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European Modulation of Agricultural Direct Payments
Political framework and financial impact analysis of incremental modulation schemes [1]

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Abstract. This paper examines the ongoing financial reorientation of the Common Agricultural Policy (CAP) towards sustainable rural development programmes. The progressive attempt and implementation of direct payment limitations since the 1992 CAP reform has developed a "modulation mechanism" aiming to transfer funds from market support and direct payment schemes (CAP first pillar) towards rural development measures (CAP second pillar). Under the 2007-2013 European financial perspectives, the annual 5% rate of modulation is expected to increase. The paper focuses on the financial impacts of the various scenarios of such an expansion and on the political feasibility at European and national levels.

The paper imposes on itself three sound constraints: (i) expanding modulation should not jeopardize the future in-depth reform of direct payment regime, (ii) modulation should be compulsory and consistent with rural development financial needs, and (iii) direct payment per farm should not be capped or subject to complex and differentiated reduction rates. Then, the various scenarios analyzed in the paper suggest to adopt an increase in the modulation rate lower than the one mentioned by the European Commission when preparing the health check. A dynamic and uniform modulation rate to be increased by 1 percent per year from 2009 (2010 financial year) and then by 2 percent during the final step reaching 10 percent in 2012 (2013 financial year) would deliver certainty to farmers and ensure an efficient use in European spending, with no need for a controversial equity instrument.

Direct payments should be more efficiently targeted. In this perspective, revising article 69 of Council Regulation 1782/2003 is essential. The progressive remoteness of "historical references" in the national decoupling schemes combined with such a revision would contribute to challenge criticisms on support distribution within the first pillar. Reinforcing rural development programmes would above all require thorough amendments to CAP regulations leading from 2013 to a new paradigm in direct payment regime. This latter will raise subsidiarity and budgetary issues which should be discussed within the European budget review. Then from 2009, renewed European decision making process and actors should outline this new European policy. Since farmers are increasingly becoming entrepreneurs, the sooner an agreement on the CAP beyond 2013 is reached, the better.

Keywords. Common agricultural policy, direct payments, rural development, European budget

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1. Introduction

Direct payments make efficient monitoring and targeting of Common Agricultural Policy (CAP) main instrument possible. Policy makers are able to consider amounts (coupled or decoupled to production, based on historical or regional decoupling scheme, static or dynamic), criteria (respecting cross-compliance or providing specific amenities), and timing (presently 2007-2013 financial ceilings) of direct payments. As CAP follows a dynamic process, prompt adjustments are the purpose of the 2008 *health check*. Rural development or remuneration of amenities from farm and rural activities are put forward in order to legitimate a modern CAP. However there is still a deep imbalance between the first (market support and direct payments) and the second pillar (rural development measures) despite the current modulation mechanism which allows transfers of funds from the former towards the latter. Criticisms on distribution become all the more relevant when recipients of first pillar subsidies are involved. Direct payments, even decoupled, reflect historical policies that are inconsistent with modern society willingness and expected world market evolution. Furthermore, despite current trends in agricultural markets, European budgetary overruns may lead to mandatory direct payment cuts. *Health check* legislative proposals from the Commission to be released by 20.05.2008, may determine, among other issues, the magnitude and modalities of cuts in direct payments.

Beyond short-term adjustments, the most important feature of this 2008 *health check* is to bring the ongoing debate regarding European agricultural and rural policy to its near-settlement. With the 2008-2009 budget review, CAP mechanisms and objectives should be fully examined in order to prepare a new long-term policy starting in 2013. That said, what are the political feasibility and financial effects of various modulation schemes within the current financial perspectives (2007-2013), if there is a need to transfer higher amounts of European funds from first to second pillar?

The first section of the paper provides key information on the progressive implementation of modulation since the 1992 CAP reform. The second section draws up policy recommendations for modalities to be. The third section estimates and discusses the financial effects of the Commission's and European Parliament's latest proposals, and it offers two alternative scenarios. These four simulations increase compulsory modulation rate by 2009 (2010 financial year). Fourth section assesses accordingly budgetary reallocation between Members States of modulated amounts.

2. Modulation's progressive implementation in European direct support

Direct payments give policy makers a clear technical tool allowing them to better target public support. In order to value public goods supplied by rural areas and consider European society willingness as budgetary trade-offs, a reorientation of direct payments towards rural development

programmes appears *necessary*[2]. Though not a new concept, this mechanism is efficient in adjusting direct payments granted within a predetermined income support scheme. This section aims to understand past development in order to prepare the future.

Modulation term appeared in the CAP glossary with reflections of the Commission leading to the 1992 CAP reform. In February 1991, considering inequity in support distribution, the Commission anticipated that modulation was likely to dominate discussions[3]. The 1992 reform finally did not limit direct payments from cereal, oilseeds and protein crops via restrictions on set-aside compensation as initially put forward by the Commission. Also, capping the total amount a farm may receive, even if considered in first proposals, was withdrawn on the final reform due to the strong opposition of the United Kingdom and Germany (Barklay, 2002). However a maximal number of head was adopted for the main animal compensatory payments –i.e. special premium for male bovines and suckler cow premium.

Agenda 2000 (1999 CAP reform) widened the 1992 shift. Partial compensation by direct payments of agreed guaranteed price decreases impacted uniformly farm recipients. Again, the Commission failed in concretising an equity tool in direct payment allocation[4]. However, it succeeded in implementing a modulation principle[5], formally defined as the transfer of funds from first to second CAP pillar. It was then voluntary, by up to 20%, and aimed at funding specific rural development accompanying measures[6]. Targeted farmers had to respect at least one of three criteria regarding (i) labour force used

[2] There is a vast literature on this, cf. for instance Chatellier V., Daniel K., Colson F., (2002); Guyomard H., Le Bris K. (2003) or Swinbank A., Tranter R. (2004).

[3] The Commission underlined: "*The argument that the modulation measures are discriminatory is somewhat misleading insofar as it is based on a rather strange concept of equality. The diversity of agricultural structures in the Community is such that farmers are not on an equal footing. In such conditions the logic of support through public funds aim at correcting inequalities by supporting those who derive fewer advantages from the market organizations. This aim is reflecting in Article 39 of the Treaty. It is the market organizations as they function now that are discriminatory. Insofar as the bigger and more intensive the farm the grater the support, a situation which should not apply were competitiveness to be the object. The argument in relation to the anti-economic nature of the modulation of support measures in not valid either*" (European Commission, 1991a).

[4] Under a *ceiling* article –which was in fact an abuse of the language –the total amount of direct payments granted to a farm exceeding 100 000 euros would be reduced by 20% for the part between 100 000 and 200 000 euros, by 25% for the part exceeding 200 000 euros. Due to German and British oppositions, this *ceiling* provision included in 18.03.1998 Commission legislative proposals was not adopted. However it corresponds to the first formal proposal of compulsory degressive modulation "*in order to take account for economics of scale and to avoid high payments to single beneficiary*" (Official Journal of the European Communities, 1998). The Agenda 2000 communication of 16.07.1997 from the Commission already proposed "*the introduction of an individual ceiling covering all direct income payments granted under the common market organizations*" without giving precise details about modalities (European Commission, 1997).

[5] Cf. article 4, Council Regulation 1259/1999 of 17.06.1999.

[6] These measures, as defined under Council Regulation 1257/1999 of 17.06.1999, consider early retirement (articles 10-12), less favoured areas and environmental restrictions (articles 13-21), agricultural methods proptecting the environment and maintaning the countryside (articles 22-24) and afforestation of agriclutual lands (article 31).

on their holding, (ii) standard gross margin evolution of their holding and/or (iii) total amount of direct payment received (uniformity of treatment).

Only the United Kingdom and France applied this provision but in different ways. France opted for an individual rate leading to internal frictions. French authorities considered the three criteria through the addition of a flat and progressive rate[7]. Microeconomic impacts of such a French mechanism were roughly low[8], releasing 145.9 million euros per year[9]. They financed a targeted contract for farmers (*Contrat Territorial d'Exploitation* or *CTE*) aiming at supporting rural development and environmental amenities within farm activities. French voluntary modulation stopped in 2002 due to complex computation criteria (fostering farmers' criticisms), election of a conservative government close to farm lobbying and lack of CTE signed[10]. By contrast since 2001, the United Kingdom implements a uniform rate at regional level (cf. *infra*).

Mid Term Review (MTR) of the Agenda 2000 made the modulation compulsory[11]. Further to the MTR Commission proposals in June 2002[12] and January 2003[13], the Luxembourg agreement (2003

[7] Cf. *Décret* n°2000-280 of 24.03.2000. For an exhaustive explication of French implementation of voluntary modulation, cf. Chatellier and Kleinhanss (2002).

[8] According to a simulation done by the Ministry of agriculture and fisheries, the French aggregated modulation rate would reach 1.9%. At the *départemental* level, it would oscillate between 0% and 6.7% (intensive cereal-specialized *départements* being the main affected). Modulation would allow a redistribution of support between and within *départements*. It would hit 9% of French farms. The same study estimated a 0.2% loss in French farm account (while loss at the *départemental* level from voluntary modulation would vary from 0% to 2.5%).

[9] Direction des Affaires Financières, Service Central des Enquêtes et Etudes Statistiques, Sous-direction des Synthèses Statistiques et des Revenues, Bureau Comptes et Revenus, 17.11.1999. Simulation de la modulation des aides directes à partir de l'enquête sur la structure des exploitations de 1997.

[10] Following the 2002 Presidential election, the new French Minister of agriculture and fisheries suspended the modulation scheme justifying the decision as following: "*The criteria for modulation are complicated, including for farmers themselves, who also consider, often justly, that the reduction is inequitable: even with equal income, some are touched, others are not. Besides, almost all the money collected over two years has up until now remained unused (215 million euros). The previous government was discussing with the Commission co-financing projects with this sum, but the rules negotiated at the time block the use of credits*" (Barclay, 2002).

[11] One of the MTR's triple objectives was "*to provide a better balance of support and strengthen rural development by transferring funds from the first to the second pillar of the CAP via the introduction of an EU-wide system of modulation and expanding the scope of currently available instruments for rural development to promote food quality, meet higher standards and foster animal welfare*" (European Commission, 2003a).

[12] It introduced from 2004, a dynamic modulation scheme reducing progressively all direct payments by 3% per year reaching 20 % at the maximum. In order to consider labour force, a 5 000 euro franchise would be applied for farms employing up to 2 full time annual working units. For each additional employed annual working unit, the franchise would be increased by some 3 000 euros. Once applied modulation, there would be a 300 000 euro ceiling in direct payment per farm. In order to target specific needs (without giving more precise details) spending released by such a dynamic modulation would be redistributed among Member States on the basis of corresponding agricultural area, agricultural employment and a prosperity criterion (gross domestic product per capita in purchasing power). Those released by the 300 000 euro ceiling would stay within generating Member States.

[13] The second proposals maintained the main features than the previous ones but established significant changes regarding both dairy sector and dynamic modulation (Guyomard and Le Bris, 2003). It introduced from 2006 a dynamic modulation scheme reducing progressively all direct payments from 1% per year to 19% in 2012. A 5000 euro franchise would be systematically applied. 2002 MTR's proposals regarding complex franchise related to labour force on the one hand, direct payment ceiling per farm on the other hand, was therefore

CAP reform) made a compromise between the two previous MTR proposals[14]. It did not ceil direct payment a farm may receive. It introduced a compulsory modulation, for all direct payments from the first pillar, with a uniformed flat rate of 3% (in 2005), 4% (in 2006) and 5% (from 2007 to 2012). A 5 000 euro franchise (free of charge for every holding but creating a kind of low-threshold effect) exempts of any modulation farmers receiving less than 5 000 euros a year. Every Member State receives at least 80% of the modulated amount he generates. A special provision for Member States with high proportion of rye within national production allows them to keep at least 90% of the modulated amount. This specificity was introduced to favour Germany, largest European budget contributor. Remaining amounts are re-allocated between Member States according to the three criteria of the MTR proposals. Finally, since the beginning of the MTR process, it was agreed that European outermost regions[15] shall be exempted of any modulation along with new Member States before homogeneity in payment level (in 2013, 2016 for Bulgaria and Romania).

Compulsory sector-based financial transfers were agreed on April 2004 for tobacco CMO and cotton support scheme[16]. Beyond uniformed modulation, the aim of these articles[17] is to reorient a share of direct payments (taking into account, as for decoupled payments, a 2000-2002 reference period) towards rural development programmes implemented in respective production areas. These specific measures are granted in addition to decoupled payments (fully decoupled for tobacco from 2010, partially decoupled for cotton from 2006). In fact, these targeted financial reallocations, and corresponding budgetary shifts from European Agricultural Guarantee Fund (EAGF) towards European Agricultural Fund for Rural Development (EAFRD), aim directly at restructuring specialized production areas with contractual programmes.

Voluntary sector-based direct payment reorientation, in discretionary addition to compulsory modulation (from 2003 reform) and cotton and tobacco financial reorientation (from 2004 reform), have been introduced with the 2003 CAP reform. Article 69 of Council Regulation 1782/2003 allowed Member States to adopt sector-based reorientation by using up to 10% of national sector-based ceilings in order to grant corresponding sectors with additional payments for "*specific types of farming*

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dropped. From 2007, a dynamic and differentiated rate would be applied for holding receiving between 5 001 and 50 000 –i.e. from 3% to 12.5%, and for holdings receiving more than 50 001 –i.e. from 4% to 19%. In fact, the modulation rate, as a percentage of direct payment reduction in order to finance rural development measures, would be similar for all holdings receiving more than 5 000 euros per year –i.e. from 1% to 6%. It would be the contribution (degressive rate) in order to finance future reform on common market organizations (CMOs) which would officially differ between holdings receiving less or more than 50 000 euros.

[14] Cf. article 10, Council Regulation 1782/2003 of 29.09.2003.

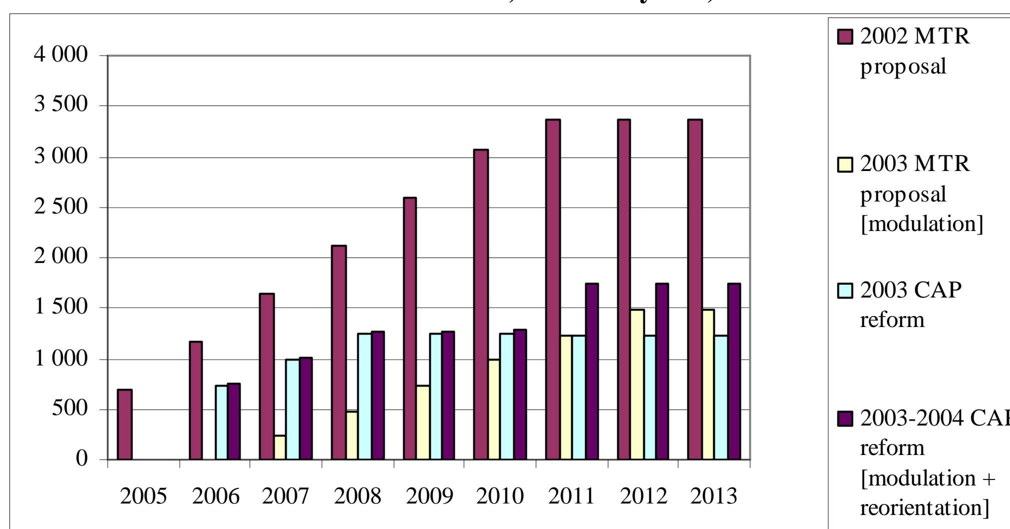
[15] French overseas *départements*, the Azores and Madeira, the Canary and Aegean islands are European outermost regions.

[16] There is no CMO for cotton. The reform of support for cotton, tobacco, hops, olive (table and oil) was negociated together and included in the same Regulation (Council Regulation 864/2004 of 29.04.2004) also known as the "Mediterranean package".

[17] Cf. articles 143d and 143e, Council Regulation 1782/2003 of 29.09.2003.

which are important for the protection or enhancement of the environment or for improving the quality and marketing of agricultural products"[18]. By being coupled to limited type of production, these payments remain part of the first pillar (and corresponding EAGF) in spite of targeted element inherent to second pillar measures (and corresponding EAFRD). Huge flexibility is still given to Member States regarding sustainable rural development measures financed by this mechanism. Seven countries and one European region[19] use article 69, independently of the adopted decoupling model (cf. Annex 1). Regarding subsidies to olive groves (2004 reform), Member States were allowed to withhold up to 10 % of respective direct payment ceilings in order to finance working programmes on quality and environmental items established by producer organisations[20]. Three countries applied article 110i(4)[21].

Figure 1.
Comparison of modulated payments from 2002 and 2003 MTR proposals, 2003 and 2004 CAP reforms, financial years, million euros



Source: Author's calculations from Guyomard and Le Bris (2003); European Commission (2003b), Commission Decision 2006/410/EC.

Far from being more ambitious than the two previous MTR proposals, the compromise made in June 2003 corresponds to the compulsory modulation commencement. It opens new perspectives for CAP development in the long-term by reflecting a strong European shift (Henke and Sardone, 2003). While 2002 MTR proposal was reorienting the largest fraction of CAP expenditures towards the second pillar, 2003 MTR proposal cut deeper first pillar direct payments (cf. Figure 1). Indeed, by the end of the final step regarding both 2002 MTR Proposal (in 2010) and 2003 MTR Proposal (in 2012) a quasi-corresponding amount of direct payments would be cut (roughly 3.3 billion euros). However, the second proposal, by making funds available to finance CMOs reform within the first pillar, would less

[18] Cf. article 69, Council Regulation 1782/2003 of 29.09.2003.
[19] Finland, Greece, Italy, Portugal, Slovenia, Spain, Sweden and Scotland (UK) apply article 69.
[20] Cf. article 110i(4), Council Regulation 1782/2003 of 29.09.2003.
[21] France, Greece and Italy apply article 110i4.

reinforce second pillar. The 2003 CAP Reform reallocated the whole modulated amount from first to second pillar.

3. The state of the (dis)union

Building a consensus on a common framework which suits to 15 or 27 heterogeneous Members States has always been a complex process. National and regional specifities are highlighted in this section in order to draw some policy recommendations.

3.1. The facts

Even if payment ceiling by farm carries a sound political signal in terms of equity, it has never been implemented[22]. On the one hand, some States would be particularly affected by this provision regarding historical or institutional specificities. On the other hand, it would lead to discriminate larger farms guided by economies of scale policy, to thwart farm businesses' plans, and would distort competition.

Table 1.
Number and percentage of holdings receiving more than 100 000, 300 000 or 500 000 euros per year in direct payments, 2005 financial year

class-size	Germany	UK	Italy	Spain	France	Portugal	9 other MSs	EU15 total
holdings x>100 000	5 310	6 100	2 290	2 720	3 560	590	1 720	22 290
x>300 000	1 660	420	290	220	40	30	80	2 740
x>500 000	720	90	110	80	10	10	30	1 050
% EU15 x>100 000	23.8%	27.4%	10.3%	12.2%	16.0%	2.6%	7.7%	100.0%
x>300 000	60.6%	15.3%	10.6%	8.0%	1.5%	1.1%	2.9%	100.0%
x>500 000	68.6%	8.6%	10.5%	7.6%	1.0%	1.0%	2.9%	100.0%

Source: European Commission (2007a)

As presented in Table 1, roughly 60% of holdings receiving more than 300 000 euros a year are German and 94.5% come from only 4 countries[23]. Also, degressive rate with brutal threshold, as

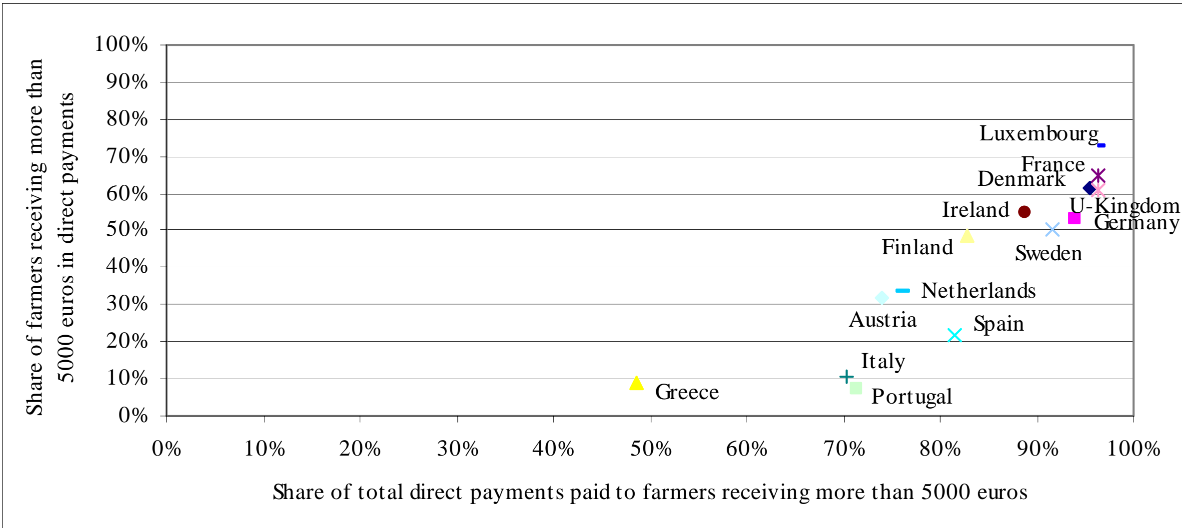
[22] In other respects, support limits by person are implemented in the United States since 1970. The 2002 Farm Bill (the coming Farm Bill being still in negotiation between the US House and the Senate) set a 360 000 US dollars ceiling which results from the addition of a 80 000 US dollar ceiling in direct payments, a 130 000 US dollar ceiling in cyclical payments and a 150 000 US dollar ceiling in marketing loans (the latter into practice is unlimited due to specific provisions). Moreover payments to farm with an adjusted gross income higher than 2.5 million US dollars are prohibited if 75% or less of the latter comes from no-farming activities (Monke, 2006).

[23] Larger German holdings are often the heritage of collective farms from the former German Democratic Republic. British liberalism culture historically fosters holding size increase. On the other side, in order to maintain family farms (through small and medium size farms), French administration micro-manages the size and viability of holdings with *Sociétés d'Aménagement Foncier et d'Etablissement Rural* (SAFER) and *Contrôles des Structures*. SAFER control the land market (notably through pre-emption rights) and farm restructurings. *Contrôles des Structures* tightly monitor, in each *département*, farm installations as well as existing farm size's reductions and increases.

included in 2003 MTR proposal, could not be sustainable[24]. It would lead some farms to change their legal structure or split their holding in order to bypass discretionary thresholds.

Member States are affected in a different way by the 5 000 euro franchise (cf. Figure 2). It is directly correlated to heterogeneous farm structures and previously biased-distribution of direct payments. It highlights countries with a relative high share of small farms (e.g. Greece where less than 10% of farms which receive half of total direct payments are affected by modulation) and the reverse (e.g. France where more than 60% of farms which receive 96.5% of total direct payments are affected).

Figure 2.
Share of farms and direct payment amounts affected by modulation
2005 financial year



Source : European Commission (2007a).

Regarding redistribution issues, areas traditionally specialised in products historically eligible to high direct payments (mainly cereal, oilseeds and protein crops) shall be confronted to larger cuts. These areas shall maintain a fraction of the modulated amount if they are involved in rural development programmes as part of *national strategy plans.* The Luxembourg agreement allows a tiny redistribution from intensive arable crop and livestock producing-areas towards more extensive and/or mountainous areas. The inter-Member States redistribution is restrained by the guarantee for each Member State to retain at least 80% of the modulated amount (cf. *supra*). It is however a positive step regarding environmental and cohesion effects. Budget return consideration (e.g. Germany, largest contributor to European budget) and the willingness of maintaining previous CAP expenditure distribution among Member States (e.g. France, largest beneficiary of CAP spending) prevented a higher redistribution of modulated amount (roughly one eighth of the total amount). It emphasizes

[24] For instance, two neighbours initially obtaining annual payments of, say, 49 000 and 51 000 euros would see their payments in 2012 reduced to, respectively, 43 500 and 42 260 euros –i.e. the formerly higher-paid farmer would, following such a payment reduction scheme, receive less than the previously lower-paid farmer.

close links between CAP and budget issues as highlighted in the statement of the 2008-2009 budget review[25].

Finally, regarding voluntary modulation schemes, the sharp opposition of the European Parliament jeopardizes this alternative. Since March 2007, the use of voluntary modulation no higher than global 20% cut is strictly limited[26]. Only the United Kingdom and Portugal are respecting one of the two criteria enabling the use of such a scheme. The former was the only Member State already implementing voluntary modulation at the entry into force of the 2007 Council Regulation[27]. The latter granted exemption on co-funding criteria regarding rural development measures[28]. Given the strong opposition over voluntary modulation by the European Parliament, no other exceptions shall be granted in the future (cf. Annex 2).

3.2. The lessons

Except for the 5 000 euro franchise integrated in modulation mechanism, and in spite of previous Commission proposals, improving equity in direct payment scheme has never been put into practice. Distribution issue within the first pillar has been concealed by distribution issue between the two pillars. Previous developments allow us to list policy recommendations regarding both distributional matters. Direct payment per farm shall not be capped or be subject to complex and distinctive modulation rates. Modulation shall consider a minimum amount franchise, avoid any threshold effects and be compulsory. Any further increase in the compulsory rate shall be reflected by a corresponding decrease in voluntary ones. Financial reallocation between Members States of modulated amounts is a sensitive issue which is going to be examined in the fourth section of this paper. Last but not least, highlighting huge possibilities in sustainable rural development funding provided by article 69 of Council Regulation 1782/2003 would be most appropriate.

Modulation mechanism challenges distribution matters between pillars. Those within the first one shall be partially sorted out by national implementation of decoupling scheme and by a revised article 69. This latter has no effect on the European budget and allows targeted measures funding. However, the use of such an article is presently unlikely because decoupling schemes are already implemented.

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[25] "*The European Council therefore invites the Commission to undertake a full, wide ranging review covering all aspects of EU spending, including the CAP, and of resources, including the UK rebate, to report in 2008/9. On the basis of such a review, the European Council can take decisions on all the subjects covered by the review. The review will also be taken into account in the preparatory work on the following Financial Perspective*" Brussels European Council of 15-16.12.2005.

[26] Cf. Council Regulation 378/2008 of 27.03.2007.

[27] In 2006, voluntary modulation rates in England, Wales, Scotland and Northern Ireland were fixed at 6%, 0.5%, 4.5% and 4.5%; in 2007 they reached 12%, 0%, 5% and 5% respectively.

[28] Council Regulation 1944/2006 of 19.12.2006 exempts Portugal from the co-financing requirement on rural development measures for a 320 million euro amount. For information, only 8.7% of Portuguese holdings in 2005 financial year receive more than 5 000 euros and therefore are affected by modulation.

Moreover the 10% of national ceiling criteria and the re-affectation to sectors affected by the retention are excessively restrictive and limit the proficiency of this article[29].

Previous recommendations, *ceteris paribus*, will not jeopardize a further in-depth reform of direct payment regime. Indeed, the key issue must be CAP reform and targeted direct payments, not modulation scheme adjustments.

4. Competing scenarios on upcoming modulation scheme

By making funds available from first to second CAP pillar, modulation progressively increases rural development spending while respecting budgetary constraints. This section will first take into account funding struggles on 2007-2013 financial period and the CAP *health check* launch, and then estimate and discuss official and alternatives modulation scenarios within the current financial perspectives.

4.1. Institutional framework and opening debate

Following an informal agreement between France and Germany, the Brussels European Council of 24-25.10.2002 established a budgetary ceiling for the 2007-2013 financial perspectives: CAP first pillar expenditures shall be kept below 2006 amount[30]. Inflation shall give no more than a (single) 1% annual increase. In order to respect such a limitation, a financial discipline mechanism shall adjust (reduce) direct payments. This budgetary ceiling not increased in 2004[31] after the adhesion of 10 new Member States or following enlargement. Annual national ceilings on direct payments have been introduced later. Rural development expenditures of the 27 Member States are exempted of any decrease as well as direct payments for the 12 new Member States.

The inter-institutional agreement of 16.05.2006[32], enabled Member States to prepare their own national rural development programmes but stated far below the EU Commission financial proposal[33]. Regarding current price estimations, funds allocated to the 2007-2013 second CAP pillar are fixed 21.7% below the Commission Proposal. Considering compulsory modulation and financial transfers from cotton and tobacco direct payment reorientation, rural development fund is still 11.6% below the Commission request.

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[29] In the November 2007 Communication preparing for the *health check* (*cf infra*), the European Commission mentions twice the possibility of a revised article 69.

[30] These amounts had been previously established by the Berlin European Council of 24-25.03.1999.

[31] Cf. the conclusion of the Copenhagen European Council of 12-13.12.2002.

[32] Resulting from the agreement at the Brussels European Council of 15-16.12.2005 on the 2007-2013 financial perspectives.

[33] On January 2006, the Commissioner for agriculture and rural development, Mariann Fischer Boel admitted that she was "*disappointed by the amount of money available for Rural Development*" and "*under the budget deal, expenditure in the EU-27 in 2013 will be roughly the same as the 2006 level for EU25 - around about 11 billion euros.*" (Mariann Fisher Boel, Challenges for EU Agriculture Policy in 2006, Grüne Woche, 12.06.2006, Speech 06/03, Berlin).

On 20.11.2007, the Commission initiated the *health check* by providing a communication preliminary to legislative proposals expected by 20.05.2008[34]. In the attempt to strengthen the second pillar, it plans to increase annually and uniformly by 2% compulsory modulation rate from 2009 (2010 financial year) and to prepare the implementation modulation mechanism in new Member States.

Table 2.
Uniform modulation rates suggested by Nov. 2007 EC Communication on the CAP *health check*

payment size / financial year	2010	2011	2012	2013
x< 5 000 € *status quo*	0% *0 %*	0% *0 %*	0% *0 %*	0% *0 %*
x> 5 001 € *status quo*	7% *5 %*	9% *5 %*	11% *5 %*	13% *5 %*

In addition to spending redistribution between pillars, the November 2007 Communication focuses on distribution within the first pillar. It considers upper and lower limits on individual direct payments. It also introduces a degressive system as equity tool[35]. Large payments "*by way of example*" between 100 000 and 200 000 euros would be reduced by 10% in addition to uniform modulation, between 200 000 and 300 000 euros by 25%, above 300 000 euros by 45%.

Table 3.
Degressive modulation rate in addition to uniform modulation for 2010-2013 financial period suggested by Nov. 2007 EC Communication on the CAP *health check*

payment size	upper cut
100 001 €<x<200 000 €	10%
200 001 €<x<300 000 €	25%
x>300 001 €	45%

On 11.03.2008 plenary session, the European Parliament adopted a report on the CAP *health check.* Without excluding a further deepening of modulation scheme, it rejects an up to 8% increase as put forward by the Commission[36]. Regarding large payments, it suggests a soft "*progressive modulation".* Payments from 10 000[37] to 100 000 euros, 100 000 to 200 000 euros, 200 000 to 300 000 euros and above 300 000 euros would be, in addition to already agreed 5% modulation rate, reduced by respectively 1%, 2%, 3% and 4%.

[34] Cf. European Commission (2007b).
[35] The Communication considers also introducing a minimum of payment per holding or increasing the minimum area requirement which allows direct payments.
[36] "*In view of the already drastic nature of individual reductions, a further reduction in direct payments of 8% cannot, in absence of an impact assessment, be accepted*" (European Parliament, 2008).
[37] Small farm consideration legitimates a 5 000 euro franchise whereas medium-size farm consideration would activate progressive modulation for payments above 10 000 euros. Considering these discretionary thresholds, it must be highlighted that correlating wealth or class of holdings to direct payment size is not most pertinent.

Table 4.
Progressive modulation for 2010-2013 financial period envisaged by EP Report on the CAP *health check* (Rapporteur: Lutz Goepel)

payment size	modulation rate
x <5 000 €	0%
5 001 €<x< 10 000 €	5%
10 001 €<x< 100 000 €	6%
100 001 €<x< 200 000 €	7%
200 001 €<x< 300 000 €	8%
x> 300 001 €	9%

Despite its sole consultative role regarding CAP issues, the European Parliament may play a significant role during the CAP *health check.* It seems inclined to offset substantial differentiated cuts in direct payments as previously put forward by the Commission[38]. For an overview of the current European Commission and Parliament statements on compulsory modulation with an historical perspective, please refer to Annex 3. The Treaty of Lisbon will give more importance to European Parliament through the extension of co-decision procedures. However, under the hypothesis of an agreement on CAP *health check* before the end of 2008[39], the Commission (proposition and execution) and the Council of Ministers (decision) remain the two relevant bodies. In addition MEPs will be associated with all stages of the 2008-2009 budget review.

4.2. Financial outcomes from competing scenarios

Four extra-modulation scenarios are run assuming that during the 2008 CAP *health check* an agreement over increasing modulation within the 2007-2013 financial perspectives is reached. Cuts in direct payments would start by 2009 and then would be allocated to rural development funds from 2010 financial year. There is systematically a 5 000 euro franchise in order to privilege support for small farms[40] (even if this provision is in fact a lump amount applied to any direct payment recipient). Indicative figures on the distribution of direct payments, by holding class-size of amount received, are those from 2005 financial year (paid from 16.10.2004 to 15.10.2005). Direct payment national amounts in 2010, 2011, 2012 and 2013 financial years are taken from Council Regulation 319/2006 of 20.02.2006[41].

[38] Draft legislative proposals for the *health check* widespread in 2008 winter are consistent with the European Parliament's sight on progressive modulation. Cf. for instance Agra Facts (28.02.2008) and Agra Europe Weekly (6.03.08). During the 2010-2013 financial period, in addition to the up to 8% compulsory modulation rate increase, payments between 100 000 and 200 000 euros would be reduced by 3%, between 200 000 and 300 000 euros by 6%, above 300 000 euros by 9%.
[39] It is planned to conclude the *health check* under the French EU Council Presidency, thus before the implementation of the Treaty of Lisbon (once ratified by each of the EU Member States) and before the 2009 European Parliament elections and new Commission appointment.
[40] In the presented financial impact assessment, upper cuts (i.e. equity tool) is applied to the remaining direct payments – i.e. once applied uniform modulation rate and paid back the franchise.
[41] Regulation 319/2006 amends Regulation 1782/2003 establishing common rules for direct support schemes under the CAP (2003 reform), especially national ceilings referred to annex VIII.

EC2007 scenario considers November 2007 Communication from the Commission preparing for the *health check*: a dynamic and uniform modulation rate increasing by 2 % per year reaching 13% in 2013 plus an equity tool. EP2008 scenario considers March 2008 Report from the European Parliament on the CAP *health check*, settled by MEP Lutz Goepel: a uniform modulation rate status quo (5%) plus an equity tool. Two alternative scenarios are experienced. First alternative scenario (ALT1 scenario) considers the same increase configuration in modulation rate than the November 2007 Communication one plus a lower equity tool[38]. Second alternative scenario (ALT2 scenario) considers an increase in modulation rate of 1% per year and 2% during the final reaching thus 10% in 2013 without any equity tool.

Table 5.
Scenarios' specifications

Competing dynamic and uniform modulation rate for payments above 5000 euros
Uniform modulation rate by financial year

financial year / **scenario**	**EC2007**	**EP2008** and Status Quo	**ALT1**	**ALT2**
2010	7%	5%	7%	6%
2011	9%	5%	9%	7%
2012	11%	5%	11%	8%
2013	13%	5%	13%	10%

Competing upper cuts i.e. equity tools
Degressive/Progressive additional modulation rate for the 2010-2013 financial period

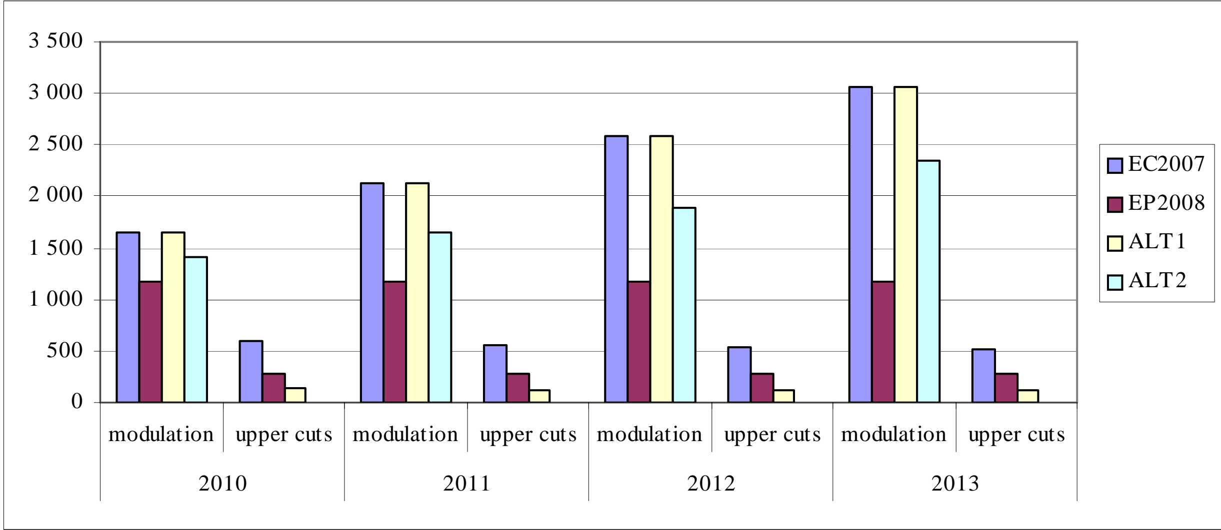
payment size / **scenario**	**EC2007**	**EP2008**	**ALT1**	**ALT2**
x <5 000 €	0%	0%	0%	0%
5 001 €<x< 10 000 €	0%	0%	0%	0%
10 001 €<x< 50 000 €	0%	**1%**	0%	0%
50 001 €<x< 100 000 €	0%	**2%**	0%	0%
100 001 €<x< 200 000 €	**10%**	**3%**	**3%**	0%
200 001 €<x< 300 000 €	**25%**	**4%**	**6%**	0%
x> 300 001 €	**45%**	**5%**	**9%**	0%

Considering methodology limits[42], amounts mentioned below have to be used with precaution. However orders of magnitude are consistent. For full results of these scenarios, please refer to

[42] Six limits regarding empirical analysis should be highlighted. First, this static analysis does not consider direct payment redistribution induced by national decoupling implementation neither holding restructurings. Also, this analysis does not consider sector-based impacts or effects on production, incomes and production processes. It is therefore assumed that the distribution by size of payment for the 2005 financial year is maintained until 2013. The same limit is valid regarding upper cuts schemes. Second, as CMOs are separately reformed, distributional data consider the following "new" schemes: dairy premium (partial implementation), aid for energy crops, area payment for starch potatoes and for nuts. Distribution effects from CMO reform modalities implemented after 2004 are therefore excluded. SFPs are not already implemented. Third, distributional data used exclude some sectors where direct payments are paid to producer associations and not directly to final beneficiary as in the case of premiums for tobacco and bananas amounting in 2005 to 905 millions and 175 millions euros respectively (European Commission, 2007a). Fouth, British and Portuguese voluntary modulations are not taking into account. Fifth, amended national ceilings from annex VIII of Regulation 1782/2003 are considered as total direct payments by Member States. Sixth, cuts due to potential financial discipline mechanism are excluded.

Annexes 4 and 5. Roughly 74% of EU15 direct payment beneficiaries receive annually less than 5 000 euros. These 75% receive 13.5% of EU15 direct payment total amount. In other words, modulation is applied to 26% of EU15 holdings which receive more than 85% of EU15 direct payment total amount. For the 2010-2013 period, EC2007, EP2008, ALT1 and ALT2 scenarios would cut EU15 direct payments by respectively 8.4%, 4.2%, 7.2% and 5.3%. Differentiating uniform modulation and equity tool, the former would cut EU15 direct payments by 6.8%, 3.4%, 6.8% and 5.3%, the latter by further 1.6%, 0.8% and 0.4% respectively (cf. Figure 3).

Figure 3.
Total amount made available to EAFRD by financial year, million euros



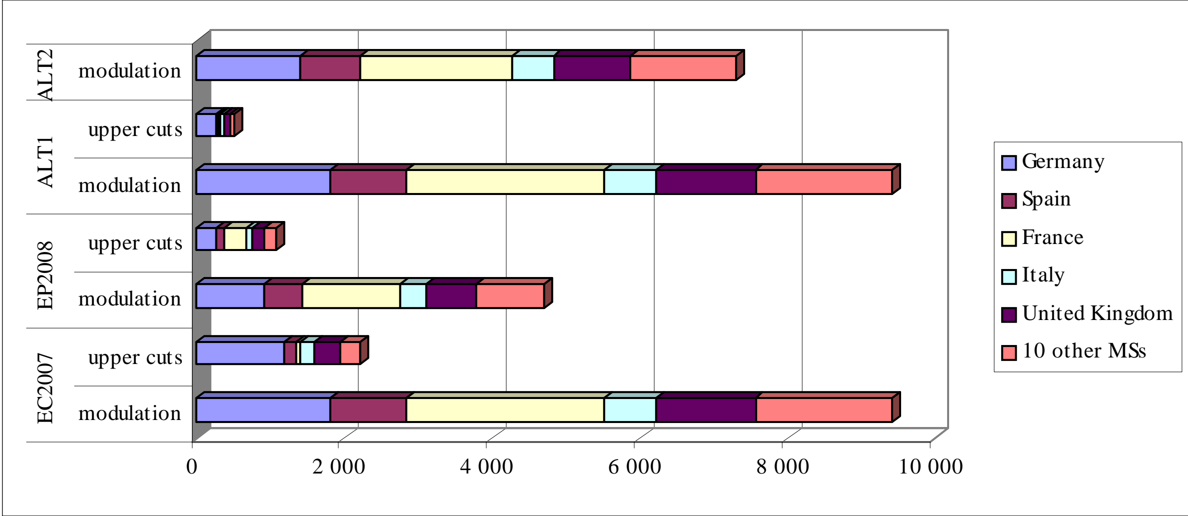
For further details, please refer to Annex 4.
Source : Official Journal of the European Union (2006), European Commission (2007a), Author's calculations.

Member States would be affected in different proportions regarding both uniform modulation and upper cuts. For the 2010-2013 financial period, main affected countries by the modulation would be France, Germany, the United Kingdom, Spain and Italy with a reduction representing respectively 28.3%, 19.3%, 14.2%, 10.9% and 7.6% of the total European modulated amount (cf. Figure 4). Indeed, these 5 Member States obtained in 2005 more than three forth of total direct payment paid to EU15 Member States.

Considering upper cuts, Germany and the United Kingdom would be the main countries affected by EC2007 (*and ALT1*) scenarios with respectively 53.1% (*51.6%*) and 15.2% (*16.5%*) of total equity tool cuts. In opposition, amount reduced by this mechanism in France would accordingly represent 3.0% (*3.5%*). The thorough effects of EC2007 upper limits would lead to a 2.2 billion euro reduction in 4 years (1.6% of total EU15 direct payments) when ALT1 scenario induce a 0.5 billion euros for the same period (0.4% of total EU15 direct payments). Bearing in mind criticisms against formal ceilings even if EC2007 scenario would exclude any threshold effect (*cf. supra*), economic and social impacts

of tangible discriminatory mechanism in the one hand, unbalance national results in the other hand would jeopardize its implementation. The latter argument is also valid considering ALT1 scenario.

Figure 4.
Total amount made available to EAFRD by Member State, 2010-2013 financial period, million euros



For further details, please refer to Annex 4.
Source : Official Journal of the European Union (2006), European Commission (2007a), Author's calculations.

Seeing that progressive modulation from EP2008 scenario is softer and starts with payments over 10 000 euros, national impacts are closed to those from uniform modulation. France would be the main affected country followed by Germany, the United Kingdom, Spain and Italy with cuts representing respectively 26.7%, 24.4%, 15.7%, 10% and 7.3% of EU15 total reduction. This proportionate outcome may have been the starting point of the European Parliament position, associated with a roughly low global financial impact (1.1 billion euros or 0.8% of EU15 total direct payments). By maintaining a uniform modulation to holding receiving more than 5 000 euros a year, ALT2 scenario would not be confronting to such frictions. Total amount released would be one fourth higher than European Parliament option, impartially spread between Member States as well.

4.3. On the efficient use of savings

Before providing budgetary allocations, concrete budgetary needs are required. It is tricky to select which scenario would effectively be able "*to make a further strengthening of the second pillar, in particular in the light of current constraints that Member States are facing due to the cut in their expected rural development support after the 2005 decision on the financial perspectives*" (European Commission, 2007b). As explained previously the Brussels European Council of 15-16.12.2005 or more precisely the latter 2006 inter-institutional agreement fixed an amount 21.7% below the Commission expectations –i.e. 11.6% when considering adjustments that followed. How to determine accurate amount that would fill the gap between 2007-2013 rural development's 2004 Commission financial proposals and effective allocation? "Uncovered" funds would vary from 4.3 billion euros

(2007-2010 proposal basis) to 9.4 billion euros (2010-2013 proposal basis) with an average of 6.7 billion euros (2007-2013 proposal basis). Regarding EC2007, EP2008, ALT1 and ALT2 scenarios, outcomes for the 2010-2013 period would reach respectively 11.6 billion euros, 5.8 billion euros, 9.9 billion euros and 7.3 billion euros. In addition to the 2003 reform's commitments (annual modulation rate of 5%) they would increase global modulated amount for the 2010-2013 financial period by respectively 147%, 23%, 111% and 55% (cf. Annex 5). Huge differences between Member States would characterize EC2007 scenario (German and Dutch modulated amounts would increase by 229.1% and 242.1%, French and Greek's by 104.9% and 104.5%). National absolute differences would be notably lower with EP2008 and ALT1 scenarios though still existing. Only ALT2 scenario would affect uniformly percentage increase by Member States with a 55% for the whole 2010-2013 period.

All the outcomes provided by these scenarios might appear useless because no concrete budgetary requirements are presently defined. Wide challenges' identification (e.g. climate change) deserves programmes' specification prior to credits' allocation. Considering the previous rural development programming period (2000-2006), 72% of funds allocated to EU15 was effectively spent (with national differences, from 49% for Greece to 85% for Finland). Co-financing criteria and restrictions regarding eligible programmes and areas in the one hand, minimum spending criteria in the other hand, jeopardize finest application of rural development measures. However such restrictive conditions, efficiently managed and monitored, allow an obvious co-responsibility at EU and national/regional levels. They may guarantee that European funds act for European objectives. This remark shall also be considered in article 69 improvement. Member States which applied this provision could discretionarily decide the type of supported farming and the condition of financing. Amending the 10% national ceiling criteria and allowing a cross-sector reallocation are expected. The use of the revised article shall be flexible within a common framework. This latter shall be consistent with the redefinition of programmes' and pillars' objectives and substance[43].

Funds released rapidly by extra-modulation may interfere already established rural development's *national strategy plans* for the 2007-2013 period. Increasing European funds for rural development shall induce an increase in national expenditures. Therefore decreasing co-financing rate for Member States would release national expenditures. In the farthest, some measures or axes could be integrally financed by European funds (e.g. measures from axe 2 which deal with environmental and land management issues, including areas with physical and natural handicaps). By contrast, the present keeping out co-financing principle granted to first pillar spending may not be irreversible. However,

[43] By instance, due to CMOs and WTO law evolution, do risk management programmes shall still be part of the second pillar? Should they not be considered as modern market stabilization tools within a renewed first pillar? If so, should a revised article 69 allow financing such schemes?

dealing with co-financing rates has to be part of a more general agreement on European budget as planed after the CAP *health check*. This sensitive issue is already specified in a declaration by the European Parliament included in the 2006 inter-institutional agreement which "*considers it would be useful to assess the issue of co-financing of agriculture in the context of the 2008-09 review*". By not being mistaken regarding the coming European calendar and by considering short-term commitments, it argues in favour of a lower increase in modulation rate than those included in EC2007 and ALT1 scenarios.

5. Financial reallocations between Member States

Should savings from direct payment reduction stay in the generating Member State or be reallocated to others? Due to the unbalanced distribution of direct payments between Member States and the total amount involved, this sensitive question has always been related to direct payment reduction. This section aims at assessing financial reallocation among Members States produced by the four previous modulation schemes.

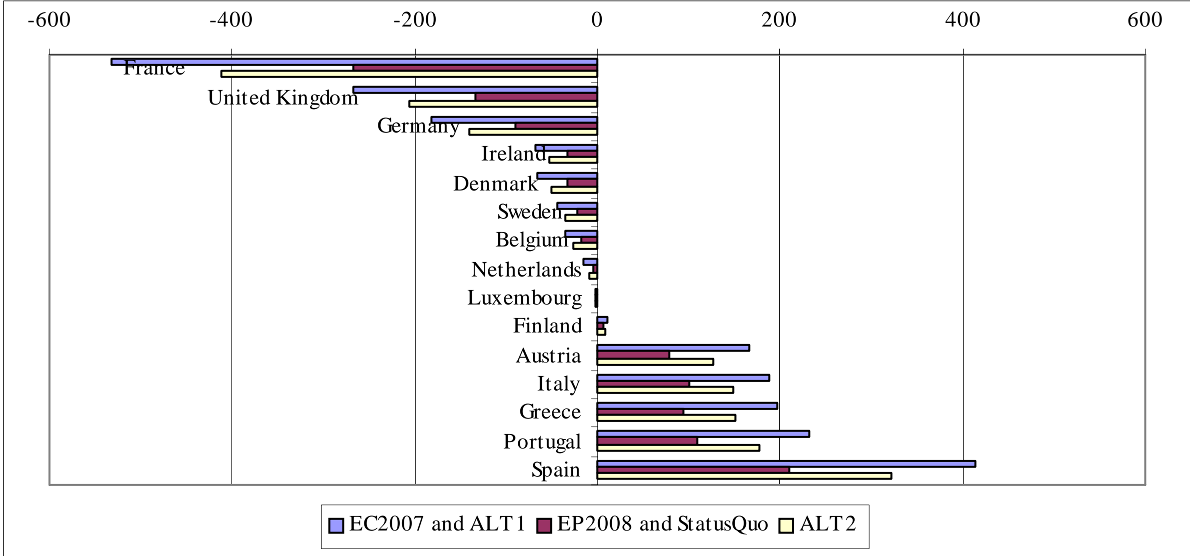
The 2003 reform introduced restrictive provisions inducing a tiny financial redistribution. In fact, each Member State keeps automatically one-percentage-point of the total modulated amount he generates[44]. The remaining amount is then allocated among Member States in accordance with national agricultural area, agricultural employment and gross domestic product per capita in purchasing power. This allocation key involves historical EU15 Member States only since new ones are excluded from the modulation mechanism until the completion of the *phasing-in* period. Furthermore an adjustment mechanism ensures each Member State to maintain at least 80% of the national modulated amount (90% for Germany).

An algorithm optimization is able to estimate inter-Member States financial redistribution. First, the corresponding one-percentage-point has to be applied to modulated amount generated by Member States. The remaining amount has then to be redistributed between them according to the allocation key. This latter is therefore the first constraint of the optimization model. Iterations are run considering the second constraint, ensuring a Member State receive at least 80% of the national modulated amount (90% for Germany). National returns of corresponding modulated amount is thus divided in three sub-amounts resulting from the three previous restraints –i.e. one-percentage-point, allocation key and adjustment from 80%/90% bound (cf. Annex 6). Simulations exclude financial transfers from tobacco CMO and cotton support scheme because amounts reoriented towards the second CAP pillar from these provisions are maintained within generating production areas. As amounts released by upper cuts

[44] In other words, the one-percentage-point criteria retains 20% of national modulated amount when a 5% rate is applied, it retains 7.7% of total amount generated when a 13% modulation rate is applied.

would stay within the generating Member State's funds, equity tools would have no reallocation effect and are therefore excluded from the simulations.

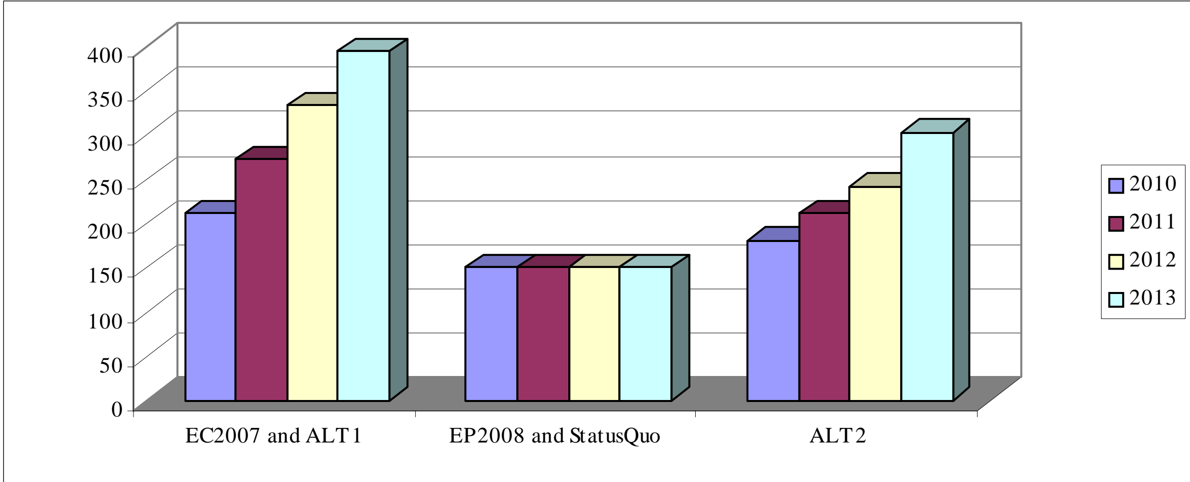
Figure 5.
Financial gains and losses by Member States from modulation scenarios, 2010-2013 financial period, million euros



For further details, please refer to Annex 6.
Source : Council of the EU (2003),OJEU (2006), European Commission (2007a), Author's calculations.

France, as the historical largest beneficiary of CAP spending, is the country most affected by financial reallocation. Spain, Greece and Portugal are the main beneficiaries of the redistribution process (cf. Figure 5) which total amount increases according to the expanding of modulation rate (cf. Figure 6).

Figure 6.
Total amount redistributed among Member States by financial year, million euros



Source : Council of the EU (2003),OJEU (2006), European Commission (2007a), Author's calculations.

Due to the one-percentage-point criteria and the minimum return of 80%/90%, an average of 30% of the amount generated by any modulation scheme is directly retained by the initiator Member State. Therefore 70% are allocated among Member States according to key principle. The minimum return rate is systematically activated for 7 countries (Belgium, Denmark, Germany, France, Ireland, Luxembourg and the United Kingdom) while 2 countries benefit from a percentage return higher than 200% (Austria and Portugal).

All scenarios present an effective financial reallocation rate of 12.7%-12.9% of the total modulated amount. Including new Member States in allocation key from 2013 may contribute to partially rebalance financial support between Member States. However altering modalities of financial reallocation shall face offensive interest and therefore has to be part of a more general agreement on the European budget. On the one hand, increasing the global remaining rate would give more incentives for extra-modulation to traditional countries which beneficiate from CAP spending. On the other hand it would partially freeze the current inter-national distribution and create crucial disadvantages mainly for new Member States. *Health check* does not to deal with this issue or strike a bargain on a sound CAP reform. Are viable at short-term, EP2008 scenario which outcomes are identical to those from a status quo as well as ALT2 scenario which moderated modulation rate does not induce a huge break in the already agreed picture.

To conclude this section, current reallocation's provisions limit the financial redistribution of CAP spending between Member States. However modulated amount which has to be returned to the initiator Member State remains a sensitive political concern for national/regional governments. Once again, it entails systemic budgetary consideration and how budget review exercises an influence over the main CAP instrument reform.

6. Concluding remarks

By introducing targeted recipients, direct payments permit a transition from past market-distorting CAP towards structural adjustment policy –a policy which remunerates positive externalities from farm and rural activities. The implementation of compulsory modulation with the 2003 reform opened a more general reorientation of CAP spending from first towards second pillar. In order to give farmers certainty and ensure an efficient use of spending, a deep increase of modulation rate shall not occur within the current financial perspectives. Nevertheless, a slight one shall rather respect budgetary ceilings and be consistent with the progressive implementation of a new policy set than truly strengthen the CAP second pillar. A dynamic and uniform modulation rate increasing by 1% per year from 2009 (2010 financial year) and 2% during the final step reaching 10% in 2012 (2013 financial year), exempted of any controversial equity instrument, would emerge as a balanced compromise.

In addition, by preventing any budgetary loss for Member States, by financing targeted sustainable productions and by allowing a partial redistribution of funds within the first pillar, opportunities provided by a revised article 69 shall be strongly considered. Reinforcing European rural development programmes would induce thorough amendments to the Council Regulation 1698/2005, along with a redefinition of each pillar's core. It would consequentially raise budgetary and subsidiarity systemic issues.

This development would not jeopardize a further in-depth reform of direct payments. Associated to strict cross-compliance, a sound modulation applied to current SFPs (and coupled subsidies) or an innovative direct payment regime shall consider the contractual time-bound remuneration of public goods. Thus characterizing these elementary European public goods and associating a price to their supply appear as a minimum basis for *common* direct payments in the future, and also as a prerequisite to any budget reform. From 2009, renewed European decision making processes and actors shall start to set up an original paradigm in direct payments that should be implemented thoroughly beyond 2013. Ahead of short term adjustment considerations, the CAP *health check* already launched a debate around the next European Sustainable Agricultural, Food and Rural Development Policy.

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Annex 1
Voluntary implementation of targeted direct payments

Table A1.1.
Application of article 69 by Member State/region and sector, Council Regulation 1782/2003 of 29.09.2003

(1) % of the component of national ceiling corresponding to each sector referred,
(2) maximum direct payments granted in accordance with article 69 (million euros, 2007 calendar year)

	2003 SFPs model	arable crops and rice	beef and veal	sheep and goat	dairy	tobacco	cotton	olive oil	sugar	all sectors
Finland	reg.H	2.1%	10%							2.8%
	partial	5.8	10.1							16.0
Greece	hist.	10%	10%	5%		2%		4%	10%	5.8%
	full*	47.3	8.8	12.6		7.6		22.2	2.2	100.8
Italy	hist.	8%	7%	5%					8%	5.2%
	full*	141.7	28.7	8.7					8.2	187.2
Portugal	hist.	1%	1%	1%				10%	10%	2%
	partial	2.0	1.7	0.6				5.7	1.1	11.1
Slovenia	reg.		10%							5%
	partial		3.0							3.0
Spain	hist.		7%		10%	5%	10%		10%	2.5%
	partial		55.0		19.8	2.4	13.4		17.6	108.1
Sweden	reg.H									0.45%
	partial									3.4
Scotland (UK)	hist.		10%							0.8%
	full		29.8							29.8

reg.= regional model of SFPs
reg.H = regional hybrid model of SFPs
hist. = historical model of SFPs
full = full decoupling from 2003 reform (except the use of article 69)
full* = full decoupling from 2003 reform (except for seeds and the use of article 69)
partial = partial decoupling from 2003 reform
Source: European Commission, overview of direct payment under the CAP in Member States, version November 2007
Official Journal of the European Union (2006, 2007), Author's calculations.

Table A1.2.
Application of article 110i(4) by Member State, Council Regulation 1782/2003 of 29.09.2003

(1) % of the national ceiling corresponding to olive groves' environmental and social scheme,
(2) maximum direct payments granted in accordance with article 110i(4)(million euros, 2007 calendar year)

	2003 SFPs model	olive oil
France	hist.	10%
	partial	0.6
Greece	hist.	2%
	full*	11.1
Italy	hist.	5%
	full*	36.0

Abbreviations and Source: cf. Table A1.1.

Annex 2.
Voluntary modulation rates in UK and Portugal by year in addition to 5% compulsory modulation rate

financial year	England	Northern Ireland	Scotland	Wales	Portugal
2008	12%	5%	5%	0%	0%
2009	13%	6%	8%	2.5%	10%
2010	14%	7%	8.5%	4.2%	10%
2011	14%	8%	9%	5.8%	10%
2012	14%	9%	9%	6.5%	10%
2013	14%	9%	9%	6.5%	10%
5 000 euro franchise	no	no	no	no	yes

Source: AgroNotícias (4.06.2007), DEFRA Communication (12.06.2007).

Annex 3.
Compulsory percentage reduction in direct payments: Proposals vs Adoption 2013 financial year

direct payment size	EC1998*	EC2002**	EC2003***	**2003 CAP reform**	EC2007	EP2008
x <5 000 €	0%	0%	0%	**0%**	0%	0%
5 001 €<x< 10 000 €	0%	20%	12.5%	**5%**	13%	5%
10 001 €<x< 50 000 €	0%	20%	12.5%	**5%**	13%	6%
50 001 €<x< 100 000 €	0%	20%	19%	**5%**	13%	6%
100 001 €<x< 200 000 €	20%	20%	19%	**5%**	23%	7%
200 001 €<x< 300 000 €	25%	20%	19%	**5%**	38%	8%
x> 300 001 €	25%	100%	19%	**5%**	58%	9%

* Legislative proposals from the Commission introduced voluntary modulation and compulsory degressive modulation (amounts in ECU). Agenda 2000 only implemented the former.
** In order to consider labour force, a 5 000 euro franchise would be applied for farms employing up to 2 full time annual working units. For each additional employed annual working unit, the franchise would be increased by some 3 000 euros. Therefore no reduction in direct payment may be occur for holdings receiving more than 5 000 euros.
*** The EC2003 figures sum the percentage of direct payment reduction in order to finance development measures (the modulation rate would be similar for all holdings receiving more than 5 000 euros per year : 6%) and the percentage of direct payment reduction in order to finance future reform on common market organizations (the reduction rate would differ for holdings receiving less or more than 50 000 euros: 6.5% applied to the former, 13% applied to the latter).

EC1998: Communication from the European Commission regarding legislative proposals for Agenda 2000 in March 1998.
EC2002: "Mid term review of the Agenda 2000" proposals from the Commission in June 2002.
EC2003: "Mid term review of the Agenda 2000" proposals from the Commission in January 2003.
2003 CAP reform: Luxembourg agreement on CAP reform adopted in June 2003.
EC2007: Communication from the European Commission preparing for the *health check* on the CAP reform in November 2008.
EP2008: Report from the European Parliament on the CAP *health check* (Rapporteur: Lutz Goepel) adopted in March 2008.

For more details on each proposal/scheme, please refer to the body of the text.

Annex 4.
Cuts in direct payments by scenario and Member State, 2010-2013 financial period, million euros

	EC2007		EP2008		ALT1		ALT2
	modulation	upper cuts	Modulation	upper cuts	modulation	upper cuts	modulation
Belgium	**176.5**	**3.5**	**88.2**	**15.7**	**176.5**	**0.9**	**136.8**
share in EU15 cut	*1.9%*	*0.2%*	*1.9%*	*1.4%*	*1.9%*	*0.2%*	*1.9%*
effective reduction	*7.2%*	*0.1%*	*3.6%*	*0.6%*	*7.2%*	*0.0%*	*5.6%*
Denmark	**328.7**	**62.7**	**164.3**	**39.1**	**328.7**	**14.1**	**254.7**
share in EU15 cut	*3.5%*	*2.8%*	*3.5%*	*3.6%*	*3.5%*	*2.8%*	*3.5%*
effective reduction	*8.0%*	*1.5%*	*4.0%*	*0.9%*	*8.0%*	*0.3%*	*6.2%*
Germany	**1 816.4**	**1 171.8**	**908.1**	**265.1**	**1 816.4**	**258.4**	**1 407.7**
share in EU15 cut	*19.3%*	*53.1%*	*19.3%*	*24.4%*	*19.3%*	*51.6%*	*19.3%*
effective reduction	*7.9%*	*5.1%*	*3.9%*	*1.1%*	*7.9%*	*1.1%*	*6.1%*
Greece	**201.9**	**4.0**	**100.7**	**10.0**	**201.9**	**0.9**	**156.4**
share in EU15 cut	*2.1%*	*0.2%*	*2.1%*	*0.9%*	*2.1%*	*0.2%*	*2.1%*
effective reduction	*2.8%*	*0.1%*	*1.4%*	*0.1%*	*2.8%*	*0.0%*	*2.2%*
Spain	**1 027.1**	**167.1**	**513.5**	**108.7**	**1 027.1**	**38.2**	**796.0**
share in EU15 cut	*10.9%*	*7.6%*	*10.9%*	*10.0%*	*10.9%*	*7.6%*	*10.9%*
effective reduction	*5.9%*	*1.0%*	*2.9%*	*0.6%*	*5.9%*	*0.2%*	*4.6%*
France	**2 662.9**	**65.1**	**1 331.3**	**289.9**	**2 662.9**	**17.3**	**2 063.7**
share in EU15 cut	*28.3%*	*3.0%*	*28.3%*	*26.7%*	*28.3%*	*3.5%*	*28.3%*
effective reduction	*8.0%*	*0.2%*	*4.0%*	*0.9%*	*8.0%*	*0.1%*	*6.2%*
Ireland	**336.9**	**4.5**	**168.5**	**28.2**	**336.9**	**1.3**	**261.1**
share in EU15 cut	*3.6%*	*0.2%*	*3.6%*	*2.6%*	*3.6%*	*0.3%*	*3.6%*
effective reduction	*6.3%*	*0.1%*	*3.1%*	*0.5%*	*6.3%*	*0.0%*	*4.9%*
Italy	**718.6**	**192.8**	**358.9**	**79.7**	**718.6**	**43.6**	**556.7**
share in EU15 cut	*7.6%*	*8.7%*	*7.6%*	*7.3%*	*7.6%*	*8.7%*	*7.6%*
effective reduction	*5.0%*	*1.3%*	*2.5%*	*0.5%*	*5.0%*	*0.3%*	*3.8%*
Luxembourg	**11.4**	**0.1**	**5.7**	**1.0**	**11.4**	**0.0**	**8.9**
share in EU15 cut	*0.1%*	*0.0%*	*0.1%*	*0.1%*	*0.1%*	*0.0%*	*0.1%*
effective reduction	*7.7%*	*0.1%*	*3.9%*	*0.7%*	*7.7%*	*0.0%*	*6.0%*
Netherlands	**194.2**	**138.0**	**97.1**	**23.0**	**194.2**	**28.3**	**150.5**
share in EU15 cut	*2.1%*	*6.3%*	*2.1%*	*2.1%*	*2.1%*	*5.7%*	*2.1%*
effective reduction	*5.7%*	*4.0%*	*2.8%*	*0.7%*	*5.7%*	*0.8%*	*4.4%*
Austria	**136.1**	**13.2**	**68.1**	**9.1**	**136.1**	**2.8**	**105.5**
share in EU15 cut	*1.4%*	*0.6%*	*1.4%*	*0.8%*	*1.4%*	*0.6%*	*1.4%*
effective reduction	*4.6%*	*0.4%*	*2.3%*	*0.3%*	*4.6%*	*0.1%*	*3.5%*
Portugal	**128.5**	**21.1**	**64.3**	**14.9**	**128.5**	**5.4**	**99.6**
share in EU15 cut	*1.4%*	*1.0%*	*1.4%*	*1.4%*	*1.4%*	*1.1%*	*1.4%*
effective reduction	*5.7%*	*0.9%*	*2.8%*	*0.7%*	*5.7%*	*0.2%*	*4.4%*
Finland	**121.6**	**1.0**	**60.8**	**8.0**	**121.6**	**0.2**	**94.2**
share in EU15 cut	*1.3%*	*0.0%*	*1.3%*	*0.7%*	*1.3%*	*0.0%*	*1.3%*
effective reduction	*5.4%*	*0.0%*	*2.7%*	*0.4%*	*5.4%*	*0.0%*	*4.2%*
Sweden	**219.5**	**26.3**	**109.8**	**22.9**	**219.5**	**6.1**	**170.1**
share in EU15 cut	*2.3%*	*1.2%*	*2.3%*	*2.1%*	*2.3%*	*1.2%*	*2.3%*
effective reduction	*7.2%*	*0.9%*	*3.6%*	*0.8%*	*7.2%*	*0.2%*	*5.6%*
United Kingdom	**1 334.9**	**336.1**	**667.6**	**170.0**	**1 334.9**	**82.8**	**1 034.6**
share in EU15 cut	*14.2%*	*15.2%*	*14.2%*	*15.7%*	*14.2%*	*16.5%*	*14.2%*
effective reduction	*8.4%*	*2.1%*	*4.2%*	*1.1%*	*8.4%*	*0.5%*	*6.5%*
EU-15	**9 415.1**	**2 207.3**	**4 706.9**	**1 085.4**	**9 415.1**	**500.4**	
effective reduction	*6.8%*	*1.6%*	*3.4%*	*0.8%*	*6.8%*	*0.4%*	
sum	**11 622.5**		**5 792.3**		**9 915.5**		**7 296.5**
effective reduction	*8.4%*		*4.2%*		*7.2%*		*5.3%*

For scenario specification, please refer to Table 5 along with the body of the text.

Source : Official Journal of the European Union (2006), European Commission (2007a), Author's calculations.

Annex 5

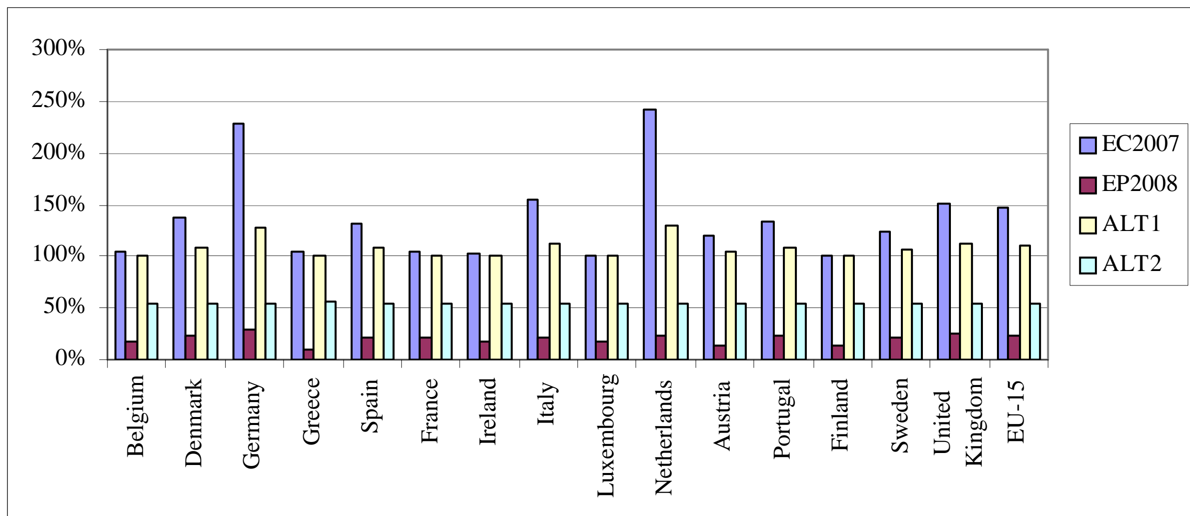
National compulsory increases in 2010-2013 direct payment reorientation: Scenarios vs. 5% Status Quo

Table A5.1.
Percentage increase in direct payment cuts by Member State, status quo basis, 2010-2013 financial period

	EC2007	EP2008	ALT1	ALT2
Belgium	104.0%	17.8%	101.0%	55%
Denmark	138.1%	23.8%	108.6%	55%
Germany	229.1%	29.2%	128.5%	55%
Greece	104.5%	9.9%	101.5%	55%
Spain	132.6%	21.2%	107.4%	55%
France	104.9%	21.8%	101.3%	55%
Ireland	102.6%	16.7%	100.7%	55%
Italy	153.9%	22.2%	112.3%	55%
Luxembourg	101.4%	18.1%	100.4%	55%
Netherlands	242.1%	23.7%	129.1%	55%
Austria	119.3%	13.4%	104.2%	55%
Portugal	132.8%	23.1%	108.5%	55%
Finland	101.5%	13.2%	100.3%	55%
Sweden	124.0%	20.9%	105.6%	55%
United Kingdom	150.3%	25.5%	112.4%	55%
EU-15	146.9%	23.1%	110.7%	55%

For scenario specification, please refer to Table 5 along with the body of the text.
Source : Official Journal of the European Union (2006), European Commission (2007a), Author's calculations.

Figure A5.1.
Percentage increase in direct payment cuts by Member State, status quo as reference, 2010-2013 financial period



For scenario specification, please refer to Table 5 along with the body of the text.
Source : Official Journal of the European Union (2006), European Commission (2007a), Author's calculations.

Annex 6.

Financial reallocation from modulation scenarios by Member State, 2010-2013 financial period, million euros

Member State / *scenario*	modulated amount	national return of the modulated amount: 1 percentage point	allocation key	adjustment	gain/loss	percentage return
Belgium						
EC2007 and ALT1	176.5	17.6	73.7	49.8	-35.3	80.0%
EP2008 and StatusQuo	88.2	17.6	34.2	18.8	-17.6	80.0%
ALT2	136.8	17.6	55.9	35.8	-27.4	80.0%
Denmark						
EC2007 and ALT1	328.7	32.9	117.9	112.2	-65.7	80.0%
EP2008 and StatusQuo	164.3	32.9	54.6	44.0	-32.9	80.0%
ALT2	254.7	32.9	89.4	81.5	-50.9	80.0%
Germany						
EC2007 and ALT1	1 816.4	181.6	904.1	549.0	-181.6	90.0%
EP2008 and StatusQuo	908.1	181.6	418.8	216.9	-90.8	90.0%
ALT2	1 407.7	181.6	685.8	399.4	-140.8	90.0%
Greece						
EC2007 and ALT1	201.9	20.1	378.3	0.0	196.5	197.3%
EP2008 and StatusQuo	100.7	20.1	175.2	0.0	94.7	194.0%
ALT2	156.4	20.1	286.9	0.0	150.7	196.3%
Spain						
EC2007 and ALT1	1 027.1	102.7	1 339.3	0.0	414.9	140.4%
EP2008 and StatusQuo	513.5	102.7	620.4	0.0	209.6	140.8%
ALT2	796.0	102.7	1015.9	0.0	322.7	140.5%
France						
EC2007 and ALT1	2 662.9	266.3	1 339.9	524.2	-532.6	80.0%
EP2008 and StatusQuo	1 331.3	266.3	620.7	178.1	-266.3	80.0%
ALT2	2 063.7	266.3	1016.4	368.3	-412.7	80.0%
Ireland						
EC2007 and ALT1	336.9	33.7	187.2	48.6	-67.4	80.0%
EP2008 and StatusQuo	168.5	33.7	86.7	14.4	-33.7	80.0%
ALT2	261.1	33.7	142.0	33.2	-52.2	80.0%
Italy						
EC2007 and ALT1	718.6	71.8	835.9	0.0	189.2	126.3%
EP2008 and StatusQuo	358.9	71.8	387.2	0.0	100.1	127.9%
ALT2	556.7	71.8	634.1	0.0	149.1	126.8%
Luxembourg						
EC2007 and ALT1	11.4	1.1	4.7	3.3	-2.3	80.0%
EP2008 and StatusQuo	5.7	1.1	2.2	1.3	-1.1	80.0%
ALT2	8.9	1.1	3.5	2.4	-1.8	80.0%
Netherlands						
EC2007 and ALT1	194.2	19.4	160.2	0.0	-14.6	92.5%
EP2008 and StatusQuo	97.1	19.4	74.2	0.0	-3.5	96.4%
ALT2	150.5	19.4	121.5	0.0	-9.6	93.6%
Austria						
EC2007 and ALT1	136.1	13.6	288.6	0.0	166.1	222.1%
EP2008 and StatusQuo	68.1	13.6	133.7	0.0	79.3	216.5%
ALT2	105.5	13.6	218.9	0.0	127.1	220.5%

Member State *scenario*	modulated amount	national return of the modulated amount			gain/loss	percentage return
		1 percentage point	allocation key	adjustment		
Portugal						
EC2007 and ALT1	128.5	12.9	348.1	0.0	232.4	280.8%
EP2008 and StatusQuo	64.3	12.9	161.2	0.0	109.8	270.9%
ALT2	99.6	12.9	264.0	0.0	177.3	278.0%
Finland						
EC2007 and ALT1	121.6	12.2	120.7	0.0	11.3	109.3%
EP2008 and StatusQuo	60.8	12.2	55.9	0.0	7.3	111.9%
ALT2	94.2	12.2	91.5	0.0	9.5	110.0%
Sweden						
EC2007 and ALT1	219.5	22.0	143.6	10.1	-43.9	80.0%
EP2008 and StatusQuo	109.8	22.0	66.5	0.0	-21.3	80.6%
ALT2	170.1	22.0	108.9	5.2	-34.0	80.0%
United Kingdom						
EC2007 and ALT1	1 334.9	133.5	690.0	244.4	-267.0	80.0%
EP2008 and StatusQuo	667.6	133.5	319.6	80.9	-133.5	80.0%
ALT2	1 034.6	133.5	523.4	170.7	-206.9	80.0%
EU 15						
EC2007 and ALT1	9 415.1	941.4	6 932.2	1 541.5	0.0	100.0%
EP2008 and StatusQuo	4 706.9	941.4	3 211.2	554.3	0.0	100.0%
ALT2	7 296.5	941.4	5258.4	1096.7	0.0	100.0%

For scenario specification, please refer to Table 5 along with the body of the text.
Source : Council of the EU (2003),OJEU (2006), European Commission (2007a), Author's calculations.