SPECIAL REPORT No 13/2003

concerning production aid for cotton together with the Commission's replies

(pursuant to Article 248(4), second subparagraph of the EC Treaty)

(2003/C 298/02)

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EXECUTIVE SUMMARY

I. This report contains the Court's findings from a sound financial management audit of the production aid scheme for cotton. This scheme had previously been audited in the early 1990s and the findings published in the Court's 1992 and 1995 annual reports.

II. The overall objective of the scheme is to support the production of cotton and to allow the producers concerned to earn a fair standard of living. The main producer Member States are Greece and Spain. A small amount of production takes place in Portugal.

III. The aid is granted to the ginners who have to pay a minimum price to the producers. It varies in amount with market prices and on quantities produced. The mechanism used to determine the aid aims to provide the ginners with a constant level of income sufficient to cover their operating costs and to allow EU produced cotton to compete on price with the imported product. When selling the cotton to the ginners, the producers receive an amount approximately two to three times greater than the commercial value of the cotton sold.

IV. The results of the Court's audit are presented under two main headings:

— management by the Commission,

— evaluation of the systems of control operating in the main producer Member States.

V. Since the establishment of the scheme in 1981, annual production of cotton in the EU has increased from 0,3 million tonnes to 1,7 million tonnes. This increase reflects the fact that the aid for cotton production is three to four times that paid for crops grown as an alternative. A comparison of the gross margins for cotton and grain maize indicate a ratio of about 1,5 in favour of cotton. About a quarter of the increase in production is due to the accession of Spain to the EEC in 1986.

VI. In 1987 a stabiliser mechanism was introduced with the objective of reducing the support payable when production exceeds the guaranteed maximum quantity.

VII. In 2001, a reform of the production aid scheme took place and included a strengthening of the stabiliser mechanism, the effect of which causes a sharp drop in the support payable when production exceeds stated thresholds.

VIII. Higher than expected Greek production in 2001/02 led to an application to have certain production eliminated from the scheme. The examination of this application identified a number of issues regarding quantities eligible for aid and the quantities which should be used to determine the penalty for production in excess of the guaranteed quantities. Amending legislation followed which sets down criteria for establishing such quantities because, if ineligible produced cotton goes undetected, all producers are penalised through a higher penalty imposed by the stabiliser mechanism. One criterion for eligibility is that aid should only be paid on quantities coming from areas declared to cotton production under IACS. In practice, the national authorities in Greece, when deciding on eligible production are constrained by the weaknesses in IACS. Moreover, the results of checks by the authorities to determine quantities to be excluded from production for the purposes of applying the stabiliser mechanism are inconsistent with the results of checks on individual producers for the purposes of verifying area declarations. In view of the weaknesses in IACS in Greece, the ability of the

Commission to monitor the correct application of the stabiliser mechanism is diminished. The Commission wished to introduce a reform of the present scheme to be effective from the marketing year commencing on 1 September 2003. This deadline has not been met and the Commission intends to present a proposal for the reform of the aid scheme for cotton to the Council and to the European Parliament in the autumn of 2003.

IX. In any year when the Community expenditure does not reach 770 million euro, the regulations provide for an increase in the amount payable to the producers provided certain conditions are met. In three of the seven years 1995/96 to 2001/02 an increase in support was paid to the producers under this provision. Furthermore, this measure mitigates the effect of the stabiliser mechanism and could be viewed as a bonus payable to the producers. Budget neutrality cannot be assured and expenditure in the other four years exceeded 770 million euro.

X. Within the Commission there is a lack of information on the negative impact which cotton production can have on the environment and there is no continuous monitoring of the environmental situation in the regions within the Member States where cotton is produced.

XI. The Commission is unaware of the effectiveness of the incentive given to the ginners to improve the quality of the cotton produced. The amount paid appears to represent unnecessary expenditure and to be a source of additional revenue, as it duplicates the revenue obtained from the market place when better quality and increased yields are produced. In addition, the Commission has not reviewed the operating costs incurred by the ginners and is thus unaware of whether the potential exists to reduce Community expenditure by altering the amount of aid paid to the ginners.

XII. While the audit in Spain did not give rise to material observations, serious weaknesses were observed in the checks undertaken by the Greek national authorities in relation to the area declarations submitted by the producers. The effects of these weaknesses are compounded by the lack of progress in implementing the IACS in Greece. For the marketing year 2001/02 the Greek authorities have estimated that about 10 % of the land planted with cotton was either not declared under IACS or was declared as cultivated with another crop. In such circumstances and, if not detected, producers receive aid twice for the same parcels of land, once on the basis of the arable crop declaration and again on the basis of the actual production of cotton.

XIII. The Court recommends that the Commission takes the opportunity of the proposed reform to address weaknesses in the present regime (absence of budget neutrality, the attractiveness of the aid rate on quantities produced and the impact of cotton production on the environment). In addition, and with regard to the present scheme, the Court recommends that the Commission reviews the financial arrangements of the ginners and examines the effectiveness of the incentive given to improve quality.

INTRODUCTION

1. A production aid scheme for cotton was introduced with the accession of Greece to the EEC [1], and applied for the first time to cotton harvested in 1981. The scheme expanded when Spain and Portugal joined the EEC in 1986.

2. In 2001, the implementing measures for the scheme were simplified and brought together in Council Regulation (EC) No 1051/2001 [2]. Commission Regulation (EC) No 1591/2001 [3], as amended [4], lays down the detailed rules for applying the production aid scheme.

(1) Protocol 4 of the Greek Act of Accession 1979 (OJ L 291, 19.11.1979 p. 174).

(2) Council Regulation (EC) No 1051/2001 of 22 May, 2001 (OJ L 148, 1.6.2001, p. 3).

(3) Commission Regulation (EC) No 1591/2001 of 2 August 2001 (OJ L 210, 3.8.2001, p. 10).

(4) Commission Regulation (EC) No 1486/2002 of 19 August 2002 (OJ L 223, 20.8.2002, p. 3).

3. The overall objective of the scheme is to support the production of cotton in the regions of the Community where it is important for the agricultural economy and which permits the producers concerned to earn a fair standard of living [1].

Cotton plant and production

4. Cotton is planted in spring and harvested in the following autumn. The raw cotton is delivered to ginning undertakings where the fibres are separated from the seeds and waste material by a process known as ginning. The marketing year runs from 1 September to 31 August.

5. Within the EU, cotton is grown almost exclusively in Greece and Spain. Annual production in the three marketing years (1999/2000 to 2001/02) has averaged 1,6 million tonnes which provides a yield of 0,51 million tonnes of ginned cotton. This level of production meets about 47 % of EU internal needs. The balance is made good by imports which enter the Community duty and levy free.

6. EU countries produce about 3 % of world output (estimated at 19 million tonnes of ginned cotton) with the United States of America, China and India being the largest producers.

Budgetary impact

7. Aid for cotton production amounts to an average of 600 million euro for Greece and 200 million euro for Spain and in total equates to almost 2 % of the EAGGF budget.

The main features of the production aid scheme

8. The regulation [2] provides that cotton producers receive an amount (the minimum price [3]) from the ginners greater than the commercial value of the unginned cotton delivered to ginning undertakings. This requirement is one of the conditions contained in the written contract covering the purchase of the cotton by the ginners. Whilst ginners are obliged to pay the minimum price for cotton of standard quality they are also free to offer more.

9. The aid paid to the ginners represents the difference or deficiency between what is termed the *guide price* [4], (which is the minimum price increased by 5 % [5]) and a value placed by the Commission [6] on the unginned cotton acquired from the producers. The regulation provides that the unginned cotton is valued as a percentage of the market price of ginned cotton which is a traded commodity and for which published prices exist.

10. The amount of aid payable changes with movements in the market prices for ginned cotton. When market prices are low, the aid increases to compensate and vice versa. As a consequence, revenue collected by the ginners from the sale of the ginned cotton combined with the aid received remains largely constant for any given level of production. This arrangement provides financial security for the ginners and allows EU produced cotton to compete on price with imports.

11. In any year when the aid does not reach 770 million euro, the regulations [7] provide for an increase in the amount payable when certain conditions are met [8]. The increase in aid is limited by the attached conditions and cannot bring total Community expenditure beyond 770 million euro. This measure, which is unique to the cotton regime, mitigates the effects of the stabiliser mechanism when world market prices are relatively strong and could be viewed as a bonus payable to producers. In three of the seven years 1995/96 to 2001/02 an increase in the aid was paid to the producers under this provision (see *Table 1* for detail). For the three years in question (1995/96, 1997/98 and 2000/01), aid paid under this provision amounted in total to 260 million euro.

12. With regard to environmental considerations, the regulations introduced in 2001 place obligations on the Member States to determine measures for the cotton sector.

(1) Protocol 4 of the Greek Act of Accession 1979 (OJ L 291, 19.11.1979 p. 174).
(2) Council Regulation (EC) No 1051/2001 which replaced Regulations (EEC) No 1964/87 and (EC) No 1554/95.
(3) Article 2 of Council Regulation (EC) No 1051/2001. The minimum price is fixed by the Council and currently stands at 100,99 euro/ 100 kg of unginned cotton.
(4) Article 2 of Council Regulation (EC) No 1051/2001. The guide price is also fixed by the Council and currently stands at 106,30 euro/ 100 kg of unginned cotton.
(5) A 5 % differential between the minimum and guide price is paid to the ginners to cover their costs in the administration of the scheme.
(6) Article 2 of Commission Regulation (EC) No 1591/2001.
(7) Article 8 of Council Regulation (EC) No 1051/2001.
(8) The conditions require that the stabiliser mechanism was applied, that the weighted average price for unginned cotton used in the determination of the aid is greater than 302 euro per tonne, that producers cannot receive, in total, more than the minimum price and that increase in aid cannot exceed that payable if the guaranteed maximum quantity was increased to 1 120 million tonnes.

Table 1

Amount received by producers

GREECE

Year	Minimum price/tonne in euro	Penalty/tonne [1] in euro	Increase/tonne [2] in euro	Net receipt/tonne in euro
1995/96	1 010	297,64	79,73	792,09
1996/97	1 010	98,86	0	911,14
1997/98	1 010	206,22	46,63	850,41
1998/99	1 010	291,26	0	718,74
1999/2000	1 010	386,93	0	623,07
2000/01	1 010	333,78	69,09	745,31
2001/02	1 010	416,70	0	593,30

SPAIN

Year	Minimum price/tonne in euro	Penalty/tonne [1] in euro	Increase/tonne [2] in euro	Net receipt/tonne in euro
1995/96	1 010	0	0	1 010
1996/97	1 010	109,49	0	900,51
1997/98	1 010	278,51	46,63	778,12
1998/99	1 010	189,21	0	820,79
1999/2000	1 010	342,29	0	667,71
2000/01	1 010	110,55	49,96	949,41
2001/02	1 010	188,15	0	821,85

(1) Penalty imposed for production in excess of guaranteed national quantity.
(2) Increase prompted by Community expenditure being less than 770 million euro.

13. Primarily as a means of limiting Community expenditure, but also as a means of discouraging increasing levels of production, a stabiliser mechanism was introduced in 1987 which has the effect of reducing the support payable on all production when the guaranteed maximum quantity (GMQ) is exceeded [1].

14. In 1995, the GMQ was increased to 1,031 million tonnes and the guide price was proportionally reduced with a view to keeping these changes budgetary neutral. Guaranteed national quantities (GNQ) were allocated to the producer Member States [2]. From this point onwards the reduction in the aid rate following overproduction is applied to the Member State in which the overproduction occurs.

15. Following a strengthening of the stabiliser mechanism in 2001 [3], an accelerated reduction in the support payable occurs when production in Spain and Greece exceeds 1,5 million tonnes. The impact of the strengthened stabiliser is such that relatively modest increases in production above this threshold causes a sharp drop in the support payable for all production. No increase was made to the maximum guaranteed quantity in 2001 and no change was made to the procedure for determining the penalty when production lies between 1,031 million tonnes and 1,5 million tonnes. *Diagram 1* demonstrates the impact of the stabiliser mechanism and compares its impact before and after it was strengthened.

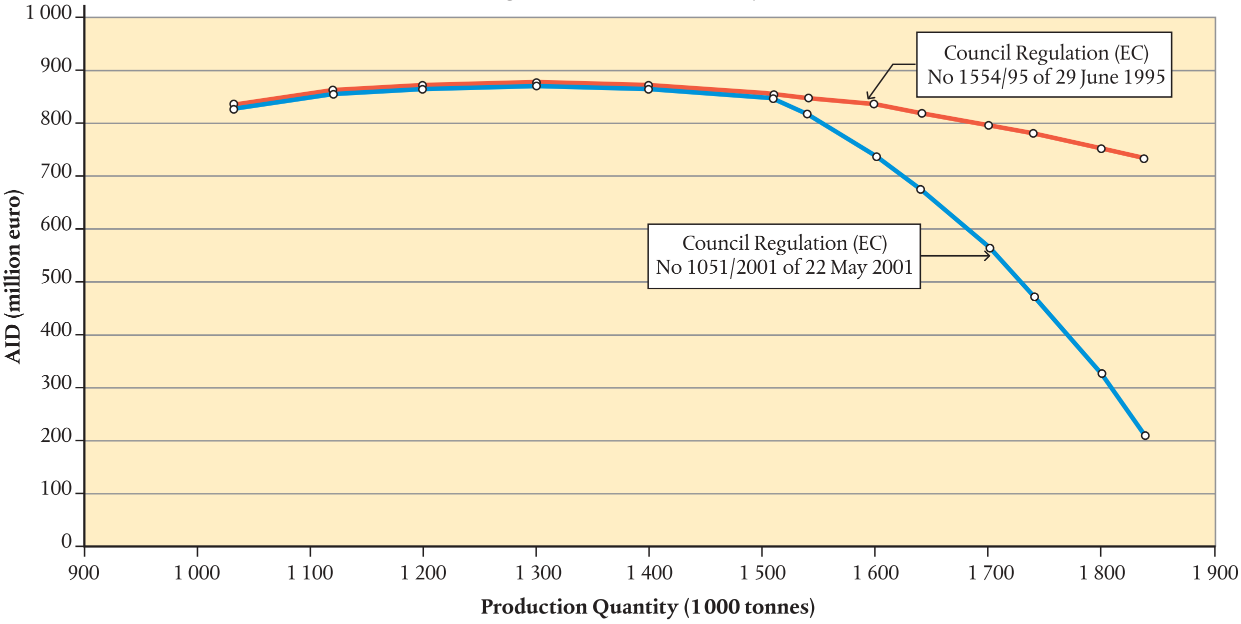
16. In every year since the introduction of the stabiliser mechanism in 1987, production has exceeded the guaranteed maximum quantities and the support received by the producers has been reduced in consequence.

17. While world market prices can be volatile, in general, the minimum price of 101 euro/100 kg payable to the producers is three to four times greater than the value of the unginned cotton produced. After the application of the stabiliser mechanism, the amount received by the producers drops to two to three times that of the value of the unginned cotton. Collectively the amount received by producers increases until production reaches 1,5 million tonnes. Thereafter, the overall amount received falls because the penalty imposed for overproduction outweighs the additional amounts received from increased production (see *Table 2* for detail).

(1) For each of the marketing years 1992/93 to 1994/95, the GMQ was fixed at 701 000 tonnes.
(2) Article 2 of Council Regulation (EC) No 1553/95 of 29 June 1995 (OJ L 148, 30.6.1995, p. 45). GMQ was increased to 1 031 000 tonnes and GNQs allocated to Spain, 249 000 tonnes and to Greece, 782 000 tonnes. When these quantities are exceeded, the guide price is reduced by 50 % of the rate of overshoot of the GNQ.
(3) Article 7 of Council Regulation (EC) No 1051/2001.

Diagram 1 — STABILISER MECHANISM

Impact of stabiliser mechanism on Community expenditure
(value of unginned cotton = 250 euro/tonne) ([1])



NB: The diagram demonstrates the aid payable for differing levels of production before and after the modification to the stabiliser mechanism in 2001.
For production increasing from 1,0 to 1,34 million tonnes, the stabiliser mechanism is effective at limiting the increase in expenditure.
Once production exceeds 1,34 million tonnes the stabiliser mechanism causes a decline in the total aid payable.
The decline in total aid payable is much more rapid following the modification introduced by Council Regulation (EC) No 1051/2001.

([1]) A value of 250 euro has been used as this is the average of the values placed on the unginned cotton in the five marketing years 1997/98 to 2001/02.

Table 2

Comparison of aid received by producers before and after stabiliser mechanism was strengthened

Impact of stabiliser mechanism prior to strengthening introduced in 2001

A	B	C	D	E
Production in 1 000 tonnes	Minimum price A × 1 010 EUR 1 000	Penalty EUR 1 000	Received by producers B − C EUR 1 000	Rate/tonne D/A EUR
1 100	1 111 000	39 171	1 071 829	974,39
1 200	1 212 000	104 599	1 107 401	922,83
1 300	1 313 000	180 336	1 132 664	871,28
1 400	1 414 000	266 392	1 147 608	819,72
1 500	1 515 000	362 595	1 152 405	768,27
1 600	1 616 000	469 251	1 146 749	716,72
1 700	1 717 000	586 223	1 130 777	665,16

Impact of strengthened stabiliser mechanism

A	B	C	D	E
Production in 1 000 tonnes	Minimum price A × 1 010 EUR 1 000	Penalty EUR 1 000	Received by producers B − C EUR 1 000	Rate/tonne D/A EUR
1 100	1 111 000	39 171	1 071 829	974,39
1 200	1 212 000	104 599	1 107 401	922,83
1 300	1 313 000	180 336	1 132 664	871,28
1 400	1 414 000	266 392	1 147 608	819,72
1 500	1 515 000	362 595	1 152 405	768,27
1 600	1 616 000	563 135	1 052 865	658,04
1 700	1 717 000	820 780	896 220	527,19

NB: The collective amount received by the producers is maximised when production reaches 1,5 million tonnes.

Table 3

Comparison of aid payable when value of unginned cotton is 200, 250, 300 and 350 EUR/tonne.

A	B	C	D	E	F	G	H	I	J	K
Production tonnes	Guide price A × 1 063 EUR 1 000	Penalty EUR 1 000	Value (A × 200) EUR 1 000	Aid (B – C – D) EUR	Value (A × 250) EUR 1 000	Aid (B – C – F) tonnes	Value (A × 300) EUR 1 000	Aid (B – C – H) EUR 1 000	Value (A × 350) EUR 1 000	Aid (B – C – J) EUR
1 100	1 169 300	39 171	220 000	910 129	275 000	855 129	330 000	800 129	385 000	745 129
1 200	1 275 600	104 599	240 000	931 001	300 000	871 001	360 000	811 001	420 000	751 001
1 300	1 381 900	180 336	260 000	941 564	325 000	876 564	390 000	811 564	455 000	746 564
1 400	1 488 200	266 392	280 000	941 808	350 000	871 808	420 000	801 808	490 000	731 808
1 500	1 594 500	362 595	300 000	931 905	375 000	856 905	450 000	781 905	525 000	706 905
1 600	1 700 800	563 135	320 000	817 665	400 000	737 665	480 000	657 665	560 000	577 665
1 700	1 807 100	820 780	340 000	646 320	425 000	561 320	510 000	476 320	595 000	391 320

NB: For whatever the level of market price, it is in or around production of 1,3 million tonnes that Community expenditure begins to decline.

18. As stated in paragraphs 9, 10 and 13, Community expenditure is determined with reference to the minimum price payable by the ginners to the producers reduced by the application of the stabiliser mechanism and by a valuation placed on the unginned cotton acquired. Community expenditure begins to decline when the additional aid payable from increased production is outweighed by the escalation in the penalty for overproduction combined with the increase in the total value placed on the unginned cotton. This normally occurs when production is in or around 1,3 million tonnes (see *Table 3* for detail).

19. Notwithstanding the fact that the scheme is production based, all Community cotton growers are required to submit an application under the integrated administration and control system (IACS) ([1]) to declare the areas sown. Data from these applications are used to forecast production, to check the existence of producers delivering to ginning undertakings and the reasonableness of the quantities delivered.

The Court's audit

Previous observations

20. The findings from the Court's previous audits were published in its 1992 ([2]) annual report and the results of a follow-up audit were published in 1996 ([3]). The Court criticised the scheme's vulnerability to irregularity and weaknesses in controls, and the inclusion of fictitious quantities on which aid was paid (in Greece). This failure was addressed by amending legislation introduced in 1995 which provides for a reduction in the quantity of unginned cotton on which aid is paid when the yield of ginned cotton is less than the 32 % standard ([4]). In such circumstances aid is paid on that quantity of unginned cotton which, had it been of standard quality, would have yielded the fibres produced. Linking quantities on which aid is paid to the yields obtained is designed to remove the incentive to exaggerate or interfere with the weight of the raw product.

21. The Court also criticised the failure of the stabiliser mechanism to discourage increasing levels of production. In the years 1995 onwards production has continued to increase.

Current audit

22. In its current audit, which covered the years from 1999 to 2002, the Court undertook an assessment of the soundness of the Commission's management of production aid for cotton having regard to the impact, both intended and unintended, of the measure employed and rules laid down to govern the operation of the scheme together with the monitoring of activities in the Member States.

23. Audit visits were undertaken to the Commission services, to four of the main producer areas in Greece ([5]) and to Andalusia in Spain. An evaluation of the control system operating in the Member States was undertaken and included tests of compliance with national and Community rules. Evidence was obtained from

([1]) Council Regulation (EEC) No 3508/92 of 27 November 1992 (OJ L 355, 5.12.1992, p. 1).
([2]) OJ C 309, 16.11.1993, p. 1.
([3]) OJ C 340, 12.11.1996, p. 1.

([4]) Article 3 of Council Regulation (EC) No 1051/2001, defines standard quality of unginned cotton as that which contains 10 % moisture, 3 % impurities and with characteristics capable of producing, after ginning, 32 % grade 5 fibres 28 mm in length.
([5]) Nomoi of Karditsa, Larisa, Rodopi and Evros.

checking documentation and records, observation of the delivery and ginning process together with the various checks undertaken by inspectors present in the ginning mills, the analytical review of data and interviews with the main stakeholders (officials from Commission and national authorities and representatives of the association of ginners and producer groups).

MANAGEMENT BY THE COMMISSION

Concerns for budgetary discipline and the environment lead to a change to the stabiliser mechanism

24. The production of cotton within the EU has increased continuously until 2000. Annual production, which was 330 000 tonnes in 1982/83, rose to over 1,7 million tonnes (see *Table 4*). This increase is a reflection of the relative attractiveness of the aid for cotton when compared to the support offered for other crops, the increase in production following the accession of Spain to the EEC in 1986 and the enhancement of the maximum guaranteed quantity in 1995. In addition, as the support is based on quantities produced, there exists an incentive for individual producers to increase the amounts received under the scheme by maximising production [1]. The data contained in *Table 5* demonstrates that the aid for cotton is three to four times greater than that payable for crops grown as an alternative. Furthermore, for the three years 1998 to 2000 a comparison was made of the margin over total costs [2] achieved for cotton production with that achieved for durum wheat and grain maize in two of the cotton growing regions in Greece and in the main cotton growing region in Spain. In both cases the margin for cotton is higher than for the two other crops. If a comparison is made of the basis of gross margins for cotton and grain maize, the results for 1999 to 2000 indicate a ratio of about 1,5 in favour of cotton.

25. While the application of the stabiliser mechanism limits Community expenditure in the face of increasing levels of production, the amount of the aid is also determined by the value of the unginned cotton acquired by the ginners. When market prices remain low for an extended period of time, expenditure increases. A comparison of the aid payable for market prices varying between 200 and 350 euro per tonne is provided in *Table 3*. In the years 1995/96 to 2001/02 the cost to the Community of supporting cotton exceeded 770 million euro in 1996/97, 1998/99, 1999/2000 and 2001/02 (see *Table 4*).

26. Also, the upward trend in production has led to concerns about the impact on the environment [3] from intensive farming and the practice of monoculture [4] and the growing of cotton in areas less suited to its production. Such concerns were voiced in a proposal for a Council regulation [5], presented by the Commission in 1999 which identified a significant rise in areas sown and output. The regulation adopted in 2001 requires the Member States to take the environmental measures they consider suitable and, before 31 December 2004, provide the Commission with a report on the environmental situation in the cotton sector and of the impact of the national measures adopted [6]. When this information is received and evaluated, the Commission will be able to make more informed decisions about sustainable levels of production.

27. Included in the 1999 Commission proposal was a revision to the stabiliser mechanism which would have the impact of making the support for cotton somewhat less attractive [7] and reduce the amount of Community expenditure. This change was sought to lessen the possibility of expenditure exceeding the reference amount of 770 million euro in those years when market prices are low. The Council did not favour the proposal and, instead, adopted a change to the stabiliser mechanism which applies when production exceeds 1,5 million tonnes [8]. If this threshold is exceeded, the revision to the mechanism causes rates of support to fall more sharply than previously. As production in the three previous years had averaged 1,6 million tonnes, it was likely that the revised stabiliser mechanism would be applied in the first year of its coming into force.

(1) This statement holds true until production reaches 1,5 million tonnes. Thereafter, the overall amount received by the producers falls because the penalty imposed for production in excess of guaranteed quantities outweighs the additional support received from increased production.

(2) Margin over total costs is defined as total production and subsidies less intermediate consumption (seed, fertiliser, crop protection, fuel, water, upkeep, energy, contract work and other direct costs), depreciation, wages, rent and interest.

(3) Cotton production uses water, chemicals (soil disinfectants, growth regulators, herbicides, pesticides, defoliants), fertilisers and plastic (mulching and containers for chemicals).

(4) The practice of monoculture, over time, can lead to soil exhaustion and depletion of water stocks.

(5) COM/99/0492 final.

(6) Article 17 of Council Regulation (EC) No 1051/2001.

(7) It proposed an enhancement in the reduction in the guide price from 50 % to 60 % of the rate of overshoot of the GNQs which was estimated would reduce Community expenditure by an annual amount of approximately 75 million euro.

(8) Article 7(4) of Council Regulation (EC) No 1051/2001. When production exceeds 1,5 million tonnes (Greece 1 138 000 tonnes, Spain 362 000 tonnes), the reduction in the guide price of 50 % of the rate of overshoot of the GNQs is increased by two percentage points for each additional 20 000 tonnes produced (Greece 15 170 tonnes, Spain 4 830 tonnes).

Table 4

Expenditure on aid for cotton production since 1982.

Year	Quantities eligible for aid (tonnes)					Expenditure (EUR million (*))				
	Greece	Spain	Italy	Portugal	EU (10, 12 or 15) (1)	Greece	Spain	Italy	Portugal	EU (10, 12 or 15) (1)
1982/83	333 162				333 162	124,7				124,7
1983/84	428 453				428 453	106,2				106,2
1984/85	481 246				481 246	151,1				151,1
1985/86	561 540				561 540	355,0				355,0
1986/87	667 779	284 550			952 329	468,1	199,5			667,6
1987/88	600 448	275 070			875 518	358,2	164,1			522,3
1988/89	805 856	383 619	99		1 189 574	434,9	207,0	0,1		642,0
1989/90	886 919	211 599	29		1 098 547	398,0	95,0	0,01		493,0
1990/91	709 871	281 838	32		991 743	313,4	124,4	0,1		437,9
1991/92	719 449	279 575	—		999 024	499,1	186,5	—		685,6
1992/93	760 685	223 932	—		984 617	570,1	167,8	—		737,9
1993/94	985 676	98 883	—		1 084 559	602,6	60,5	—		663,1
1994/95	1 191 400	143 249		—	1 334 649	603	72,5		—	675,5
1995/96	1 364 798	104 400		1	1 469 199	671,4	76,2		—	747,6
1996/97	927 650	300 221		—	1 227 871	603,3	191,5		—	794,7
1997/98	1 085 482	379 358		99	1 464 942	590,9	179,1		—	770
1998/99	1 210 900	337 567		147	1 548 614	675,5	220,4		—	895,9
1999/2000	1 350 677	409 518		73	1 760 268	640,1	213,5		—	853,9
2000/01	1 272 873	300 657		0	1 573 530	544,9	190,2		—	735,1
2001/02	1 273 103	336 984		612	1 574 699	571	233			804

(1) The figures for the marketing years 1982 to 1986 (10 EU Member States).
The figures for the marketing years 1986 to 1994 (12 EU Member States).
The figures for the marketing years 1994 to 2001 (15 EU Member States).
(*) Million Ecu up to 1998.
Source: Commission DG Agri/C/200.

Table 5

Comparison of the aid for cotton with that paid for alternative crops
AID PER HECTARE

(EUR/ha)

Crop/Region	Cotton	Maize	Cereals (excluding maize)	Durum wheat	Oilseeds	Protein crops	Non-fibre flax
Andalusia (irrigated)	2 071	478	234	530	584	338	452
Greece (region 1)	1 508	484	191	550	349	275	369

Source: Commission working paper, 'The Cotton Sector in the European Union' (Sec(2000)1630 of 5.10.2000).
NB:
(a) The table ignores costs of production.
(b) Higher profitability in Andalusia compared to Greece is a reflection of higher average yields in Spain.
(c) Average annual aid in the years 1995 to 1999.

Comparison of margins over total inputs for cotton as compared with durum wheat and grain maize

(EUR/ha)

Macedonia-Thrace	**1998**	**1999**	**2000**
Cotton	616	572	572
Durum wheat	301	192	192
Grain maize	144	119	113
Thessaly	**1998**	**1999**	**2000**
Cotton	445	738	989
Durum wheat	341	344	387
Grain maize	15	598	191
Andalusia	**1998**	**1999**	**2000**
Cotton	1 241	1 132	1 253
Durum wheat	545	488	533
Grain maize	736		1 064

Source: Commission DG AGRI/G.3, March 2003.

Stabiliser system

28. When production reaches the stated thresholds for implementing the strengthened stabiliser mechanism (Greece 1 138 000 tonnes and Spain 362 000 tonnes), the minimum price payable to the producer is reduced by 24 % (24,18 euro/100 kg). When production reaches 1,7 million tonnes (an increase of 13 % over the thresholds) the minimum price is reduced by 48 % (48,28 euro/100 kg) and when production reaches 1,840 million tonnes (an increase of 23 % over the thresholds) the support payable to the producer is reduced by 69 % (70,07 euro/100 kg). While market prices do vary, it is in or around this level of penalisation that the amount of the aid diminishes to nothing ([1]) and the amount payable to the producer equates to the commercial value of the cotton.

29. In 2001/02 marketing year, which was the first year of the application of the new Community and national rules, Greek production reached 1,354 million tonnes which is 19 % greater than the threshold for implementing the strengthened stabiliser mechanism. The Greek authorities made application to the Commission to have production totalling 206 362 tonnes regarded as outside of the scheme and neither grant aided nor taken into consideration when deciding the level of penalisation to apply to the aid rate. This procedure was not covered by the regulations. The Commission highlighted certain issues in the conception of the regulations, namely:

(a) there was an absence of precise rules on whether all production or only that produced in accordance with Community rules should be utilised to determine the impact of the stabiliser mechanism;

(b) if, as had been the previous practice, all quantities of sound, fair and merchantable quality produced were used to determine the amount of the penalty, the support received by the producers would have been reduced by 58 % which is considerably greater than the penalty applied in any previous year ([2]); after the examination of the data provided by the Greek authorities the Commission excluded 144 551 tonnes from the scheme which resulted in a 41 % reduction in the minimum price paid to the producers;

(c) the practice of including all production in deciding upon the level of penalisation was at variance with the approach generally followed in other agricultural support schemes;

(d) there was an absence of a specified time limit for completion of the on-the-spot checks of the area declarations submitted by cotton producers; such checks are ineffective if they are not undertaken while the plant is still in the ground; the findings from these checks are necessary in reaching a conclusion as to the reliability of the data on areas declared for cotton production and the probable yield individual growers should produce and deliver to the ginning undertakings.

30. These findings, identified by the Commission in this particular case, prompted the introduction of amending legislation in August 2002, which defines the quantities eligible for aid and the quantities to be included in the determination of the impact of the stabiliser mechanism. Only cotton of fair, sound and merchantable quality, coming from areas declared under IACS and not coming from areas excluded for environmental reasons can be eligible for aid and used to determine the level of penalisation. These rules were applied to the determination of the effect of the stabiliser mechanism on the aid rate for Greek production in 2001/02 and, as stated, resulted in a 41 % reduction in the minimum price paid to the producers.

31. In 2001, actual production in Greece was much greater than that forecasted and a danger existed that the amounts paid by way of advance would be higher than that finally determined as due. When this possibility became apparent, the Greek paying agency instructed the ginners to pay the commercial value only for cotton delivered in excess of thresholds fixed for each producer.

Difficulties in verifying the accuracy of the area declarations and in establishing eligible quantities

32. Previously, aid had been paid on quantities entering the ginning mills in accordance with the rules laid down, one of which was that the producer must have made a declaration of areas sown with cotton. The 2002 amending legislation (introduced because of the necessity to clarify eligibility requirements) specifically excludes cotton coming from an area not declared or coming from an area restricted for environmental reasons from receiving aid. Such cotton cannot be identified with absolute precision and national authorities will be obliged to make a decision as to which quantities are accepted under the scheme and which should be the subject of further checking.

([1]) Aid is the guide price of 106,3 euro reduced by the penalty (in this example 70 euro) and the value of the unginned cotton.

([2]) In the four previous years the penalty applied caused, on average, a reduction of 29 % in the minimum price paid to Greek producers.

33. Over the years, national authorities have undertaken checks of coherence between the quantities delivered and areas declared and obtained data on yields achieved. As there can be many reasons why yields might vary, such as weather conditions, farming practices and varieties sown, it is a matter for the national authorities to make a judgment as to the yields which might reasonably have been obtained from the areas declared. However, weaknesses in IACS in Greece limits the reliability of the system as a source of accurate and comprehensive information on which to base judgments and as a tool for further checking. Furthermore, as it is impossible in practice to check the origin of all deliveries to ginning mills, the risk exists that aid will be paid on quantities cultivated on undeclared areas or from areas excluded for environmental reasons. To the extent that ineligible produced cotton goes undetected, it has the effect of penalising all bona fide producers through the application of higher penalties.

34. The regulations require that the national authorities verify the accuracy of at least 5 % of the area declarations through the use of on-the-spot inspections which compare the area planted with cotton with that declared (1). Such checks will establish if producers tested have submitted accurate declarations with regard to areas declared. However, on-the-spot inspections may fail to identify areas planted to cotton but not declared.

35. With regard to the on-the-spot inspections undertaken in 2000, the Greek national authorities discovered only three discrepancies in over 5 000 area declarations checked. In contrast, extensive checking undertaken in the following year concluded that about 10 % (44 000 hectares) of the total area cultivated was either not declared under IACS or was declared as cultivated with another crop. In that year (2001) 94 000 producers submitted area declarations showing cotton cultivation on a total of 379 000 hectares. Given that the average area cultivated by each producer was four hectares, it is likely that a substantial number did not declare the full extent of the areas devoted to cotton in 2001. The extensive checks carried out by Greece in 2001 provided the basis for a regulation of the Commission to place a quantity of cotton outside the scheme. This cotton came from areas not eligible for aid pursuant to Article 17(3) of Council Regulation (EC) No 1051/2001 (2) or from areas not declared under IACS or declared as cultivated with another crop. This had an impact of lowering the penalty for overproduction and increasing the support to producers.

The financial position of the ginners under the scheme has not been reviewed in the light of changing circumstances, in particular increasing levels of production

36. The regulation provides that (3), for the purpose of determining the amount of the aid, the unginned cotton acquired by the ginners is deemed to have a value of between 20,6 % to 24,4 % of the internationally quoted price for ginned cotton. The mechanism for determining how much aid is paid to the ginners is designed in such a way as to provide the ginner with a trading profit, sufficient to cover the cost of ginning of between 98,8 euro and 125,4 euro/tonne (see *Table 6* for detail).

37. Prior to 1995, the Commission calculated the cost of ginning and set the value of the unginned cotton at a level which provided the ginners with funds sufficient to cover the operating costs incurred by them. However, as this exercise proved cumbersome and difficulties were experienced in getting sufficient and reliable data, a simplified procedure was introduced (4) which determines the value of the unginned cotton with reference to the historical relationship between the market price of the ginned cotton and the value determined by the Commission for the unginned cotton.

38. The cost of ginning may have changed with the passage of time and with increased throughput but the Commission has not reviewed the funding received by ginners against actual operating costs and is thus unaware of whether a potential exists to reduce Community expenditure by altering the percentages applied. None of the ginners interviewed during the audit expressed dissatisfaction with the mechanism used to determine the value of the unginned cotton.

(1) Article 13(1)(a) of Commission Regulation (EC) No 1591/2001.
(2) Article 17(3) of Council Regulation (EC) No 1051/2001 makes provision for Member States to restrict the areas eligible for production aid for unginned cotton on the basis of objective criteria related to the environment.
(3) Article 2(2) of Commission Regulation (EC) No 1591/2001.
(4) Article 3 of Council Regulation (EC) No 1554/1995 of 29 June 1995 (OJ L 148, 30.6.1995, p. 48).

Table 6

Funding received by ginners

For this table, the harvest is 1,5 million tonnes of unginned cotton, with a standard yield of 32 %, produces 480 000 tonnes of ginned cotton

A	B		C	D	E	F	G	H	I	J	K	L	M
Market value ginned cotton (euro/tonne)	Value of unginned cotton (euro/tonne) (1)		Revenue cotton sales EUR 1 000 (A × 480 000)	Guide price EUR 1 000 (2)	Value of unginned cotton EUR 1 000 (B × 1,5 mio)	Penalty EUR 1 000 (3)	Aid EUR 1 000 (D – (E + F))	Total revenue EUR 1 000 (C + G)	Paid to producers EUR 1 000 (4)	Funds to ginners EUR 1 000 (H – I)	Contribution to administrative costs EUR 1 000 (5)	Trading profit EUR 1 000 (J – K)	Trading profit euro/tonne
900	185,4	(20,6 %)	432 000	1 594 500	278 100	362 600	953 800	1 385 800	1 152 250	233 550	79 650	153 900	102,6
950	195,7	(20,6 %)	456 000	1 594 500	293 550	362 600	938 350	1 394 350	1 152 250	242 100	79 650	162 450	108,3
1 000	206	(20,6 %)	480 000	1 594 500	309 000	362 600	922 900	1 402 900	1 152 250	250 650	79 650	171 000	114
1 050	216,3	(20,6 %)	504 000	1 594 500	324 450	362 600	907 450	1 411 450	1 152 250	259 200	79 650	179 550	119,7
1 100	226,6	(20,6 %)	528 000	1 594 500	339 900	362 600	892 000	1 420 000	1 152 250	267 750	79 650	188 100	125,4
1 150	250,7	(21,8 %)	552 000	1 594 500	376 050	362 600	855 850	1 407 850	1 152 250	255 600	79 650	175 950	117,3
1 200	261,6	(21,8 %)	576 000	1 594 500	392 400	362 600	839 500	1 415 500	1 152 250	263 250	79 650	183 600	122,4
1 250	287,5	(23,0 %)	600 000	1 594 500	431 250	362 600	800 650	1 400 650	1 152 250	248 400	79 650	168 750	112,5
1 300	317,2	(24,4 %)	624 000	1 594 500	475 800	362 600	756 100	1 380 100	1 152 250	227 850	79 650	148 200	98,8
1 350	329,4	(24,4 %)	648 000	1 594 500	494 100	362 600	737 800	1 385 800	1 152 250	233 550	79 650	153 900	102,6
1 400	341,6	(24,4 %)	672 000	1 594 500	512 400	362 600	719 500	1 391 500	1 152 250	239 250	79 650	159 600	106,4
1 450	353,8	(24,4 %)	696 000	1 594 500	530 700	362 600	701 200	1 397 200	1 152 250	244 950	79 650	165 300	110,2
1 500	366	(24,4 %)	720 000	1 594 500	549 000	362 600	682 900	1 402 900	1 152 250	250 650	79 650	171 000	114

(1) Commission Regulation (EC) No 1591/2001, Article 2, provides that unginned cotton be valued as a percentage of the market value of ginned cotton.
(2) Guide price of 1 063 euro/tonne multiplied by 1,5 million tonnes.
(3) Abatement following the application of the stabiliser mechanism.
(4) Minimum price of euro 1 514 850 000 less penalty of euro 362 600 000. (Minimum price = 1 009,9 euro/tonne multiplied by 1,5 million tonnes = 1 514 850 000).
(5) An amount of 53,1 euro/tonne paid to ginners to cover the cost of administration.

Not all ginners differentiate on quality when purchasing cotton and the 'quality incentive' appears to be nothing more than a source of additional income

39. The Community scheme recognises that varying qualities of cotton can be produced and stipulates that producers should be paid according to the quality of the product delivered.

40. In Greece not all ginners pay the producers on the quality of particular batches, preferring instead to offer the producers a price equal to that which would be paid for cotton of above average quality [1]. This practice removes the incentive for producers to apply cultivation and harvesting techniques which result in the delivery of best quality cotton.

41. In addition to the above, provision exists to pay aid to the ginner on a quantity greater than that delivered when the quality of the ginned cotton received in any year is higher than standard [2]. The percentage increase in quantity is limited to 3,125 % [3] and is calculated when all ginning has been completed and is based on the yields achieved for the year taken as a whole. The Commission has no specific knowledge about the success or otherwise of this provision in improving the quality of the cotton produced. Furthermore, there is no requirement within the regulation for the ginner to pass this additional revenue onto the producers.

42. While the wish to promote quality is laudable, the market place, through increased revenues, already offers the incentive to improve the quality and the quantity of the fibres produced. On the basis of the evidence available, it appears that the incentive paid to improve quality is little more than an additional source of revenue for the ginners.

(1) Some ginners take the view that, as the unginned cotton is processed in bulk, there is no incentive for them to measure the specific quality characteristics of individual batches and to determine and pay the producers slightly different amounts for each batch delivered.

(2) Article 15 of Council Regulation (EC) No 1051/2001.

(3) In each year and for both producer Member States, the quantity on which the aid is paid is increased by about 3 % which is close to the maximum percentage applicable. If the average aid rate is taken as 500 euro/tonne, the amount paid to ginners under this provision is in the region of 25 million euro per annum.

EVALUATION OF THE SYSTEMS OF CONTROL IN THE MEMBER STATES

43. In the period between October 2001 and February 2002, the Court undertook a specific examination of aid for cotton in connection with its obligation to provide a statement of assurance on the 2001 financial statements of the Commission [4]. Material observations arose from the Court's audit of the controls operating in Greece only.

Absence of the application of risk criteria and poor quality of checking in Greece

44. One key control is a check on the existence of producers and the reasonableness of the quantities delivered utilising data from the area declarations submitted by producers. The effectiveness of this control relies on the correct application of IACS in the Member States. Many deficiencies have been noted in its operation in Greece. Because these deficiencies continue, the findings reported in the Court's 2001 Annual Report are mentioned hereafter.

45. In Greece, around 30 % of parcels declared use references which are incompatible with the IACS references. This renders it impossible to confirm the area of these parcels. In addition, computerised systems allow multiple entry of reference numbers for individual registration of parcels.

46. Also, risk criteria were not used to select the sample for checking and there were no clear comprehensive instructions as to the timing and methodology to be applied to on-the-spot checks of area declarations submitted by cotton producers and for 2000/2001 marketing year, very few discrepancies were reported (0,05 % of the number examined). An error rate of 0,05 % contrasts with the results of the Court's audit testing on the accuracy of the area declarations for 2001/2002. In 16,7 % of the cotton declarations checked, significant differences were found (exceeding national tolerances) between the areas declared and those cultivated with cotton. The error rate of 0,05 % is also inconsistent with the results of checks by the authorities to identify quantities to be excluded from production for the purposes of applying the stabiliser mechanism.

47. Because of the material difference between forecast and actual production in 2001, the Greek authorities undertook investigations which concluded that about 10 % of the land sown to cotton in 2001 was either not declared under IACS or was declared as being cultivated with another crop. This finding is an indicator that producers submit aid applications for arable crops for areas

(4) OJ C 295, 28.11.2002, p. 1.

on which they produce cotton. In such circumstances and if not detected, growers receive EU aid twice for the same parcels of land, once on the basis of the arable crop declaration and again on the basis of actual production of cotton. This situation illustrates the difficulties in monitoring EU aid payments when the underlying integrated administration and control system (IACS) has not been properly applied.

CONCLUSIONS

48. In its previous audits, the Court criticised the scheme's vulnerability to irregularity and weaknesses in controls and the inclusion of fictitious quantities (in Greece) on which aid was paid. The Commission's revision of the scheme in 1995 addressed this failure (paragraph 20). However, other weaknesses exist in the regime.

Mechanism employed and its effect on Community expenditure

49. The increase in cotton production over the last 20 years, from 0,3 million tonnes to 1,7 million tonnes, reflects the relative attractiveness of the scheme compared to other crops; aid for cotton is three to four times greater than that paid for crops grown as an alternative. Comparison in terms of gross margins per hectare indicate a ratio of about 1,5 in favour of cotton. About a quarter of the increase in production is due to the accession of Spain to the EEC in 1986 (paragraph 24).

50. A stabiliser mechanism introduced in 1987 has been effective at reducing the support payable after production exceeds guaranteed quantities. However, as movements in market prices are also reflected in the aid rate, the Commission does not have control over final expenditure and budget neutrality can never be assured (paragraph 25).

51. When market prices are low, the cost is borne by the Community in the form of an increase in the aid rate payable. In contrast, in those years when market prices and production levels are high resulting in Community expenditure not reaching 770 million euro, additional support is paid to the producers. This measure mitigates the effect of the stabiliser mechanism (paragraphs 11 and 25).

52. Community aid combined with sales revenue provide the ginners with a constant level of income to cover their operating and administrative costs. Since 1995, the Commission has not reviewed the extent to which the funds remaining to the ginners after the payment of the minimum price to the producers reflect the actual costs incurred by them and is thus unaware of whether any potential exists to reduce Community expenditure (paragraphs 36 and 37).

53. Lack of clarity in the rules governing the operation of the scheme led to the introduction of amending legislation in 2002 which defines quantities eligible for receiving aid and the quantities to be taken into account when determining the penalty for overproduction (paragraphs 29 and 30).

54. The amended rules state that aid may only be paid on quantities coming from an area declared under IACS and not from an area excluded for environmental reasons. Weaknesses in the operation of IACS limits the ability of the Commission to monitor the correct application of the stabiliser mechanism. Checks on the origin for all deliveries to ginners is impossible in practical terms. The results of controls undertaken by national authorities in 2000 and 2001 demonstrate variations on the quality of work executed to verify the accuracy of the area declarations and the eligibility to aid of quantities delivered to ginning plants. To determine eligible quantities, national authorities will be required to exercise judgment as to the probable yields of unginned cotton coming from the areas declared. As there can be many reasons why yields might vary, the ability of the Commission to monitor this aspect of the scheme has been weakened. To the extent that ineligible produced cotton goes undetected, all producers, without distinction, are penalised through a higher reduction in the minimum price (paragraphs 32 to 34).

Environment

55. Cotton production can have a negative impact on the environment and the Member States concerned should determine and adopt the measures they consider suitable to regulate the use of land for cotton production. Currently no information is available on the application of this provision since it is not continuously monitored by the Commission. Member States will, as required by the regulations, provide the Commission with a report on the environmental situation in the cotton sector and on the impact of measures taken before 31 December 2004 (paragraph 26).

Promotion of quality

56. The scheme promotes the quality of cotton by allowing adjustments to be made to the amounts paid to the producers on the basis of the quality of the product delivered. In Greece, not all ginners pay differing amounts for differing qualities which removes the incentive to produce best quality cotton. In addition, the Commission is unaware of the effectiveness or otherwise of the

quality incentive given to the ginners. This incentive duplicates the additional revenue coming from the market place when better quality and higher yields are achieved (paragraphs 39 to 42).

Systems of control

57. The Court's examination of the checks undertaken in the Member States has revealed continuing serious weaknesses in Greece, in particular those related to the checking of the areas declared by cotton producers (paragraphs 43 to 47).

RECOMMENDATIONS

58. The Court recommends that the Commission takes the opportunity to address the weaknesses identified in the present regime when formulating its reform proposals. In particular, the Court recommends that the Commission

(a) considers the incorporation of a mechanism which ensures budget neutrality and which does not mitigate against the impact of the stabiliser mechanism;

(b) has regard to the relative attractiveness of the aid for cotton and the effect of the aid on quantities produced;

(c) obtains data on the negative impact of cotton production on the environment.

59. With regard to the present scheme the Court recommends that the Commission:

(a) ensures that the controls operated in Member States for establishing eligibility for aid are transparent, well-founded and applied consistently;

(b) reviews the financial arrangements for the ginners;

(c) examines the effectiveness of the incentive offered to improve the quality of the cotton produced.

This report was adopted by the Court of Auditors in Luxembourg at its meeting of 24 and 25 September 2003.

For the Court of Auditors

Juan Manuel FABRA VALLÉS

President

THE COMMISSION'S REPLIES

EXECUTIVE SUMMARY

IX. In the context of a deficiency payments scheme, expenditure depends by definition, at least partially, on world prices, and consequently budget neutrality as mentioned by the Court cannot be assured.

As an integral part of the stabiliser, this provision is a reduction of the penalty in the level of support when the expenditure does not reach EUR 770 million.

X. Since 2001, on the basis of Council Regulation (EC) No 1051/2002, Member States have applied national environmental provisions, which have been examined by the Commission.

The follow-up of these national measures and the subsequent report to be submitted by Member States before the end of 2004 should give the Commission additional information on the environmental situation in the cotton sector.

XI. The Commission considers that the fact that the yields in ginned cotton are usually higher than the standard 32 % is an indicator of the effectiveness of the provisions relating to the improvement of quality.

The quality premiums on the world market prices for ginned cotton are relatively modest and, considering the level of world prices for ginned cotton, might not be a source of significant additional revenue for ginners.

The Commission has in the past tried to review the operating costs incurred by ginners but discussions with the Member States were inconclusive due to the high variability of the results. Consequently, in the context of the 1995 reform, the Council decided to determine the calculation of the world price of unginned cotton on the basis of the historical ratio between the world price for ginned cotton and that calculated for unginned cotton, which took the ginning costs into account.

XII. The Commission is well aware of the problems linked to deficiencies in the IACS in Greece and in particular the land parcel identification system and controls on it, and they are closely monitored under the clearance of accounts procedure, for area aid and the other aid schemes alike.

The same applies to the phenomenon of the under-declaration of land under cotton in Greece. This phenomenon is the result not only of the problems with the IACS in Greece, but also the new national environmental rules, the fact that some producers are trying to circumvent them, and their underestimation of the importance of the link between the quantities produced (the purpose of the aid) and the land on which those quantities are grown.

XIII. The Commission will take the weaknesses mentioned by the Court into consideration when formulating the reform proposals. In addition, it will also take account of the fact that the present regime is highly complicated and not in line with the recent evolution of the CAP.

INTRODUCTION

11. As an integral part of the stabiliser, this provision is a reduction of the penalty in the level of support when expenditure does not reach EUR 770 million.

17. Both Community expenditure and the amount received by producers are primarily dependent on the quantities produced.

20. The amending legislation introduced in 1995 included several measures with a view to improving the management of the scheme. Among these, the most relevant were:

— the division of the MGQ into guaranteed national quantities so as to make producers in each Member State more accountable for their production,

— the increase in the MGQ accompanied by a proportional reduction in the guide and minimum prices with a view to adapting these quantities to the recorded average production, maintaining budget neutrality,

— the abolition of the special aid scheme for small producers which did not serve its original purpose and,

— as the Court mentions, a provision linking eligible quantities to the yields obtained.

In 2001, a strengthening of the stabiliser mechanism introduced an accelerated reduction in the support payable when production exceeds 1,5 million tonnes. The impact of the strengthened stabiliser is such that relatively modest increases in production above this threshold cause a sharp drop in the support payable for the whole production.

MANAGEMENT BY THE COMMISSION

24. In 1995, the MGQ was increased and the guide price was proportionally reduced with a view to keeping these changes budgetarily neutral.

25. In the context of a deficiency payments scheme, the expenditure depends by definition, at least partially, on world prices.

26. Until 2000, the Commission had limited power to require detailed environmental provisions for cotton growing, as cotton was included neither in the Annex to Council Regulation (EC) No 1259/1999 nor in Council Regulation (EC) No 1257/1999.

Since 2001, on the basis of Council Regulation (EC) No 1051/2001, Member States have applied national environmental provisions, which have been examined by the Commission.

The follow-up of these national measures and the subsequent report to be submitted by Member States before the end of 2004 should give the Commission additional information on the environmental situation in the cotton sector.

28. The penalties applied in each Member State due to the stabiliser system depend almost exclusively on each Member State's production. Therefore, penalties are higher in the Member State mainly responsible for overproduction.

29. After a detailed examination of the figures communicated by Greece as well as a legal assessment of the breakdown of the 206 362 tonnes, the Commission took the following measures:

— 6 376 tonnes were not included in the scheme because they were not of sound and fair merchantable quality;

— 61 811 tonnes were included in the actual production and the remaining 138 175 tonnes were excluded.

(a) Following the same line of interpretation of the legal texts, clarification on the production eligible for aid and on the production to be taken into account for the stabiliser mechanism was straightaway added to the legislation so as to be in force as from the following marketing year, i.e. 2002/03.

(d) Since the 2002/03 marketing year, the deadline for completion of the on-the-spot checks on area declarations has been fixed at 15 November, just before the time of the revised production estimates.

The potential risks to the EAGGF of any inadequacies in on-the-spot checks of land under cotton are allowed for in the clearance-of-accounts procedure. Thus, financial corrections have already been applied and will continue to be applied where necessary.

33 to 35. The Court's comments refer mainly to the weaknesses in the Greek control systems. These weaknesses are well known by the Commission services. The potential risks to the EAGGF of weaknesses in the IACS and the administration and control system for cotton as implemented by Greece are allowed for in the clearance of accounts procedure. Thus, financial corrections have already been applied and will continue to be applied where necessary.

The Commission has also identified the potential risk arising from the method for selecting applicants for direct premiums undergoing on-the-spot checks in Greece. These risks are being analysed under the current clearance of accounts procedures.

36. Due to the absence of international quotations for unginned cotton, its price is calculated on the basis of international prices of ginned cotton, taking into account the historical relationship between the two. This relationship included ginning costs, so consequently these are indirectly considered in the calculation of the world price for unginned cotton.

38. The Commission has, in the past, tried to review the operating costs incurred by ginners but the discussions with the Member States were inconclusive due to the high variability of the results. Consequently, in the context of the 1995 reform, the Council decided to determine the calculation of the world price of unginned cotton on the basis of the historical ratio between the world price for ginned cotton and that calculated for unginned cotton, which took the ginning costs into account.

40. The aid scheme establishes that the price is to be adjusted according to the quality of the cotton delivered. This adjustment is to be determined by agreement between parties on the basis of the necessary samples taken at delivery and must concern each batch of unginned cotton. This is an incentive for individual producers to deliver better quality cotton.

The audits carried out by the Commission under the clearance of accounts have not confirmed that the system in place is failing to achieve the aim of providing an incentive to improve quality.

41. Better quality unginned cotton allows for higher yields in ginned cotton, but this can only be worked out after ginning. The increase in eligible quantities due to this provision is limited to 3,125 %, but there is no limit to the reduction that can be applied

to the eligible quantities in case of low yields due to poor quality unginned cotton. The fact that the yields in ginned cotton are usually higher that the standard 32 % means that the quality of the unginned cotton delivered is good on average. The incentive given to ginners in this way allows them to pay the producers higher prices than the minimum price, as is usually the case.

42. The quality premiums on the world market prices for ginned cotton are relatively modest and, considering the level of world prices for ginned cotton, might not be a source of significant additional income for the ginners.

EVALUATION OF THE SYSTEMS OF CONTROL IN THE MEMBER STATES

45. The Commission is well aware of the problem linked to deficiencies in the IACS in Greece and in particular the land parcel identification system (LPIS).

The resultant risks to the EAGGF are allowed for in the clearance-of-accounts procedure, for area aid and the other aid schemes alike. In the particular case of production aid for cotton, several clearance procedures are currently in progress.

46. The Commission fully recognises the serious failings referred to by the Court as regards on-the-spot checks on land parcels used for growing cotton. On the whole, they mirror the findings regularly made by the Commission in its reports.

47. The land irregularly declared under the IACS as being under a crop other than cotton creates a risk for the area aid, and account is taken of this in the clearance of accounts procedures.

The aspects relating to the common market organisation for cotton are being analysed by the Commission under the current clearance of accounts procedures.

CONCLUSIONS

50. In the context of a deficiency payments scheme, expenditure depends by definition, at least partially, on world prices and consequently budget neutrality as mentioned by the Court cannot be assured. The reform of 2001 introduced a strengthening of the stabiliser mechanism in order to increase accelerated sanctions in the support payable when production exceeds the threshold of 1 500 000 tonnes, which can result in sharp reductions in expenditure in certain cases.

51. As an integral part of the stabiliser this provision is a reduction of the penalty in the level of support when expenditure does not reach EUR 770 million.

52. The Commission has in the past tried to review the operating costs incurred by ginners but the discussions with the Member States were inconclusive due to the high variability of the results. Consequently, in the context of the 1995 reform, the Council decided to determine the calculation of the world price of unginned cotton on the basis of the historical ratio between the world price for ginned cotton and that calculated for unginned cotton, which took the ginning costs into account.

54. The Commission considers that the amended rules produced in 2002 clarify the definition of eligible production and does not think that its ability to manage the scheme has been weakened. The weaknesses described by the Court concerning the IACS and the control system for cotton in Greece are similar to those already identified by the Commission in the framework of the clearance of accounts. Financial corrections have been applied and will continue to be applied where necessary.

55. Until 2000, the Commission had limited power to require detailed environmental provisions for cotton growing, as cotton was included neither in the Annex to Council Regulation (EC) No 1259/1999 nor in Council Regulation (EC) No 1257/1999.

Since 2001, on the basis of Council Regulation (EC) No 1051/2001, Member States have applied national environmental provisions, which have been examined by the Commission.

The follow-up of these national measures and the subsequent report to be submitted by Member States before the end of 2004 should give the Commission additional information on the environmental situation in the cotton sector.

56. The scheme provides for adjustments on the price, by common consent between the ginner and the producer, depending on the quality of each batch of unginned cotton delivered. This is an incentive for individual producers to apply agricultural practice that will result in better-quality cotton. Better quality unginned cotton allows for higher yields in ginned cotton, which can only be worked out after ginning. The fact that the yields in ginned cotton are usually higher than the standard 32 % means that the quality of the unginned cotton delivered is good on average. The quality premiums on world market prices for ginned cotton are relatively modest, so the incentive given to ginners allows them to pay the producers higher prices than the minimum price, which is usually the case.

The audits carried out by the Commission under the clearance of accounts have not formally confirmed that the system in place is failing to achieve the aim of providing an incentive to improve quality.

57. As indicated in paragraphs 42 to 46, the deficiencies relating to declarations and checks on agricultural land in Greece detected by the Court of Auditors were already identified by the Commission in previous audits. The resultant risks are being monitored closely and are allowed for under the clearance of accounts procedure, for area aid and the other aid schemes, such as production aid for cotton, alike.

RECOMMENDATIONS

58. (a) and (b). The Commission will take the weaknesses mentioned by the Court into consideration when formulating the reform proposals. In addition, it will also take account of the fact that the present regime is highly complicated and not in line with the recent evolution of the CAP.

(c) The Commission already collects all information coming to its attention.

59. (a) The Commission accepts the Court's recommendation and, as in the past, will continue to verify correct and consistent application of controls.

(b) The Commission has in the past tried to review the operating costs incurred by ginners but the discussions with the Member States were inconclusive due to the high variability of the results.

(c) The Commission considers that the fact that the yields in ginned cotton are usually higher than the standard 32 % is an indicator of the effectiveness of the provisions relating to quality improvement.