

Official Journal

of the European Communities

ISSN 0378-6986

C 297

Volume 30

6 November 1987

English edition

Information and Notices

<u>Notice No</u>	Contents	Page
	<i>I Information</i>	
	Court of Auditors	
87/C 297/01	Special Report No 3/87 on the common organisation of the market in raw tobacco accompanied by the Commission's replies	1
87/C 297/02	Special Report No 4/87 on Community wine distillation measures accompanied by the Commission's replies	14

I

(Information)

COURT OF AUDITORS

SPECIAL REPORT No 3/87

on

The common organisation of the market in raw tobacco accompanied by the Commission's replies
(87/C 297/01)

(Observations pursuant to Article 206a(4) of the EEC Treaty)

TABLE OF CONTENTS

	Paragraph reference
1. INTRODUCTION	1.1 — 1.3
2. BUDGETARY EXPENDITURE	2.1
3. ADMINISTRATION OF THE PREMIUM	3.1 — 3.7
Rules for granting the premium	3.1 — 3.3
Observations concerning administration by the Member States	3.4 — 3.7
Supervision at first processing stage	3.4 — 3.5
Procedure for issuing the premium certificate	3.6 — 3.7
4. THE FIXING OF THE PREMIUM	4.1 — 4.7
The two components	4.1 — 4.5
Competing substitute varieties	4.6 — 4.7
5. PROCESSING COSTS	5.1 — 5.3
6. RELATED VARIETIES WITH DIFFERENT PREMIUMS AND NORM PRICES	6.1
7. PRODUCTION AREAS	7.1 — 7.3
8. RELATIONSHIP BETWEEN PRICES, PREMIUMS AND QUALITY	8.1 — 8.6
9. SUMMARY AND CONCLUSIONS	9.1 — 9.5
Supervision of first processing	9.1
Issuing and checking the premium certificate	9.2
Policy aims and the premium level	9.3 — 9.5
THE COMMISSION'S REPLIES	Page 9 — 13

1. INTRODUCTION

1.1. The present review is limited to the Community of 10 where tobacco is cultivated principally in Italy and Greece, and to a lesser extent in France, the FR of Germany and Belgium (Table 1). There are about 215 000 growers, most of them working plots of about one hectare as their chief or only source of livelihood. Total production in 1986 amounted to 352 702 tonnes, equivalent to some 46 % of requirements ⁽¹⁾. As may be seen from Table 2, one-third of the crop consists of varieties in low or very low demand (Groups III and IV) which can only find market outlets by receiving a high level of budgetary support.

1.2. The common organization of the market dates from 1970 and replaced the different national schemes. The basic regulation ⁽²⁾ provides for a support system, including public storage arrangements for both leaf and baled

⁽¹⁾ The footnotes appear together at the end of the report.

tobacco. Community producers receive relatively little tariff protection from world supplies of raw tobacco. The chief support is provided by way of a premium on Community leaf tobacco. The premium is paid to first processors (i.e. those who process the leaf into bales) to enable the Community norm price ⁽³⁾ to be paid to growers.

1.3. In addition to supporting producer incomes and ensuring disposal of the crop, the premium system aims to encourage improvements in quality and a changeover to the production of tobacco varieties which are in greater demand ⁽⁴⁾.

2. BUDGETARY EXPENDITURE

2.1. As Table 3 shows budgetary expenditure on the market has more than doubled from 361,8 Mio ECU in 1981 to 782,2 Mio ECU in 1986. This is mainly due to the

Table 1 — Production of leaf tobacco by Member State 1981-1986

	EUR 10					(tonnes)
	1981	1982	1983	1984	1985	1986
Italy	130 969	145 018	156 064	161 142	161 444	156 068
Greece	127 403	132 382	111 591	143 088	141 319	150 998
France	41 626	43 870	36 216	34 907	32 312	36 140
FR of Germany	7 839	8 112	6 809	7 230	7 534	7 545
Belgium	1 419	2 141	2 078	2 054	1 600	1 951
Total	309 256	331 523	312 758	348 421	344 209	352 702

Source: EC Commission.

Table 2 — Raw tobacco production by group

Group of varieties	EUR 10					(tonnes)
	1981	1982	1983	1984	1985	1986 (¹)
I — greatest demand	69 483 (22 %)	78 625 (24 %)	69 523 (22 %)	84 345 (24 %)	91 403 (27 %)	103 472 (29 %)
II — moderate demand	108 100 (35 %)	112 073 (34 %)	121 173 (39 %)	141 594 (41 %)	137 539 (40 %)	116 959 (33 %)
III — low demand	89 313 (29 %)	92 466 (28 %)	73 480 (23 %)	71 307 (20 %)	67 185 (19 %)	72 871 (21 %)
IV — problem varieties	42 360 (14 %)	48 354 (14 %)	48 582 (16 %)	51 398 (15 %)	48 082 (14 %)	59 400 (17 %)
Total	309 256 (100 %)	331 518 (100 %)	312 758 (100 %)	348 644 (100 %)	344 209 (100 %)	352 702 (100 %)

Source: EC Commission.

⁽¹⁾ Provisional.

Table 3 — The expenditure of the Community on tobacco

(Mio ECU)

Item	Heading	Expenditure					
		1981	1982	1983	1984	1985	1986
170	Refunds of tobacco	5,84	17,27	27,9	36,5	32,0	32,1
171	Premiums for tobacco	286,13	575,23	614,8	711,7	819,0	733,9
172	Intervention storage for tobacco						
1720	Technical cost of public storage	3,6	9,42	10,9	6,2	6,9	9,2
1721	Financial costs of public storage	8,0	4,34	3,1	1,5	1,6	1,4
1722	Other public storage costs	58,1	16,36	14,6	20,5	3,4	5,6
	Total 172	69,7	30,12	28,6	28,2	11,9	16,2
173	Other intervention for tobacco	0,16	0,003	0	0	0	0
	Total Chapter 17	361,8	622,62	671,3	776,4	862,9	782,2

accessión of Greece. In relation to the area under cultivation, tobacco is the most highly subsidised crop in the common agricultural policy. In 1985, for example, budgetary expenditure per hectare was over 4 300 ECU, compared with 529 ECU for oil seeds, 410 ECU for wine, 260 ECU for olive oil and 85 ECU for cereals. The high level of aid for the tobacco sector had, indeed, already been noted in the Court's 'Report in response to the conclusions of the European Council of 18 June 1983'; see, for example, paragraph 2.3.2 and 2.3.15(c) thereof ⁽⁵⁾. For some of the 198 000 hectares under tobacco, however, the possibilities for alternative use are, according to the Commission, limited by agronomic factors.

3. ADMINISTRATION OF THE PREMIUM

Rules for granting the premium

3.1. Commission Regulation (EEC) No 1726/70 ⁽⁶⁾ of 25 August 1970 contains the detailed rules for the application of the premium system. Member States are required to institute a system of supervision at the first processing stage, to check the leaf tobacco received and ensure that it will not be released before completion of first processing. Under the terms of Article 1 of that Regulation taken together with the 5th recital, when leaf tobacco is brought under supervision on arrival at a processing undertaking, it

must be examined to determine its net weight, quality and moisture and impurities content.

3.2. When the tobacco is brought under supervision a 'premium certificate' is to be issued by the intervention agency fully identifying the quantity and quality of the leaf tobacco (Article 3 of above Regulation). The information relating to the tobacco is entered on the premium certificate so that the quantity and quality of the baled tobacco that is produced can be checked. The certificate later serves as the basis of a claim for premium.

3.3. The right to the premium is acquired when the tobacco leaves the place of first processing. The amount payable is calculated by reference to the net weight, the variety and the crop year shown in the premium certificate. If the weight on leaving the premises is less than that shown on the certificate, the premium is adjusted taking into account the permissible losses fixed in Commission Regulation (EEC) No 410/76 ⁽⁷⁾ of 23 February 1976. The premium may be paid in advance provided a cultivation contract exists between the producer and the purchaser of the tobacco and a guarantee of 20 % of the amount of the premium is lodged.

Observations concerning administration by the Member States

Supervision at first processing stage

3.4. The requirement to supervise the receipt (paragraph 3(1)) is interpreted differently in the Member States:

- (a) in the FR of Germany the leaf tobacco is delivered by the tobacco growers to specified points of sale where, during the delivery period, the customs authorities monitor the weighing of the tobacco and the determination of its quality. Checks at the premises of the processing undertakings are infrequent;
- (b) in Greece, these checks are carried out by officials of the National Tobacco Board at the growers premises. A further small percentage of spot checks is made by officials who are stationed in each processing plant, when the leaf tobacco is received;
- (c) in France, they are made by officials of the intervention agency at the 110 local 'Commissions d'achat' which buy tobacco for onward delivery to the processing undertakings which are themselves state controlled. The on-the-spot checks are on average made for only 1 to 2 days, although the purchasing period varies from one week to 3 months and averages about 30 to 40 days.

In the abovementioned Member States the principal checks are, for the most part, not made at the processor's premises as required by the regulation. Furthermore, in France, the extent of the checks is insufficient.

3.5. The Italian authorities informed the Court that in Italy an official is present at all processing premises and personally weighs the tobacco when it is received. The Court recommends that in future the supporting documentation should include some written and signed record of the examinations conducted, which was not the case at the time of the Court's audit.

Procedure for issuing the premium certificate

3.6. The premium certificate referred to in paragraph 3.2 should be issued when the tobacco is brought under supervision. In France and Italy, only one premium certificate is issued to the processing undertaking for each crop year and for each variety after the last delivery has taken place. As a result, the greater part of the year's crop is likely to have been processed before the premium certificate is issued. This practice also delays the moment at which an advance may be granted, since an advance may be paid only after the certificate has been issued.

3.7. The Commission should take steps to ensure compliance by the two Member States in question.

4. THE FIXING OF THE PREMIUM

The two components

4.1. A separate premium is fixed by the Council for each of the 26 varieties of tobacco cultivated in the Community of 10. According to Article 4 of the basic regulation the premium should be such as to 'secure the norm price and ensure the sale of the tobacco produced in the Community'. The amount should consist of two 'components'. The first component is to be calculated with regard to:

- (a) 'past and foreseeable outlets for the sale of the tobacco under normal conditions of competition on the Community market';
- (b) 'the influence of trends in prices for tobaccos imported from third countries in so far as such tobacco is a competitive substitute for the Community produced tobaccos'.

The second 'standard component' is 'designed to secure, in the best possible manner, the guaranteed price and income and ensure the sale of Community tobacco'.

4.2. The Commission services maintain, rightly in the Court's view, that the application of the components cannot be based solely on an arithmetic formula such as the difference between the world market price and the domestic price. This was indeed the formula applied for the first year (1970 or, in the case of Greece, 1981). Since 1970, a variety of methods have been applied. From 1975 onwards, a basket of competing (foreign) varieties has been established for each Community variety, and it is the maximum and minimum price scale of the former which is used to compare with the price of the latter in applying criterion (b) of the first component.

4.3. In practice, since 1977 the Council has tended to apply the same annual percentage changes to premiums as to norm prices. The rises were generally the same for all varieties within the same group. However, since 1984, when norm prices began to be reduced, the premiums were reduced in line or, in some cases, even more sharply.

4.4. In the light of the foregoing, it is difficult to trace precisely the application of the various elements of the components. The Commission services, in the above

mentioned report, point to cases where premiums were fixed outside the scale of competing prices as examples of the application of the second component. However, most of the documentation presented to the Council at the time of price fixing relates to the comparison with competing varieties and there is little to show how the other elements have been arrived at. Indeed the continued support, at a high level and over a long period, of problem varieties points to a rather weak influence of criterion (a) of the first component, which is designed to favour the cultivation of varieties and qualities which are readily marketable.

4.5. The Commission services state that there are serious difficulties in applying the different elements of the two components in a consistent and transparent manner. It is important for the legislative authorities to have clear information on which to base policy decisions. The Commission should therefore suggest ways by which these problems could be solved.

Competing substitute varieties

4.6. In order to apply criterion (b) of the first component (see paragraph 4.1), it is necessary to establish, for each Community variety, the competing substitute varieties imported from third countries. The Commission has set up a group of experts composed of tobacco specialists from the Member States to assist in the selection of such varieties; however, it may modify the experts selection. Since 1970 the Commission has adopted four lists of competing varieties, (the last in 1983), following proposals from this group. However, no attention was paid to whether a particular foreign variety did in fact compete on the Community market. Instead, the Commission has established that a third country variety could theoretically compete and then used price information concerning it to calculate the premium necessary for its Community analogue. In fact the Commission has only limited information on the quantities of such tobaccos imported into the Community. Without detailed information on the level of imports of these competing varieties it is not possible to ensure that the premiums proposed are not being unduly influenced by varieties that are only marginally traded or not in fact imported into the Community.

4.7. In 1984, the Commission did not follow the experts advice concerning two baskets of foreign varieties used in setting the premiums for two Community varieties in low demand (group III), Perustitza and Erzegovina. The experts' advice would have led to the two premiums being 30 % and 27 % respectively lower than those finally fixed.

A lack of supporting documentation has hampered an evaluation of whether the Commission's amendments were justified. The potential financial cost of the Commission's decision is about 10 Mio ECU per annum.

5. PROCESSING COSTS

5.1. The regulation ⁽²⁾ requires that the processing costs used in calculating the premiums correspond to the costs of well managed undertakings. However, the Commission does not have accurate and up to date information on processing costs and has not undertaken a regular review of the amounts used in the calculation. Since 1983 the latter have been frozen at levels ranging from 1,096 ECU to 1,875 ECU per kilo depending on the variety. These amounts are 82 % to 39 % higher (0,4 to 0,3 ECU/kg) than those used in calculating the derived intervention price for baled tobacco, although these too are supposed to represent the processing costs of well managed undertakings.

5.2. The processing costs used in the premium calculations should be updated. The Commission services obtained information from the Member States on the costs involved in processing tobacco from the 1983 harvest, but the data was not in a form that could be readily used and compared. In any case the use of two different sets of costs is difficult to justify.

5.3. The premium calculations made by the Commission also take account of loss of weight during processing. The coefficients used to make these allowances have not been revised since the introduction of the scheme. With technical innovation which has taken place it is unlikely that such losses have remained at the same level and they should be regularly reviewed.

6. RELATED VARIETIES WITH DIFFERENT PREMIUMS AND NORM PRICES

6.1. Italian Burley receives a premium of about 63 % of the norm price while for Greek Burley it amounts to 43 %. For both, the competing substitute varieties are the same. The cause of the disparity appears to be that after the calculation of the initial support levels (in 1970 for the Community of 6 and in 1981 for Greece) no further alignments have been proposed by the Commission. Instead premium calculations have been made on the basis

that they are different varieties. The premium for Italian Burley has been consistently higher than that for Greek Burley (in 1985 the rates per kilogramme were respectively 1,621 ECU and 0,972 ECU). Production in that year was 60 000 tonnes in Italy and 29 655 tonnes in Greece. This premium difference is all the more difficult to defend since the average quality of Greek Burley is, according to the Commission, generally higher than that in Italy and the latter has disposal problems. The additional cost of paying a higher premium on 60 000 tonnes at 1986 prices was 38,1 Mio ECU. For the years 1981 to 1985 the amounts involved were 26,4 Mio ECU, 30,6 Mio ECU, 38,1 Mio ECU, 39,8 Mio ECU and 38,9 Mio ECU.

7. PRODUCTION AREAS

7.1. When the common organization of the market in raw tobacco was established the idea of a 'national' variety cultivated in a particular Member State was abolished; instead the same norm price and premium were applied to each variety having the same botanical characteristics. Nevertheless the level of the norm price and premium tended to reflect the market needs and conditions of the Member State in which the variety was indigenous. When cultivated in another Member State or region a change can occur in the quality and characteristics of the tobacco. This is what happened when the variety Forchheimer Havanna began to be developed in Italy, with the benefit of the premium which had been fixed initially with reference to production conditions in the FR of Germany.

7.2. Production of Havanna ceased in the FR of Germany but in Italy since 1981 it has risen rapidly to a level of some 20 000 tonnes per annum. The Italian Havanna is generally of a lower quality than that of the German tobacco. It has been regularly sold into intervention. The annual budgetary cost of supporting this unwanted tobacco is 45 to 50 Mio ECU.

7.3. The Council has now fixed 'production areas' for each of the Community varieties⁽⁸⁾. The effect of this is that while any variety of tobacco may be grown in any region of the Community the market support system will not apply unless the region is recognised as a production zone for that variety. The Court welcomes this development and believes that it will assist in the future control of undesirable transfers of varieties from one country to another. In particular, the arrangements will control the transfer of the problem variety Tsebelia from Greece to Italy which has occurred in recent years as only certain Greek regions are now recognized as production areas.

8. RELATIONSHIP BETWEEN PRICES, PREMIUMS AND QUALITY

8.1. In recent years the premiums, expressed as a percentage of the norm prices, have, on average, ranged between 44 % and 79 %. For the problem varieties (group IV) the range was from 66 % to 79 %. It should be noted however that, in the 1986/87 price proposals the Commission gives the overall range as 45 % to 65 % which appears to understate the level of premium support for the problem varieties and those in low demand.

8.2. When compared with average producer prices the level of support varies more widely, between 39 % and 115 % depending on the variety. Per hectare cultivated, the premiums vary from 2 070 ECU to 7 316 ECU. For the varieties Badisher Geudertheimer, Paraguay and Forchheimer Havanna the premiums in Italy (totalling 64 Mio ECU) were in fact higher than the actual prices paid to Italian growers of these varieties (115 %, 115 % and 111 % respectively). The Commission services explained that this is partly due to the high cost of sorting the tobaccos in question. However, the processing subsequent to sorting of these tobaccos is relatively simple. In France and in the FR of Germany (where Geudertheimer and Paraguay are also grown), the relevant percentages for Geudertheimer are 82 % and 87 % and for Paraguay in France it is 64 %. If the additional cost of export refunds is taken into account the aid rises for all three varieties to approximately 125 % of the prices actually paid to Italian producers for the primary product. Destruction of the tobacco with compensation, at an earlier stage, would have produced a budgetary saving without financial loss to the producer.

8.3. The situation described in the foregoing paragraph is due, in no small measure, to the poor quality of some Community tobaccos, notably Forchheimer Havanna, and consequently to the lower producer prices which they command by reference, for example, to the norm prices fixed for the 'standard' quality. This is borne out by a comparison of prices (unit values) of tobacco imported and exported (see Table 4). The figures must be treated with caution as they refer to tobacco types rather than varieties and the Commission services have pointed out that imported tobaccos may have different uses than similar Community-grown varieties. However, the figures serve to underline a need to improve quality.

8.4. At present, while intervention prices⁽³⁾ vary with the quality of the tobacco concerned, premiums do not. The budgetary cost of granting premiums on low quality problem varieties for sale on the open market is higher than the cost of intervention purchase, storage and resale of those same qualities. For example, for Forchheimer Havanna, the premium of 2 161 ECU per tonne compares with an intervention cost of about 1 500 ECU per tonne for the lowest quality assuming a 1 year stocking period. This apparent anomaly is a reflection of the fact that the full

Table 4 — Comparison of import and export unit values

(Unit value: ECU/kg)

Tobacco description (Not stripped)	1982		1983		1984		1985	
	Imports	Exports	Imports	Exports	Imports	Exports	Imports	Exports
Flue cured virginia type	3,62	2,64	4,04	3,10	4,35	2,00	4,54	2,55
Light air cured Burley type	4,07	1,70	4,92	2,19	4,30	2,10	5,58	1,59
Light air cured Maryland type	3,80	1,31	4,99	1,33	5,83	0,85	6,50	1,03
Fire cured Kentucky type	4,02	1,08	4,60	0,91	5,27	0,73	4,81	0,98
Fire cured other types	5,08	0,47	5,43	0,35	6,11	0,45	6,62	0,87
Light air cured other than Burley and Maryland	2,63	1,29	2,72	0,76	3,35	0,41	3,30	0,69
Sun cured oriental type	2,88	0,45	3,30	1,11	3,69	0,93	3,91	1,15
Dark air cured	2,57	1,11	2,91	1,50	3,56	1,48	4,34	1,37
Flue cured other than Virginia type	2,73	1,64	3,29	1,72	2,86	1,12	2,30	3,75
Other	3,40	3,01	3,62	2,63	5,98	2,34	6,60	2,18

Source: Eurostat Nimex.

premium is granted for low quality tobacco; whereas the intervention purchase price is adjusted to the quality and no premium is payable on quantities bought in.

8.5. If premiums varied with quality an incentive would be provided to producers and processors to improve quality. The Commission services rule out the introduction of premiums differentiated by quality on the grounds that official and trade bodies believe that verification of quality would be both costly and difficult. In addition, fraud would be encouraged as there would be an incentive to overdeclare qualities. Furthermore, purchasers might be less willing to enter into cultivation contracts (thereby committing themselves to purchase the tobacco harvested, irrespective of quality), if they were not aware of the precise premium that would be paid.

8.6. In view of the benefits that could be obtained from applying premiums differentiated by quality the Court believes that the introduction of such a system, either fully or for selected varieties, merits serious examination.

9. SUMMARY AND CONCLUSIONS

Supervision of first processing

9.1. The regulations require that the net weight should be determined when the tobacco comes under supervision at

the processors premises. This control is essential in order to ensure that the premium is paid only on quantities actually processed and that only genuine processing losses are taken into account. None of the main producing Member States is at present operating satisfactory arrangements to implement this requirement.

Issuing and checking the premium certificate

9.2. In France and Italy only one premium certificate is issued to a processing plant for all deliveries of a given variety during a particular harvest year. The natural inference from such a procedure is that much of the harvest will have been processed before issue of the certificate. This practice is irregular and steps should be taken to ensure that individual certificates are issued when tobacco comes under supervision.

Policy aims and the premium level

9.3. Most of the production has been disposed of without using the intervention machinery but this has only been possible by granting high premiums and export refunds to varieties in low demand. This policy, which has resulted in the payment of high subsidies compared to the value of the

tobacco has meant that the intended switch from the problem tobacco varieties grown in Italy and Greece, has not occurred. In fact, between 1981 and 1985 the area committed to group IV problem varieties increased from 29 329 to 33 578 hectares with a consequent increase in production from 42 360 to 48 082 tonnes. This is due principally to the rapid rise in production of the variety Forchheimer Havanna in Italy. Action should have been taken several years ago to discourage production of the problem varieties and steer production towards those varieties in real demand. It is regrettable that, since the scheme began in 1970, the Commission has not proposed premiums that reflected market requirements. As a consequence, the intended changes in production set out in the regulation ⁽²⁾, namely improvement in quality and a switch to varieties in demand, have been sluggish. As a result after 16 years of Community support only 29 % of the crop is in real demand. In addition the high ratio of aid to the final value of the crop reflects the low average quality of the tobacco produced and, in terms of support per hectare, the budgetary cost of the problem varieties in particular, appears to be untenable. The cost of paying premiums alone for the problem varieties (group IV) is of the order of 130 Mio ECU per annum.

9.4. In addition to the foregoing, this report has identified particular problems relating to certain varieties, viz:

- (a) non-acceptance of the advice of the experts regarding competing substitute varieties (paragraph 4.7, potential financial impact 10 Mio ECU per annum);
- (b) substantially different premiums for related varieties (paragraph 6.1, financial impact 35 Mio ECU per annum);
- (c) cases of premiums in excess of producer prices (paragraph 8.2).

9.5. In the period under review, the premium regime has evolved with insufficient regard to the conditions of the international market or to the Community's stated objective of discriminating in favour of tobacco varieties for which there is consumer demand. Unless varieties which are really in demand can be produced at reasonably competitive prices, Community preference involving a high level of support is difficult to justify. The tobacco regime is now costing about 800 Mio ECU annually for the Community of 10 alone. In so far as a significant portion of this expenditure continues to benefit varieties for which there is little or no demand, the Court believes that the time is overdue for a close examination of policy in the tobacco sector.

The present report was adopted by the Court of Auditors at Luxembourg at its meeting of 15 July 1987.

For the Court of Auditors

Marcel MART

President

(¹) The accession of Spain and Portugal adds a further 43 000 tonnes of production, 75 % of it being varieties in declining demand, and leaves the self-sufficiency ratio little changed at about 45 %.

(²) Council Regulation (EEC) No 727/70 of 21.4.1970 on the common organization of the market in raw tobacco (OJ L 94, 28.4.1970).

(³) The norm price is fixed by the Community each year. It is the price intended to be paid to the producer. The intervention price is fixed at 85 % of the norm price.

(⁴) Preamble to Council Regulation (EEC) No 727/70.

(⁵) OJ C 287 of 24.10.1983.

(⁶) Commission Regulation (EEC) No 1726/70 of 25.8.1970 on the procedure for granting the premium for leaf tobacco (OJ L 191, 27.8.1970).

(⁷) Commission Regulation (EEC) No 410/76 of 23.2.1976 fixing the maximum permissible weight losses in connection with the supervision of the first processing and market preparation of tobacco (OJ L 50, 26.2.1976).

(⁸) Council Regulation (EEC) No 1577/86 of 23.5.1986 fixing for the 1986 harvest the norm and intervention prices and the premiums granted to purchasers of leaf tobacco, the derived intervention prices for baled tobacco, the reference qualities and the production areas. (OJ L 139, 24.5.1986).

THE COMMISSION'S REPLIES

1. INTRODUCTION

1. Under the national market organizations which existed prior to the setting up of an EEC market for raw tobacco, producers received an assurance that their produce would be marketed at prices which should provide them with a fair income.

Because customs duties were bound in GATT, the application of the Common Customs Tariff did not allow of any narrowing of the gap between the Community producer price and world market prices. Tariffs, therefore, do not offer Community tobacco growers sufficient protection against competition from non-Community countries. Special provisions were adopted, including a system of premiums or intervention measures making it compulsory to purchase tobacco at the intervention price, in order to provide Community producers with a fair level of income. Because of the difference between world market prices and market prices within the Community, due to differing structures of production and labour costs, a scheme similar to the 'deficiency payments' system had to be set up whereby a premium was granted to purchasers of leaf tobacco from Community growers.

2. The Community countries traditionally produced mainly sun-cured tobacco, demand for which has fallen over the last few years because consumers have been switching to new 'American blended'-type cigarettes. In order to respond to this trend, the Community has differentiated prices and premiums in order to discourage production of less popular varieties. In 1982, 1983 and 1984, for example, the different varieties were split into three groups with increasingly wider differences between the prices and premiums for the different groups. This differentiation in prices and premiums was further accentuated in 1986 when the tobacco varieties were split into four groups. When fixing the prices and premiums for the 1987 harvest, the Council, as proposed by the Commission, re-classified the varieties into five groups on the basis of the market situation, the quantities bought in, the market outlets available and production trends. This made for further differentiation between the different varieties.

As a result of this policy, 65 % of the current Community production consists of varieties readily sold on the markets

or well adjusted to demand. Although production of the varieties falling within Group IV of Table 2 in the Court of Auditors' report has not been cut back to the extent hoped for, allowance must be made for the fact that production is concentrated in the less-favoured areas of the Community where the proportion of the workforce employed in agriculture is highest and where incomes are low. These are areas where the structural situation prevents redeployment.

3. The quantities bought in have been considerably reduced over the last few years. In 1985, for example, hardly any of the 'problem' varieties such as Havana, Tsebelia and Mavra were sent to the agencies. The prices and premiums for these varieties were reduced by 20 % between 1984 and 1987. Also export refunds have been frozen since 1981.

2. BUDGETARY EXPENDITURE

2.1. The accession of Greece increased production potential in the Community by more than 70 % in comparison with the Community of Nine. This naturally had an impact on the Community budget. Expenditure in connection with Spain and Portugal was included for the first time in the 1986 figures.

It is important to stress that tariffs do not properly protect the tobacco industry against competition from non-Community countries.

Finally, as in the case of other products, when comparing the Community's budgetary expenditure per hectare on tobacco with its expenditure on oilseeds, wine, olive oil and cereals, allowance must be made for the structural differences between the market organizations in question. For example, production costs in respect of one hectare of tobacco are about 10.000 ECU whereas the production costs in respect of one hectare of cereals are about 600 ECU.

3. ADMINISTRATION OF THE PREMIUM

Observations concerning administration by the Member States

Supervision at first processing stage

3.4. and 3.5. During inspections carried out in connection with the clearance of accounts, the Commission observed that the following procedures were followed:

In Belgium, France and Germany, 'purchasing boards' operated in purchasing centres, representing the vendor, the purchaser, experts (if any) from the two parties or representatives of the tobacco growers' federation and the intervention agency. These boards inspect and classify the leaf tobacco, take samples to check the moisture content, weigh the bales and fix the purchase price for leaf tobacco. All these data will appear on the premium certificate and on the records kept by the purchasing centre and the intervention agency. When the lorry transporting the bales arrives at the factory, the driver hands over a receipt corresponding to the tobacco for delivery. In the case of factories supervised by the EAGGF, the tobacco is again inspected, classified and weighed and samples are again taken to establish the moisture content. The representatives of the intervention agency are present or, if not, they subsequently carry out spot checks to see that the quantities recorded as having entered the factory tally with the data supplied by the purchasing board or with the data which they record during their checks.

In Italy and Greece, all the operations described above are normally carried out at the factory gate and in the presence of the vendors/growers, the purchasers and the experts/inspectors from the intervention agency. Frequent checks are also carried out beforehand at the collection centres and on the growers' premises.

Procedure for issuing the premium certificate

3.6. and 3.7. Although it is true that, in France and Italy, there is no premium certificate as such for each producer/vendor and for each variety, this is because the system set up by these two Member States provides that the intervention agency should keep a daily record of its intake of leaf tobacco. The pages of these records are stamped and numbered by a notary. These records contain all the

information provided for by Article 2 of Regulation No 1726/70.

On the basis of these daily records, reports of checks carried out on leaf tobacco under supervision and summaries of checks carried out on such tobacco, the intervention agency draws up the official premium certificate. There is reason to think that the processing of this leaf tobacco which has been delivered and inspected takes place before the purchaser's premium certificate giving all the information relating to the purchase of a particular variety from a particular harvest is officially drawn up: the advance cannot be granted until such time and then only in respect of leaf tobacco for which there is a cultivation contract.

The Commission takes the view that this procedure meets the requirements of the legislation.

4. THE FIXING OF THE PREMIUM

The two components

4.4. and 4.5. The Commission has sent to the Council an analysis of the criteria for fixing the premium, in connection with its 1987 proposals for prices and premiums (OJ No C 89, 3 April 1987 (Annex 5)).

In its conclusions, the Commission states its conviction of the need to use a wide range of criteria in evaluating the levels at which the norm price and the premium should be fixed. To do otherwise or to try to lay down a rigid arithmetical method would be to run the risk of distorting not only the conditions of competition between different varieties of tobacco but also the economic conditions which favor tobacco-growing as distinct from other agricultural activities.

Competing substitute varieties

4.6. and 4.7. The Commission's staff regularly monitor trends in tobacco production on the basis of specialized trade documentation.

In the particular case raised by the Court, the Commission did indeed consult experts before choosing the competing substitute varieties. When the list of such varieties was updated in 1984, the Commission was given, in succession, two different opinions on the composition of the 'baskets of competing varieties' for Perustitza and Erzegovina tobacco. Thanks to the information provided by the Member State directly concerned, a consensus of expert opinion was subsequently arrived at with regard to the composition of the relevant baskets of competing varieties and the Commission's decision was based on this consensus.

When fixing the premiums for Community varieties from the 1985 and 1986 harvests, the Commission received confirmation that it had taken a correct decision in 1984 on the composition of the basket of competing varieties for Perustitza and Erzegovina. With regard to the 10 Mio ECU annual potential financial cost of this decision, the Commission believes that it would be easier to argue that the decision has helped to cut EAGGF costs: when allowance is made for the level of the fixed premium, production of those varieties is marking time and there is no record that any quantities have been bought in over the last few years.

5. PROCESSING COSTS

5.1. and 5.2. The Commission has always monitored very closely trends in processing costs within the Community. Currently, using a detailed lay-out drawn up in 1983, it is gathering information from government and tobacco experts to enable it once again to update the processing costs which may be used to calculate the prices and premiums for Community varieties for the 1988 harvest.

The Commission wishes to make it clear that it actually uses two sets of processing costs. One is used to fix the premiums paid in order to market the product normally (and should therefore tend to reflect the real processing costs so as to ensure competitiveness and market outlets for Community-grown tobacco); the other, comprising reduced processing costs, is used in the calculation whereby the derived intervention price which is paid for processed and baled tobacco bought in is fixed.

In order to discourage buying-in and to lessen its cost, the Commission has made a flat-rate reduction in the processing costs used to calculate the derived intervention prices. The use of two different sets of processing costs for two separate calculations and management instruments is more a reflection of the particularly restrictive budgetary approach which the Commission has adopted. It should

also be noted in this connection that all the processing costs expressed in ECU which have been used over the last few years in fixing the prices and premiums for raw tobacco were frozen at their 1983 levels.

5.3. The Commission agrees with the Court on this point. It is aware of the technical progress which has been made in processing and is already considering whether the coefficients laid down in Annex V to Regulation No 1727/70 should be altered.

6. RELATED VARIETIES WITH DIFFERENT PREMIUMS AND NORM PRICES

6.1. The Commission maintains that, in the light of its present information, there is a good case on economic and agronomic grounds, for granting different norm and intervention prices and premiums for different Community-grown varieties of Burley.

Although these were originally a single type of tobacco, they have actually become different varieties because of different soil and climatic conditions and growing methods within the Community. Each of these different varieties of Burley has its particular characteristics, production costs and marketing conditions, and this justifies different prices and premiums.

All the governments and tobacco experts who have been consulted agree with the Commission on this point and unanimously recognize the individual identity of the different varieties of Burley grown in the Community.

Moreover, the specific characteristics of the Community-grown varieties of Burley are described (in terms of their genetic, botanical and morphological aspects, soil and climatic factors, conditions of production and methods of cultivation) in the Commission Regulation fixing the characteristics of all the varieties of tobacco grown in the Community.

Finally, bringing the premium granted to Burley tobacco down to the lower level would inevitably lead to distortions in competition which could result either in increased buying-in or to a fall in production or even disappearance of these readily-marketable varieties of Burley in certain areas of the Community.

This would run counter to the Commission's policy, which it has been pursuing for many years, to reduce the quantities bought in and to encourage Community growers to switch to the most popular varieties.

The difference between the premium for Italian Burley and for Burley grown in Greece is due to the situation in Greece when it joined. Over the last few years, however, the production and marketing of Greek Burley has deteriorated to such an extent that the Commission has had to propose an increase of about 27 % in the premium for the 1987 harvest, bringing it close to the premium for other varieties of Burley grown in the Community.

7. PRODUCTION AREAS

7.1. and 7.2. The Commission wishes to stress that the tobacco grown in recognized production areas in Italy under the variety name 'Forchheimer-Havanna' is indeed Forchheimer-Havanna tobacco and, as such, should attract the prices and premiums fixed for that variety.

These prices and premiums were fixed from the earliest years of the market organization with reference both to German and Italian production. As long as 1971, although very little Forchheimer-Havanna was grown in Italy (only about 90 tonnes) this was nevertheless more than was grown in Germany. Production in the Federal Republic has never been more than experimental (55 tonnes in 1970, 34 tonnes in 1971 and 18 tonnes in 1972) and ceased completely in 1973 so that it is now difficult to make relevant qualitative comparisons between the German and the Italian-grown tobacco.

Annual production of Forchheimer-Havanna fluctuates around 22.000 tonnes, on average, 95 % of the crop has been marketed over the last few years, with the exception of the 1982 harvest, of which only 85 % found buyers on the markets. Since then, the quantities bought in have dwindled to a trickle; according to the latest information available, 98.6 % of the 1985 production has been marketed.

7.3. The Commission wishes to point out that only once has production of Tsebelia been claimed in Italy by certain private operators reporting that 3 tonnes were harvested in 1984. Production of this variety subsequently ceased in that country. Moreover, since the Council has recognized only certain Greek regions as production areas for this variety,

Tsebelia prices and premiums cannot now be paid for tobacco of this kind produced in any other Member State.

8. RELATIONSHIPS BETWEEN PRICES, PREMIUMS AND QUALITY

8.1. The ratio, expressed as a percentage, between the premium and the norm price referred to by the Court of Auditors has fallen but, on the face of it, still seems high. The Commission, however, sees little significance in this comparison. For economic purposes, it is more usual to take the ratio between the premium and the cost of production, which is between 18 % and 35 % for the varieties mentioned (OJ C 85, 14 April 1986).

8.2. The norm and intervention prices are fixed by the Council for a particular reference quality. The prices actually paid, however, depend on the quality and presentation of the product (see also points 9.4.-9.6.).

Having examined the matter in depth, the Commission takes the view that this apparent discrepancy between the premiums and the prices paid to growers for certain varieties is accounted for by differences in quality, the different grading and packaging processes and certain peculiar market conditions.

With regard to the Court's suggestions that the tobacco should be destroyed and compensation paid to the producer, the Commission wishes to point out that the cost of destruction (estimated at 0.20 ECU per kilogram) together with practical and environmental problems would outweigh the budgetary saving hoped for.

As regards the level of the premium in relation to certain prices paid to growers, it should be noted that this relates only to quality class C, which accounts for only 10 % of a normal consignment of tobacco or of loose leaf tobacco.

8.3. As part of the Community's agricultural research programme, the Commission is carrying out research with a view to improving the varieties and the quality of tobacco grown in the Community. This objective is specifically mentioned in the Commission's prices and premiums proposal for the 1987 harvest.

8.4. to 8.6. The possibility of varying the premium according to quality has been and is still being carefully considered by Commission staff. It should nevertheless be noted that, although the premium was, in fact, varied according to quality between 1970 and 1974 (in the case of Virgin SCR), the information forwarded by the Member states and obtained from trade bodies showed that this

variation of the premium, which at first seems logical, is not always easy to apply and could even encourage fraud. Moreover, from an economic point of view, varying the premium in this way according to quality would reduce the attraction of lower qualities and the budgetary savings hoped for would probably be equalled (or even exceeded in the event of poor harvests) by the cost of the additional quantities of inferior quality tobacco that might have to be bought in.

The Commission notes the interest expressed by the Court of Auditors in varying the premium with quality and undertakes to continue studying the case for the feasibility and the effects of setting up such a system. The possibility of varying the premium is, however, allowed only 'by way of exception' in Regulation No 1727/70.

9. SUMMARY AND CONCLUSIONS

9.1., 9.2., 9.3., 9.4., 9.5. The Commission takes the view that, in accordance with its objectives, the market organization for tobacco has, in particular, moved production in the direction demanded by the international market and reduced the quantities bought in to less than 3 % of total production. Public stocks from harvests prior to 1985 have also been disposed of.

The Commission is pursuing a policy aimed at bringing Community tobacco production into line with market requirements by means of varietal conversion and improvement of quality.

As regards the level of the premium and financial protection for the industry, the amount of the premium must be related to the real costs of production and processing. The Commission has undertaken to present a report on production and processing costs in the various producer countries when making its prices and premiums proposal for the 1988 harvest.

By way of comparison, the price guaranteed to Community growers is half that guaranteed to a grower in the United States and one fifth of the price guaranteed to a Japanese grower. A certain balance has to be maintained between Community production and imports so that the Community manufacturing industry is supplied with raw tobacco without excessive dependence on suppliers in non Community countries. At present, nearly twice as much raw tobacco is used by the Community manufacturing industry as is produced by Community growers.

Finally, the Commission has checked the administrative procedures and inspection standards in the Member States and has not found any major irregularities.