MODULATION OF PAYMENTS UNDER THE COMMON AGRICULTURE POLICY (CAP) PRE – "CAP HEALTH CHECK"[1]

This Quick Guide gives a historical picture of modulation up to the CAP Health Check taking place in 2008. See the Members' Research Service research paper *EU Common Agricultural Policy: 2008 CAP Health Check*[1] for details.

Background

Modulation is a way of redistributing money within the CAP[2] without increasing the overall budget. Direct payments to farmers under pillar 1 of the CAP (through for example, the Single Farm Payment) are reduced and the receipts are made available to support rural development activities, for example, community initiatives and agri-environment schemes, under pillar 2 of the CAP. At the EU level, modulation on a voluntary basis was introduced in 2001. From the outset, the UK has applied modulation with France and Germany also making short-term use of the voluntary regime.

Within the UK, each of the 4 constituent countries has a Commission approved Rural Development Plan (RDP)[3], reflecting the constitutional settlement for devolved administrations. From 2001 to 2004, a uniform rate of voluntary modulation applied across the UK where the receipts generated were ring-fenced to support agri-environment measures under axis 2 (maintaining and protecting the environment and rural heritage) of the current Rural Development Plans.

Compulsory Modulation

Under the CAP reform agreement of June 2003, given legal effect in Council Regulation 1782/2003, compulsory modulation was applied across the 15 Member States of the European Union (EU 15) from 2005. The rate was set at 3 per cent for that year, rising to 4 per cent in 2006 and then to 5 per cent from 2007 onwards.

Transitional measures were agreed (Commission Regulation 1655/2004), in recognition of the position within the UK, that, with the introduction of compulsory modulation from 2005, a Member State could apply additional modulation to continue to generate receipts to support RDP measures that had been approved by the Commission by December 2005. This agreement provided that the additional modulation regime could apply at a regional level.

Use of Modulation in Wales up to 2007

For Wales, this has meant that overall modulation was set at the rate of 4.5 per cent for both 2005 and 2006 (with the compulsory element at 3 per cent and 4 per cent respectively). The receipts generated were targeted on agri-environment measures under

[1] Members' Research Service Research Paper 08/007, *EU Common Agricultural Policy: 2008 Health Check*, February 2008
[2] The Common Agricultural Policy (CAP) is one of the most important EU policies and is made up of two "Pillars". Pillar 1 encompasses market support measures (such as the Single Payment Scheme) and direct subsidies to EU producers (farmers), while Pillar 2 supports rural development programmes, including Tir Gofal. For further information on the CAP, see Chapter 2 of the European Union – Second Report, ordered by the House of Lords, 6 June 2005
[3] National Assembly for Wales, Rural Development plan for Wales 2000-2006 The Rural Development Plan for Wales 2007-2013 was formally approved by the European Commission's Rural Development Committee on 20 Feb 2008.

axis 2[4] of the current Rural Development Plan and, in particular, to take forward an expanded agri-environment agenda under Tir Gofal and Tir Cynnal.

Modulation is designed to enable the delivery of an overall balanced package for rural development by allowing funds to be shifted between the two pillars of the CAP within the financial limits set by the EU. For the 2007-2013 Rural Development Plan, it has been possible to make funding available for agri-environment activities (axis 2) whilst at the same time enabling resources from the European Agricultural Guidance and Guarantee Fund (EAGGF)[5] to be deployed under axes 1 (creating stronger agriculture and forestry sectors) and 3 (improving the economic competitiveness of rural communities and areas) of the RDP.

The "N" Arrangements (Rules for Spending Modulated Receipts)

Receipts from modulation must be spent within a specified time frame under the "N" arrangements. From 2001, the rule is "N+4" and receipts from the voluntary modulation regime must be utilised by the end of the fourth year after the year in which the receipt was collected[6]. Receipts from compulsory modulation collected in 2005 operate under an "N+0" rule, i.e. receipts collected in 2005 must be utilised by 15 October 2006 (the end of the financial period governing the Rural Development Plans for the 2000-06 planning round). Thereafter, the rule which applies is "N+2", receipts having to be utilised by the end of the second year after the year in which they were collected.

Under the "N" arrangements, any receipts not utilised by the date specified must be returned to the Commission.

Modulated Receipts

Pending utilisation, receipts from voluntary modulation are held in a suspense account, which sits outside the main Assembly budgets. European Union regulations set out the accompanying measures from the RDP on which modulated receipts can be spent. These include agri-environmental and forestry schemes.

The collection of modulated receipts began in 2001. Up until 31 May 2008, **£26.9 million** of modulated receipts had been collected.

Table 1 - Voluntary modulated receipts by Financial Year

Financial Year	Receipts (*£ million*)
2001-02	2.4
2002-03	4.0
2003-04	7.1
2004-05	6.6
2005-06	5.1
2006-07	0.9
2007-08	0.8
2008-09[(a)]	0.0
Total	**26.9**

Source: Welsh Assembly Government
Note: [a] As of 31 May 2008

[4] The EU Strategic Guidelines for Rural Development outline 4 axes under which money can be spent. Axis 2 covers the environment and the countryside – see MRS Quickguide 10 Rural Development Funding in Wales for further information
[5] EAGGF was one of the four structural funds available to the EU for the 2000-2006 programme round to address social and economic disparity across eligible areas within the Union.
[6] The EAGGF financial year runs from October to October

The expenditure of revenue from modulated receipts commenced in 2003. Expenditure in the 2003-04 financial year was £1.3 million and this amount has increased in subsequent years. As of 31 May 2008, a total of £18.9 million of voluntary modulation funds had been spent.

Table 2 - Expenditure of Voluntary Modulation Funds by Financial Year

Financial Year	Receipts (*£ million*)
2003-04	1.3
2004-05	0.9
2005-06	4.2
2006-07	3.9
2007-08	6.1
2008-09[(a)]	2.5
Total	18.9

Source: Welsh Assembly Government
Note: [a] As of 31 May 2008

The balance of voluntary modulated receipts held in the suspense account at 31 May 2008 was, therefore, **£8 million**.

Receipts from compulsory modulation are not held in a suspense account but are drawn down from Europe. Compulsory modulation was introduced in 2005 at the rate of 3 per cent; this rate was raised to 4 per cent in 2006 and 5 per cent for 2007.

Change from 2007

At the December 2005 meeting of the European Council of Ministers, agreement was reached on the EU financial perspective for the 2007 -2013 programming period[7]. Within the agreement was the introduction of a voluntary modulation regime (VM), in addition to the compulsory modulation regime (CM), whereby VM could be applied to a maximum of 20 per cent. Where VM is adopted, the Rural Development Plans 2007-2013 are required to set out the annual rates that are to be applied.

In terms of the "N" arrangements, for the "new" Voluntary Modulation regime from 2007, the rule which applies is "N+2".

From 2001, receipts from modulation in Wales have been supported by pound-for-pound match funding from HM Treasury. Match Funding received from the Treasury in respect of modulation is located within the Tir Cymru Budget Expenditure Line (BEL) within the Environment, Planning and Countryside Main Expenditure Group (MEG). Match Funding for modulation was built into the Assembly's Departmental Expenditure Limit (DEL) as part of the 2004 spending review. As such, it is drawn down from HM Treasury in the same way as all the resources that are allocated to the Assembly for any given financial year.

Proposals for the future

Under the CAP Health Check, the European Commission has proposed changes to Compulsory Modulation. The proposals, published on 20 May 2008, suggest increasing

[7] European Council, *Financial Perspective 2007-2013*, Paragraph 62 deals with voluntary modulation

Compulsory Modulation on payments between €5,000 - €99,999 by 2 per cent per annum up to 2012. This would be in addition to the existing 5 per cent rate until the total rate is 13 per cent. The Commission is also proposing to increase Compulsory Modulation by 3 per cent in successive thresholds, as explained in the following table:

Table 3 - Proposed compulsory modulation rates for EU-15 states

	Calendar Year			
Thresholds (€)	**2009**	**2010**	**2011**	**2012**
1 to 5,000	0	0	0	0
5,000 to 99,999	5% + 2%	5% + 4%	5% + 6%	5% + 8%
100,000 to 199,999	5% + 5%	5% + 7%	5% + 9%	5% + 11%
200,000 to 299,999	5% + 8%	5% + 10%	5% + 12%	5% + 14%
above 300,000	5% + 11%	5% + 13%	5% + 15%	5% + 17%

Source: EU CAP Health Check proposals

It is proposed that all new receipts from modulation will stay within the member state that generates them. The table above will apply to the EU-15 member states.

These are subject to negotiation with Member States and may change again before they are formally adopted.

Additional information relating to the proposals can be found in the European Commission CAP Health Check Proposals shown below under *further information*.

Further Information:

Welsh Assembly Government Welsh European Funding Office

Welsh Assembly Government Environment and Countryside

European Commission Rural Development Policy

European Commission CAP Health Check proposals

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