

# **E**uropean **L**andowners **O**rganisation

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## **THE MODULATION OF AGRICULTURAL SUPPORT PAYMENTS:** **A FLAWED POLICY**

### ***Introduction***

1. After prompting a flurry of interest in the early 1990s, the issue of modulation seemed to have vanished from policy-makers' agenda. It has now resurfaced with a vengeance. The ELO had produced a paper on modulation in 1995 (EPG 2/95). In light of the renewed calls for modulation of agricultural support payments, it was though appropriate to reconsider our views on this important issue.
2. The main impetus behind the 1992 'MacSharry' reform was the spiralling cost of agricultural support as well as international pressure for the EC to adopt a less trade-distorting system. The system which was adopted marked a significant break with the CAP's traditional support mechanisms. Until then, support to agriculture was principally based on the use of price mechanisms: protected by tariff barriers, farmers in the EC benefited from high levels of internal prices. Apart from a limited number of commodities (such as sugarbeet), these prices applied to all producers, regardless of size or volume of output. The 1992 reform went some way towards breaking the link between price and support, as levels of price support were reduced, and compensation was paid to farmers on a per hectare or headage basis. In the case of livestock payments, support was limited to a certain number of eligible animals each year, thus introducing an element of ***modulation*** of support within the CAP.
3. Strictly speaking, 'modulation' of support means structuring support payments in such a way as to benefit a specific group within a target population, to the expense of the rest of the group. Within the context of the CAP, this is generally understood as using holding size as a discriminating

criterion to concentrate support on smaller holdings. Many arguments are invoked to justify the use of modulation, ranging from the environment to socio-economic reasons. Their common thread is that they consider smaller holdings as being worthier of attention.

4. Thus modulation of support, it is claimed, would among other things:
  - concentrate resources on supporting people who play a vital role in maintaining the rural economy;
  - favour a sector of the farming community which is more environment-friendly (and therefore more in tune with current aspirations) than other farming groups;
  - contribute to the struggle against ever-increasing holding size (seen as a 'bad thing');
  - support holdings which are perceived as more economically vulnerable;
  - reverse the existing situation, considered as 'unfair', in which some farmers receive payments of ECU 1 million under the arable area payment scheme.
  
5. It is argued here that the introduction of modulation would not only fail to satisfy these objectives, but would have a negative impact on the economy as a whole. In many cases, **the relation 'small holding' = 'good thing' = deserving of more support' does not hold**. This will be discussed in the following pages. It is important to emphasise that the case against modulation is prompted less by the fact that it would fail to reach some of its objectives (in themselves may not be undesirable), but that it provides a **highly inefficient** way of doing so.

### ***Arguments against modulation***

6. The argument that ***modulation, by supporting small holdings, would contribute to the increased prosperity of rural communities*** is fundamentally flawed as it rests on the assumption that rural areas are mainly dependent on agriculture. Though some rural areas are undeniably more dependent on agriculture than others, the European-wide trend over past decades has been towards a gradual reduction of the share of agriculture's contribution to the rural economy. Supporting small holdings as a means of supporting the rural economy thus would be inefficient.

7. If the objective of modulation is to sustain the rural economy, one must ask whether public funds could not be better used on stimulating the wider rural economy? The multiplying effects of using public funds to support broader rural development initiatives would be much greater. They could among other things provide non-agricultural employment opportunities for family members in small farm households, consequently increasing the spending power of the household (and enabling the family farm to survive), with a positive impact on the whole local economy... This would also contribute to developing a sustainable rural economy, whereas the use of modulation would create a false feeling of security for smaller holdings, entirely dependent on *continued* hand-outs (which, in the present climate of budgetary austerity is more than doubtful).
  
8. The argument that ***modulation would target those farmers who are more environmentally-inclined*** can also be rejected. In fact, there is no empirical evidence to support this. Research for the Royal Society for the Protection of Birds (RSPB) found “no clear connection between the economic or physical size of a farm and its environmental sensitivity”<sup>1</sup>. There does, however, seem to be a link between the degree of financial constraint of the holding and active involvement in conservation. Gasson and Potter (1988)<sup>2</sup> have shown that farmers under the least financial constraint (which were on average the larger holdings) had the highest levels of conservation orientation. This is because environmental work is often costly to undertake. Though managers of small farms can and often do care for the environment, they often will not have the resources (either in capital or labour) to devote to environmental work which managers on larger holdings have.
  
9. If the main reason behind the use of modulation is to support environment-friendly practices, is it not more reasonable to use these resources in a more targeted fashion, through the use of specific grants / payments for the production of environment goods? The use of modulation would be an indiscriminate way of ‘sprinkling’ funds over the countryside with no assurance that the extra resources would be used for environmental tasks. Moreover, it would deliberately ignore the larger holdings, i.e. those which cover proportionately more land and can potentially contribute greatly to the

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<sup>1</sup> Potter, C., Loble, L. (1992); *Small farming and the environment*; RSPB; May 1992.

<sup>2</sup> Gasson, R., Potter, C. (1988); “conservation through land diversion: a survey of farmers’ attitudes”; *Journal of Agricultural Economics* 39(3):340-351.

environmental well-being of the countryside. This could have potentially harmful consequences for the environment.

10. The argument that ***modulation would support the continued existence of small holdings***, perceived as socially more desirable than larger holdings, is a fallacious one. The preceding paragraphs have argued why smaller holdings are overall unlikely to be more environment-friendly, or greater contributors to the rural economy than larger holdings.
11. Short of paying huge amounts to support smaller holdings (which could be a politically difficult idea to sell), such payments are unlikely to reverse the trend towards the enlargement of holdings. The history of the CAP offers an illustration of this, as it is generally accepted that the CAP slowed down, but did not prevent the shift towards the amalgamation of holdings. The way in which modulation could slow down this trend is by encouraging artificial farm divisions, particularly of those holdings which are close to the threshold. This would subvert the objectives of the system and lead to increased public expenditure (both through payments and through monitoring).
12. Arguably, all other things being equal, a smaller holdings will generally be less financially secure than a larger one. However, many small holdings in the EU are financially secure, either through agricultural diversification towards high value-added products (e.g. fruit and vegetables), or through pluri-activity. It is also true that smaller holdings often do not have the capacity to purchase large equipment or to negotiate favourable agreements with traders. In many countries of the EU however, co-operatives and machinery rings exist precisely to overcome these difficulties.
13. If modulation were *really* aimed at helping small holdings overcome handicaps of scale, would these funds not be better used on helping them *improve* their situation, either by supporting co-operative ventures, or offering technical assistance to help them improve the quality of their output or to diversify? Modulation would discriminate against larger holdings without necessarily helping smaller ones to become more viable - and sustainable - in the longer run. In this it would constitute a crutch, rather than a cure, recalling the proverb which is often cited in the debate on the nature of aid to developing countries: 'give a man a fish and he will eat for one day, teach him how to fish and he will be able to eat all his life'.

14. Moreover, it is important not to lose sight of the fact that the forthcoming WTO negotiations are likely to put further pressures on the EU to reduce its support to agriculture, and open up to imports from third countries. Consequently EU farms will have to be increasingly efficient, which will generally mean that the smallest European holdings, which do not benefit from some economies of scale, will be at a competitive disadvantage. Southern European countries, which are most vocal in asking for modulation of support, have to face up to the prospect of free trade by 2010 with Southern Mediterranean countries (Algeria, Israel, Jordan, Morocco, Tunisia, Turkey...) all of which will prove fierce competitors to EC producers. A more long-sighted policy would be to encourage Southern European producers to prepare for these forthcoming changes. Modulation would not contribute to such a process of adaptation.

### **Summary**

15. Modulation of agricultural support, under closer scrutiny, thus appears as a very inefficient means of providing support to a target group. It would be acceptable only if it could be clearly proven that the population it targeted were particularly deserving of support, for environmental or socio-economic reasons. This has been shown not to be the case: farmers on small holdings are not necessarily more environment-friendly than farmers on larger holdings, neither is supporting them more likely to generate a healthier rural economy. The very arbitrariness of the modulation process also makes it inappropriate as a social policy instrument: poverty is not a linear function either of activity (farming / non-farming) or of size (large / small).
16. In the wake of the Cork Conference, it seems clear that rural development objectives are gaining importance within the EU. Modulation of support to agriculture is not an effective way of supporting these objectives, as it is targeted to a small section of the rural population. Resources which could have been used on stimulating the wider rural economy, or on helping targeted small holdings to improve their performance, would be concentrated on artificially maintaining a number of small holdings.
17. If modulated payments were the way adopted by the EU, they would have first to satisfy internal requirements for social justice, environment-friendliness etc. It is far from clear that this would be the case. It is conceivable that modulation violates competition law in the EU as it may

give an unfair competitive advantage to some holdings. Moreover, modulation may increase distortions of trade within the EU, as support to less effective holdings may result in higher food prices than if the market were encouraging efficiency gains.

18. Modulation in the EU would also have to meet with approval at an international level. It would seem that modulated payments would only be acceptable if they were totally decoupled from production. This means, for instance, that they could be fixed on a historical base. Such a system is only workable in the short run. After a time, transfers of holdings or of land, render such a base meaningless, and the system unworkable.
19. The recent US Farm Bill, for instance, has introduced a form of modulation of support by replacing target price /deficiency payment programmes with a programme of decoupled payments for 7 years that are not related to most farm-level production decisions or market prices. To qualify, a producer enters into a “production flexibility contract payment” for seven years. This requires him to comply with some conservation and other requirements. Payments are based on enrolled contract acreage, and are not based on current plantings. The annual contract payments are limited to \$40,000 per person. These maximum amounts are **declining** over time, which makes them acceptable under the terms of the GATT / WTO, , which accepts support arrangements which are clearly **transitional** in nature and/or totally decoupled from production.
20. Finally, it is important to point out that since modulation as it is generally understood in the EU would result in a less efficient agricultural industry, this would benefit the EU’s trading competitors. Thus the USA, Australia, Canada and other grain exporting countries have everything to gain from a European agricultural policy which has willingly weakened its industry by protecting its less efficient producers., at the expense of the more efficient ones.
21. Taking into account all these elements, modulation of farm support does not appear to be a sustainable way forward for EC agriculture. Resources would be more efficiently spent on specific policy objectives to:
  - help small holdings improve their viability and competitive position,
  - encourage the diversification of rural economies (off-farm income),

- set up environment management programmes (and create a market other than for food production),  
all of which could contribute to the development of a sustainable countryside and rural economy.

Annex

**Employment in agriculture (% of total civilian employment)**

|             | 1970 | 1980 | 1990 | 1994  |
|-------------|------|------|------|-------|
| Belgium     | 5.0  | 3.2  | 2.7  | n/a   |
| Denmark     | 11.5 | 8.1  | 5.7  | 3.0   |
| Germany     | 8.6  | 5.3  | 3.5  | 3.0   |
| Greece      | 40.8 | 30.3 | 23.9 | 20.8  |
| France      | 13.5 | 8.5  | 5.6  | 4.8   |
| Ireland     | 27.1 | 18.3 | 15   | 12.0  |
| Italy       | 20.2 | 14.3 | 8.8  | 7.9   |
| Luxembourg  | 9.7  | 5.5  | 3.3  | 2.8   |
| Netherlands | n/a  | 4.9  | 4.6  | 4.0   |
| Austria     | 18.7 | 10.6 | 7.9  | 6.9*  |
| Portugal    | n/a  | 28.5 | 18.0 | 11.7* |
| Finland     | 24.4 | 13.5 | 8.4  | 8.3   |
| Sweden      | 8.1  | 5.1  | 3.4  | 3.4   |
| UK          | n/a  | 2.7  | 2.2  | 2.2   |

\* 1993 data

Source: European Commission

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