**EXPLANATORY MEMORANDUM TO**

# THE COMMON AGRICULTURAL POLICY SINGLE PAYMENT AND SUPPORT SCHEMES (AMENDMENT) REGULATIONS 2007

**2007 No. 3182**

**1.** This explanatory memorandum has been prepared by the Department for Environment Food and Rural Affairs and is laid before Parliament by Command of Her Majesty.

## 2. Description

2.1 This instrument amends the Common Agricultural Policy Single Payment and Support Schemes Regulations 2005 (S.I. 2005/219) which came into force on 1 March 2005 and which is available on the OPSI website with its accompanying Explanatory Memorandum (at www.opsi.gov.uk/si/si2005/20050219.htm).

2.2 S.I. 2005/219 provided for the application in England of the Single Payment Scheme (SPS) under the reformed Common Agricultural Policy (CAP).

2.3 These Regulations extend those provisions to reflect the incorporation of additional funding for income support into the SPS following reform of the EU Sugar Regime. They also provide for the application of rates of voluntary modulation for 2007 to 2012.

## 3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 Regulation 3 of this instrument substitutes a new paragraph for regulation 2(3) of S.I. 2005/219: this provision is made under the new powers at paragraph 1A of Schedule 2 to the European Communities Act 1972 (see paragraph 4.2, fourth bullet point, below).

## 4. Legislative Background

4.1 This instrument is being made to amend S.I. 2005/219, which came into force on 1 March 2005.

4.2 The amendments are intended to achieve the following:

- They set out the method for incorporating into the SPS the new income support arising from the reforms of the EU Sugar Regime. The arrangements for the Single Payment Scheme are principally provided for in Council Regulation (EC) No. 1782/2003 establishing common rules for direct support under the common agricultural policy and establishing certain schemes for farmers[1]. That Regulation was amended by Council Regulation (EC) No. 319/2006[2] to incorporate payments arising from the sugar reforms into the existing SPS. Council Regulation (EC) No. 1782/2003 (as amended) provides for areas of national discretion in relation to the distribution of funding under the SPS

[1] OJ No. L 270, 21.10.2003, p. 1.
[2] OJ No. L 58, 28.2.2006, p. 32.

generally, and, under the amendments introduced by Council Regulation (EC) No. 319/2006, in relation to the new funding arising from the reforms of the sugar regime. This instrument provides for the distribution of that new funding, including the setting of criteria for payment, pursuant to the discretion provided for in Council Regulation (EC) No. 1782/2003, as amended.

- These Regulations also set out the rates of voluntary ("additional") modulation to be applied to payments under the SPS and the other CAP direct aid schemes pursuant to Council Regulation (EC) No. 378/2007[3]. S.I. 2005/219 sets out the rates for the years 2005 and 2006. These Regulations set out the rates for the years 2007-2012, and update the references to Community instruments.
- They update the definition of one of the English regions (moorland) to reflect some minor amendments to the Moorland Map. Article 58 of Council Regulation 1782/2003 allows Member States to apply the SPS at regional level and to define the regions to which payment applies.
- They update the references to the Community instruments in S.I. 2005/219: these may be taken now as references to those Community instruments as amended at the date these Regulations are made (by virtue of section 20A of the Interpretation Act 1978 as amended by the Legislative and Regulatory Reform Act 2006). They use new powers also inserted by the 2006 Act as paragraph 1A of Schedule 2 to the European Communities Act 1972 to provide for the incorporation of future amendments to the Community legislation defined in S.I. 2005/219.

**5. Territorial Extent and Application**

5.1 This instrument applies in England.

**6. European Convention on Human Rights**

6.1 As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

**7. Policy background**

7.1 The policy background to the principal Regulations is referred to at paragraph 2.2

7.2 The most important provisions contained in this instrument concern the incorporation of sugar funding into the SPS and the setting of voluntary modulation rates.

*Sugar*

7.3 Reforms of the EU Sugar Regime agreed in November 2005 included new income support which was to be incorporated into the SPS. Under the terms of the EU agreement this new support must be incorporated into the model of the SPS that Member States have already adopted. For England, this means the flat rate per hectare model, with a transitional phase to 2012 during which a declining element of the value of each SPS payment entitlement will be determined by farmers' historical subsidy receipts (the alteration in historically based payments relative to the flat rate payments over the transitional phase is known as 'progressive modification').

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[3] OJ No. L 95, 5.4.2007, p. 1.

7.4 Member States do have some areas of discretion in relation to exactly how the new support is incorporated into their SPS model. Regulations 4, 5 and 7 of this instrument set out the choices made in England. Regulations 5 and 7 provide for the means by which support is to be allocated between historic sugar beet growers and all SPS applicants. The 'allocation method' chosen awards a higher proportion of the support to historic sugar beet producers (compared with the standard SPS progressive modifications which were provided in Schedule 1 in SI 2005/219 prior to these amendments) during the critical period up until 2010 of phasing in of price cuts arising from the Sugar Reform. Regulation 4 sets out, for the purposes of paragraph 1, point K of Annex VII to Council Regulation (EC) No. 1782/2003 (as amended), the qualifying criteria (contracted sugar tonneage relative to that of other historic sugar beet producers) and reference year (2005/06 marketing year), to be used to allocate the historic element of the support. It also provides for a farmer (a "linked" farmer) who meets the qualifying criteria to elect to transfer his entitlement to the support to another where a specified linking relationship exists. This flexibility was introduced following discussions with industry representatives.

7.5 The choices described above were subject to a formal consultation during the period February to May 2006 (to which 352 responses were received). The respondents included industry representative organisations and individual growers. 94% of respondents supported the option closest to the chosen 'allocation method' for distributing the support between historic sugar beet growers and all applicants. The chosen allocation method incorporates changes to the favoured option which were requested by many respondees. 96% and 95% supported the chosen qualifying criteria and marketing year respectively. A summary of the responses to the consultation is available via the Defra Information Resource Centre, Lower Ground Floor, Ergon House, c/o Nobel House, 17 Smith Square, London SW1P 3JR.

*Voluntary modulation*

7.6 Since 2001, the United Kingdom has made use of the facility to transfer voluntarily (or 'modulate') a proportion of its budget for payments under Pillar 1 of the CAP (since 2005 this has principally been the Single Payment Scheme) and to make the money available for spending under Pillar 2 on rural development measures. The Rural Development Regulation (Council Regulation 1698/2005includes a range of measures designed to improve the competitiveness of the agriculture and forestry sectors; to improve the environment and the countryside (for example through agri-environment schemes); and to improve the quality of life in rural areas. The application of voluntary modulation has allowed the UK to compensate for a disproportionately low allocation of rural development funds from both the European Agricultural Fund for Rural Development (EAFRD) and its predecessor the European Agricultural Guidance and Guarantee Fund (EAGGF); and to operate larger and more far-reaching rural development programmes than would otherwise have been feasible, in order to achieve the desired policy outcomes, particularly for the achievement of environmental benefits.

7.7 The voluntary modulation rates applied in England for scheme years 2005 and 2006 (2% and 6% respectively) were set out in SI 2005/219. Following agreement in December 2005 by the European Council of the EU budget for the financial perspective 2007-13, including the principle of continued application of voluntary modulation, the Agriculture Council agreed Council Regulation (EC) No. 378/2007 in

March 2007. This provides a basis for certain member states to apply voluntary modulation for the years 2007-12. The UK made clear its intention to use this option and the proposed rates of voluntary modulation for England were announced to Parliament on 30 March 2007. Regulation 6 of this instrument sets out the rates which will apply in England. The rates have been chosen to ensure that the Rural Development Programme for England for 2007-2013 contains sufficient funds to meet its objectives, principally by expanding the coverage of agri-environment schemes, as well as honouring existing contractual commitments carried forward from the period 2000-2006 and earlier. The application of voluntary modulation is in line with the Government's view that public money should be used to deliver public goods.

7.8 An impact assessment in respect of the voluntary modulation rates as required by Regulation 378/2007 is attached to this memorandum. The impact assessment indicates that when the wider benefits of the extra spending on the Rural Development Programme are considered, it is expected that the application of Voluntary Modulation will have an overall positive impact on rural areas and the agricultural sector; in terms of the impact on businesses, it is expected that increased rates of voluntary modulation will have negligible impacts on prices and production upon all agricultural sectors.

7.9 The proposals for the Rural Development Programme for England 2007-13 (RDPE) were subject to wide consultation with a formal consultation exercise from February to May 2006 and continuing informal consultation with stakeholders at both national and regional levels. A number of stakeholders commented on the principle of voluntary modulation as part of these consultations. The final rates of voluntary modulation were determined according to the need to provide the required budget to meet the agreed objectives of the programme and were not subject to separate consultation.

*Other changes*

7.10 In April 2004, the Government announced that there would be three English regions for the purpose of SPS, including 'moorland within the Severely Disadvantaged Area'. Different flat-rate payments apply in each English SPS region. Regulation 3 updates the definition of moorland area in England to reflect a recent amendment to the moorland map. This map has been revised slightly in 2007, principally to reflect past successful appeals from farmers against the moorland status given to their land.

7.11 The changes covered in this instrument have been communicated to farmers through a combination of the Scheme Handbooks issued to each SPS applicant, letters to affected farmers, Press Releases and via the Defra and Rural Payments Agency websites.

## 8. Impact

8.1 A Regulatory Impact Assessment on the options for incorporation of the income support payments arising from the reform of the EU Sugar Regime into the SPS and an impact assessment in respect of the amendments to the arrangements for voluntary modulation are still relevant for this purpose and are attached to this memorandum.

8.2 The only impact on the public sector will be the requirement for the Rural Payments Agency to introduce administrative procedures to reflect the provisions contained within this instrument.

## 9. Contact

Claire Williams at the Department for Environment Food and Rural Affairs Tel: 0207 238 3157 or e-mail: claire.williams@defra.gsi.gov.uk can answer any queries regarding the instrument.

## ANNEX A

# FINAL REGULATORY IMPACT ASSESSMENT: OPTIONS FOR THE INCORPORATION OF THE INCOME SUPPORT PAYMENTS ARISING FROM THE REFORM OF THE EU SUGAR REGIME INTO THE SINGLE PAYMENT SCHEME (November 2007)

## 1. Purpose and intended effect

### *1.1 Objective*

To incorporate into the Single Payment Scheme (SPS) the new income support arising from reform of the Common Agricultural Policy's (CAP) Sugar Regime.

### *1.2 Background*

At the November 2005 meeting of the EU Agricultural and Fisheries Council, political agreement was reached on wide-ranging reform of the EU sugar regime. A key element of that agreement was a 36% cut in the guaranteed price for white sugar, with an associated income support payment being incorporated into the SPS. Further details of that agreement can be found on the European Commission's website at: http://europa.eu.int/comm/agriculture/capreform/sugar/index_en.htm

The purpose of the analysis in this Regulatory Impact Assessment (RIA) is to assess the implications of different ways of incorporating the new income support payments for farmers into the existing decoupled SPS model in England (as little or no sugar beet is currently being grown in Scotland, Wales or Northern Ireland). A fuller consideration of the impact of sugar reform itself on beet growers in the context of the SPS was given in Defra's final RIA on Reform of the EU Sugar Regime, published in May 2006[4].

This analysis does not consider how the existing SPS funds are distributed and what their impacts might be[5]. It simply focuses upon the *additional* money available by virtue of sugar reform, and how that might be allocated between sugar beet growers and others under different scenarios.

### *1.3 Rationale for government intervention*

An amendment to Council Regulation No. 1782/2003 giving effect to the November agreement in respect of the new support was adopted at a meeting of the EU Agricultural and Fisheries Council on 20 February 2006 and allocates the following sums to the UK:

[4] www.defra.gov.uk/farm/crops/sugar/eu/pdf/FINALRIAMay06.pdf

[5] Defra's analysis relating to the original decision behind the SPS model in England can be obtained via the Defra Information Resource Centre, Lower Ground Floor, Ergon House, c/o Nobel House, 17 Smith Square, London, SW1P 3JR.

**Table 1**

| Year | Main Income Support (Euro '000) | Additional Income Support** (Euro '000) | Total New Income Support (Euro '000) | Total New Income Support (£ '000)* |
|---|---|---|---|---|
| 2006 | 64, 340 | 9,985 | 74,325 | 52,028 |
| 2007 | 80, 528 | 9,985 | 90,513 | 63,359 |
| 2008 | 96,717 | 9,985 | 106,702 | 74,691 |
| 2009 | 105,376 | 9,985 | 115,361 | 80,753 |
| 2010 | 105,376 | 0 | 105,376 | 73,763 |
| 2011 | 105,376 | 0 | 105,376 | 73,763 |
| 2012 | 105,376 | 0 | **105,376** | 73,763 |

**Assuming 1 Euro = £0.7* *** in respect of reform related to derived prices*

Under the terms of the EU agreement, it is not possible to adopt the historic model of the SPS in respect of this support in England as the total sums must be incorporated into the model of the SPS that Member States have already adopted.

For England, this means the flat rate per hectare model, with a transitional phase to 2012. The existing SPS flat rate/historical splits are as follows**:**

**Table 2**

| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|---|---|---|
| Flat Rate (%) | 10 | 15 | 30 | 45 | 60 | 75 | 90 | 100 |
| Historic (%) | 90 | 85 | 70 | 55 | 40 | 25 | 10 | 0 |

However, Member States have an element of discretion in respect of the detail of how they incorporate the payments into their SPS models in three key areas. In practice, this translates into the following areas of discretion in respect of the model of the scheme we have adopted in England:

- we can use the same historical/flat rate split that currently applies to all entitlements (i.e. in 2006, 15% flat rate/85% historical) or have a different arrangement in each year to 2012 in respect of the entitlements held (initially at least) by sugar beet growers;
- we can determine how the historical element of the value of entitlements will be distributed amongst sugar beet growers by fixing:
    - the qualifying criteria e.g. contracted tonnage for quota sugar or area of land under sugar beet; and
    - the reference year(s) in which those qualifying criteria apply.

## 2. Options

For the purposes of this RIA, we outline two main options (which appeared in the consultation document) and a third method for comparative purposes on the key issue of the allocation of the new income support between sugar beet growers and all other SPS claimants. In each case, the analysis was undertaken on the assumption that there would be no change in the existing transitional arrangements (i.e. 15% flat rate / 85% historic split) in 2006 as significant change would almost certainly have a negative impact on the payment timetable for all 2006 SPS claimants. The end of the transitional phase is also set at 2012 to ensure compliance with the decision announced in 2004 to establish a flat rate value for all SPS entitlements in each English area by 2012.[6]

### Option 1: the "Default"

Incorporate the new income support payments into the current transitional SPS model from 2006.

[6] www.defra.gov.uk/corporate/ministers/statements/mb040212.htm

**Table 3**

| Year | Flat Rate | Historic |
|---|---|---|
| 2006 | 15% | 85% |
| 2007 | 30% | 70% |
| 2008 | 45% | 55% |
| 2009 | 60% | 40% |
| 2010 | 75% | 25% |
| 2011 | 90% | 10% |
| 2012 | 100% | 0% |

Option 2: Targeting new income support in 2007-2009 towards 'sugar' entitlements

As Option 1, maintaining the existing flat-rate / historic splits, but in 2007-2009 allocating the additional payments (relative to the €74m in 2006) fully to the SPS entitlements that sugar beet growers held in 2006 ('sugar' entitlements).

That would mean:

- In 2007, €74m would be allocated on the basis of the 30/70 split. Total new income support for 2007 are €91m, and the residual €16m would be allocated purely to 'sugar' entitlements.
- In 2008, €74m would be allocated on the basis of a 45/55 split. Total new income support for 2008 is €107m, and the difference between this and the 2006 amount (€32m) would be allocated purely to 'sugar' entitlements.
- In 2009, €74m would be allocated on the basis of a 60/40 split. Total new income support for 2009 is €115m, and the difference between this and the 2006 amount (€41m) would be allocated purely to 'sugar' entitlements.

The effect of this option is to raise the share of the new income support allocated to sugar entitlements during the three years when EU-wide restructuring of the industry, facilitated by the EU restructuring scheme foreseen in the November agreement, is expected to occur. Under this option, during 2010 to 2012, the existing flat-rate / historic split will apply to all entitlement values as in Option 1, so by 2012 all entitlements will have a common flat-rate value in each English area.

This option can also be illustrated by the following table:

**Table 4**

| | 2006 Baseline: €74million | | Cumulative Increase in Income Support | |
|---|---|---|---|---|
| Year | Flat Rate | Historic | Flat Rate | Historic |
| 2006 | 15% | 85% | - | - |
| 2007 | 30% | 70% | 0% | 100% |
| 2008 | 45% | 55% | 0% | 100% |
| 2009 | 60% | 40% | 0% | 100% |
| 2010 | 75% | 25% | 75% | 25% |
| 2011 | 90% | 10% | 90% | 10% |
| 2012 | 100% | 0% | 100% | 0% |

**The 'maximum historic' method**

A third method ("maximum historic") is also included for comparison purposes and illustrates what would happen if 100% of the new income support available by virtue of sugar reform was allocated purely to 'sugar' entitlements

This method demonstrates what could occur if the 15/85 split was maintained in 2006, but from 2007-2011 allocates 100% of the new support to 'sugar' entitlements. However, in 2012, all of this support

would go to fund the common flat rate value which will apply to all SPS entitlements in each English area and so align with the current SPS model in England.

**Table 5**

| | Maximum Historic | |
|---|---|---|
| Year | Flat Rate | Historic |
| 2006 | 15% | 85% |
| 2007 | 0% | 100% |
| 2008 | 0% | 100% |
| 2009 | 0% | 100% |
| 2010 | 0% | 100% |
| 2011 | 0% | 100% |
| 2012 | 100% | 0% |

## 3. Costs and Benefits

For each of the above options, we consider:

(i) the impact on sugar beet growers in the aggregate;
(ii) the impact on a stylised case study of an individual beet grower. We take the case where 25 hectares(ha) of sugar beet are grown on a 150 hectare general cropping farm. These figures broadly correspond to Farm Business Survey data as analysed by Cambridge University in their 2004 report for Defra on sugar reform. The mean size of sugar beet enterprises is between 20 and 25 hectares (over 7,000 growers on 170,000 has) and the crop share of sugar beet in the median farm is around 16% (see Figure 1 below)[7].

For each option the financial impacts of incorporation for each of the years 2006-2012 is given. We assume that the new income support from sugar reform is not materially affected by other factors (financial discipline, modulation, national reserve etc) during the period.

The analysis converts euro payments into sterling assuming an exchange rate of €1 = 70p. However, this is for illustrative purposes only. The sterling value of this new support in each year will vary with the exchange rate.

### *3.1 Analysis*

Each of these options will have different distributive effects. Under each option, over the period 2006-2012, different proportions of the new support will be redirected, via the flat-rate elements of entitlement values, to non-sugar beet growers. Had the SPS been based on a purely historic model of the SPS the new income support would have accrued directly to holders of 'sugar' entitlements. Defra's RIA on Options for Sugar Reform (June 2005) highlighted that, in such a scenario, such payments (based on 60% of the price cut), would actually leave many growers clearly better off, particularly high-cost growers of sugar beet who could move out of beet and grow more winter cereals with reasonable yields. British Sugar's need for adequate raw supply might also mean that beet prices in the UK may not fall as far as envisaged[8].

Against this, the transitional SPS flat-rate model adopted in England means that land on which sugar beet is grown becomes eligible for increasing flat-rate entitlement values. FBS data in the 2004 Cambridge study shows that the share of beet in cropping ranges between 1% and 32% (Figure 1). Further, sugar beet growers typically produce other crops, including potatoes, vegetables and peas and beans, all of which would be eligible to establish and activate SPS entitlements, with authorisations as appropriate.

The transitional flat rate SPS model therefore has two opposing impacts on sugar beet growers:

[7] University of Cambridge, *Economic, social and environmental implications of EU sugar regime reform* (2004), Table 2.3, Fig 2.5.
[8] Partial RIA of Options for Reform of the EU Sugar Regime (June 2005), section 5.2.13.

- It provides ‘windfall’ increases in the flat-rate element of entitlement values in respect of eligible beet land, rising from 2005 through to 2012;
- The new income support in respect of EU sugar reform cannot fully be allocated to sugar beet growers on a permanent basis but must go to fund a common flat rate value for entitlements in each English area by 2012.

### *3.2 Aggregate analysis*

Table 6 shows the increases in entitlement values (in £m) – both historic and flat rate elements - to sugar beet land in aggregate under each of the options between 2006 and 2012. It is partial because it treats sugar beet in isolation from other sectors.

**Figure 1**

Source: FBS / Cambridge University (2004)

**Table 6**

| | Option 1 | Option 2 | Maximum Historic |
|---|---|---|---|
| | £m | £m | £m |
| 2006 | £44 | £44 | £44 |
| 2007 | £45 | £48 | £63 |
| 2008 | £42 | £52 | £75 |
| 2009 | £33 | £50 | £81 |
| 2010 | £20 | £20 | £74 |
| 2011 | £9 | £9 | £74 |
| 2012 | £2 | £2 | £2 |
| **Total 2006-2012** | £195 | £225 | £413 |

The “maximum historic” method provides the maximum benefits for sugar beet growers in England. Option 1 provides around 40% of the new support to sugar beet growers. The difference between Options 1 and 2 is not large. All options converge to the full flat rate model in 2012.

Had the SPS been originally based only on historic entitlements, the full sugar payment would have been available for growers. However, they would not have benefited from flat-rate element of entitlement values under the model actually chosen. The value of the flat rate is not certain over the 2005-2012 period, but a ballpark figure would be around £140m (before deductions for modulation and financial discipline). With the “maximum historic” method, by contrast, sugar beet growers – at least until 2012 – would receive a double benefit: receiving an increasing flat-rate entitlement values under the basic SPS, as well as receiving the maximum new support increases in respect of sugar reform between 2007 and 2011.

The increase in entitlement values in respect of all other non-sugar beet non-SDA eligible land is given in Table 7. Under all options, by 2012, £72m of the £74m new support available is redistributed to non-sugar beet land.

**Table 7**

| | Option 1 | Option 2 | Maximum Historic |
|---|---|---|---|
| | £m | £m | £m |
| 2006 | £8 | £8 | £8 |
| 2007 | £19 | £15 | £0 |
| 2008 | £33 | £23 | £0 |
| 2009 | £47 | £30 | £0 |
| 2010 | £54 | £54 | £0 |
| 2011 | £65 | £65 | £0 |
| 2012 | £72 | £72 | £72 |
| **Total 2006-2012** | £297 | £267 | £80 |

### *3.3 Individual case study analysis*

No farm grows only sugar beet and no other crop (Figure 1). Therefore as the historic value element decreases, the flat-rate value of entitlements held by beet farmers will become more valuable, and this will limit the losses from the redirection away from beet. At this stage it is important to note that all entitlement values form a 'single payment' unique to each farm. Because it is a single *decoupled* payment, it does not depend on, and is not assigned to any particular enterprise, even though the historic element will reflect past production patterns.

To illustrate the magnitude of the impacts, we consider a simple stylized case of a 150 ha general cropping farm on which 25 ha of sugar beet has been historically grown. Table 8 shows the new support (£) for the farm from sugar reform under each of the options.

Although the "maximum historic" method is the most favourable to sugar beet growers, and Option 1 the least favourable, the proportionate difference is smaller than in the aggregate case. This is because non-sugar beet land on a farm receives an increasing flat-rate entitlement. For instance, in Option 1, of the £34,000 of new support accruing to the farm, around £6,000 of this is through the flat-rate value of entitlements. In "maximum historic", the flat-rate element is only around £1,600.

**Table 8**

| | Option 1 | Option 2 | Maximum Historic |
|---|---|---|---|
| | £ | £ | £ |
| 2006 | £6,668 | £6,668 | £6,668 |
| 2007 | £6,929 | £7,356 | £9,316 |
| 2008 | £6,761 | £8,044 | £10,984 |
| 2009 | £5,790 | £7,959 | £11,879 |
| 2010 | £3,898 | £3,898 | £10,850 |
| 2011 | £2,508 | £2,508 | £10,850 |
| 2012 | £1,581 | £1,581 | £1,581 |
| **Total 2006-2012** | £34,136 | £38,014 | £62,129 |

Similarly, had the SPS model been purely historic, although the case-study farm would have received around £70,000 over the 2006-2012 period, it would have not received aid (perhaps up to £20,000) arising from an increase in flat rate entitlement values for eligible sugar beet land. And insofar as sugar beet growers also grow potatoes, beans and field vegetables, they would not have benefited

from the increasing flat-rate value of entitlements in respect of the land used for these other non-Arable Area Payment Scheme (AAPS) enterprises.

### *3.4 Costs of incorporating the additional aid into the SPS*

RPA's IT costs associated with the incorporation of the new income support into the SPS include approximately £350,000 in relation to changes for the 2006 scheme year (which covers the development of an interim IT system needed to deliver sugar funding to the industry without impacting on the main SPS payments) and approximately £1 million in relation to changes for scheme years 2007 onwards (which covers enhancements to the main SPS IT system).

### *3.5 Environmental impacts*

The environmental impacts of Sugar Reform were considered in Defra's Regulatory Impact Assessment of options for Reform of the EU Sugar Regime[9]. The detailed arrangements for the incorporation of new income support into the SPS, as presented in this consultation, are in themselves not expected to have any significant impact on the environment.

## 4. Sectors and groups affected

Little or no sugar beet is historically grown in the UK outside of England. This, in practice means that the vast majority of the new income support relating from the reform of the Sugar Regime is likely to go to farmers within England.

This new support has then to be allocated between 7,000 sugar beet growers and non sugar beet growing SPS claimants (i.e. around 113,000) who will also be affected, either directly or indirectly, due to the increases in flat rate values of all SPS entitlements between 2006 and 2012. The exact extent of this impact would depend on the option chosen.

## 5. Small Firms Impact Test

Sugar beet farmers form the largest group of small businesses affected by reform of the EU Sugar Regime although other farmers who hold SPS entitlements will also be affected. Most farms fall under the official definition of small businesses, in that they have fewer than 50 employees, are not generally owned by someone else and have a turnover below £4.44 million.

Thus, although small business will certainly be affected by the sugar reform agreement, it is not the case that reform will have a disproportionate cost on small firms, *relative to larger-sized businesses.* The key interests in both the sugar producing and using sectors belong to large/listed companies. The Government is in regular contact with the National Farmers Union, who represent all sugar beet farmers. Many individual farmers also wrote to Defra as part of the 2003/2004 and 2005 consultation exercises on the impact of sugar reform and the European Commission's draft proposals. The study by Cambridge University produced for Defra provides further information on the impact of reform on beet farmers.

## 6. Competition assessment

In general, the agreement to reform the EU Sugar Regime is likely to loosen the rigidities within the European sugar market.

In particular, several elements of the agreement are likely to have positive effects on competition:

- quota cancellation and reallocation would imply more sugar trading between EU countries, thus reducing market concentration within individual member states;
- an increase in isoglucose quotas should provide more choice and competition for industrial buyers of sugar;

[9] www.defra.gov.uk /farm/crops/sugar/eu/pdf/FINALRIAMay06.pdf

- a significant inflow of unmanaged LDC imports into EU domestic markets;
- more transparent price reporting.

It could also be argued that, because of the SPS model adopted in England, any redirection of the new income support away from beet growers would impact on their competitiveness if other member states that decouple on a historic basis see a more limited production impact. The result would be to put UK beet growing and processing at a 'competitive disadvantage' to other member states, particularly during the uncertain period up to 2010 in which the EU sugar industry will be undergoing substantial restructuring.

But the need for producers, both at home and abroad, to adapt in a rational manner to a lower-priced and more competitive EU sugar market is fundamental to the concept of transition embedded in the agreement. Under the current SPS model, there is a similar 'transitional' period in which certain groups of producers can adapt to lower levels of direct support.

It is economically rational for the competitiveness of the UK sugar industry to be determined not by how the new income support is paid but by how efficient growers and processors can be in producing sugar for a European market that will become more market-oriented as a result of the recent reform. As the Partial RIA on Sugar Reform and the Environment, Food and Rural Affairs (EFRA) Committee's report from November 2005 stated, British Sugar itself will need to make a commercial judgement about what incentives to provide UK growers to ensure that it maintains a sustainable throughput of beet[10].

### *6.1 Principles of the Single Payment Scheme*

When the decision to adopt the flat-rate model of the SPS was made in 2004, the key principles included greater simplicity, transparency, a clear path of adjustment and the need to avoid a situation in which payments were allocated solely on the basis of past activities themselves undertaken in the context of production-linked support.[11]

Decoupled payments, however they are paid, and within reasonable levels, should not distort production decisions in the same way that coupled payments and price support do. If the new income support arising from sugar reform was exclusively reserved for the benefit of existing sugar beet growers, this would run the risk of their being treated as coupled payments or a form of 'compensation' for the loss of the historic level of support superior to that for all other crops and unavailable to those without quota. This could impede the efficiency improvements and rationalisation of production which the reform itself is designed to achieve, as well as perpetuating the privileged position of existing quota holders.

## 7. Consultation

### *7.1 Overview of consultation response*

The public consultation was launched on 27 February 2006. It closed on 21 April 2006 in respect of comments on the qualifying criteria for distribution of the historical element of entitlement values and 22 May 2006 in respect of comments on the historic / flat rate split and reference year(s). A total of 352 responses were received from industry representative organisations, individual growers and other interested parties.

The consultation responses showed overwhelming (94%) support for Option 2 on the flat rate/historical splits to be used in relation to the new income support. Growers and industry representatives considered that the new income support directed, under this option, to sugar beet growers in the key transitional period 2007-9 would be critical in helping the industry to cope during the period for implementation of price cuts. However, they also agreed that under Option 2 the deficit area premium element of the support, worth approximately €10 million per annum in years 2007-9

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[10] EFRA (www.publications.parliament.uk/pa/cm200506/cmselect/cmenvfru/585/58502.htm), pp. 27-9.
[11] www.defra.gov.uk/corporate/ministers/statements/mb040212.htm

(shown as 'Additional Income Support' in Table 1), would be allocated entirely to sugar beet growers who met the defined qualifying criteria.

The majority of respondents supported the Defra recommendation to use contracted tonnage (96% of respondents) in the 2005/06 marketing year (95% of respondents) to determine how the historic element of the value of entitlements will be distributed amongst sugar beet growers. There were, however, a couple of issues which were raised by several respondents. Firstly, we were asked to consider whether provision could be made for those growers who have either entered the industry or expanded their quota since 2005/06. Secondly, we were asked to consider the position of growers who leased in quota tonnage during the reference year. There were divergent views on this latter point, with some respondents arguing for the historic reference amount to be allocated to the lessors and some for it to be allocated to the lessees.

### *7.2 Related consultations*

The Government has previously consulted on the wider issues of reform of the Sugar Regime in 2004[12] and on the European Commission's draft proposals for reform of the Sugar Regime in 2005[13]. In addition, there have been a number of consultations in respect of the SPS, including on the model of the scheme adopted in England. [14]

## 8. Enforcement and Sanctions

The existing control framework for the SPS in England is set by Commission Regulation no. 796/2004 and The Common Agricultural Policy Single Payment and Support Schemes (Integrated Administration and Control System) Regulations 2005 (SI 218/2005)[15]. The incorporation of new income support may have a marginal effect on the incentive for fraud and more complex arrangements to allocate those funds might present a marginal increase in the challenge to detect such fraud. However, the control framework itself is not directly affected whichever option is chosen.

## 9. Monitoring and Review

The RIA for the allocation of Single Payment entitlements set out the Department's plans for monitoring and review in respect of the SPS.[16] Those plans apply equally to new income support arising from reform of the EU Sugar Regime.

## 10. Summary and Recommendation

### *10.1 Summary*

The incorporation of the new income support into the SPS is mandatory, so the only decisions to be made relate to the areas of discretion available to Member States.

On 22 June 2006 Ministers announced[17] that, in order to simplify to the maximum possible extent the arrangements for incorporation of this new income support into the SPS, all of the additional funds available in 2006 would be added to the value of entitlements held by sugar beet producers who met the qualifying criteria i.e. the support would be allocated on a 100% historic basis. This decision took

[12] www.defra.gov.uk/corporate/consult/sugar-cap/index.htm
[13] www.defra.gov.uk/corporate/consult/sugar-regime/index.htm
[14] Defra's analysis relating to the original decision behind the SPS model can be obtained via the Defra Information Resource Centre, Lower Ground Floor, Ergon House, c/o Nobel House, 17 Smith Square, London, SW1P 3JR.
[15] www.defra.gov.uk/farm/singlepay/furtherinfo/legislation/index.htm
[16] The RIA for the allocation of Single Payment entitlements can be obtained via the Defra Information Resource Centre, Lower Ground Floor, Ergon House, c/o Nobel House, 17 Smith Square, London, SW1P 3JR.
[17] www.defra.gov.uk/corporate/ministers/statements/dm060622.htm

account of the challenges which the Rural Payments Agency was already facing in implementing the SPS. It was a decision which was welcomed by the industry.

On the flat rate/historical splits to be used from scheme year 2007 onwards, the results from the consultation strongly supported the view that the additional funds directed to sugar beet growers under Option 2, compared with Option 1, would be important in helping the survival of the English sugar beet industry during the key period of sugar reform. By moving to the flat-rate model by 2012, Option 2 remains consistent with the principles behind the SPS model.

Contracted tonnage for the 2005/06 marketing year is felt to be a fair and simple basis on which to allocate the new income support between sugar beet growers. Again, this was overwhelmingly supported by respondents to the consultation.

Growers were invited to apply under the National Reserve provisions if by 3 March 2006 (a date set in EU regulations), they increased their contracted sugar tonnage from that which they held in the 2005/06 marketing year. This caters for growers who had newly entered the industry or expanded their contracted quota since the 2005/06 marketing year.

## *10.2 Recommendation*

On the areas of discretion available to us in relation to years 2007 onwards, it is recommended that:

- from 2007, the new income support should be incorporated into the SPS on the basis of the existing SPS flat-rate/historic splits, but that in 2007-9 the increments in new income support (relative to the 2006 level) should be allocated fully to entitlements held (initially at least) by sugar beet growers. The deficit area premium element of the support (worth approximately €10 million per annum for the four years 2006-2009) should also be allocated entirely to entitlements held (initially at least) by sugar beet producers.
- the historic element of the new income support should be based on growers' contracted tonnage for quota sugar for the 2005/06 marketing year, with support allocated to lessors rather than lessees.

## 11. Ministerial Declaration

I have read the Regulatory Impact Assessment and I am satisfied that the benefits justify the costs.

SIGNED: Jeff Rooker
Jeff Rooker
Minister of State
Department for Environment, Food and Rural Affairs

DATE: 7th November 2007


**Contact point:**
Claire Williams
e-mail: claire.Williams@defra.gsi.gov.uk
Tel.: 0207 238 3157

# ANNEX B

**COMMUNICATION TO THE EUROPEAN COMMISSION BY THE UNITED KINGDOM GOVERNMENT CONCERNING VOLUNTARY MODULATION**

**Council Regulation (EC) No 378/2007 laying down rules for voluntary modulation of direct payments provided for in Regulation (EC) No 1782/2003 establishing common rules for direct support schemes under the Common Agricultural Policy and establishing certain support schemes for farmers, and amending Regulation (EC) no 1290/2005**

## SECTION 1 – INTRODUCTION AND BACKGROUND

1. This communication is submitted in order to fulfil the requirements of article 2 and 3 of Council Regulation (EC) No 378 of 2007 on the voluntary modulation of direct payments under the Common Agricultural Policy.

2. Member States who have decided to use voluntary modulation in accordance with Article 1 of this regulation are required to communicate the rates of voluntary modulation that will be applied to direct payments during the period 2007 to 2012 to the European Commission within 2 months of the regulation entering into force (12th April). The regulation also imposes a requirement on those Member States to submit an assessment of the impact of the application of voluntary modulation, "*in particular on the economic situation of the farmers concerned, taking into account the need to avoid unjustified unequal treatment between farmers*". Where VM is applied on a regional basis, there must also be an assessment of the impact of applying differentiated rates of VM within a member state.

3. Since 2001, the United Kingdom has made use of the facility to transfer voluntarily (or 'modulate') a proportion of its budget for payments under Pillar 1 of the Common Agricultural Policy and to make the money available for spending on rural development measures under Pillar 2. This has allowed the UK to compensate for a disproportionately low allocation of rural development funds (see Annex 2) from both the European Agricultural Fund for Rural Development (EAFRD) and its predecessor the European Agricultural Guidance and Guarantee Fund (EAGGF); and to operate much more meaningful, ambitious and far-reaching rural development programmes than would otherwise have been the case. Quite simply, without the application of voluntary modulation, the rural development programmes for 2007-2013 would not have contained sufficient funds for entering into new agreements with beneficiaries, as most of the funds from the EAFRD would have been used for existing contractual commitments carried forward from the period 2000-2006 and earlier. This would have considerably weakened the UK's ability to contribute to the Göteborg and Lisbon agendas.

4. The table below shows the EAGGF allocation in the UK; total voluntary modulation and match-funding; and total rural development spending during the last programme period 2000-2006. It demonstrates that, when looking at the UK as a whole, more rural development money was made available via voluntary modulation and match-funding than from the EAGGF during the period 2000-2006. This clearly underlines the UK's commitment to funding rural development / agri-environment schemes.

| (€m) | EAGGF Allocation 2000-2006 | Voluntary modulation and match funding 2000-2006 | Total RD spend 2000-2006 |
|---|---|---|---|
| **England** | 655 | 902 | 2299 |
| **Northern Ireland** | 138 | 69 | 286 |
| **Scotland** | 282 | 182 | 848 |
| **Wales** | 169 | 100 | 746 |
| **TOTAL** | **1244** | **1252** | **4323** |

5. The facility for voluntary modulation was first introduced under Council regulation No (EC) 1259 of 1999 and voluntary modulation was first applied on a UK-wide basis at an initial rate of 2.5%. Following the CAP reforms of 2003, the voluntary modulation rules were adjusted by Commission Regulation 1655 of 2004. This regulation allowed modulation to be applied on a regional basis within Member States. During calendar years 2005 and 2006, different rates of voluntary modulation applied in England, Scotland, Wales and Northern Ireland. Crucially, and in line with devolved arrangements for Government, this allowed the constituent parts of the United Kingdom to set their voluntary modulation rates at a level appropriate to their circumstances, preferences and rural development needs.

6. In December 2005, the European Council unanimously agreed that Member States should continue to be allowed to use voluntary modulation as a means of supplementing rural development expenditure during the period 2007-2013.

**WHY IS THE UK CONTINUING TO USE VOLUNTARY MODULATION**

7. Pillar 2 of the CAP contributes to the realisation of Community priorities, in particular in relation to the Göteborg sustainability goals and to the renewed Lisbon strategy for growth and jobs established by the European Council. The rationale for using voluntary modulation is consistent with the policy rationale underpinning the Rural Development Regulation as set out in the Community Strategic Guidelines[18]. These guidelines summarise the overall objectives for the CAP – encompassing both pillars – and state that:

> *"The guiding principles for the CAP, market and rural development policies, were set out by the European Council of Göteborg (15 and 16 June 2001). According to its conclusions, strong economic performance must go hand in hand with the sustainable use of natural resources and levels of waste, maintaining biodiversity, preserving ecosystems and avoiding desertification. To meet these challenges, the CAP and its future development should, among its objectives, contribute to achieving sustainable development by increasing its emphasis on encouraging healthy, high-quality products, environmentally sustainable production methods, including organic production, renewable raw materials and the protection of biodiversity. The reformed CAP and rural development can make a key contribution to competitiveness and sustainable development in the coming years."*

8. The United Kingdom believes that, although the precise circumstances will differ between regions, as a general rule targeted support under Pillar 2 provides the best way to deliver against these agreed EU priorities for the CAP. Recipients of rural development funds should be rewarded for delivering public benefits which are consistent with the Göteborg and Lisbon agendas, and would not otherwise be provided by the market. Consequently, it is necessary to ensure that Pillar 2 of the CAP in the United Kingdom is adequately funded.

9. In deciding to use voluntary modulation, the United Kingdom has given consideration to the overall balance of funding between Pillar 1 and Pillar 2. The table at **Annex B** shows that, in comparison with the other EU15 Member States, the United Kingdom receives a disproportionately low share of pillar 2 funds when compared to its share of utilised agricultural area. Importantly, the United Kingdom also has the second lowest ratio of Pillar 2 funds to Pillar 1 funds in that the EU budget allocation for direct payments is some 14 times greater than the EU allocation for rural development. The EU15 average ratio of Pillar 1 to Pillar 2 funds is 5 to 1. Applying voluntary modulation allows the UK to tackle this disparity, and helps to ensure that the balance of funding between Pillar 1 and Pillar 2 is closer to that of other EU15 Member States.

**SECTION 2: UK VOLUNTARY MODULATION RATES TO APPLY DURING THE PERIOD 2007-2012**

10. Article 1 of Regulation 378/2007 allows those Member States who made use of the voluntary modulation provisions under the old regulation (1655/2004), to continue to apply voluntary modulation during the period 2007-2012. The United Kingdom meets this requirement, and the rates of voluntary modulation that were applicable under Article 1 of 1655/2004 in the four regions of the UK, in addition to compulsory modulation of 3% in 2005 and 4% in 2006, are shown in the table below:

| | Voluntary Modulation rate | Voluntary Modulation rate |
|---|---|---|

[18] http://eur-lex.europa.eu/LexUriServ/site/en/oj/2006/l_055/l_05520060225en00200029.pdf

| | for 2005 | for 2006 |
|---|---|---|
| England | 2% | 6% |
| Wales | 1.5% | 0.5% |
| Scotland | 3.5% | 4.5% |
| Northern Ireland | 0% | 4.5% |

11. Article 3 of Regulation 378/2007 provides for those member states that have used voluntary modulation in the past to continue to apply voluntary modulation on a regional basis and to choose whether to apply a franchise.

12. **All four regions of the United Kingdom: England, Scotland, Wales and Northern Ireland, will be applying voluntary modulation during the period 2007-2012. Additionally, all four regions of the UK will be exercising the flexibility <u>not</u> to apply a franchise to amounts which are subject to voluntary modulation.**

13. A summary of the UK rates of voluntary modulation that will apply to direct payments under Pillar 1 during the period 2007-2012 is provided below, with further detail provided in the table at **Annex 1**. Applying voluntary modulation at a regional level and without a franchise will enable the four regions of the UK to ensure the level of voluntary modulation is no higher than that required to fund their rural development programmes adequately.

| Year | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|---|
| England | 12% | 13% | 14% | 14% | 14% | 14% |
| Wales | 0% | 2.5% | 4.2% | 5.8% | 6.5% | 6.5% |
| Scotland | 5% | 8% | 8.5% | 9% | 9% | 9% |
| Northern Ireland | 4.5% | 6% | 7% | 8% | 9% | 9% |

14. During the period 2000-2006, voluntary modulation receipts were deducted at source by the four UK paying agencies disbursing Pillar 1 funds. This money was then made available for spend solely on the rural development programme in the region to which the Pillar 1 payments related. As such, any modulation raised was guaranteed to be spent in the same region of the UK as that in which the Pillar 1 payment related.

15. Under the new voluntary modulation regulation, a guiding principle is that funds must transit through the Community budget. This means that it is necessary to apply the following indicative breakdown to the UK's ceiling for direct payments as laid down in Annex VIII to regulation (EC) No 1782/2003 (as amended).

| | % Share Direct Payments |
|---|---|
| England | 65.6% |
| Wales | 8.9% |

| | |
|---|---|
| Scotland | 16.4% |
| N Ireland | 9.1% |
| **Total** | 100% |

16. This breakdown reflects expenditure under Pillar 1 within the four UK regions during the reference period 2000-2002 and is comparable to that used for allocating compulsory modulation receipts (deducted in accordance with article 10 of regulation (EC) No 1782/2003) within the UK, for 2005, 2006 and the period 2007-2013. As far as possible, this helps to ensure that money transferred from Pillar 1 budgets is made available for expenditure under the rural development programme in the same region to which the Pillar 1 payment would otherwise have been made.

17. This method is not entirely precise though, as it is impossible to predict the actual share of pillar 1 payments that will be made in each of the four regions in advance. Consequently, the actual effects of using this breakdown will be monitored and any necessary adjustments will be made either when voluntary modulation is reviewed in light of the CAP Healthcheck, or through amending the allocation of EAFRD funds to the four United Kingdom regions.

## SECTION 3 – ASSESSMENT OF THE IMPACT OF THE APPLICATION OF VOLUNTARY MODULATION

18. During the negotiations on the voluntary modulation regulation, the European Parliament expressed concern that voluntary modulation would lead to an unlevel playing field and cause unfair discrimination. However, the CAP has evolved into a policy under which Member States have considerable discretion as to how they organise support under both pillars, and as a result the treatment of farmers varies across all member states. Moreover, given that CAP Pillar 1 payments and all CAP Pillar 2 payments are deemed to be largely WTO Green Box compatible, then it follows that it would be impossible for voluntary modulation to be significantly trade distorting, as money is simply moved from one compliant, non-distorting area of spending to another.

19. The objectives of the CAP are detailed at Article 33 of the Treaty and include *"to ensure a fair standard of living for the agricultural community"*. The Treaty also says that *"the particular nature of agricultural activity, which results from the social structure of agriculture and from structural and natural disparities between the various agricultural regions"* should be taken into account. Consequently, the Treaty itself would seem to recognise that some degree of difference across Member States is inevitable.

20. There are a number of characteristics of the Common Agricultural Policy which also causes differential treatment between Member States, and therefore farmers. Relative to these existing disparities, any differential treatment resulting from the application of Voluntary Modulation in the UK appears marginal. For example:

- the rate of payment a farmer can expect to receive under Pillar 1 is not consistent across the Community. The table at **Annex 2** shows that, after adjustments for compulsory modulation, the annual average amount of direct payments varies considerably across the older EU15 member states from €144 per hectare in Portugal, to €523 per hectare in Greece. Applying VM still leaves the UK well within this range. Even if 20% modulation were applied across the UK, this would only result in a reduction of around €45 /ha of UAA. Consequently, given that the rates of voluntary modulation being applied are clearly below 20%, the impact of the UK applying VM is small when compared to the disparities between the differences in €/ha of Pillar 1 support across the EU15.

- Similarly, comparing the allocation of Pillar 2 funds under the EAFRD to the EU15 member states on a euro per hectare of UAA basis reveals further disparities. The United Kingdom will receive the lowest amount of €16 per hectare of UAA per year during the period 2007-2013; whilst at the other extreme Austria receives €171 per hectare per year. Applying VM helps to rectify this disparity, bringing the UK close to the EU15 average of c€56/ha of UAA for Pillar 2 payments.

- The Horizontal Regulation which was agreed during the 2003 CAP reforms, (Reg (EC) No 1782/2003) afforded Member States considerable discretion over how to implement direct

payments under Pillar 1. For example, payments can be based on an historic or area basis, with hybrid models (partial decoupling) and discretion over the use of national envelopes allowable as well.

- Similarly, under the rural development regulation, Member States have considerable discretion over which measures are implemented, provided that the minimum expenditure per axis requirements are observed. This means that in one member state, a farmer might have access to an early retirement scheme, whilst in another they would not. Farmers are therefore treated differently in each member state, but this is justifiable as it allows Member States to implement the CAP in a way appropriate to its own circumstances and economic, social and environmental requirements. Voluntary modulation is simply another example of flexibility available within the CAP framework, and so any differences it causes are justifiable.

- Again under Pillar 2, Member States also have considerable discretion over how much national financing is provided to accompany EU funds. For example, under Axis 2, the EAFRD contribution in a non convergence region of any member state could be as high as 55% or as low as 20% (or national co-financing levels could be as high as 80% or as low as 45%) This flexibility over co-financing can result in large differences over the total amount of rural development support between Member States, For example, several EU15 member states receive an EAFRD allocation which exceeds €6bn for the 7-year period. Flexibility over co-financing means that, in approximate terms, total rural development spending (excluding any state aid funded measures) in those member states could legally be as high as €30 billion or as low as €10 billion. In this context, differences arising from VM in the UK again appear small.

- The direct payment system is being phased-in in the new Member States; until 2013, farmers in the "New" and those in the "Old" member states will be treated differently.

- Land used for growing fruit, vegetables and potatoes can receive payments under Pillar 1 in some member states but not in others.

21. As demonstrated, there are legitimate variations in the implementation of the CAP between member states. The effects of voluntary modulation, even if only applied in two member states, are likely to be marginal compared to the disparities which already exist in the CAP, some of which are evident in the table enclosed at **Annex 2**.

22. The CAP has rightly evolved into a flexible framework within which Member States have discretion over implementation in accordance with the principle of subsidiarity. It is not, nor should it be, a prescriptive policy which is implemented in a homogenised way. Voluntary modulation is merely a further extension of the flexibility and discretion available to member states under the CAP. It does not in itself create disparities, which are already inherent in the system. Conversely, the application of voluntary modulation allows the United Kingdom to adjust its ratio of Pillar 1 to Pillar 2 funds. It will also afford much greater opportunities than would otherwise be the case for UK farmers to access rural development support (as their European counterparts are able to).

**Impact of the Application of Regionally Differentiated Rates of Modulation**

23. The decision to operate voluntary modulation on a regional basis within the UK is a further extension of the flexibility that is currently enjoyed within the UK for operating both pillars of the CAP. As permissible under regulation 1782/2003, England, Scotland, Wales and Northern Ireland have all operated a slightly different model of Pillar 1 support in light of the 2003 CAP reforms. Rural development policy is also a devolved matter in the UK. Separate rural development programmes have operated in each of the four regions since 2000, consistent with devolved constitutional arrangements in the UK. In 2005 and 2006, all four regions of the UK operated different rates of voluntary modulation as permitted under regulation 1655/2004. Voluntary modulation will be applied differently in each of the four regions during 2007-2013, in common with all other aspects of CAP support which are organised on a regional basis. This has allowed the authorities to set the rate of voluntary modulation at a level required to meet rural development needs, but also in such a way as to reflect the structure of agriculture and other circumstances in the regions.

24. Similarly, the decision to operate voluntary modulation without the €5,000 franchise that applies to compulsory modulation reflects the nature and structure of the UK Agricultural sector. Under a decoupled CAP

where support is not linked to production, the largest recipients of direct payments are not necessarily the most efficient or competitive, nor are the smallest recipients of direct payments the most reliant upon those payments. Many recipients of less than €5,000 of direct payments might be hobby farmers or owners of small parcels of agricultural land, and their primary source of income will not necessarily be farming or agricultural activity, so it is difficult to argue that they should be exempt from voluntary modulation. There is also no reason for the largest recipients of direct payments to be subject to a more than proportional reduction. Non-application of the franchise ensures all recipients of direct payments are treated equally, but also means that the yield of receipts generated from voluntary modulation is maximised. This means that the rates of voluntary modulation are lower than they would have been had a franchise applied (in England, for example, the rate is 2 percentage points lower than would have been required with a franchise to fund the same programme).

**ASSESSMENT OF THE IMPACT OF APPLYING MODULATION AT UK LEVEL**

25. The most recent Total Income from Farming and Net Farm Income figures[19] would suggest that, even though voluntary modulation has been applied since 2001, and in light of significant restructuring over recent years, the UK Agricultural industry is in a relatively healthy and competitive state. In general terms, the effect of applying voluntary modulation in the UK is to reduce farmers' incomes, but it provides funding for schemes through Rural Development Programmes that will deliver substantial benefits to the farming community, the agricultural sector and the rural economy more widely, thus enabling the UK to deliver against the Göteborg and Lisbon agendas.

26. In February 2007, research on the impact of increased modulation in the UK undertaken by Queen's University Belfast and Agri-Food and Biosciences Institute, and the Food and Agricultural Policy Research Institute (FAPRI) was published[20]. The research found that, even under an extreme, hypothetical scenario of 25% total modulation in the UK:

- dairy commodity prices do not change when there is 25% modulation in the UK relative to the baseline. Consequently, the UK milk producer price remains unchanged.
- Reducing direct payments via voluntary modulation has no significant impact on beef, sheep, dairy and cereal production or prices and the presence or absence of match funding for voluntary modulation makes no difference.
- There is also no discernible impact on the pig and poultry sectors.

27. Receipts which are generated by voluntary modulation can only be spent on rural development schemes under Pillar 2, so therefore all money remains within the umbrella of the CAP. Under Pillar 1, there is no requirement to co-finance CAP funds. Consequently, co-financing of voluntary modulation receipts in the UK will result in a net increase in UK CAP spending. Such co-financing would therefore help the UK to redress the clear disparity between the Euros per hectare value of funds from the EAFRD compared to the EU15 Member States.

**<u>Conclusion</u>**

28. This impact assessment has demonstrated that the application of voluntary modulation in the United Kingdom, including on a regional basis is justifiable because:

- The UK believes that, given its circumstances, it is best placed to deliver against the Community objectives for the CAP as a whole through targeted support under the 2nd pillar – rural development; and that given the allocation of rural development funds it receives, it is necessary to make use of the facility to transfer funds through voluntary modulation in order to achieve this;
- When the wider benefits of the extra spending on the Rural Development Programme are considered, it is expected that the application of Voluntary Modulation has an overall positive impact on rural areas and the agricultural sector;

[19] http://statistics.defra.gov.uk/esg/statnot/account.pdf
[20] http://statistics.defra.gov.uk/esg/reports/UK%20report%202007%20(revised).pdf

- When viewed in the context of the inherent disparities which already exist within the CAP, the application of voluntary modulation in the United Kingdom will not result in unjustified unequal treatment between farmers;

- Because the rates of voluntary modulation being applied in the United Kingdom are clearly below 20%, the impact of the UK applying voluntary modulation is small when compared to the disparities between the differences in €/ha of Pillar 1 support across the EU15 Member States;

- The application of regionally differentiated rates of voluntary modulation within the United Kingdom is consistent with the regional flexibility already available under both pillars of the CAP;

- The presence of co-financing for voluntary modulation will result in a net increase in total CAP spending within the United Kingdom, thus allowing it to mitigate the implications of a disproportionately low share of the EAFRD allocation for the EU15 member states;

- Given the WTO Greenbox compatibility of both Pillar 1 and Pillar 2 payments under the CAP, voluntary modulation can only be either non or minimally, trade distorting;

- Increased rates of voluntary modulation will have negligible impacts on prices and production upon all agricultural sectors.

## SECTION 4 – APPLICATION OF VOLUNTARY MODULATION IN THE FOUR UNITED KINGDOM REGIONS

### A. ENGLAND

#### Voluntary Modulation and co-financing Rates that will apply

29. As detailed in the table at Annex 1, the rates of voluntary modulation that will apply in England on each Single Payment Scheme (SPS) year during the period 2007-2012 shall be:

2007 – 12%
2008 – 13%
2009 – 14%
2010 – 14%
2011 – 14%
2012 – 14%

Money generated from modulating SPS in any given year is made available for spend in the subsequent year (i.e. modulation of SPS 2007 is available for use in 2008).

#### Impact of the Application of Voluntary Modulation on Farms

30. Clearly, the application of VM is likely to lead to a reduction in farm incomes, since modulation payments will be deducted from the Single Farm Payment. However, it is important to put any reductions in income into context. For example:

- Farm income has fluctuated considerably in previous years. In 2006, UK Total Income from Farming (TIFF) was 60% lower in real terms than in 1995, but 41% higher than 2000. In the last year, UK TIFF is estimated to have risen by almost 7% in real terms. TIFF therefore fluctuates significantly, and whilst voluntary modulation will have an impact on farm incomes, it will not necessarily be the sole or largest driver of any changes in TIFF.

- At an aggregate level, funds subject to voluntary modulation are recycled into rural development payments, the majority of which go back to farmers in exchange for delivering environmental benefits. The decision to co-finance voluntary modulation expenditure on Axis 2 measures at a ratio of 60% EU to 40% national funds means that net CAP spending in England will be higher than it would have been without voluntary modulation.

- Research on the multiplier or ripple effect of agri-environment payments is limited, but it is reasonable to assume that expenditure under Axis 2 measures in England (expected to be some £3.3 billion over the period 2007-2013) will benefit the wider rural economy – perhaps in terms of payments to actors in the rural economy who specialise in delivering conservation advice or undertaking conservation work; or in terms of the economic side benefits of a well maintained and attractive rural environment. Agri-environment payments directed towards the promotion of public access in particular may generate additional economic benefits if new visitors are attracted to an area as a result of agri-environment activity made possible by voluntary modulation funding.

- 20% of all voluntary modulation funds will also be spent on axis 1 and 3 rural development measures which are designed to improve the competitiveness of the agriculture and forestry sectors and to enhance opportunity in rural areas. It is difficult to make an assessment at this stage about how much of this money will be recycled directly into farm incomes, but it certainly will not be zero.

31. Analysis[21] was undertaken in 2006 by independent consultants to examine different scenarios of voluntary modulation (VM). In the scenarios used, VM rates varied between 7.5% to 20% and the potential effects of these rates was assessed. However, the research concluded that many of the effects of increased voluntary modulation were uncertain, not least because the Single Payment Scheme was still in the early stages of implementation. Consequently, it was only one of a number of guiding factors which helped inform the

[21] Cumulus Consultants, IEEP and CCRU, “Analysis of scenarios of co-financing and voluntary modulation”

decision over voluntary modulation and co-financing rates to apply. The key findings of this research in relation to farm impacts are summarised below.

- Increasing voluntary modulation would increase modestly the proportion of farms with unprofitable production; however, this is on top of an already high proportion with negative income.

- Responses to increased voluntary modulation are expected to be varied including: seeking to cut costs further, develop other sources of income, move to larger farming units and increased use of contractors, or in a few extreme cases, exiting the industry.

- The higher the voluntary modulation rate, the faster and more widespread restructuring within the industry would be expected; although the extent of these effects is uncertain. Increased voluntary modulation could encourage farmers to adopt cost cutting measures, thus helping to move the industry towards sustainability and self-sufficiency.

**Environmental implications**

32. The major benefit of applying voluntary modulation in England is to generate funds for schemes under the Rural Development Programme, and particularly for agri-environment schemes. As discussed in the programme document itself, these deliver a wide range of benefits, including:

- wildlife conservation (both in protected areas and the wider countryside);
- the protection of the historic environment (focusing on the field monuments and vernacular buildings associated with the farmed environment);
- the maintenance of landscape quality and character;
- the promotion of public access and understanding;
- natural resource protection (focusing on the management of soil and water).

33. The analysis prepared by the consultants concluded that there could be positive and negative environmental impacts associated with higher rates of voluntary modulation. These impacts were also associated with the recent CAP Reforms, an important aspect of which was shifting support from Pillar 1 to Pillar 2 through compulsory modulation. The conclusions assumed that a rate of 20% with low (or even zero) co-financing would be applied, and given that the rate in England will peak at 14% with 40% co-financing under Axis 2, it is important to moderate these conclusions accordingly.

34. Positive environment impacts could arise from more targeted use of inputs including fertilisers, reductions in over grazing; and increased incentives to join agri-environment schemes in order to recoup some of income “lost”. Potential negative environmental impacts might include: under-grazing of some internationally important habitats; more rapid intensification of dairy and beef which affect water quality in specific locations; and further intensification in the arable sector may have negative impacts in relation to soil erosion and water quality.

35. Overall, the study concluded that there is significant uncertainty about the extent of these environmental effects under increasing rates of voluntary modulation. Importantly though, any potential negative environmental implications of applying voluntary modulation can be mitigated through the increased funding available for Environmental Stewardship Scheme.

**Impact on production and prices**

36. In terms of production and prices, the same academics from Queen’s University Belfast who undertook the UK level research quoted in Section 3 above also analysed the implications of increased modulation at England level. Their study concluded that if the modulation rate was increased to 25% it would yield a marginal production impact on the English beef and sheep sectors and negligibly small price increases, irrespective of either the presence or absence of match funding. The other sectors (dairy, crops, pork and poultry) show virtually no response. This is unsurprising, given the decoupled nature of the single payment.

**How were the rates decided upon?**

37. In deciding the voluntary modulation rates to apply, a number of factors were taken into consideration:

- Our experience of applying voluntary modulation since 2001;
- The need to ensure adequate funding for our rural development programme and agri-environment schemes in particular;
- The need to ensure that the rates of voluntary modulation did not have a disproportionate impact on the English farming industry, and that they should phased so as to provide the opportunity to adjust;
- The need to honour the significant amount of contractual commitments carried forward into the new Programming period;
- The need to ensure sufficient funding is provided for renewing agri-environment agreements close to expiry in order to ensure that the environmental outcomes which have been secured over the past 10 years (and before) are enhanced and maintained and not lost;
- The need to underpin the Government's commitment that Entry Level Stewardship should be open to all farmers and target of 70% agricultural land covered by the scheme;
- The need to observe the minimum expenditure per axis requirements laid down in EU legislation, which requires 10% of modulated funds to be spent under Axis 1 and 10% under Axis 3.

38. Since its launch in 2005, the Environmental Stewardship agri-environment scheme has been very successful and popular with English farmers. As at 1 June 2007, there were 29,500 agreements under the Entry Level of the scheme, covering some 4.3 million hectares of land, with annual payments set to exceed €210 million (£144 million). Under Higher Level Stewardship, there are already 475 agreements covering 116,000 hectares of land with annual payments close to €44 million (£30 million). For Entry Level Stewardship we are aiming to get 70% of agricultural area in England into the scheme by the end of the new programme period, equating to 6.4 million hectares. To date we have got about 46% of agricultural area in the scheme. For Higher Level Stewardship we are aiming to get over 635,000 hectares into the scheme during the lifetime of the programme.

39. Approximately €538 million of the €1.1 billion total EAFRD allocation for the Rural Development Programme 2007-2013 will be spent on commitments which were signed up to during the previous programme period and before. When factoring in ongoing commitments, the need to observe minimum expenditure requirements per axis and our ambitions for the Environmental Stewardship scheme, it is clear that the allocation of EU rural development funds will quickly become exhausted, and this is why the ability to apply voluntary modulation in order to supplement rural development funding is so crucial.

40. In deciding upon the rates of modulation to apply, a range of stakeholder interests and expectations were also taken into account. Some bodies were keen that the full 20% modulation rate allowable was applied in order to maximise the amount of funding available for expenditure on natural resource protection and environmental support measures. At the other end of the spectrum, there remain some stakeholders who would have preferred to see zero (or at least low) voluntary modulation. This was never an option though, as rates would have needed to be at least the level applied in 2006 in order to honour existing contractual commitments.

41. In summary, the rates of voluntary modulation that will be applied in England are deemed to be those that strike the right balance between funding under Pillar 1 and Pillar 2 support mechanisms, whilst contributing to EU and national priorities and objectives. The impacts of applying voluntary modulation will, as they have been since it was first used in 2001, continue to be monitored. It is hoped that the flexibility will be introduced to allow rates to be adjusted in light of implementation and the CAP healthcheck, as this will permit adjustments to be made in light of future developments at domestic or European level. Voluntary modulation in England will rise to 14% by 2009, an increase of 8 percentage points compared to 2006 levels but much lower than the 14 percentage point increase that would have been allowable under the regulations, which reflects the need to strike the right balance of funding under both Pillars of the CAP in England.

**How will voluntary modulation funds be spent in England and what benefits will be derived?**

42. In England, 80% of voluntary modulation receipts will be spent on agri-environment measures under axis 2 of the Rural Development Programme for England. 10% of voluntary modulation receipts will be spent under Axis 1, and 10% under Axis 3. Voluntary modulation spent on Axis 2 measures will be co-financed at an EU: National ratio of 60:40. This means that for every €60 of voluntary modulation spent under axis 2, the Government will provide a further €40. It is estimated that over the period to 2012, this will result in a net increase in overall CAP spending in England of approximately €1 billion.

43. The draft rural development programme for England 2007-2013 which was recently submitted to the European Commission contains a large amount of evidence justifying the level of priority attached to agri-

environment support in England[22]. Equally, this evidence underpins the importance of using voluntary modulation in order to ensure adequate funding for agri-environment support is provided.

44. For environment and land management, the analysis of the evidence showed that there are specific environmental problems in England in relation to biodiversity, resource protection, landscape (including historic features), and smaller scale, but still significant problems, in relation to land marginalisation and provision of access. Section 3.1 of the draft programme explains that it has been demonstrated that expenditure under the previous Programme has helped to slow, and in some cases reverse, environmental decline. However, it was also clear that significant expenditure is required in the future to safeguard investments already made and to continue to protect and enhance the environment; as well as address new environmental issues.

45. The natural and cultural environment has an inherent intrinsic value, which is difficult to quantify. There are however both direct and indirect benefits that result from its conservation, support for which is made possible by voluntary modulation. Although most of the direct benefits, such as improved biodiversity; protected and improved landscape (including the preservation of irreplaceable historic artefacts) do not have a monetary value, they may support economic activity. Contingent valuation studies show that many such environmental assets are highly valued by the public[23]. Evaluations of previous expenditure on the environmental impacts of land management[24],[25],[26] have concluded that such expenditure generated significant environmental benefits and were good value for money.

46. In addition there are secondary and indirect benefits resulting from the conservation of the natural and cultural environment which agri-environment (and voluntary modulation) supports. This includes increased employment resulting directly from agri-environment support, as well as indirectly through increased tourism and recreation. In addition a well-managed landscape provides an attractive environment for rural investment and is a source of wider economic opportunity in rural areas. It is logical that expenditure to maintain and improve that environment should result in maintained and improved economic returns; however data are not available directly relating improvement in the rural environment with increased economic activity.

47. Voluntary Modulation funds raised in England can only be spent on the Rural Development Programme for England, and this will result in benefits for farmers which do not directly manifest themselves in income. Support under Axis 1 of the Programme for example seeks to enhance the long-term competitiveness and sustainability of the agricultural and forestry sectors through focusing on knowledge transfer, modernisation, innovation and quality in the food chain and on investment in physical and human capital. Under Axis 3 of programme, resources must target the diversification of the rural economy and enhancing quality of life in rural areas. This will include supporting the creation of employment opportunities and conditions for growth, and the promotion of capacity building and skills acquisition.

## Other Issues

### Cost of entering agri-environment schemes

48. As explained, voluntary modulation entails the transfer of funds earmarked for Direct Payments to agri-environment schemes. This means that farmers and other land managers have to actively apply to join those schemes in order to gain access to the funding available. In England, responsibility for delivering the agri-environment schemes which will be funded from voluntary modulation resides with Natural England, an executive non-Departmental Public Body. Entry Level Stewardship is open to all farmers who wish to join it, and the application procedures have been designed to be simple and straightforward.

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[22] http://www.defra.gov.uk/erdp/rdp07_13/index.htm

[23] Economic Valuation of Environmental Impacts in the Severely Disadvantaged Areas –report for Defra by the Economics for the Environment Consultancy Ltd. (eftec). (2005)

[24] Defra (2002) Economic evaluation of agri-environment schemes Centre for Rural Economics Research, Department of Land Economy, University of Cambridge and CJC Consulting. Defra (2002) Economic Evaluation of the Organic Farming Scheme Centre for Rural Economics Research Department of Land Economy University of Cambridge

[25] Defra (2003) Review of agri-environment schemes – monitoring information and R&D results Ecoscope Applied Ecologists report, Ref RMP/1596.

[26] Boatman, N, Deppe, C, Garthwaite, D, Gregory, S and Jones, N E (2004) Evaluation of the pilot entry level scheme, final report Central Science Laboratory, Sand Hutton, York.

49. Access into the Environmental Stewardship may require farmers and land managers to significantly alter their farming or land management practices in order to deliver specific environmental outcomes upon their land. For higher level stewardship, applications are judged on the basis of the environmental outcomes that they are delivering and their cost. Changes to farming systems are compensated through income foregone payments and some associated capital works, e.g. for livestock introduction - fencing, livestock handling, water troughs may be supported through the scheme. Where major business structure changes are involved typically these include expensive options and will be weighed up against the environmental outcomes that these changes will deliver.

50. A formal evaluation of the Environmental Stewardship Scheme is due to be published later this year[27], and is expected to confirm that, on average, it takes an applicant only 16 hours to join the Entry Level scheme, which is the tier open to all farmers. This includes filling in the forms required, recording the features on their farm, and selecting which options from the broad range available they wish to base their agreement around. An interim report on the independent formal evaluation of Environmental Stewardship[28] has confirmed that the scheme is attractive to farmers, and that the majority of applicants found the forms for the Entry Level scheme easy to fill in.

Summary

51. This assessment of the impact of voluntary modulation in England has demonstrated that:

- The presence of co-financing for voluntary modulation will result in a net increase in CAP spending in England, thus helping to enhance the economic situation of farmers in England;
- Increased rates of voluntary modulation will have negligible impacts on prices and production;
- When viewed in context, the magnitude of voluntary modulation reductions on income is small in comparison with recent variations in TIFF;
- Whilst not necessarily affecting their short-term income, farmers will benefit In the longer term from the economic impacts of rural development support measures funded from voluntary modulation receipts;
- Although difficult to quantify at this stage, the use of voluntary modulation and co-financing on agri-environment schemes is expected to generate positive economic, as well as environmental benefits.

[27] http://www2.defra.gov.uk/research/Project_Data/More.asp?I=MA01028&M=CFO&V=CSL
[28] http://www.defra.gov.uk/science/project_data/DocumentLibrary/MA01028/MA01028_3736_EXE.doc

**B. NORTHERN IRELAND**

52. This assessment shows the economic impact of Voluntary Modulation in Northern Ireland and demonstrates that this does not result in unjustified unequal treatment between farmers. The rates of voluntary modulation to be applied to the Single Farm Payment scheme years are as follows:

| | |
|---|---|
| 2007 | 4.5% |
| 2008 | 6% |
| 2009 | 7% |
| 2010 | 8% |
| 2011 | 9% |
| 2012 | 9% |

**Impact of Voluntary Modulation on the Economic Position of Farmers**

53. In order to measure this, it is considered that it is necessary to look at the impact on production and prices of the principal commodities common to Northern Ireland and farmers' income.

**Production and Prices**

54. The Food and Agricultural Policy Research Institute (FAPRI)[29] in work published in February 2007 considered the impact on production and prices of increasing the rate of Voluntary Modulation from 4.5% (the rate applied in Northern Ireland in 2006) to 20% (the maximum allowed). The impacts on the various sectors are as follows:

**Table 1: Impact of increase in Voluntary Modulation rate from 4.5% to 20% on Northern Ireland agriculture**

| Sector | Production (% change) | Prices (% change) |
|---|---|---|
| Beef | -1 | 0 |
| Sheep | -1 | 0 |
| Dairy | - | - |
| Crops | - | - |
| Pigs | - | - |
| Poultry | - | - |

- indicates no discernable impact or significant change

55. The scenario examined by FAPRI represented, in effect, an increase in modulation rates of 15.5%. In Northern Ireland, as the highest rate of Voluntary Modulation to be applied is 9%, the impact will be less than that indicated in the scenario analysed by FAPRI. Hence, it is concluded that the application of Voluntary Modulation has no significant impact on agricultural production and prices in Northern Ireland and, hence, no differential impact on the competitiveness of Northern Ireland producers compared with those elsewhere in the UK or EU.

**Incomes**

56. In order to measure the impact on farmers' incomes, it was considered that the aggregate measure of Total Income from Farming (TIFF) should be used. As the FAPRI analysis shows no significant impact on production and prices, a static analysis of the impact of Voluntary Modulation on TIFF was considered appropriate.

57. Voluntary Modulation has two impacts on farmers' income. First of all, it reduces SFP by the stated percentage but it also provides additional money for the Rural Development Programme, some of which is returned to farmers as income. In Northern Ireland, 78% of Voluntary Modulation receipts will be spent on Axis

[29] Analysis of the Impact of the Abolition of Milk Quotas, Increased Modulation and Reductions in the Single Farm Payment on Northern Ireland Agriculture. Joan Moss, Myles Patton, Philip Kostov and Lichun Zhang (Queen's University Belfast & Agri-Food & Biosciences Institute) Julian Binfield and Patrick Westhoff (Food and Agricultural Policy Research Institute (FAPRI), University of Missouri) February 2007

I and Axis II Programme measures which benefit farmers' income directly. There is also expected to be direct and indirect benefit to farmers through Axis III of the Programme, but, as the exact funding amounts for each Axis III measure will not be determined until after the submission of local development strategies, this is not included in the calculations.

58. The Northern Ireland Assembly is currently undertaking a Comprehensive Spending Review which will determine the level of national funding available for the Rural Development Programme. However, based on working assumptions, it is anticipated that Government will co-finance Voluntary Modulation at rates of approximately 76%, i.e. for every £1 raised through Voluntary Modulation, Government will add £0.76. Without Voluntary Modulation, it is unlikely that this national funding would be available for the Programme. These additional national monies are particularly focused on those schemes in axis I and II which benefit farmers directly and hence the co-financing rate for these schemes is 96%. This will also have beneficial effects on farmers' incomes.

59. One of the Axis II schemes which will benefit from Voluntary Modulation and the associated national co-financing is the Less Favoured Area Compensatory Amounts (LFACA). The objective of this scheme is to target the sustainable use of agricultural land by compensating for additional costs related to farming in less favoured areas. Of the total extra monies which are made available for schemes of direct benefit for farmers as a result of voluntary modulation, 32% has been allocated to LFACA. Therefore the extra spending on the LFACA scheme as represented by Voluntary Modulation receipts and associated national funding is 49% (0.78 x 1.96 x 0.32 x 100) of Voluntary Modulation deductions. **Consequently 49% of total Voluntary Modulation deductions is returned to farmers as income as a result of extra LFACA scheme expenditure.**

60. In 2006, as Voluntary Modulation was 4.5% in Northern Ireland, TIFF for that year has been adjusted to what it would have been had no Voluntary Modulation been imposed, using the same assumptions as those outlined in the previous paragraph. TIFF for the years 2007 – 2012 has similarly been calculated.

**Table 2: Impact of specified Voluntary Modulation rates on Total Income From Farming in Northern Ireland (TIFF)**

| Year | VM Rate (%) | VM Deducted (£m) | RD Farmer Receipts (£m) | RD Receipts retained as income (£m) | TIFF (£m) | Income Impact on TIFF (%) |
|---|---|---|---|---|---|---|
| 2006 | 4.5 | 11.0 | 16.9 | 5.4 | 190.5 | - |
| 2006 | 0 | 0.0 | 0.0 | 0.0 | 196.1 | - |
| 2007 | 4.5 | 11.0 | 16.9 | 5.4 | 190.5 | -3 |
| 2008 | 6 | 14.7 | 22.5 | 7.2 | 188.6 | -4 |
| 2009 | 7 | 17.2 | 26.2 | 8.4 | 187.4 | -4 |
| 2010 | 8 | 19.6 | 30.0 | 9.6 | 186.1 | -5 |
| 2011 | 9 | 22.1 | 33.7 | 10.8 | 184.9 | -6 |
| 2012 | 9 | 22.1 | 33.7 | 10.8 | 184.9 | -6 |

Notes to Table 2

1. In 2006 in Northern Ireland, SFP (before any deductions) was £245m (€361.5 x 0.67770) and it is assumed to be constant for the period 2007 – 2012. This is the figure from which Voluntary Modulation is deducted
2. Rural Development (RD) receipts are the extra expenditure for Axis I and Axis II Rural Development Schemes which benefit farmers directly. They are calculated based on 78% of VM receipts being allocated to these schemes at a co-financing rate of 96%. Hence RD receipts = VM deducted x 0.78 x 1.96
3. RD receipts retained as income are based on the calculation that 32% of RD receipts are retained as income via LFACA scheme. RD receipts retained as income = RD farmer receipts x 32% or VM deducted x 49%.
4. TIFF for 2006 at 4.5%VM is the actual Northern Ireland figure as published. It has subsequently been adjusted for no VM to provide a baseline against which to assess the income effect of all VM deductions.
5. TIFF for 2007 is calculated as TIFF 2006 (adjusted for no VM) – VM deducted in 2007+ RD receipts retained as income in 2007. TIFF for 2008 – 2012 is similarly calculated.
6. Income impact is the change in TIFF compared with 2006 as adjusted for no VM.

61. At a Voluntary Modulation rate of 9%, the impact is to decrease aggregate farmers' income by 6%. It should be noted that TIFF can vary by much more than that between years due to other factors. For example, in

2002, TIFF decreased by 31% compared with 2001. The magnitude of the impact is such that it does not impact significantly on the economic situation of farmers and their comparative position in the agricultural sector.

62. It should also be noted that the extra money which Voluntary Modulation generates for the Rural Development Programme provides benefits for farmers which do not directly manifest themselves in income. For example, Axis I of the Programme directly aims to improve the competitiveness of the agricultural and forestry sector through:

- Providing farmers and farm families with bespoke and innovative vocational training and information actions
- Adding value to agricultural products through the application of appropriate technology together with sound manufacturing and environmental management practices;
- Encouraging greater integration and collaboration between producers, processors and others in the food chain, improving the application of technology within the supply chain and improving the marketing capability of businesses; and
- improving the application of technology in the forestry sector, encouraging greater integration and collaboration between producers, processors and others in the wood supply and renewable energy chains and improving the marketing capability of businesses
- Improving the physical capital of farm holdings; and
- Supporting new collaborative initiatives in the agri-food sector, leading to more effective and sustainable supply chains

63. Axis II of the Programme has the objective of improving the environment and the countryside through:

- Promoting environmental services and practices
- Preserving the farmed landscape
- Encouraging the development of new and existing forests and woodlands
- Supporting the growth of organic farming

64. Within the Axis III objective of improving the quality of life in rural areas and diversification of the rural economy, a specific measure aims to increase economic activity and employment rates in the wider rural economy through encouraging on-farm diversification into non-agricultural activities, off-farm diversification and re-skilling. Farmers and farm families are also expected to participate in, and benefit from, the other measures in Axis III of the Programme.

65. Before the application of Voluntary Modulation, the ratio of pillar 1 to pillar 2 payments in Northern Ireland is 15:1. This is out of line when compared with the EU-15 average of 5:1. The Voluntary Modulation rates applied in Northern Ireland will change the pillar 1: pillar 2 ratio payment to 6:1 by 2012, which is closer to both the EU-15 average and the UK position (after the application of VM in the UK).

**Conclusion**

66. It is concluded that the application of VM in Northern Ireland at the rates specified does not have a significant impact on production and prices. While farmers' incomes do decrease, the magnitude of the decrease is such the economic position of farmers or their comparative position in the agricultural sector is not altered significantly. Consequently, there is no unjustified unequal treatment of farmers in Northern Ireland when compared to those in the UK or other EU Member States. When the wider benefits of the extra spending on the Rural Development Programme are considered, it is felt that the application of Voluntary Modulation has an overall positive impact on rural areas and the agricultural community. Finally, it is noted that Voluntary Modulation means that the ratio of pillar 1: pillar 2 spending in Northern Ireland is much closer to the EU average than it would otherwise have been.

## C. SCOTLAND

67. This section sets out the voluntary modulation rates applicable in Scotland for 2007-2013 and goes on to provide an analysis of the impact and rationale behind the decision to use voluntary modulation in Scotland for the Scotland Rural Development Programme (SRDP) in accordance with Article 3 of the voluntary modulation regulation EC No. 378/2007.

68. Voluntary modulation is not new in Scotland, being used already, with rates of 3.5% and 4.5%, in 2005 and 2006 respectively. These resources were required to support a variety of agri-environment and forestry measures under the SRDP 2000-2006.

**Voluntary Modulation and Co-Financing Rates That Will Apply**

69. Table 1 shows the voluntary modulation rates for Scotland for the SRDP 2007-2013. For 2007, there is a 0.5% increase in the rate of voluntary modulation above the current rate. Over the programme, a stepped approach to increasing voluntary modulation is adopted with 5% in 2007, 8% in 2008, 8.5% in 2009 and rising to 9% from 2010 onwards. The rationale behind this stepped approach is that it gives farmers time in the early years of the programme to plan ahead for increased rates in later years.

**Table 1: Voluntary Modulation Rates for Scotland 2007-2012**

| | **2007** | **2008** | **2009** | **2010** | **2011** | **2012** |
|---|---|---|---|---|---|---|
| Rate of voluntary modulation | 5% | 8% | 8.5% | 9% | 9% | 9% |

70. These rates have been chosen to yield the amount of income required to deliver the outcomes desired from the SRDP.

71. The amount of money raised through voluntary modulation depends on two factors: the single farm payment baseline and the rate of voluntary modulation. Annex 1 presents the single farm payment baselines and voluntary modulation rates for all regions in the UK.

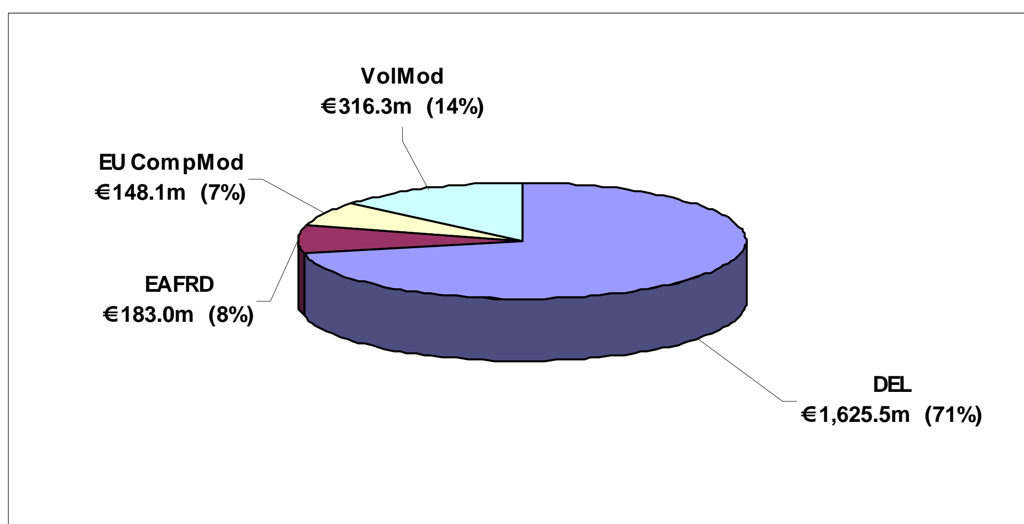
72. Table 2 shows the money raised from voluntary modulation in Scotland. In 2007, a voluntary modulation rate of 5% applied to the single farm baseline yields €32.48m. Total voluntary modulation receipts over the period 2007-2012 are €316.3m.

**Table 2 Modulation Yield in Scotland 2007-2012**

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | Total |
|---|---|---|---|---|---|---|---|
| Single Farm Payment Baseline (€m) | 649.60 | 652.26 | 653.68 | 652.04 | 652.04 | 655.04 | 3911.65 |
| Rate of voluntary modulation | 5% | 8% | 8.5% | 9% | 9% | 9% | - |
| **Yield (€m)** | **32.48** | **52.18** | **55.56** | **58.68** | **58.68** | **58.68** | **316.27** |

73. The chart below presents information on the income sources for the SRDP. Voluntary modulation receipts of €316.3m amount to 14% of total income. The largest component of income is €1625.5m of Scottish government Spending (DEL or departmental expenditure limit). This is equivalent to 71% of total income. The other sources of income are the European Agricultural Fund for Rural Development (EAFRD) and EU Compulsory Modulation. This means that for every €100 of voluntary modulation raised, the Scottish government provides €514. These figures are based on an exchange rate of £1=€1.46

**Income Sources for the SRDP 2007-2013**




74. In terms of expenditure, total expenditure for the SRDP 2007-2013 is estimated to be €2340.8m. Total Scottish government funding is €1,625.5m, giving a co-financing rate of 69%.

**How Will Voluntary Modulation Funds be Spent in Scotland and What Benefits will be derived?**

75. Spending of the rural development budget, including voluntary modulation, will be spread across the Axes in the Rural Development Regulation as follows: 16% of spend will be under Axis 1; 11% under Axis 3; and the majority (70%) under Axis 2.

76. The focus of spending under Axis 2 will contribute to important economic and social outcomes as well as environmental benefits. First, Less Favoured Area payments will maintain land-based activity in upland and remote areas, which are characterised by difficult physical operating conditions and long distances to markets. Second, environmental and landscape improvements under Axis 2 often benefit the wider economy, for example through the creation of productive woodlands and the development of tourism opportunities. A greater proportion of funding is allocated to Axis 2 in order to honour existing commitments – mainly to agri-environment and forestry - and to reflect the critical role of land management in the quality of our countryside and environment and its consequential impact on the economic and social development of rural Scotland. Funding will also be provided to promote standards of animal health and welfare significantly better than those required by law, further improving the reputation and competitiveness of the Scottish livestock industry and helping to protect society, the economy and the environment from the effects of animal diseases.

77. Overall, the money raised through voluntary modulation will be spent on the Scottish Government's five strategic objectives by encouraging:

- *a greener Scotland* through a combination of measures supporting woodland creation, agri-environment payments (including organic production), tackling climate change by providing support for renewable energy and improving the water environment;
- a *wealthier and fairer rural Scotland* through providing support to new entrants to farming, assisting the restructuring of agricultural businesses, promoting diversification of farm and forestry businesses and developing micro-enterprises;
- a *healthier Scotland* through building on Scotland's reputation for producing high quality food and funding measures to increase access to greenspace for leisure and recreation;
- *a safer and stronger rural Scotland* by supporting co-operation in rural areas, compensating those farming in Scotland's Less Favoured Areas for the permanent disadvantage they face when compared with other areas of Europe and providing recreation and sporting facilities for rural communities; and
- *a smarter rural Scotland* by providing resources for continuing skills development and modernisation through the use of technology, funding vocational training and promoting the understanding of the environment and countryside.

78. A wide range of economic, social and environmental benefits will therefore be derived from the SRDP. The evidence base for the choice of priorities and measures in the SRDP 2007-2013 are set out in detail in the programme document.

**Impact on Farming**

79. It is important to explore what impacts increasing rates of voluntary modulation might have on the farming industry. There are two main types of impact (i) impacts on agricultural production and prices and implications for the comparative position of Scottish agriculture and (ii) impact on farm incomes and implications for the economic situation of Scottish farmers. These impacts are now explored.

**Impact on production and prices**

80. The impact on production and prices in Scotland is sourced from the research into the impact of modulation conducted by FAPRI and the Queen's University of Belfast (referred to earlier). In addition to the UK level findings, a separate report presented the impacts at the Scotland level.

81. The research estimated the impact of modulation on production and prices in the dairy, beef, sheep and arable sectors in Scotland.

82. As with the UK level analysis, the FAPRI research used a voluntary modulation rate of 20%. Given a baseline rate of 5% for compulsory modulation, the analysis thus assumed an aggregate modulation rate of 25%.[30]

83. Table 3 summarises the results from the FAPRI research for Scotland. The table clearly shows that a high rate of modulation has negligible impacts on production and prices across all sectors. These findings mirror those for the UK.

**Table 3 Impact of Modulation at 25%: Results from FAPRI Research for Scotland**

| **Sector** | **Impacts of Modulation** |
|---|---|
| Dairy | • No discernable impacts on milk production.<br>• No change in the UK milk producer price. |
| Beef | • Slight negative impact on beef production in Scotland. The sizes of the suckler cow and total cattle herds will reduce by 1%. Consequently, beef production in Scotland will drop by 1%. |
| Sheep | • The number of Scottish ewes will drop by 1% and consequently production will fall by 1%.<br>• The drop in production will have a negligible negative impact on the producer price for sheepmeat. |
| Arable | • The impacts on wheat, barley, rapeseed and oats production in Scotland are negligible.<br>• Consequently, prices in the arable sector will remain unchanged. |

84. These results imply that any increase to the rates of modulation will have no effect on production or the competitive position of Scottish agriculture. Scottish Agriculture will therefore be well placed to compete with other countries in the European Union.

**Impact on cash incomes**

85. The impact on farm incomes is explored by using data on cash incomes from the Farm Accounts Survey in Scotland (a survey of around 500 farms across different farm types).

86. Cash income is measured as revenue (sales of livestock, livestock products, crops and payments/subsidies) minus expenditure (variable costs, general overheads, fuel, repairs, rent paid, paid labour, etc).

87. A lower single farm payment through modulation reduces revenue and results in a lower cash income.

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[30] The FAPRI model further assumes that the 25% aggregate rate of modulation is phased in from 2007 to 2010 in equal steps in all four regions of the UK – Scotland, England, Northern Ireland and Wales. The first €5,000 for each farmer is exempt from compulsory modulation but not from voluntary modulation. The analysis assumes that funds raised through voluntary modulation are 100% match-funded from domestic funds, and are redistributed to measures under Axis 2.

88. Impacts on cash income are estimated from a 5 year average of cash income between 2000 and 2005. An average over 5 years is used since cash incomes in some sectors fluctuate in particular years due to factors such as weather.

89. Since farmers are already paying 4.5% in voluntary modulation, the analysis focuses on the additional impact on cash income as a result of rates of voluntary modulation in excess of 4.5%.

90. The voluntary modulation rates of 5, 8%, 8.5% and 9% result in increases in voluntary modulation rates of 0.5%, 3.5%, 4% and 4.5% respectively.

91. The purpose of the analysis is to estimate differential impacts associated with different rates of voluntary modulation. Therefore, the analysis estimates average annual impacts and does not estimate cumulative impacts over the 2007-2012 period.

92. Additional contributions are estimated by applying the modulation rates to the single farm payment (or subsidies in earlier years). The contribution is then presented as a percentage of cash income.

93. Table 4 shows the additional contributions to the rural development budget that farmers would be making for voluntary modulation rates of 5%, 8%, 8.5% and 9%, over and above the voluntary modulation they pay at present (4.5%).

**Table 4 Additional Annual Contributions in Modulation (€ amount and as % of cash income) Compared to Current Situation**

| Farm Type | 5% Voluntary Modulation Rate | | 8% Voluntary Modulation Rate | | 8.5% Voluntary Modulation Rate | | 9% Voluntary Modulation Rate | |
|---|---|---|---|---|---|---|---|---|
| | Additional Contribution (€) | Impact on cash income | Additional Contribution (€) | Impact on cash income | Additional Contribution (€) | Impact on cash income | Additional Contribution (€) | Impact on cash income |
| LFA Specialist Sheep | 99 | -0.4% | 692 | -3.1% | 790 | -3.5% | 889 | -4.0% |
| LFA Specialist Beef | 209 | -0.5% | 1,460 | -3.5% | 1,669 | -4.0% | 1,877 | -4.5% |
| LFA Cattle and Sheep | 207 | -0.6% | 1,452 | -4.0% | 1,659 | -4.6% | 1,866 | -5.2% |
| Lowground Cattle and Sheep | 189 | -0.7% | 1,321 | -4.6% | 1,510 | -5.2% | 1,699 | -5.9% |
| Cereals | 217 | -0.5% | 1,520 | -3.4% | 1,738 | -3.9% | 1,955 | -4.3% |
| General Cropping | 219 | -0.4% | 1,532 | -2.5% | 1,751 | -2.9% | 1,969 | -3.3% |
| Dairy | 165 | -0.2% | 1,156 | -1.5% | 1,322 | -1.7% | 1,487 | -1.9% |
| Mixed | 268 | -0.6% | 1,877 | -4.0% | 2,146 | -4.6% | 2,414 | -5.2% |
| **Average** | **197** | **-0.5%** | **1,376** | **-3.3%** | **1,573** | **-3.8%** | 1,770 | **-4.3%** |

94. The additional annual contribution to modulation receipts for an average farm business is €197 (for a voluntary modulation rate of 5%). This increases to €1,770 for a voluntary modulation rate of 9%. The contributions vary by farm type with LFA specialist sheep farm businesses having the lowest contributions and mixed farm types the highest.

95. As a percentage of cash income, the average reduction in cash income is 0.5% for a rate of 5% (and 4.3% for a rate of 9%, respectively). By farm type, the highest percentage reduction in annual cash income is for low-ground cattle and sheep farm businesses (-5.9% for a 9% voluntary modulation rate).

96. At the maximum rate of voluntary modulation (20%), the average additional annual contribution would be €6,095 and the reduction in annual cash income 14.7% (figures not shown in table).

97. Although average cash incomes may be reduced by up to €1,770 per year from 2010 as a result of modulation, if farmers take up measures offered in the programme, such as those aimed at restructuring their businesses, then any reduction in farm incomes should be offset by consequent cost reductions and productivity improvements arising from restructuring.

98. In addition to measures focused at restructuring, other measures in the programme, such as diversification, will provide opportunities for farmers to offset income reductions from voluntary modulation by increasing their income streams, for example by adding value through the food supply chain or offering tourism products and services.

**Summary**

99. This section has explored the impact of increased rates of voluntary modulation on the farming industry in Scotland. The conclusions are as follows:

- Increased rates of voluntary modulation will have negligible impacts on prices and production. The competitive position of Scottish agriculture should therefore be unaffected and Scottish Agriculture will therefore remains well placed to compete with other countries in the European Union.
- Rates of voluntary modulation of between 5% and 9% will increase farmers' contributions to the rural development budget on average by between €197 (for 5%) to €1,770 (for 9%) per year.
- As a proportion of cash income, these additional contributions from rates of voluntary modulation of 5% and 9% reduce annual cash incomes by between 0.5% and 4.3% respectively.
- Despite income losses through modulation, farmers have the opportunity to undertake measures in the SRDP for which they will receive payments. Many of these payments will supplement farm incomes.
- Under Axis 1, for example, restructuring measures should result in efficiencies and cost savings thereby increasing farm income.
- Under Axis 2, for example, although agri-environment measures are paid on the basis of income forgone and therefore will not increase farm incomes, measures for non-productive investment provide an opportunity to increase the capital value of the business.
- Under Axes 1 and 3, other measures such as adding value and diversification will provide farmers with an opportunity to diversify and strengthen their income streams.
- The stepped approach to increasing in voluntary modulation, with lower rates in the earlier years, will allow farmers to plan early on how to adapt to higher rates in later years. This approach should minimise any adverse impacts of voluntary modulation.

**D. WALES**

Voluntary Modulation and co-financing Rates that will apply

100. Table 1 below sets out the rates of voluntary modulation that will apply in Wales during the period. The Total line is that shown in the table at Annex 1.

**Table 1 – Rates of Voluntary Modulation**

| | 2007 % | 2008 % | 2009 % | 2010 % | 2011 % | 2012 % |
|---|---|---|---|---|---|---|
| **Baseline** | 0 | 2.50 | 3.20 | 3.50 | 3.60 | 3.60 |
| **Axis 2 Review** | 0 | 0 | 1.00 | 2.30 | 2.90 | 2.90 |
| **Total** | **0** | **2.50** | **4.20** | **5.80** | **6.50** | **6.50** |

101. Voluntary modulation shall be co-financed at an EU: National ratio of 55%:45%. It is estimated that over the period to 2012, this will result in a net increase in overall CAP spending in Wales of approximately €55 million (including receipts from the previous voluntary modulation regime). This provides an incentive to farmers who have had their direct payments modulated to apply to join rural development schemes. This net increase in overall CAP spending will also help to mitigate the impact of direct payment beneficiaries in Wales having up to 6.50% of their payments subject to voluntary modulation although given that CAP direct payments under the Single Payment regime are decoupled, they no longer affect a farmers' ability to compete in the market.

How will voluntary modulation funds be spent?

102. In accordance with the requirements of Council Regulation (EC) 1698/2005 that provides the high level legal framework for rural development actions, 80% of voluntary modulation receipts will be spent on agri-environment measures under Axis 2 of the Rural Development Plan for Wales. 10% of voluntary modulation receipts will be spent under Axis 1 and 10% under Axis 3.

103. As shown in Table 1, from 2009 the rate of voluntary modulation will increase with the additional receipts primarily ring-fenced to fund the implementation, in 2010, of the results of the comprehensive review of Axis 2. The key objective of this review is to maximise the effectiveness of spending under Axis 2 in meeting both specific scheme objectives and the Welsh Assembly Government's wider environmental objectives. In respect of the latter, actions that contribute to the Environment Strategy for Wales and those relating to the climate change agenda, addressing the loss of biodiversity and the development of landscape-scale and ecosystem approaches to environmental issues. The Axis 2 review implementation is taking account also of the Assembly Government's long-term strategic agenda for Welsh farming as set out in "Farming for the Future" and will be informed by the Report from the "2020 Sustainable Farming Group" due in July 2007. The review will cover the sustainable management of woodlands, address a number of fundamental issues such as the effects of the implementation of CAP reform in Wales in 2003, which are as yet imperfectly understood but which may have profound impacts on the environment; the need to tackle wider environmental objectives, including carbon and water management to tackle climate change and to prepare for the implementation of the Water Framework Directive; and the need for greater integration between schemes.

Assessment of Impact of voluntary modulation on farming in Wales

104. There are two main types of impact on farming (i) impacts on agricultural production and prices and implications for the comparative position of Welsh agriculture and (ii) impact on farm incomes and implications for the economic situation of Welsh farmers.

**Impact on Production and Prices**

105. Farming in Wales is dominated by livestock production – sheep, beef and dairy. Arable represents around 10 per cent of production. The impact on production and prices is estimated using the FAPRI-UK model which gives results on the impacts of modulation for the dairy, beef, sheep and arable sectors in Wales. The FAPRI-UK model uses a voluntary modulation rate of 20% plus the baseline rate of 5% for compulsory modulation to give a cumulative rate of 25%. Although Wales is applying voluntary modulation at a rate well below this, it is not possible to alter the FAPRI-UK rates and so it has been used here for illustrative purposes.

106. The results of the analysis are summarised in Table 2. As concluded in the FAPRI-UK report, a modulation rate of 25% yields a marginal production impact on the Welsh beef and sheep sectors and negligibly small price increases. The dairy sector, together with the pork and poultry sectors, shows virtually no response. By implication, the application of the significantly lower rates proposed by Wales will have either negligible or zero impacts.

**Table 2 – Summary of FAPRI-UK Analysis for Wales**

| Sector | Impacts |
|---|---|
| **Dairy** | • There are no discernable impacts on dairy production;<br>• No change in the milk producer price. |
| **Beef** | • Slight negative impact on beef production;<br>• Negligible upward impact on projected cattle prices. |
| **Sheep** | • Projected Welsh ewe numbers will drop by 1% with a similar drop in production;<br>• Negligible upward impact on sheep meat prices. |
| **Arable** | • Small impact on the production of wheat, barley and rapeseed;<br>• Crop prices remain unchanged. |

**Impact on Incomes**

107. The impact on farm incomes can be assessed in two ways. At the farm level we can consider the impact on cash income. At the aggregate level we have looked at Total Income from Farming (TIFF). There are differences in the way that cash income and TIFF are calculated and as a result the impact on the two measures is not comparable.

108. Table 3 sets out the impact of changing the rate of voluntary modulation on cash incomes. In summary, the additional (i.e. additional to the modulation rate in 2006) annual contribution to modulation receipts for All Farm Types is £423 which represents an average reduction of 1.50%

for a rate of 2.50% in 2008, increasing to £1,269 which represents an average reduction of 4.40% for a rate of 6.50% in 2012.

109. Although cash incomes may be reduced, if farmers take up the measures offered in the RDP under Axis 1 such as those aimed at improving profitability and efficiency, then any income reduction arising from voluntary modulation can be offset by consequent cost reductions and productivity improvements. In addition, RDP measures focused on restructuring, such as non-agricultural diversification and agri-food schemes, will provide opportunities for farmers to mitigate reduction in the direct payments element by increasing their income streams from diversified sources. It is also the case that the RDP provides for an expansion in existing agri-environment activity under Axis 2 and that this expansion will accelerate from 2010, providing realistic opportunity for the farming community to participate in a broadening sustainable environment led-agenda while at the same time enhancing farm-income generation.

**Table 3 – Impact on Cash Incomes**

| **Year<br>VM rate** | | **2007<br>0%** | **2008<br>2.50%** | **2009<br>4.20%** | **2010<br>5.80%** | **2011<br>7.30%** | **2012<br>8.50%** | **2012<br>8.50%** |
|---|---|---|---|---|---|---|---|---|
| **Dairy** | £ | 75 | -298 | -552 | -790 | -895 | -895 | -895 |
| | % | 0.2 | -0.8 | -1.4 | -2.0 | -2.3 | -2.3 | -2.3 |
| | | | | | | | | |
| **LFA Grazing Livestock** | £ | 119 | -478 | -884 | -1,266 | -1,434 | -1,434 | -1,434 |
| | % | 0.5 | -1.9 | -3.4 | -4.9 | -5.6 | -5.6 | -5.6 |
| | | | | | | | | |
| **Lowland Grazing Livestock** | £ | 92 | -368 | -681 | -976 | -1,105 | -1,105 | -1,105 |
| | % | 0.5 | -1.9 | -3.5 | -5.0 | -5.6 | -5.6 | -5.6 |
| | | | | | | | | |
| **All Farm Types** | £ | 106 | -423 | -783 | -1,121 | -1,269 | -1,269 | -1,269 |
| | % | 0.4 | -1.5 | -2.7 | -3.9 | -4.4 | -4.4 | -4.4 |

110. Table 4 sets out the position in terms of Total Income from Farming (TIFF). For the purposes of the assessment 2006 has been taken as the baseline year adjusted for no voluntary modulation. Income impact is the change in TIFF compared to the adjusted 2006 figure.

**Table 4 – Impact on Total Income from Farming (TIFF)**

| **Year** | **VM Rate<br>%** | **TIFF<br>£m** | **Income Impact<br>%** |
|---|---|---|---|
| *2006* | *0.0* | *108.7* | *0.0* |
| 2007 | 0.0 | 108.7 | 0.0 |
| 2008 | 2.5 | 104.5 | -3.9 |

| | | | |
|---|---|---|---|
| 2009 | 4.2 | 101.6 | -6.6 |
| 2010 | 5.8 | 98.9 | -9.1 |
| 2011 | 6.5 | 97.7 | -10.2 |
| 2012 | 6.5 | 97.7 | -10.2 |

111. The arguments about farmers being able to address reductions in TIFF through greater cost efficiency, improved productivity and participation in other RDP schemes designed to diversify the farm income base are equally applicable.

112. In addition, the stepped approach to increase in voluntary modulation plus the clear proposals for how the receipts will be used, will allow farmers to plan how to adapt their businesses in order to minimise the impact.

**Impact on the Environment**

113. It is expected that there will be both positive and negative environmental impacts associated with voluntary modulation but these are effectively the same as those associated with the current CAP Reforms. The Welsh Assembly Government is already considering the likely effects of the reforms and this work will contribute to the recently commenced review on Axis 2 measures and where the conclusions will influence the development and implementation of current and future schemes.

114. Briefly, it is expected that positive impacts will arise from the increased emphasis on agri-environment and land management schemes including the introduction of catchment sensitive farming measures and the enhanced package of measures anticipated as a result of the Axis 2 review. The most likely areas where negative impacts might be expected include reductions in suckler cow numbers, which could lead to under-grazing and damage to biodiversity and habitat, and intensification of dairy and beef farming, which could adversely affect water quality.

115. Both the positive and negative impacts will be monitored as part of the ongoing monitoring and evaluation arrangements for the RDP as a whole and at scheme level.

Other Issues

116. In accordance with Council Regulation 378/2007, Wales will monitor the impact of voluntary modulation.

## ANNEX 1

| 2007 | ENGLAND | | | SCOTLAND | | | WALES | | | NORTHERN IRELAND | | | UNITED KINGDOM | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Payment (€) (1) | Rate of Vol. Mod (%) (2) | Retention (€) (3) = (1)*(2) | Payment (€) (4) | Rate of Vol. Mod (%) (5) | Retention (€) (6) = (4)*(5) | Payment (€) (7) | Rate of Vol. Mod (%) (8) | Retention (€) (9) = (7)*(8) | Payment (€) (10) | Rate of Vol. Mod (%) (11) | Retention (€) (12) = (11)*(12) | Total payments (€) (13)=(1)+(4)+(7)+(10) | Total retention (€) (14)=(3)+(6)+(9)+(12) | Total payments - Total retention (13)-(14) |
| SPS | 2,593,090,315 | 12.0% | 311,170,838 | 622,927,750 | 5.0% | 31,146,388 | 353,590,764 | 0.0% | 0 | 361,577,171 | 4.5% | 16,270,973 | 3,931,186,000 | 358,588,198 | 3,572,597,802 |
| Art 69 Beef | - | 12.0% | 0 | 29,800,000 | 5.0% | 1,490,000 | - | 0.0% | 0 | - | 4.5% | 0 | 29,800,000 | 1,490,000 | 28,310,000 |
| Area payments for nuts | 12,075 | 12.0% | 1,449 | - | 5.0% | 0 | - | 0.0% | 0 | - | 4.5% | 0 | 12,075 | 1,449 | 10,626 |
| Aid for energy crops | 7,751,214 | 12.0% | 930,146 | 421,310 | 5.0% | 21,066 | 8,244 | 0.0% | 0 | 26,993 | 4.5% | 1,215 | 8,207,761 | 952,426 | 7,255,335 |
| Protein crop premium | 7,719,679 | 12.0% | 926,361 | 458,834 | 5.0% | 22,942 | 56,784 | 0.0% | 0 | 16,240 | 4.5% | 731 | 8,251,538 | 950,034 | 7,301,504 |
| Total | | | 313,028,794 | | | 32,680,395 | | | 0 | | | 16,272,918 | | 361,982,107 | |

of which

England

Scotland

Wales

Northern Ireland

| 2008 | ENGLAND | | | SCOTLAND | | | WALES | | | NORTHERN IRELAND | | | UNITED KINGDOM | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Payment (€) (1) | Rate of Vol. Mod (%) (2) | Retention (€) (3) = (1)*(2) | Payment (€) (4) | Rate of Vol. Mod (%) (5) | Retention (€) (6) = (4)*(5) | Payment (€) (7) | Rate of Vol. Mod (%) (8) | Retention (€) (9) = (7)*(8) | Payment (€) (10) | Rate of Vol. Mod (%) (11) | Retention (€) (12) = (11)*(12) | Total payments (€) (13)=(1)+(4)+(7)+(10) | Total retention (€) (14)=(3)+(6)+(9)+(12) | Total payments - Total retention (13)-(14) |
| SPS | 2,609,279,315 | 13.0% | 339,206,311 | 622,927,750 | 8.0% | 49,834,220 | 353,590,764 | 2.5% | 8,839,769 | 361,577,171 | 6.0% | 21,694,630 | 3,947,375,000 | 419,574,930 | 3,527,800,070 |
| Art 69 Beef | - | 13.0% | 0 | 29,800,000 | 8.0% | 2,384,000 | - | 2.5% | 0 | - | 6.0% | 0 | 29,800,000 | | 27,416,000 |
| Area payments for nuts | 12,075 | 13.0% | 1,570 | - | 8.0% | 0 | - | 2.5% | 0 | - | 6.0% | 0 | 12,075 | 1,570 | 10,505 |
| Aid for energy crops | 7,751,214 | 13.0% | 1,007,658 | 421,310 | 8.0% | 33,705 | 8,244 | 2.5% | 206 | 26,993 | 6.0% | 1,620 | 8,207,761 | 1,043,188 | 7,164,573 |
| Protein crop premium | 7,719,679 | 13.0% | 1,003,558 | 458,834 | 8.0% | 36,707 | 56,784 | 2.5% | 1,420 | 16,240 | 6.0% | 974 | 8,251,537 | 1,042,659 | 7,208,878 |
| Total | | | 341,219,097 | | | 52,288,632 | | | 8,841,395 | | | 21,697,224 | | 424,046,347 | |

of which
England
Scotland
Wales
Northern Ireland

| 2009 | ENGLAND | | | SCOTLAND | | | WALES | | | NORTHERN IRELAND | | | UNITED KINGDOM | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Payment (€) (1) | Rate of Vol. Mod (%) (2) | Retention (€) (3) = (1)*(2) | Payment (€) (4) | Rate of Vol. Mod (%) (5) | Retention (€) (6) = (4)*(5) | Payment (€) (7) | Rate of Vol. Mod (%) (8) | Retention (€) (9) = (7)*(8) | Payment (€) (10) | Rate of Vol. Mod (%) (11) | Retention (€) (12) = (11)*(12) | Total payments (€) (13)=(1)+(4)+(7)+(10) | Total retention (€) (14)=(3)+(6)+(9)+(12) | Total payments - Total retention (13)-(14) |
| SPS | 2,617,938,315 | 14.0% | 366,511,364 | 622,927,750 | 8.5% | 52,948,859 | 353,590,764 | 4.2% | 14,850,812 | 361,577,171 | 7.0% | 25,310,402 | 3,956,034,000 | 459,621,437 | 3,496,412,563 |
| Art 69 Beef | - | 14.0% | 0 | 29,800,000 | 8.5% | 2,533,000 | - | 4.2% | 0 | - | 7.0% | 0 | 29,800,000 | 2,533,000 | 27,267,000 |
| Area payments for nuts | 12,075 | 14.0% | 1,691 | - | 8.5% | 0 | - | 4.2% | 0 | - | 7.0% | 0 | 12,075 | 1,691 | 10,385 |
| Aid for energy crops | 7,751,214 | 14.0% | 1,085,170 | 421,310 | 8.5% | 35,811 | 8,244 | 4.2% | 346 | 26,993 | 7.0% | 1,889 | 8,207,761 | 1,123,217 | 7,084,544 |
| Protein crop premium | 7,719,679 | 14.0% | 1,080,755 | 458,834 | 8.5% | 39,001 | 56,784 | 4.2% | 2,385 | 16,240 | 7.0% | 1,137 | 8,251,537 | 1,123,278 | 7,128,260 |
| Total | | | 368,678,980 | | | 55,556,671 | | | 14,853,543 | | | 25,313,428 | | 464,402,622 | |

of which

- England
- Scotland
- Wales
- Northern Ireland

| 2010 | ENGLAND | | | SCOTLAND | | | WALES | | | NORTHERN IRELAND | | | UNITED KINGDOM | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Payment (€) (1) | Rate of Vol. Mod (%) (2) | Retention (€) (3) = (1)*(2) | Payment (€) (4) | Rate of Vol. Mod (%) (5) | Retention (€) (6) = (4)*(5) | Payment (€) (7) | Rate of Vol. Mod (%) (8) | Retention (€) (9) = (7)*(8) | Payment (€) (10) | Rate of Vol. Mod (%) (11) | Retention (€) (12) = (11)*(12) | Total payments (€) (13)=(1)+(4)+(7)+(10) | Total retention (€) (14)=(3)+(6)+(9)+(12) | Total payments - Total retention (13)-(14) |
| SPS | 2,607,953,315 | 14.0% | 365,113,464 | 622,927,750 | 9.0% | 56,063,498 | 353,590,764 | 5.8% | 20,508,264 | 361,577,171 | 8.0% | 28,926,174 | 3,946,049,000 | 470,611,400 | 3,475,437,600 |
| Art 69 Beef | - | 14.0% | 0 | 29,800,000 | 9.0% | 2,682,000 | - | 5.8% | 0 | - | 8.0% | 0 | 29,800,000 | 2,682,000 | 27,118,000 |
| Area payments for nuts | 12,075 | 14.0% | 1,691 | - | 9.0% | 0 | - | 5.8% | 0 | - | 8.0% | 0 | 12,075 | 1,691 | 10,385 |
| Aid for energy crops | 7,751,214 | 14.0% | 1,085,170 | 421,310 | 9.0% | 37,918 | 8,244 | 5.8% | 478 | 26,993 | 8.0% | 2,159 | 8,207,761 | 1,125,725 | 7,082,035 |
| Protein crop premium | 7,719,679 | 14.0% | 1,080,755 | 458,834 | 9.0% | 41,295 | 56,784 | 5.8% | 3,293 | 16,240 | 8.0% | 1,299 | 8,251,537 | 1,126,643 | 7,124,894 |
| Total | | | 367,281,080 | | | 58,824,710 | | | 20,512,036 | | | 28,929,632 | | 475,547,458 | |

of which
- England
- Scotland
- Wales
- Northern Ireland

| 2011 | ENGLAND | | | SCOTLAND | | | WALES | | | NORTHERN IRELAND | | | UNITED KINGDOM | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Payment (€) (1) | Rate of Vol. Mod (%) (2) | Retention (€) (3) = (1)*(2) | Payment (€) (4) | Rate of Vol. Mod (%) (5) | Retention (€) (6) = (4)*(5) | Payment (€) (7) | Rate of Vol. Mod (%) (8) | Retention (€) (9) = (7)*(8) | Payment (€) (10) | Rate of Vol. Mod (%) (11) | Retention (€) (12) = (11)*(12) | Total payments (€) (13)=(1)+(4)+(7)+(10) | Total retention (€) (14)=(3)+(6)+(9)+(12) | Total payments - Total retention (13)-(14) |
| SPS | 2,607,953,315 | 14.0% | 365,113,464 | 622,927,750 | 9.0% | 56,063,498 | 353,590,764 | 6.5% | 22,983,400 | 361,577,171 | 9.0% | 32,541,945 | 3,946,049,000 | 476,702,307 | 3,469,346,693 |
| Art 69 Beef | - | 14.0% | 0 | 29,800,000 | 9.0% | 2,682,000 | - | 6.5% | 0 | - | 9.0% | 0 | 29,800,000 | 2,682,000 | 27,118,000 |
| Area payments for nuts | 12,075 | 14.0% | 1,691 | - | 9.0% | 0 | - | 6.5% | 0 | - | 9.0% | 0 | 12,075 | 1,691 | 10,385 |
| Aid for energy crops | 7,751,214 | 14.0% | 1,085,170 | 421,310 | 9.0% | 37,918 | 8,244 | 6.5% | 536 | 26,993 | 9.0% | 2,429 | 8,207,761 | 1,126,053 | 7,081,708 |
| Protein crop premium | 7,719,679 | 14.0% | 1,080,755 | 458,834 | 9.0% | 41,295 | 56,784 | 6.5% | 3,691 | 16,240 | 9.0% | 1,462 | 8,251,537 | 1,127,203 | 7,124,335 |
| Total | | | 367,281,080 | | | 58,824,710 | | | 22,987,626 | | | 32,545,836 | | 481,639,253 | |

of which

England

Scotland

Wales

Northern Ireland

| 2012 | ENGLAND | | | SCOTLAND | | | WALES | | | NORTHERN IRELAND | | | UNITED KINGDOM | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Payment (€) (1) | Rate of Vol. Mod (%) (2) | Retention (€) (3) = (1)*(2) | Payment (€) (4) | Rate of Vol. Mod (%) (5) | Retention (€) (6) = (4)*(5) | Payment (€) (7) | Rate of Vol. Mod (%) (8) | Retention (€) (9) = (7)*(8) | Payment (€) (10) | Rate of Vol. Mod (%) (11) | Retention (€) (12) = (11)*(12) | Total payments (€) (13)=(1)+(4)+(7)+(10) | Total retention (€) (14)=(3)+(6)+(9)+(12) | Total payments - Total retention (13)-(14) |
| SPS | 2,607,953,315 | 14.0% | 365,113,464 | 622,927,750 | 9.0% | 56,063,498 | 353,590,764 | 6.5% | 22,983,400 | 361,577,171 | 9.0% | 32,541,945 | 3,946,049,000 | 476,702,307 | 3,469,346,693 |
| Art 69 Beef | - | 14.0% | 0 | 29,800,000 | 9.0% | 2,682,000 | - | 6.5% | 0 | - | 9.0% | 0 | 29,800,000 | 2,682,000 | 27,118,000 |
| Area payments for nuts | 12,075 | 14.0% | 1,691 | - | 9.0% | 0 | - | 6.5% | 0 | - | 9.0% | 0 | 12,075 | 1,691 | 10,385 |
| Aid for energy crops | 7,751,214 | 14.0% | 1,085,170 | 421,310 | 9.0% | 37,918 | 8,244 | 6.5% | 536 | 26,993 | 9.0% | 2,429 | 8,207,761 | 1,126,053 | 7,081,708 |
| Protein crop premium | 7,719,679 | 14.0% | 1,080,755 | 458,834 | 9.0% | 41,295 | 56,784 | 6.5% | 3,691 | 16,240 | 9.0% | 1,462 | 8,251,537 | 1,127,203 | 7,124,335 |
| Total | | | 367,281,080 | | | 58,824,710 | | | 22,987,626 | | | 32,545,836 | | 481,639,253 | |

of which

England

Scotland

Wales

Northern Ireland

ANNEX 2

| EU15 Ceilings (in €) | Pillar 1 Total 2007-2013 (Reg 2013/2006) | Pillar 2 Total 2007-2013 (Dec 636/2006) | Total CAP Ceiling 2007-2013 | Total Utilised Agri Area ('000ha) | % Share of Utilised Agri Area | Pillar 1 Annual average €/ha of UAA | Pillar 2 Annual average €/ha of UAA | Pillar 2 as % of Total CAP | Ratio Pillar 1 : Pillar 2 |
|---|---|---|---|---|---|---|---|---|---|
| | **(A)** | **(B)** | **(C)** | **(D)** | **(E)** | **(F)** | **(G)** | **(H)** | **(I)** |
| **Belgium** | 4,024,588,760 | 418,610,306 | 4,443,199,066 | 1,386 | 1% | 415 | 43 | 9% | 10:1 |
| **Denmark** | 6,836,821,540 | 444,660,796 | 7,281,482,336 | 2,712 | 2% | 360 | 23 | 6% | 15:1 |
| **Germany** | 38,227,507,850 | 8,112,517,055 | 46,340,024,905 | 17,035 | 13% | 321 | 68 | 18% | 5:1 |
| **Greece** | 13,924,820,930 | 3,707,304,424 | 17,632,125,354 | 3,805 | 3% | 523 | 139 | 21% | 4:1 |
| **Spain** | 31,055,942,050 | 7,213,917,799 | 38,269,859,849 | 25,690 | 20% | 173 | 40 | 19% | 4:1 |
| **France** | 55,462,743,450 | 6,441,965,109 | 61,904,708,559 | 29,632 | 23% | 267 | 31 | 10% | 9:1 |
| **Ireland** | 8,922,275,460 | 2,339,914,590 | 11,262,190,050 | 4,307 | 3% | 296 | 78 | 21% | 4:1 |
| **Italy** | 25,588,874,780 | 8,292,009,883 | 33,880,884,663 | 14,710 | 11% | 249 | 81 | 24% | 3:1 |
| **Luxembourg** | 246,328,620 | 90,037,826 | 336,366,446 | 129 | 0% | 273 | 100 | 27% | 3:1 |
| **Netherlands** | 5,249,172,490 | 486,521,167 | 5,735,693,657 | 1,924 | 1% | 390 | 36 | 8% | 11:1 |
| **Austria** | 4,845,356,470 | 3,911,469,992 | 8,756,826,462 | 3,263 | 2% | 212 | 171 | 45% | 1:1 |
| **Portugal** | 3,746,819,270 | 3,929,325,028 | 7,676,144,298 | 3,722 | 3% | 144 | 151 | 51% | 1:1 |
| **Finland** | 3,762,508,560 | 2,079,932,907 | 5,842,441,467 | 2,267 | 2% | 237 | 131 | 36% | 2:1 |
| **Sweden** | 4,983,351,620 | 1,825,647,954 | 6,808,999,574 | 3,201 | 2% | 222 | 81 | 27% | 3:1 |
| **United Kingdom** | 26,445,920,100 | 1,909,574,420 | 28,355,494,520 | 16,761 | 13% | 225 | 16 | 7% | 14:1 |
| **Total** | **233,323,031,950** | **51,203,409,256** | **284,526,441,206** | **130,544** | **100%** | 255 | **56** | **18%** | **5:1** |
| *United Kingdom** | *21,156,736,080* | *7,198,758,440* | *28,355,494,520* | *16,761* | *13%* | *180* | *61* | *25%* | *3:1* |

**Explanatory Notes**

**Column A:** Direct payment ceilings for each EU15 member state for the period 2006-2012 in Euros which were last updated by Regulation 2013 of 2006. All of these figures have been adjusted to reflect 4% deduction for compulsory modulation in 2006, and 5% compulsory modulation for years 2007-2012.

**Column B:** EAFRD allocation (including redistribution of compulsory modulation receipts) for each EU15 member state in accordance with Commission Decision number 636 of 12 September 2006. This is the allocation of EU rural development funds.

**Column C:** Total of Column A and Column B. Constitutes a combined ceiling for Pillar 1 and Pillar 2

**Column D:** Total utilised agricultural area, Source: Eurostat Yearbook 2006-07. This reflects the total area used for crops production which is exhaustively described as arable land including temporary grassing and fallow and green manure, permanent grassland, land under permanent crops, crops under glass and other utilised agricultural areas.

**Column E:** Automatically calculated, shows each Member States' respective percentage share of EU15 utilised agricultural area.

**Column F:** Automatically calculated by dividing the amount in Column A by the amount in Column D. Gives an indication of how many euros are available per hectare of utilised agricultural land area under Direct Payment support.

**Column G:** Automatically calculated by dividing the amount in Column B by the amount in Column D. Gives an indication of how many euros are available per hectare of utilised agricultural land area under EU rural development support.

**Column H:** Automatic percentage calculation based on columns B and C and indicates the proportion of overall CAP support which is directed through Pillar 2.

**Column I:** The ratio of Pillar 1 support to Pillar 2 support.

* Second line for United Kingdom is provided to illustrate the effects of 20% UK voluntary modulation on Pillar 1 and Pillar 2 average annual €/ha based on Utilised Agricultural Area