EU data set (2006)

Table 5 - Distribution of the modulation cuts among Member States (2012, %)

	Basic Mod. (5%)	Add. Progr. Mod	Tot. Mod.
Belgium	1,5	1,4	1,4
Denmark	3,4	3,2	3,3
Germany	18,3	21,5	19,9
Greece	1,8	1,7	1,7
Spain	12,6	12,5	12,5
France	28,7	26,7	27,7
Ireland	3,5	3,2	3,3
Italy	8,1	8,3	8,2
Luxemburg	0,1	0,1	0,1
Netherlands	2,0	1,8	1,9
Austria	1,3	1,2	1,3
Portugal	1,4	1,4	1,4
Finland	1,2	1,1	1,2
Sweden	2,1	1,9	2,0
United Kingdom	14,0	14,1	14,1
EU-15	100,0	100,0	100,0

Source: elaborations on EU data set (2006)

In 2012, the total cut to direct payments produced by modulation will amount to about 2.8 billion euro. Of these, slightly more than 1 billion will come from the 5% cut (basic modulation, at the same rate as it is implemented nowadays), while about 1,8 billion will be originated from the new additional progressive modulation. As shown in table 4, about 27.7% of the total cut of direct payments will com from France, by far the largest contributor, followed by Germany (around 20%) and United Kingdom (14%).

Finally, in table 6 it is reported the share of the total cut to the total DP per member State. It is worth noting that such share coincides with the actual rate of modulation, that is a combination of the basic, additional and progressive modulation. The actual rate is rather different within the Member States: at the EU-15 level, in 2012 it reaches 8.9%, but this ranks from 3.1% in Greece up to 11.2% in the United Kingdom.

Table 6 - Rate of modulation cut according to the new proposal

	Total cut/Total payments (%)			
	2009	2010	2011	2012
Belgium	4,7	6,0	7,3	8,7
Denmark	5,5	7,0	8,5	10,0
Germany	6,4	7,9	9,4	10,9
Greece	1,6	2,1	2,6	3,1
Spain	4,4	5,5	6,7	7,9
France	5,6	7,1	8,7	10,3
Ireland	4,2	5,4	6,6	7,8
Italy	3,7	4,7	5,6	6,6
Luxemburg	5,2	6,6	8,1	9,6
Netherlands	4,5	5,7	7,0	8,2
Austria	3,0	3,8	4,6	5,5
Portugal	4,0	5,1	6,2	7,3
Finland	3,6	4,6	5,7	6,7
Sweden	4,6	5,9	7,2	8,5
United Kingdom	6,2	7,9	9,5	11,2
EU-15	5,0	6,3	7,6	8,9

Source: elaborations on EU data set (2006)

The reinforcement of pillar 2 of the CAP

The main task of modulation

The new modulation proposed with the Health Check combines two main objectives of the new CAP: on one side the financial reinforcement of pillar 2 through a shift of resources originally placed in pillar 1; on the other side the capping of direct payments enjoyed by large farms. The former is an “old” task that deepens its roots in the Conference of Cork and the debate about the livelihood of the rural areas in the EU. The latter has more to do with distributive issues within the EU and the growing need to intervene to limit the concentration of direct payments in the largest farms.

The enhancement of pillar 2 arises a number of questions that are not fully addressed by the specific norms of the CAP. Firstly, the amount of resources shifted from the first to the second pillar of the CAP does not follow the actual distribution of the financial support per country but rather tends to alter it. This, of course, can be a positive result in itself, and it is worth underlining here that modulation does affect the resource balance among Member States and among farms. Secondly, the shift of resources from pillar 1 to pillar 2 can be opposed not only by the supporters of pillar 1 – those that prefer to receive money for their status of farmers and according to the historical distribution of direct payments – but also by the national governments that should add resources on their own because of the co-financing rule of pillar 2⁶.

Finally, another relevant issue is the fact that modulation adds progressively resources to the rural development programmes (RDPs)⁷. Such shift opens relevant issues, that needs further discussion. One has to do with the concentration of resources on specific objectives, the other with the timing of expenditure. The regulation proposal on this matter is quite unclear, naming as objectives specific schemes addressing the “new challenges” facing the European rural environment: climate change, bioenergies, biodiversity and water management. Another issue has to do with the fact that, with modulation, the pick of resources shifting from pillar 1 to pillar 2 would be reached in 2012, when the planning period is practically over. It is then not very clear when and how those resources would be available for the programmes, especially in a totally uncertain future of the CAP and the rural development policy after 2013 (Mantino, 2007)⁸. Finally, considering also the national co-financing of resources coming from modulation into the RDPs, there may be a serious risk of over-financing of the plans, with the institutions managing the plans (Regions, States) unable

⁶ On this matter, there is no agreement within the Member States. It might also be agreed that the resources coming for the additional progressive modulation do not need co-financing. This would create an important case for the financial support of the CAP under Pillar 2.

⁷ It has been noted that the link between Pillar 1 and Pillar 2 does not found on solid ground: the regional allocation of modulation depends ultimately on the historical distribution of Pillar 1 payments and on farm structures; moreover, resources coming from modulation often address “accompanying measure- like” interventions, for which expenditure is simpler and whose main objectives are internal to the primary sector (Osterburg, 2006).

⁸ About this specific issues, it is possible that the Commission takes into consideration a different schedule for the actual expenditure of resources coming from modulation, not following the n+2 module.

to spend in a effective way all the resources in the programmed time, even considering an extended period for them ($n+x>2$).

Said that, in the next pages the focus will be on the process of reinforcement of financial resources for pillar 2 coming from modulation. According to what the new regulation proposal says, the amount of resources raised with modulation will follow two main streams: the 5% cut (that is, the “old” mandatory modulation, net of the franchise) would return to the EU that will redistribute the resources among Member States according to a key that combines three elements: the share of labour in agriculture, the share of UAA and the GDP per capita⁹. All the rest of the modulation (the additional and the progressive modulation) would be used to create a sort of “national envelope” that would transfer resources from pillar 1 to pillar 2 within the same Member State. According to this complex mechanism, the redistributive effect of the new modulation is quite reduced, being it limited only to the original 5% cut of the direct payments and to the franchise. The contribution of modulation to pillar 2 and its effects are shown in the next tables. Table 7 reports the shares of resources according to their destination: it is worth noting how the share that returns to the EU to be redistributed according to the “objective criteria” reduces by time, while the national envelope increases: in 2012, at the EU level, 37% of the total modulation cut returns to the EU for redistribution and 63% is transferred to the Member States pillar 2, but only for addressing the “new challenges”.

Tab. 7 - Shares of modulation resources according to their destination

	2009		2010		2011		2012	
	EU	Envelope	EU	Envelope	EU/	Envelope	EU	Envelope
	%	%	%	%	%	%	%	%
Belgium	71,0	29,0	55,3	44,7	45,3	54,7	38,3	61,7
Denmark	69,5	30,5	54,4	45,6	44,7	55,3	37,9	62,1
Germany	59,1	40,9	47,8	52,2	40,1	59,9	34,6	65,4
Greece	71,4	28,6	55,5	44,5	45,4	54,6	38,4	61,6
Spain	67,2	32,8	53,0	47,0	43,7	56,3	37,2	62,8
France	70,3	29,7	54,9	45,1	45,0	55,0	38,1	61,9
Ireland	71,1	28,9	55,3	44,7	45,3	54,7	38,4	61,6
Italy	65,4	34,6	51,9	48,1	43,0	57,0	36,7	63,3
Luxemburg	71,8	28,2	55,8	44,2	45,6	54,4	38,6	61,4
Netherlands	70,5	29,5	55,0	45,0	45,1	54,9	38,2	61,8
Austria	70,3	29,7	54,9	45,1	45,0	55,0	38,1	61,9
Portugal	67,8	32,2	53,3	46,7	43,9	56,1	37,4	62,6
Finland	71,3	28,7	55,5	44,5	45,4	54,6	38,4	61,6
Sweden	70,0	30,0	54,7	45,3	44,9	55,1	38,1	61,9
United Kingdom	66,2	33,8	52,4	47,6	43,3	56,7	36,9	63,1
EU-15	66,6	33,4	52,6	47,4	43,5	56,5	37,0	63,0

Source: elaborations on EU data (2006)

⁹ The Health Check paper does not provide any information about the actual implementation of the modulation, so it is assumed here that the criteria will be exactly the same as indicated in the Reg. 1782/2003.

The shift of resources to pillar 2

The percentages of modulation may well change in the future and be set up at a much more conservative level, but the trend towards a progressive shift of resources from pillar 1 to pillar 2 is to be considered irreversible, after so much talking about it and notwithstanding the current preoccupations of the local administration about the extra-budget devoted to pillar 2 that needs to be managed on the RDPs.

Table 8 shows that the redistribution process activated by modulation in favour of pillar 2 is positive for Greece, Spain (the largest beneficiary given these rules of modulation), Italy, Netherlands, Austria, Portugal and Finland. In other words, the largest beneficiaries are the Mediterranean countries plus countries whose the farm structure is mostly characterised by small units. Of all the net contributors, the largest is by far France (around 650 million euro), followed by Germany (390,5 million euro) and United Kingdom (306 million euro). All in all, 13.6 billion euro are transferred to pillar 2 with modulation; such amount counterbalances what had been previously cut from the rural development budget during the financial perspective discussion for 2007-13. Of course, the distribution among countries is different from that following the financial decisions, for two reasons: firstly, the distribution criteria among countries is different; secondly, the NMS are included in the repartition of the resources for rural development, while will not be included in the modulation before 2013 (Mantino, 2005).

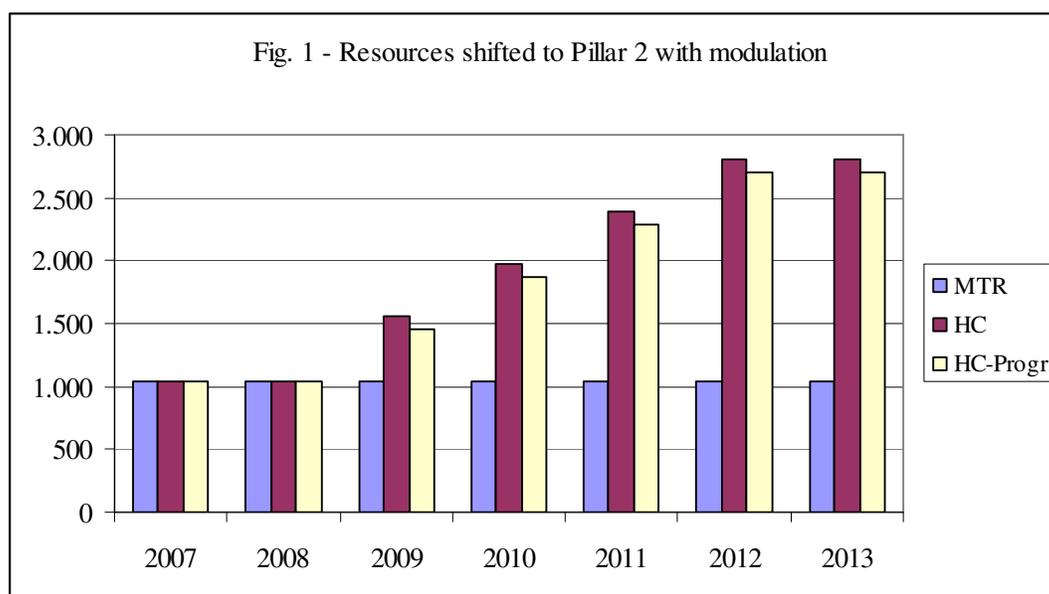
Table 8 - Distribution of resources coming from modulation (2007-13, Meuro)

	Cut	Redistr.	Envelope	Tot Mod	Balance
Belgium	196,2	72,7	87,6	160,3	-35,9
Denmark	449,1	123,6	203,3	326,9	-122,1
Germany	2669,2	937,8	1.340,9	2.278,7	-390,5
Greece	239,1	516,2	106,3	622,5	383,4
Spain	1708,9	1.344,9	791,2	2.136,2	427,3
France	3792,2	1.439,4	1.704,4	3.143,8	-648,4
Ireland	454,0	196,3	202,5	398,8	-55,2
Italy	1108,3	937,8	522,3	1.460,1	351,9
Luxemburg	15,0	7,3	6,7	13,9	-1,1
Netherlands	259,3	159,9	116,3	276,2	16,9
Austria	176,8	305,3	79,4	384,7	208,0
Portugal	190,4	356,2	87,7	443,9	253,5
Finland	162,0	130,9	72,1	203,0	41,0
Sweden	275,1	145,4	123,9	269,3	-5,8
United Kingdom	1913,9	712,4	894,9	1.607,4	-306,6
EU-15	13.609,4	7.269,8	6.339,6	13.609,4	0,0

Source: elaborations on UE data (2006)

In fig. 1 the comparison among the 2003 reform and the Health Check in terms of capacity to bring additional resources to pillar 2 is presented (2007-13). It is worth underlining that, in the case of the Fischler reform with a stable cut at 5% from 2007 to 2013, the additional resources for pillar 2 would amount to 14.2% of the total (51 billion euro),

while with the Health Check proposal they would reach 26.6%. In comparison to the version of modulation in Reg. 1782/2003 (that reached 7.280 million euro), the new proposal supplies an additional amount of resources equal to about 6.300 million euro for the EU-15. In the same figure it is also shown the possibility that the new modulation would not include the progressive component and be limited to the additional one. In that case, the total amount modulated would equal to slightly more than 13 billion euro (2007-2013). This shows how the progressive component of modulation does not alter significantly the total amount of resources shifted to pillar 2 (around 600 million euro in the whole period), but is launches an important signal into the direction of redistributive issues¹⁰.



In table 9 the additional resources for pillar 2 per Member State are reported, with a comparison with the current mandatory modulation (5%) and also with the hypothesis of the new modulation without the progressive component. Given the actual distribution of the funds for RDPs for the planning period 2007-2013, the additional resources coming from modulation modifies quite evidently the whole picture: with the Health Check proposal, in United Kingdom they represent 84.2% of the total funds, 73.4% in Denmark, 56.8% in the Netherlands, and so on; the lowest share are shown by Finland and Austria (both at 9.8%). Looking at the largest EU-15 countries, the situation is still quite heterogeneous: besides United Kingdom, France is at 48.8%, Italy at 17.6%, Germany at 28.1%. In any case, as was expected, the new modulation would generally increase the amount of resources shifted from pillar 1 to pillar 2. This can be seen as a positive trend if one shares the point of view of the

¹⁰ It is worth underlining that the progressive component of modulation does not alter the balance of modulation in terms of distribution, given that it is supposed to remain in the “national envelope”. The beneficiaries and the contributors are determined only by the basic component of modulation (5%) that is redistributed according to the “objective criteria”.

Commission and of many stake holders, but it is a heavy constraint according to supporters of pillar 1 and also to the managers of RDPs at the local level, that might consider a risk the over-concentration of resources on pillar 2¹¹. It is quite interesting to note that, all in all, the progressive element does not add many resources to pillar 2: most of the countries would remain at the same rate of additional resources, with the clear exceptions of Germany and United Kingdom. This means that the extra-burden of the progressive component of the new modulation would be borne by only two Member States. Such component, in conclusion, has a relevant political cope but not as much as an economic and redistributive one: this could give the negotiation a strong element to go in favour of a dismantling of the progressive component of modulation.

Table 9 - Comparison of resources added to RD (2007-13)

	RD	Mod. May 08		Mod. 2003
	(Meuro)	(%) tot.	(%) - prog.	(%)
Belgium	418,6	38,3	38,1	18,8
Denmark	444,7	73,5	72,0	33,1
Germany	8.112,5	28,1	24,7	12,5
Greece	3.707,3	16,8	16,8	11,8
Spain	7.213,9	29,6	28,8	17,6
France	6.442,0	48,8	48,3	24,6
Ireland	2.339,9	17,0	17,0	8,9
Italy	8.292,0	17,6	17,0	10,6
Luxemburg	90,0	15,5	15,5	8,0
Netherlands	486,5	56,8	56,4	30,0
Austria	3.911,5	9,8	9,8	6,8
Portugal	3.929,3	11,3	11,2	7,8
Finland	2.079,9	9,8	9,7	5,8
Sweden	1.825,6	14,8	14,6	8,1
United Kingdom	1.909,6	84,2	80,0	40,4
EU-15	51.203,4	26,6	25,6	14,3

Source: elaborations on UE data (2006)

Conclusions

The last fifteen years of CAP reforms have seen a progressive shift of the political focus from market tools to rural non-sector tools, even though the financial resources available for the two pillars are still quite uneven distributed. Presently, it is very hard to acknowledge pillar 1 as a market oriented set of policies and pillar 2 as a “pure” territorial one, for three main reasons. In no particular order, the first is the actual dismantling of market policies (still going on also with the Health Check proposal). The second has to do with the mix of policies under pillar 2, addressing different issues according to the logic of the Axes (sector-based, environmental, territorial). Finally, the third is the increasing level of integrations between the two pillars, so that it is more and more difficult to include one intervention into one or the other pillar. Moreover, in spite of the emphasis registered in all

¹¹ The increase of resources originated with modulation can be considered a problem also by National government that should co-finance measures in Pillar 2. The case and extent of co-financing resources coming from modulation is an issue currently under discussion.

the official papers of the EU about the need to enhance pillar 2 of the CAP, the results are quite disappointing, especially if one considers the budget cut borne in 2006.

Starting from Agenda 2000 and still in the most recent CAP reform proposal in 2007, modulation is by far the main instrument that shifts resources from the first to the second pillar of the CAP, being the other policies within some CMOs (tobacco and wine). Is such shift a good thing? The supporters of the traditional market policies would say it is not, mainly because it is a way to cut “certain” resources to farmers that return in a much more complicated way to the rural areas but not necessarily to the farmers and certainly not to those ones that bear the cut. On the other hand, the complex network created around the rural areas, made of local institutions, non government organisations, research institutions, groups of citizens and of farmers, environmental organisations and so on see very much in favour a progressive reinforcement of pillar 2 that overlaps also with a more decentralised management of the CAP expenditure and with a financial involvement of the national governments (co-financing).

From a more theoretical point of view, the whole process of reinforcement of pillar 2 should better be placed in a wider rethinking of the future of the CAP and the EU budget (Esposti, 2007; IEEP, 2007). The whole process of CAP reform seems to design two pillars whose boundaries are less and less clear and also more and more difficult to justify. As underlined before, the objectives and the instruments of both pillars tend to become similar, while the functioning and the financing rules are still quite different.

Coming to the specific tool of modulation, it still is the only active instrument of reinforcement of pillar 2, according to a logic that seemed to respond more to a temporary than to a stable financial mechanism. Looking at the latest version of modulation in the *Health Check* proposal, it is evident how modulation is moving from a “symbolic approach”, with a marginal cut of direct payments, to a more relevant one, that ensures, altogether, quite a relevant amount of resources to pillar 2, often increasing by a relevant amount the total resources available for the rural development policies.

With regards to modulation and the new Member States, it has to be underlined the specific features of the pillars in these countries, where the actual distribution of financial resources is rather different from the Fifteen and relatively in favour of the rural development policies. Given this picture, does modulation have a role in the new Member States? Given the redistribution effect of modulation, this could in the future become another cause of conflict among old and new Member States in terms of competition for resources (Henke and Storti, 2005).

In conclusion, looking at the more general issue of the distribution of resources among pillars, two aspects need to be underlined: one has to do with the instrument of modulation in itself; the other, more general, with the increase of resources for the policies within pillar 2 of the CAP. Modulation activates a flow of financial resources that basically depends on the distribution of the funds allocated for pillar 1: if the logic behind this is, on one hand,

understandable and to be supported to some extent, on the other it is hard to accept that the shape and the strength of one pillar is to depend on the other. As for the second aspect, as said earlier, the increasing overlapping of objectives, rules and mechanisms of the two pillars at this stage of the reform process would require a deeper debate about their future and, in a more general way, about the future and the scope of the financial resources of the CAP within the EU budget.

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