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## Information and Notices

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#### Court of Auditors

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accompanied by the replies of the Commission .....

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## I

*(Information)*

## COURT OF AUDITORS

## SPECIAL REPORT No 2/90

on

the management and control of export refunds accompanied by the replies of the Commission  
(90/C 133/01)

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

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## 0. PROLOGUE

1. One morning in May 1989, as part of the Court's enquiry into export refunds, two auditors found themselves at the German port of Hamburg to examine the physical controls over cereals shipments. The auditors were informed that the Russian ship, Kapitän Danilkin, which was moored alongside the port silos at the time of their visit, was being loaded with cereals under a special Community measure to relieve the German market of surplus German wheat. Upon observation of the operation the auditors saw that the bow of the ship was indeed being loaded with cereals. The two auditors observed also that a similar operation was taking place at the stern of the ship, except that upon closer inspection the mound of cereals there appeared to be rapidly diminishing, rather than increasing, in size. In fact the cereals were being transferred from the holds at the stern of the ship to holds at the bow of the ship via a portside silo, an operation of several days duration.

2. Later the auditors learnt that the ship had first been loaded with French wheat at Dunkerque and that, en route to the USSR, it had then docked at Hamburg for its cargo of wheat to be simultaneously unloaded and reloaded via a portside silo. Further investigation revealed that this was one of many similar operations which had either taken place or were planned to take place at Hamburg and other German ports. Yet clearly such an apparently superfluous activity, expensive in harbour and silo charges and wasteful of the time of both the ship and its crew, could not be motivated by normal commercial practice. The answer, indeed, lies elsewhere.

3. Wheat, having a common definition in all Member States can be sold into intervention storage throughout the Community, wherever the best deal is to be obtained. This had led in large part to up to 2 Mio tonnes of wheat per annum entering into German intervention stores over recent years. In October 1988 the German Ministry for Agriculture, mindful of this trend, informed the Commission that it forecast a worsening situation in 1989, with German production in excess of national requirements and a risk of 'massive quantities of wheat' being bought into intervention <sup>(1)</sup>. The Commission concurred and on the premise that the Community market overall would be unlikely to absorb the surplus <sup>(2)</sup>, they agreed to adopt a special measure on 27 January 1989 to relieve the German

market by granting a subsidy for the export to third countries of surplus German wheat <sup>(3)</sup>.

4. Trade response to the special measure was good. The original ceiling of 300 000 tonnes was increased to 500 000 tonnes and subsequently to 700 000 tonnes following the suspension of the general free market arrangements for the export of wheat as a further encouragement to traders to make use of the special measure. By 16 March 1989 the success of the measure was not in doubt as all 700 000 tonnes had been agreed for export at a cost of some 47,67 Mio ECU, or 68 ECU per tonne.

5. On 28 March, however, the Commission received a telephone facsimile from the German authorities which indicated that, of the wheat so far physically exported under the special measure (some 470 000 tonnes, of which the first shiploads had completely escaped physical control), none had been of German origin. Nor indeed had the wheat been taken from the German market. Apparently ships en route to the USSR and Poland, and loaded with French wheat taken on board at French ports, were docking at German ports for the simultaneous unloading and reloading of their cargoes in order that the wheat might be recognised as 'exported from the FR of Germany' and so qualify for the export refund payable under the special measure.

6. The Commission, believing themselves legally constrained from limiting the application of any intervention measure by reference to the origin of the agricultural produce concerned (notwithstanding previous precedents for Spanish barley and Greek durum), had attempted to restrict the scope of the special measure by requiring the wheat to be 'exported from the FR of Germany'. This device had apparently promised the double advantage of satisfying the lawyers and of enabling the Commission to target the German market. In practice, however, it seemed that the extra cost involved in exporting wheat not of German origin through German ports was not proving a deterrent to certain traders. Some traders needed export licences in order to complete an export deal with the USSR, others were attracted by the higher than normal refund level.

7. The Commission reaction, on 6 April, was to increase the quantity available under the special measure by a further 200 000 tonnes to a total of 900 000 tonnes and to introduce a requirement for a minimum protein content of 12,5 %. Both changes were linked as by this stage it was becoming clear that the quality of the German wheat harvest was perhaps the best in the Community with only wheat of German origin able to meet the protein requirement. A further 145 000 tonnes only were disposed of under the new conditions. The previous forecast surplus

<sup>(1)</sup> Commission Regulation (EEC) No 212/89 of 27 January 1989 (OJ No L 25, 28.1.1989), preamble.

<sup>(2)</sup> Commission Regulation (EEC) No 212/89 of 27 January 1989 (OJ No L 25, 28.1.1989), 'Whereas the possibility of that surplus being absorbed by the Community market is slight'.

<sup>(3)</sup> Commission Regulation (EEC) No 212/89 of 27 January 1989 (OJ No L 25, 28.1.1989), article 1.

of 'massive quantities of wheat' was now seen to be significantly out of step with reality as the Community market proved a ready outlet for this high quality wheat.

8. The last deliveries under this programme were authorized on 25 May, when the Commission accepted bids totalling 55 000 tonnes at refund rates between 51 and 54 ECU per tonne. On the same day the Commission rejected a bid to export wheat from the open market at a refund rate fractionally less than 40 ECU per tonne, having decided to suspend all further market sales other than those under the special German measure.

9. The Commission does not know the origin of the wheat exported under the special measure to relieve the German market of surplus German wheat. The Commission believes that traders were unaware that for their cargoes of French wheat to be recognised as 'exported from the FR of Germany' they would have to physically unload and reload the wheat via a German port silo, (at a cost estimated by the Commission of up to 10\$ per tonne) and therefore did not take the extra costs into account when submitting their bids for refunds under the special measure. The forecast by the German Ministry of Agriculture and the Commission of 'massive quantities' of wheat on the thresholds of German intervention stores was wide of the mark (in the event only 800 000 tonnes was bought in comparison with an annual intake of 2 Mio tonnes over recent years).

10. The Court estimates, on the basis of an analysis of 60 % of quantities exported, that of the 845 000 tonnes eventually subsidised for export, between 130 000 and 160 000 tonnes only was harvested in the FR of Germany. The balance of about 700 000 tonnes was transhipped via German ports, mainly from France but also from the United Kingdom and Denmark en route to the USSR and Poland. In contrast the Commission has cited a trade source which believes some 350-400 000 tonnes of the wheat exported to have been harvested in the FR of Germany. The justification for this claim is unclear to the Court. The total cost of the special measure to the Community budget was some 57,5 Mio ECU.

## 1. INTRODUCTION

1.1. Over the past two years the subsidised export of agricultural produce to countries outside the Community has replaced intervention storage as the principal instru-

ment by which the Community maintains the equilibrium of the internal market, thereby regulating its internal agricultural price level. The produce exported may be taken from the open or 'free' market or from intervention stores. The subsidy may take the form of an export refund, a low price sale from intervention storage or a combination of both. The subsidy enables exporters to compete in world markets where prevailing prices (in part influenced by the subsidies of other producers) are generally lower than Community prices. Rates of refund for produce exported depend on the precise classification of the goods concerned and they can also vary according to the country of final destination.

1.2. In 1988 the Community budget subsidised the export either from the market or from intervention stocks, of 24,8 Mio tonnes of cereals, 0,8 Mio tonnes of beefmeat and 16,8 Mio tonnes of milk and milk products with export refunds totalling 7 000 Mio ECU. In addition there are losses borne by the Community budget arising from the export of intervention stocks at low prices (1).

1.3. Much of the day-to-day administration of the policy is delegated to Member States' paying agencies. Customs authorities also have a vital role to play in the control of export movements. All the important policy decisions are taken by the Commission. It is the Commission, usually following consultation of the Management Committees (see paragraph 2.3) for the relevant markets, which determines the level of subsidy in each case, principally by setting refund rates and determining minimum prices for low-price sales from intervention. The Commission also has a decisive voice over such key parameters as the timing, quantity and destination of subsidised exports.

1.4. Export refund rates may be set as a result of tendering, judgementally by reference to the perceived difference between Community and world market prices or by purely *ad-hoc* means. In order to qualify for export refund the trader is normally required to commit himself to export a determined quantity and quality of produce within a set period to a defined range of third countries. It is the licence, issued to the trader by Member States' paying agencies on behalf of the Commission, which is the legal expression of the contract struck between the Community and the trader. The present report does not examine the licensing system as such, but since many of the report's observations presuppose some knowledge of that system it is summarised in Annex 1.

(1) A full costing of Community export subsidies would have to take account of depreciation. No such costing appears in the budget and accounts.

1.5. From the point of view of the Community budget, the system of rate-setting and licences can be said to provide a basis for central control over expenditure. It also gives the Commission a flexible means of managing the export market. For example, the Commission may apply 'correctives' to previously agreed and published refund rates to discourage or encourage traders to export in particular situations or to a specific destination.

1.6. *Table 1* shows how budgetary expenditure on export refunds developed over the last 10 years and *Table 2* indicates how export refunds have superseded public intervention storage as the key-stone of the price guarantee system under the common agricultural policy (CAP). A characteristic feature of export refunds which is not revealed by the tables is that for certain products the value of the export refund payable on a single export consignment will often exceed the price payable by the third country customer. By way of illustration the Court found the following examples (based on rates applicable in 1986/87) during the course of its audit:

- (a) a single container of beefmeat exported to Libya  
export refund: 34 700 ECU  
invoice value: 18 600 ECU
- (b) a consignment of 161 tonnes of butter oil to Abu Dhabi  
export refund: 347 850 ECU  
invoice value: 218 000 ECU

- (c) a contract for the exporting of 450 tonnes of butter to USSR  
export refund: 867 850 ECU  
invoice value: 150 620 ECU
- (d) a contract for 2 000 tonnes of milk powder to Algeria  
export refund: 2 515 000 ECU  
invoice value: 1 536 430 ECU
- (e) a consignment of feta cheese to Iran  
export refund: 2 720 000 ECU  
invoice value: 2 511 000 ECU

The significance of such cases for the Community and the Community's auditors is that the financial risks of the transaction are potentially bigger for the Community than for the purchaser.

1.7. More than 35 % of EAGGF Guarantee expenditure is taken by export refunds and more than 70 % of this lies within three market areas: beefmeat, cereals and milk products. Export refunds in these three market areas are the subject of this report. The aspects examined are, firstly, the Commission's central role in setting refund rates and determining minimum prices for low price sales (chapter 2) and secondly (chapter 3), national controls over export consignments in the Member States principally concerned, viz., Denmark, FR of Germany, France, Ireland, Italy, Netherlands, United Kingdom. This second part of the report results from an extension to the cereals and milk products sectors of earlier audit work done by the Court in certain countries in the beef sector of which a first

Table 1 — Evolution of payments for export refunds, 1980-1989 <sup>(1)</sup>

(Mio ECU)

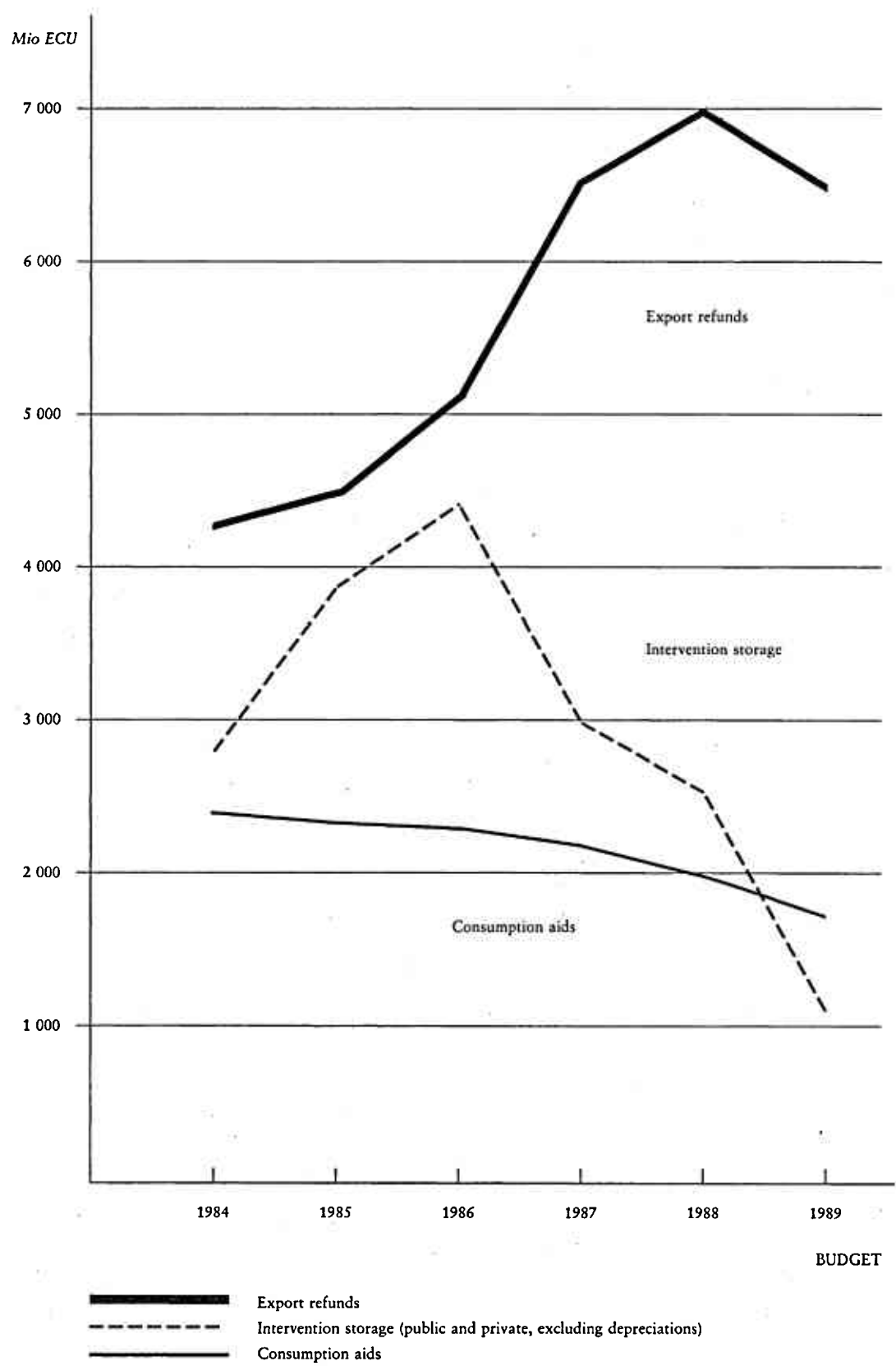
|                     | Cereals <sup>(2)</sup> | Milk Products | Beef Meat | Miscellaneous | Total   |
|---------------------|------------------------|---------------|-----------|---------------|---------|
| 1980                | 1 174,7                | 2 745,9       | 715,6     | 804,8         | 5 441,0 |
| 1981                | 1 206,3                | 1 886,4       | 825,3     | 1 008,1       | 4 926,1 |
| 1982                | 1 209,0                | 1 521,2       | 643,5     | 1 376,7       | 4 750,4 |
| 1983                | 1 554,6                | 1 326,8       | 828,2     | 1 816,3       | 5 525,9 |
| 1984                | 944,4                  | 1 943,4       | 1 392,7   | 1 922,3       | 6 202,8 |
| 1985                | 1 102,2                | 2 028,3       | 1 338,6   | 2 118,8       | 6 587,9 |
| 1986                | 1 756,7                | 2 154,9       | 1 214,3   | 2 113,3       | 7 239,2 |
| 1987                | 3 206,3                | 2 427,2       | 877,9     | 2 540,8       | 9 052,2 |
| 1988                | 3 128,6                | 3 082,4       | 768,7     | 2 806,7       | 9 786,4 |
| 1989 <sup>(3)</sup> | 2 827,0                | 2 443,0       | 1 209,0   | 2 907,8       | 9 386,8 |

<sup>(1)</sup> Including export refunds paid for food aid deliveries.

<sup>(2)</sup> Including refunds for cereal based spirituous beverages.

<sup>(3)</sup> Initial budget for 1989.

Table 2 — Evolution of expenditure for export refunds, intervention and consumption aids for three key products (cereals — milk and milk products — beefmeat)



instalment of conclusions appeared in the Court's 1987 Annual Report.

1.8. The report also updates previous observations as to the national arrangements for compliance with Council Directive 77/435/EEC of 27 June 1977 <sup>(1)</sup> [now replaced by Commission Regulation (EEC) 4045/89] <sup>(2)</sup> which requires Member States to carry out systematic a posteriori checks of the commercial documents of undertakings receiving payments from or making payments to the CAP. Such checks are complementary to the controls normally carried out by Customs and Paying Agencies.

1.9. The main issues considered by the enquiry are whether:

- (a) Commission procedures for setting refund rates, concluding special deals and arranging low cost disposals, are consistent with the principles of sound financial management, and are effective;
- (b) appropriate controls are foreseen and in operation at both Community and national level to ensure the legality and regularity of all Community expenditure in relation to export refunds;
- (c) appropriate independent controls are provided for and effectively performed on the export refund transactions.

1.10. The Court regrets the tone adopted by the Commission in its replies to the Court's observations.

## 2. COMMISSION MANAGEMENT OF EXPORTS

### *The regulatory framework*

2.1. The basic regulations establishing the common organization of the markets in milk and beef were

<sup>(1)</sup> Council Directive 77/435/EEC of 27 June 1977 (OJ No L 172, 12.7.1977)

<sup>(2)</sup> Commission Regulation (EEC) No 4045/89 (OJ No L 388, 30.12.1989).

published in June 1968 <sup>(3)</sup>. The EEC grain market regulation was established in 1962. The present market organization is laid down in Council Regulation (EEC) No 2727/75 <sup>(4)</sup>. All three regulations make a common provision for the use of export refunds to facilitate the exportation of products for which world prices are below those ruling within the Community. Refunds for many of the most important export contracts are fixed by tender. In other cases the applicable rates are those published by the Commission. The latter rates are required to be fixed at regular intervals but the Commission may alter them at any time, either on its own initiative or at the request of a Member State.

2.2. Export refund rates are the same for the whole Community. They vary by product and may be differentiated according to destination. For cereals and beef there is significant differentiation but in the milk sector this only applies to cheese. Licences are required for all cereals, beef, butter and skimmed milk powder (SMP) exports and are required for all other milk products if the exporter exercises the option to fix the rate of refund in advance (a procedure known as pre-fixing) <sup>(5)</sup>.

2.3. The regulations also established Management Committees for each market comprising representatives from the Member States presided over by a representative of the Commission. Although the Commission can change the level of refund rates at any time, it is required to consult the appropriate Management Committee periodically about the refund rates, with a view to confirming or

<sup>(3)</sup> Basic regulation for milk and milk products: Council Regulation (EEC) No 804/68 of 27 June 1968 (OJ No L 148, 28.6.1968, p. 13) as last amended by Council Regulation (EEC) No 763/89 of 20 March 1989 (OJ No L 84, 29.3.1989, p. 1); for beef meat: Council Regulation (EEC) No 805/68 of 27 June 1968 (OJ No L 148, 28.6.1968, p. 24) as last amended by Council Regulation (EEC) No 571/89 (OJ No L 61, 4.3.1989, p. 43).

<sup>(4)</sup> Council Regulation (EEC) No 2727/75 of 29 October 1975 (OJ No L 281, 1.11.1975) as last amended by Council Regulation (EEC) No 1213/89 of 3 May 1989 (OJ No L 128, 11.5.1989, p. 1).

<sup>(5)</sup> For cereals article 12 of Council Regulation (EEC) No 2727/75 of 29 October 1975 (OJ No L 281, 1.11.1975, p. 1) as last amended by Council Regulation (EEC) No 1213/89 of 3 May 1989 (OJ No L 128, 11.5.1989); for beef meat article 15 of Council Regulation (EEC) No 805/68 of 27 June 1968 (see above); for milk and milk products article 13 of Council Regulation (EEC) No 804/68 of 27 June 1968 (see above) and Commission Regulation (EEC) No 2729/81 of 14 September 1981 (OJ No L 272, 26.9.1981, p. 19) as last amended by Commission Regulation (EEC) No 222/88 of 22 December 1987 (OJ No L 28, 1.2.1988, p. 1).

changing them. The Committee is required to give an opinion. Should the Committee vote against the proposal the Commission must refer the proposal to the Council which has one month in which to reach a different decision by qualified majority.

2.4. General rules for granting export refunds on milk, beef and cereals are laid down in Council Regulations (EEC) No 876/68, No 885/68 and No 2746/75 respectively <sup>(1)</sup>. The criteria to be taken into account when determining refunds are essentially the same for the three markets and are summarised in Annex 2.

2.5. The legislative framework for the system of export refunds has burgeoned since the market organisations were established. There are numerous regulations concerning export licences, pre-fixing, advance payment, sales from intervention by tender or at fixed price and many which are market specific, for example, deboning of meat, transformation of butter into oil and cereal co-efficients for flour.

#### *General agreement on tariffs and trade (GATT)*

2.6. Within the framework of GATT a series of negotiations (known as the Uruguay Round) has been in progress since September 1986 with the objective inter alia of reducing levels of agricultural support and protection. This is particularly pertinent to the USA and the EEC with respect to the world grain trade in which they continue to compete by offering subsidised exports. The American Export Enhancement Programme (EEP) which was launched in 1985 has to date resulted in 102 initiatives aimed at 65 countries covering 12 commodities.

2.7. It is Commission policy to match the subsidies on US agricultural exports in order to protect traditional markets and particularly in the milk sector to promote exports of products with a high value-added element. On occasions the policy of matching has led to the award of exceptionally

high refund rates, for example for wheat to Egypt (paragraph 2.65 refers) and the 20 % increase in rates for pure bred cattle (paragraph 2.40 refers).

#### *Setting the level of subsidy*

2.8. The premise which underpins the Community policy of subsidising agricultural exports is that it would not be possible to export the quantities of cereals, milk products and beef necessary to stabilise internal market prices at the desired level without the provision of financial assistance to exporters in order to bridge the gap which normally exists between the level of prices obtainable in world markets and the (higher) Community price level. If the level of financial assistance exceeds the minimum necessary for that purpose, exporters are over-compensated at the expense of the Community budget (and — because of the consequence for internal prices — the Community consumer). The dilemma for the Commission is how to achieve what is a fine balance between effectiveness (i.e. the exportation of surplus Community products) and economy.

2.9. The Commission uses two main instruments for subsidising the export of agricultural products: low price sales from intervention and the offer of export refunds for the export of products either from the free market or from intervention. The relative importance of each instrument varies from case to case, as does the extent of Commission involvement. There are published refund rates for all three sectors covered by the present review. These are the rates which are available to any trader at any time; they are sometimes referred to as 'standing refunds'. They may be enhanced or reduced in a number of ways, e.g. by 'correctives' valid for particular destinations and periods.

2.10. The Commission can draw on two main sources of external information to guide its decisions about refund rates. One is such data as are published or are available in Member States about Community and world price levels. The other is the evidence of market prices derived from tenders. Neither source can be regarded as wholly reliable or objective.

2.11. Ultimately, it is the Commission's judgement which is paramount in determining the rate of refund and the

(1) Council Regulation (EEC) No 876/68 (milk products) of 28 June 1968 (OJ No L 155, 3.7.1968) as last amended by Council Regulation (EEC) No 1344/86 of 6 May 1986 (OJ No L 119, 6.5.1986, p. 36); Council Regulation (EEC) No 885/68 (beef meat) of 28 June 1968 (OJ No L 156, 4.7.1968, p. 2) as last amended by Council Regulation (EEC) No 427/77 (OJ No L 61, 5.3.1977); Council Regulation (EEC) No 2746/75 (cereals) of 29 October 1975 (OJ No L 281, 1.11.1975).

price level at which low-price sales take place. Whatever the objective mechanisms theoretically available to the Commission it would be unrealistic to imagine that such mechanisms could be sufficiently fine-tuned and responsive to substitute finally for the exercise of what is essentially commercial judgement. The management problem for the Commission is how to apply such judgement whilst satisfying the requirements of public accountability. The most pertinent of these are in the Court's view that: information is maintained in a form suited for the requirements of management and of independent control by third parties; economy is exercised in determining rates and low-price sales with their budgetary cost ascertained and monitored; the effectiveness of measures taken is assessed to determine performance against plan and whether remedial action is necessary; correct procedures for the information and consultation of traders are followed.

2.12. The Court has examined Commission decisions determining export refunds and low price sales in the three markets under review. The Court's examination was principally concerned with decisions taken in the years 1987 and 1988. The control problem, whether from the standpoint of the Court of Auditors or that of Financial Control, is how to determine with reasonable assurance whether sound judgements have been made. In principle this is possible only through discussion with the officials concerned, evaluation of procedures followed and scrutiny of the documentation which records their evaluation of particular cases. In this way it should be possible to establish a clear link between the facts of the case as perceived by the Commission and the judgement made as to the appropriate rate of refund or price level for low price sales. In the absence of a satisfactory documentary record for these important decisions the requirements of accountability cannot be met in form or in substance.

2.13. The export operations which are the subject of the present chapter are broadly of three sorts. There are, firstly, standard operations in which export sales are made from the free market either with the aid of published export refunds or by open tendering. Secondly, there are low price sales from intervention stocks, in which the level of subsidy (often a combination of low price and export refund) is determined by tender or pre-determined by the Commission. Lastly, there are 'special measures', which are initiated either to take advantage of a specific export opportunity or to match the terms of competing offers from the US or other producers. This sequence is reflected in the three sections below (paragraphs 2.14 to 2.78) which present the Court's findings with regard to the Commission's management of export subsidies in each of the three markets under review.

## *Milk*

### *Introduction*

2.14. The export market in milk products comprises bulk products (namely butter and SMP) and so-called derived products such as cheese, enriched whole milk powder (WMP) and condensed milk. The market as a whole lacks a recognised 'barometer' for world prices. However, the minimum price levels set by GATT effectively determine the floor of the world market for the main products. The reduction in EC stocks of the two bulk products — butter and SMP — has been remarkable. This has been achieved largely as a result of special disposal programmes (mainly for butter) and more favourable market conditions facilitating export (especially for SMP). Butter stocks of 1,3 Mio tonnes as at the end of 1986 had been reduced to 64 000 tonnes by March 1989 and SMP stocks had been eliminated.

2.15. The world market is shared principally between the Community, New Zealand and to a lesser extent the USA. Competition is intense with the direct commercial involvement of the New Zealand Dairy Board in export transactions, providing it with the information necessary for setting the most competitive export subsidy without the risk of transgressing GATT minimum prices.

2.16. One problem for the Commission is how to establish and maintain a reliable indicator of current world prices. Another is how to intervene effectively in the market without infringing GATT minimum prices. A further difficulty for the Commission in this particularly competitive market is how to fulfil the requirements of accountability, such as through the publication of refund rates, without alerting foreign competitors to its trade intentions (with obvious risks to the success of its initiatives).

### *Setting the level of subsidy*

### *Published Rates*

2.17. The key rates are those for butter, SMP, WMP and certain cheeses from which all other milk product rates are

derived. The rates represent the difference between the Commission's estimations for world and Community prices. The Community price is calculated weekly by reference to price information supplied by Member States' Paying Agencies and that for the world market by reference to various trade and published sources. The Court found that certain Paying Agencies were not always forthcoming with the information required and that consequently there were examples of the same prices being used over several months by default. The Court found also that there was no systematic collation, analysis or recording of sources for world prices by the Commission, although a weekly report is produced for internal use which covers significant events and quotes some prices.

2.18. The Commission claims to apply a standard methodology in calculating refund rates based on the difference between world and Community prices. The Court's auditors attempted to re-perform the calculation of the refund rates for butter, SMP and cheddar as published in Commission Regulation (EEC) No 701/89 of 17 March 1989 <sup>(1)</sup>. The results of the auditors' calculation are set out in *Table 3*. There was no record of the Commission's own calculation of these rates. Indeed for SMP and butter the published refund rates were based on oral instructions from the Commissioner. One of the elements of the auditors' calculations was the information about world prices published in 'Dairy Market News' (Volume 56 No 13 of 31 March 1989) this being the only independent source of evidence about world prices which was available in the Commission for that period. The Community price was taken as the lowest of the ex-factory prices of the four main Community exporting countries.

Table 3 — Comparison of actual refund rates with those calculated by the Court

|         | Court<br>Calculated<br>Refund<br>ECU/100 kg | Actual Refund<br>ECU/100 kg<br>[Regulation<br>(EEC) No 701/89] | Difference<br>ECU |
|---------|---------------------------------------------|----------------------------------------------------------------|-------------------|
| Butter  | 174,38                                      | 170                                                            | - 4,38            |
| SMP     | 46,99                                       | 55                                                             | + 8,01            |
| Cheddar | 148,70                                      | 156,68                                                         | + 7,98            |

<sup>(1)</sup> Commission Regulation (EEC) No 701/89 of 17 March 1989 (OJ No L 76, 18.3.1989, p. 31).

2.19. In view of the difficulty which they had experienced in ascertaining the basis on which previous rates had been fixed, the auditors also examined the latest published rates at the time of audit [Commission Regulation (EEC) No 1476/89 of 25 May 1989] <sup>(2)</sup>. At the time of audit, no documentary evidence in support of these rates appeared to be available. However, following a meeting with the Director General documents were later produced. These showed appreciable discrepancies between the decreases for SMP, WMP and butter proposed by the market division and those adopted.

#### Unpublished Rates

2.20. At the end of 1986 the Commission's published rates for certain export markets were frequently being undercut by the New Zealand Dairy Board and stocks of butter and SMP remained high (*Table 4* refers). Faced with this unhappy combination of circumstances the Commission took the decision to adopt an alternative approach for setting refund rates. The objectives of this new approach were to exploit the lower transport costs (which are not always fully reflected in available price data) of Community exporters due to their relative proximity to the main export markets and to set the most competitive rates possible without transgressing GATT minimum prices. In order not to reveal publicly the Commission's trade intentions, the rates would not be published in the Official Journal, nor would public tendering be entered into. The Commission's intention was to compensate for the operational advantage which the New Zealand Dairy Board enjoyed by virtue of its position as sole exporter.

2.21. The Commission clearly needed to contact the trade in order to obtain the information necessary for meeting the objectives set out above. However it did not want to deal directly. The procedure which it adopted had a superficial resemblance to tendering in that intervention agencies were asked to request offers from regular traders in terms of the refund they would require in order to export SMP, butter or butteroil to specific destinations. The offers received were collated on a weekly basis and forwarded to the Commission. The market division would examine the offers and calculate a rate close to the GATT minima based on the latest US dollar exchange rate. The refund rate(s) would be set out in a Decision document for signature by the Commissioner. Signed Decisions were handed over to Member States' representatives to disseminate to the traders involved via the intervention agencies. Those

<sup>(2)</sup> Commission Regulation (EEC) No 1476/89 of 29 May 1989 (OJ No L 146, 30.5.1989, p. 14).

Table 4 — Development of intervention stocks of cereals, butter and SMP

(1 000 tonnes)

|                      | 31.12.86        | 31.12.87       | 31.12.88       | 30.6.89        |
|----------------------|-----------------|----------------|----------------|----------------|
| <b>Cereals</b>       |                 |                |                |                |
| Common wheat         | 7 715,9         | 2 909,0        | 3 346,7        | 2 391,2        |
| Durum                | 1 114,3         | 1 442,7        | 1 279,7        | 1 160,6        |
| Barley               | 2 867,7         | 3 022,5        | 2 818,7        | 2 983,1        |
| Rye                  | 1 115,1         | 750,0          | 905,4          | 1 073,2        |
| Maize                | 96,0            | 22,3           | 18,3           | 548,4          |
| Sorghum              | 0               | 6,9            | 86,8           | 1,4            |
| <b>Total</b>         | <b>12 909,0</b> | <b>8 153,4</b> | <b>8 455,6</b> | <b>8 157,9</b> |
| <b>Beefmeat</b>      |                 |                |                |                |
| — Public storage     | 575             | 780            | 424            | 145            |
| — Private storage    | 130             | 110            | 215            | 50             |
| <b>Total</b>         | <b>705</b>      | <b>890</b>     | <b>639</b>     | <b>195</b>     |
|                      | 31.12.86        | 31.12.87       | 31.12.88       | 31.3.89        |
| <b>Milk products</b> |                 |                |                |                |
| Butter               |                 |                |                |                |
| — Public storage     | 1 283           | 860            | 103            | 64             |
| — Private storage    | 83              | 98             | 110            | —              |
| <b>Total</b>         | <b>1 366</b>    | <b>958</b>     | <b>213</b>     | <b>64</b>      |
| <b>SMP</b>           |                 |                |                |                |
| — Public storage     | 772             | 473            | 10             | 7              |

Source: Commission internal documents on physical stocks.

wishing to trade would apply for licences in the normal way but prefixing at the unpublished rates. Traders were not bound by the offers previously submitted to paying agencies. Those whose offers had been at a higher rate were still eligible to benefit from the unpublished rate as were those who had not bid. Conversely, those who had requested a lower refund rate received the (higher) unpublished rate.

2.22. The first unpublished rates (for SMP, butter and butteroil) were set in Decision 86/2508/EEC for the period 18 December 1986 to 5 January 1987. There were a further 32 Decisions in 1987 and 17 in 1988 after which the practice was suspended. The number of special rates so determined was 108. The average validity period for these rates was 8 days and the average premium over published rates was as follows:

|           | ECU/100 kg | % Increase |
|-----------|------------|------------|
| SMP       | 2,5        | 2,45       |
| Butter    | 7,5        | 3,55       |
| Butteroil | 14,75      | 5,61       |

Several of the Decisions relate to a single destination (Algeria, Mexico, India). For these decisions the file notes explain the methodology of the calculations but do not reveal either the underlying price data or the nature of the offers received.

2.23. Although the Commission tended to accept or set rates at the lower end of the range of offers received, the absence of working files precludes any view as to the economy of the operation overall. The Court calculates that some 300 000 tonnes of SMP and 450 000 tonnes of butter/butteroil were exported with the benefit of unpublished rates.

*Special sales*

2.24. These are one-off sales of bulk products which are initiated either to take advantage of a specific export opportunity or to match the terms of competing offers from other producers. In the dairy sector special sales are exceptional and relate to the disposal of intervention stocks only, i.e. SMP and butter. During the period under review there have been three special export operations, of which the following two are significant:

- (a) Commission Regulation (EEC) No 765/86 <sup>(1)</sup>: Sale of intervention butter for export to India, Pakistan, Mongolia and USSR;
- (b) Commission Regulation (EEC) No 727/87 <sup>(2)</sup>: Sale of SMP from public stocks for export.

2.25. The first-mentioned operation illustrates the difficulties of the Commission in relying upon tendering to set an appropriate level of refund when a particular export market is accessible through a single trader only, such as is the case for many deals with Eastern-bloc countries. The second operation, which took place in a market with numerous traders, demonstrates the possible consequences of not allowing prices to be determined by market forces, as facilitated by open-tendering.

#### Commission Regulation (EEC) No 765/86: Butter for Russia

2.26. The large stocks of butter and SMP, once held in Community intervention stores, raised expectations that the Commission would be selling at low prices in the near future. These expectations depressed world prices. This phenomenon was acknowledged by GATT which, in order to relieve the world butter market of this particular burden, gave the Community dispensation to conclude special disposal arrangements with certain third countries at prices which were considerably below the GATT minima. As a result Regulation (EEC) No 765/86 was adopted in March

1986 for highly subsidised sales of butter to India, Pakistan, Mongolia and the USSR.

2.27. EEC intervention stocks were 1,15 Mio tonnes as at the end of February 1986. Until 31 December 1986 the sales under Regulation (EEC) No 765/86 were by tender at a little less than 70 % of the intervention price level. Published rates of export refund were also payable. The combined effect of the low price and the refund effectively meant that the butter was sold below the GATT minimum price of 1 000 USD/tonne. The special concession should have ended on 31 December 1986 [Commission Regulation (EEC) No 3535/86 refers] <sup>(3)</sup> but because the USSR held off buying in the anticipation that they would be able to obtain even lower prices only 105 000 tonnes were sold during the year. Given the measure's relative lack of success, GATT agreed that for contracts signed with the USSR prior to this date, the concession would remain valid. Only one company held such a contract.

2.28. As of 1 January 1987 the combination of export refund and low prices was stopped by Commission Regulation (EEC) No 155/87 <sup>(4)</sup>. Instead, export subsidy was provided simply by means of low price sales for which prices were reduced by an amount more or less equal to the refund which was previously payable. Prices continued to be set by means of monthly adjudications even though the Commission was dealing with only one trader.

2.29. The Court examined the bids received at the German intervention agency. The Commission rejected all bids submitted for adjudication on 27 January 1987, the first for which export refunds were not payable. For the next adjudication (10 February 1987) one German bid was 20 ECU/tonne higher than five other bids from the FR of Germany and corresponded exactly to the rates bid by four companies in France and another in the Netherlands. In later adjudications the German bids were uniform. An examination of Commission records revealed that this was also the case for bids submitted in other Member States. The bids were orchestrated by the contract holder. Licences for 610 000 tonnes were awarded at an average price of 215 ECU/tonne reflecting subsidies of more than 90 % of the intervention price. Total sales under Regulation (EEC) No 765/86 were 715 300 tonnes.

<sup>(1)</sup> Commission Regulation (EEC) No 765/86 of 14 March 1986 (OJ No L 72, 15.3.1986, p. 11).

<sup>(2)</sup> Commission Regulation (EEC) No 727/87 of 13 March 1987 (OJ No L 71, 14.3.1987, p. 11).

<sup>(3)</sup> Commission Regulation (EEC) No 3535/86 of 20 November 1986, modifying Commission Regulation (EEC) No 765/86 (OJ No L 326, 21.11.1986, p. 17).

<sup>(4)</sup> Commission Regulation (EEC) No 155/87 of 21 January 1987 modifying Commission Regulation (EEC) No 765/86 (OJ No L 20, 22.1.1987, p. 17).

Commission Regulation (EEC) No 727/87 of 13 March 1987: SMP for export

*Beef*

2.30. Under this Regulation 261 381 tonnes of SMP were sold at the buying-in price applied by the intervention agency on the day of sale, minus 30 ECU per tonne. The prevailing rates of export refund were also payable. 92 % of sales were from German intervention.

2.31. Sales were modest until December 1987 when they reached 83 000 tonnes (more than three times the previous month's total). The Commission did not react to this upturn, although they were aware of the sales situation. In January 1988, monthly sales reached 91 000 tonnes and a similar escalation was observed for sales of SMP on the internal market at intervention price [Commission Regulation (EEC) No 2213/76] <sup>(1)</sup> (see *Table 5*).

2.32. At the Management Committee meeting held on 22 January 1988 it was decided to suspend sales at intervention price minus 30 ECU/tonne amidst fears of speculation by traders. In this way the price was brought up to that prevailing for internal sales under Regulation (EEC) No 2213/76. No further sales for export took place at the higher price but sales for the Community market continued apace: 138 500 tonnes left intervention during April alone. The first four months of 1988 saw stocks fall from 473 000 to around 100 000 tonnes.

2.33. The 'cost' of Regulation (EEC) No 727/87 amounted to 265,8 Mio ECU for refunds, plus 7,8 Mio ECU in terms of intervention sale price reduction. The objective of the Commission was to reduce stocks of SMP as quickly as possible by encouraging exports to third countries. The ex-intervention price was accordingly set by reference to available price information and judgement. A marked and continuing improvement in world and Community market conditions meant that the ex-intervention price set by the Community quickly became much too low. However, the Commission did not take advantage of the changed market conditions and sold SMP for export cheaply when it did not need to do so. In fact given the strong demand for SMP on the internal market <sup>(2)</sup> it is unlikely that the disposal of intervention SMP to third countries was justified at all.

<sup>(1)</sup> Commission Regulation (EEC) No 2213/76 of 10 September 1976 (OJ No L 249, 11.9.1976, p. 6), last amended by Commission Regulation (EEC) No 1384/88 (OJ No L 128, 21.5.1988).

<sup>(2)</sup> Annual Report on the 1988 financial year, OJ No C 312, 12.12.1989, paragraph 6.70.

*Introduction*

2.34. The Community is one of the market leaders with 20 % of world beef exports in 1988. From 1984 the normal internal supply of meat was augmented by the slaughtering of milk cows as a consequence of the introduction of milk quotas. Since 1987 a fall in cattle numbers and hence the breeding stock has resulted in an overall reduction of 4,5 % in 1988. A further decline of some 3 % is envisaged for 1989. Total production of beef and veal was 8,1 Mio tonnes in 1987 and 7,7 Mio tonnes in 1988. Consumption within the Community is around 7,5 Mio tonnes in gross terms. With imports of nearly 0,5 Mio tonnes the Community has an annual surplus in the region of 1 Mio tonnes. Community export subsidies can have a significant effect on world prices in this market. In 1987 909 000 tonnes were exported mainly to the Middle East (28 %) and Egypt (20 %). In 1988 exports fell to 789 000 tonnes. Sales of intervention meat accounted for 535 000 tonnes, meat exports from the free market were 186 000 and the remainder (8 %) was in the form of meat products or live cattle. In 1988 10 countries bought 74 % of all exports, the three most important purchasers being Egypt, Iran and Poland, each taking well in excess of 100 000 tonnes.

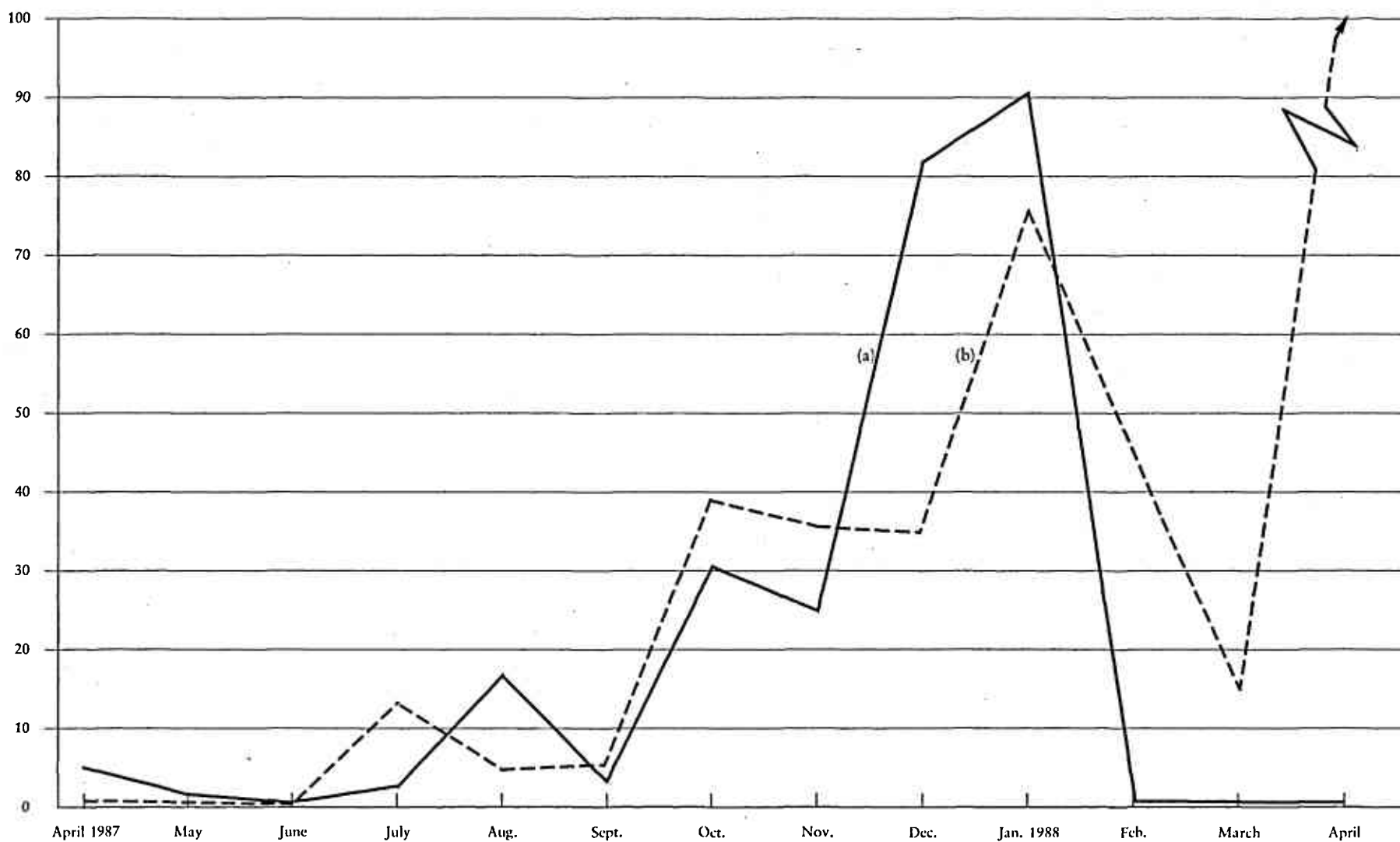
2.35. The EEC export market is characterised by a small number of major trading companies. Even fewer operators are involved where the export is to Eastern bloc countries. Due to the high financial risks involved and the need to put up guarantees for transactions which are normally for substantial amounts, smaller traders are only able to participate indirectly in sales by tender by obtaining export rights (in the form of sub-licences) from the larger companies. For free market sales there is greater scope for the smaller trader and for more competition.

*Setting the level of subsidy*

2.36. For export sales from the open or 'free' market the Commission, in principle, sets refund rates by reference to available price information. These rates are then published in the Official Journal. In the case of intervention sales, the level of subsidy is determined by 'mini-tenders', based on a published minimum acceptable price, although in certain circumstances refunds may be payable in addition.

Table 5 — Sales of skimmed milk powder (1 000 tonnes) from intervention storage under Special Regulations <sup>(1)</sup> in 1987/88

(1 000 tonnes)



(1) a) Regulation (EEC) No 727/87 of 13 March 1987 (SMP for export) —————

b) Regulation (EEC) No 2213/76 of 10 September 1976 (SMP for internal sales) - - - - -

2.37. In the absence of an index of world and Community prices the Commission maintains its own indicators based on available price information. In practice, Member States' Intervention Agencies telex the Commission every week with details of national producer prices. Information as to world prices is obtained chiefly from traders operating in third countries but also from producer association publications.

### Published Rates

2.38. Rates for the numerous different qualities and cuts of meat, including rates for live animals and products, have a common base in the sense that they are all derived from the rate for a full carcass, which reflects the Commission's estimate of the difference between Community and world prices. The forequarter rate is equal to 70 — 80 % of the carcass rate in terms of ECU per tonne and the hindquarter rate equals 120 — 130 %. The rate for live cattle is equal to some 59 %.

2.39. Some rates were originally set several years ago and have subsequently been subjected to incremental and ad hoc changes. For example, in November 1986 in order to limit budgetary expenditure on refunds, all meat rates were reduced by an average of 10 %. This decrease had no noticeable effect on export trade.

2.40. In setting rates for certain export markets the Commission may have to take into account not only the difference between Community and world prices, but also the extent of any export subsidy offered by foreign competitors (which may not be reflected in reported prices). In the face of aggressive initiatives by competitors in the world market the Commission would appear to have little choice but to increase rates accordingly if it is to maintain the volume of exports. Such a situation occurred in March 1988 when in response to the United States' Export Enhancement Programme (EEP) and Austria's special subsidy on sales to Spain the rate for pure bred cattle was increased by 20 %.

2.41. Where it sees opportunities to export to third countries the Commission has sometimes taken existing published rates as a base and increased them until exports are stimulated. Two such cases occurred in October 1988:

- (a) deboned frozen meat destined for the USA. The refund was increased from 90 ECU/100 kg to 100 ECU in March 1988 and to 112 ECU in October 1988. The reason for this was to stimulate exports in order to meet the annual 5 000 tonne quota agreed with the USA. The first increase proved inadequate. Exports for October through December totalled 3 590 tonnes;
- (b) in response to an opportunity to sell some 120 000 tonnes to Iran, Algeria and Tunisia, following the Iran/Iraq ceasefire, the rate for fresh male meat (half carcass) destined for North Africa, Near and Middle East was increased by 10 % from 152,5 to 168 ECU/100 kg. By the end of May 1989 123 000 tonnes had been sold. On 26 June 1989 the refund was reduced to the pre-October 1988 rate.

2.42. Both initiatives have been effective. However, it is less certain whether the quantities disposed of through these sales could not have been exported elsewhere (or sold on the Community market) at lower cost to the budget, bearing in mind the rundown of nearly 700 000 tonnes of intervention stocks of beefmeat in the eighteen months to June 1989 (*Table 4* refers).

### Sales from intervention

2.43. Commission policy currently favours the use of tendering in this market, in contrast with the previous policy of fixed price sales. The form of tender adopted by the Commission is a two stage system [the so-called 'mini-tender' under Commission Regulations (EEC) No 2173/79 <sup>(1)</sup> and No 2539/84 <sup>(2)</sup>] whereby bids are invited in excess of a minimum price published in the Regulation announcing the sale. Any meat remaining after the adjudication has been held is put up for sale at this minimum price. The minimum price in effect serves as a reserve price in that it is the minimum acceptable bid price. The Court found that in 1989 between 20 to 35 % of quantities on offer were sold by tender, and that these sales were either at the minimum price or at prices which were marginally above it. The Court recognises the attractions from the traders' point of view of a procedure which minimises the hazards of tendering but believes that a more competitive procedure would benefit both the budget and

<sup>(1)</sup> Commission Regulation (EEC) No 2173/79 of 14 October 1979 (OJ No L 251, 5.10.1979, p. 12), last amended by Commission Regulation (EEC) No 1809/87 of 29 June 1987 (OJ No L 170, 30.6.1987, p. 23).

<sup>(2)</sup> Commission Regulation (EEC) No 2539/84 of 5 September 1984 (OJ No L 238, 6.9.1984, p. 13), last amended by Commission Regulation (EEC) No 3333/88 of 27 October 1988 (OJ No L 295, 28.10.1988, p. 34).

export policy. In the Court's view the publication of minimum prices is of doubtful value.

2.44. Regulation (EEC) No 2173/79 (Article 6) requires a minimum period of 14 days between date of publication in the Official Journal and the deadline for submission of bids to the intervention agencies. This article does not apply to mini-tenders. The annex to the Regulation announcing the sales serves as the notification. In 1987 in four cases only 2 days elapsed between publication and the deadline. During 1988 the average was 5 days but one Regulation was published the same day as the deadline and another just one day before it. According to the Commission, members of the Management Committee relay details of forthcoming tenders to the intervention agencies immediately after their meetings, and publication merely fulfils a legal requirement. The effect of this is to place the onus on the Intervention Agencies to notify interested parties which may mean that competition is unnecessarily restricted.

#### *Special sales*

2.45. There have been four special export sales since 1986, only two of which are significant in terms of the quantities sold:

- (a) Commission Regulation (EEC) No 1812/86 <sup>(1)</sup>: 200 000 tonnes of beef for Brazil;
- (b) Commission Regulation (EEC) No 2415/88 <sup>(2)</sup>: 206 000 tonnes of beef for Eastern bloc countries.

The Court offers the following observations on these two sales.

#### *Brazil*

2.46. An opportunity arose for the export of 200 000 tonnes of Community intervention beef to Brazil. Beyond setting a ceiling for exports of 200 000 tonnes the extent of Commission involvement is unclear. Apparently the Commission did not seek to arrive at any sort of prior understanding on prices with the sole Brazilian importer, rather this aspect was left to be settled by tender between

the importer and individual exporters. The negotiating strength of the Commission is, of course, much greater in the first eventuality than in the second, with important consequences for the budget.

2.47. An invitation to tender was published in the Official Journal on 12 June 1986. The Regulation required that the operation draw on stocks of at least three Member States and it stipulated that at least 40 % by quantity was to be taken from Italian intervention stores. In this way the Commission apparently intended to draw down stocks more or less evenly between Member States whilst correcting an imbalance in the size of the Italian stockholding.

2.48. The minimum bid quantity was set at 10 000 tonnes and no ceiling was indicated. The export subsidy was entirely by way of a low price sale. A condition attached to the sale of the first 100 000 tonnes was the Commission's agreement to the import from Brazil of 5 000 tonnes of so-called Hilton beef and to the import of 2 000 tonnes of beef from Argentina and 1 000 tonnes from Uruguay by way of compensation for loss of trade. The value of the imported beef on the European market is estimated at some 30 Mio ECU.

2.49. All offers for round one (26 June 1986) were rejected; all those for round two (9 July 1986) totalling 100 000 tonnes were accepted and of the 170 000 tonnes bid for in round three (13 August 1986) only 100 000 tonnes were accepted. For rounds two and three the Commission fixed separate prices for each Member State, taking as its guide price that which was apparently obtained by the USA in a recent sale to Brazil involving a comparable quantity of beef. In both rounds the Italian price was the lowest. This is consistent with the Commission's desire to promote sales from Italian intervention although Council Regulation (EEC) No 2388/86 <sup>(3)</sup> of 29 July 1986 reduced the requirement from 40 % to 30 %.

2.50. It is apparent from an analysis of the bids received that traders were co-operating, with bids from different traders identical for each Member State concerned. It is also worth mentioning that in advance of any formal notification of the sale, one company approached the Commission with a proposal to export 100 000 tonnes of intervention beef to Brazil. The same company won a total of 45 000 tonnes for export through the tendering procedures as did another company which submitted identical bids for each round of bidding.

<sup>(1)</sup> Commission Regulation (EEC) No 1812/86 of 11 June 1986 (OJ No L 157, 12.6.1986, p. 43).

<sup>(2)</sup> Commission Regulation (EEC) No 2415/88 of 1 August 1988 (OJ No L 208, 2.8.1988, p. 11).

<sup>(3)</sup> Council Regulation (EEC) No 2388/86 of 29 July 1986 (OJ No L 206, 30.7.1986).

## Eastern European Countries

2.51. The Court has been unable to establish the terms of an agreement with the USSR which apparently linked the sale of 110 000 tonnes of butter to that for 200 000 tonnes of beef (a goal established in July 1988). The butter was delivered in August but no beef sales had taken place. Given the high level of intervention stocks at this time (770 000 tonnes in June 1988) the Commission decided to open a sale by tender. The invitation was published on 2 August 1988. The special features of this invitation were:

- (a) export had to be to Eastern European countries (Bulgaria, Czechoslovakia, Hungary, Poland, Romania, USSR and Yugoslavia);
- (b) a high minimum tendering quantity (25 000 tonnes);
- (c) the quantity sold from a single Member State could not exceed 50 %.

2.52. It is not clear why the sale was restricted to Eastern European countries. The first evidence on Commission files of any Eastern bloc interest in a sale came from Poland and is dated two weeks after publication of the invitation to tender. The regulation states that the high minimum tendering quantity was for 'purposes of control'. The effect was to exclude medium and small scale traders from the tendering procedure. In fact the minimum tender quantity was doubled after the first adjudication by introducing a requirement to submit bids of at least 25 000 tonnes in two Member States [Commission Regulation (EEC) No 2602/88 of 19 August 1988] <sup>(1)</sup>. Despite repeated requests from the traders to reduce this minimum, the Commission chose to maintain it. The 50 % limit was designed to facilitate the disposal of hormonzed meat.

2.53. For the first adjudication only one company submitted bids (one through the French intervention agency and another through the German intervention agency). Both were rejected as too low: average value 1 385 ECU/tonnes. In the second adjudication the same company increased its bids to an average of 1 397,5 ECU/tonne and was successful. There were no bids for round three. For the subsequent adjudication (10 October 1988) a second company matched the bids made by the first, again at an average price of 1 397,5 ECU/tonne. There were no bids for the adjudication held on 8 November 1988. For the sixth round (13 December 1988) the two companies showed the same degree of co-operation in submitting identical bids. Only the French bids were accepted, at 1 351 ECU/tonne. A

final adjudication was held in January 1989, when again both companies submitted identical bids for a combined total of 100 000 tonnes. The bids submitted in the FR of Germany (50 000 tonnes) were at 1 410 ECU/tonne, some 4 ECU/tonne higher than successful bids in rounds two and four. Despite this the Commission rejected all bids on the grounds that they had achieved the 200 000 tonnes envisaged and had promised the Management Committee not to accept further bids without discussing the possibility of reducing the minimum tender quantity.

2.54. In total 206 000 tonnes of beef were sold. The Commission does not know with certainty how much went to each country but it is thought that at least half went to Poland and some 40 000 tonnes went to the USSR. As with the export of beef to Brazil, this special sale was effective in that the target quantity for disposal was fully met. However allowing for the export refund paid (895 ECU/tonne) the beef was sold at a net 500 ECU/tonne at a time when hindquarters were being sold to the Community processing industry at four times the sale price to the Eastern bloc.

## Cereals

### Introduction

2.55. Whilst total world production has recently tended to fall below current consumption, within the EEC productivity is increasing and is likely to grow by some 2 to 3 % per annum, despite the reductions in guarantee prices and the introduction of the set-aside scheme. The major cereal producing countries in the EEC are France, the FR of Germany, Spain, Italy and the United Kingdom. 1988 EC cereal production was some 162,5 Mio tonnes; estimates for 1989 vary around 160,5 Mio tonnes. Domestic consumption is predicted to decline by 4 to 7 Mio tonnes between 1989 and 1995.

2.56. Estimated world trade in wheat and grains during 1988/89 was some 200 Mio tonnes, equivalent to 16 % of world production. Although the EEC's share of grain exports increased during 1988/89 to 15 % the United States dominates this market taking more than 50 % of all trade.

<sup>(1)</sup> Commission Regulation (EEC) No 2602/88 of 19 August 1988 (OJ No L 231, 20.8.1988).

The Chicago Corn Exchange makes the market and prices are therefore closely tied to the value of the dollar. The Community's cereal surplus for 1988/89 was some 30 Mio tonnes; for all but sorghum and maize it is self-sufficient. The EEC's biggest customers are the USSR, China, Algeria and, more recently, Poland and Egypt.

2.57. The export market for cereals is dominated by even fewer and bigger operators than the beef market. These companies include multinationals with a complex network covering all the Member States in which cereals are grown for export. Often they have branches or subsidiaries in non-EEC countries. Indeed such companies can and do trade between their constituent parts. Thus an export refund may be granted to a subsidiary within the Community that exports to another of the same company outside the EEC. From a regulatory point of view this is permitted: so long as the cereals leave the EEC for consumption in a third country, refunds are payable. There is no requirement for change of ownership.

#### *Setting the level of subsidy*

2.58. Some 90 % of all cereals exports from the EEC take place as a result of tendering. This tendering takes one of two forms:

- (a) for a price to buy from intervention;
- (b) for an export refund.

The remainder take place either using the published refund rates although these are often enhanced by 'correctives' (also published) or using special rates. The various options are described in more detail below.

#### **Published Rates**

2.59. Basic published rates apply to both intervention and free market sales. Over the past two years they have varied

between 20 and 60 ECU/tonne for main cereals. They are judgement based (i.e. not calculated by reference to a formula). In practice the basic published rates are rarely used. The effective rates for exports from the free market and from intervention are determined by tender with the addition in some cases of correctives.

#### **Correctives**

2.60. Correctives are additions to or deductions from the published rates for specific destinations and are a unique feature of cereals market management. They may also be applied to tendered refund rates and it is in this context that they are generally used. The Commission believes that the advantage of correctives over special rates is that they are a flexible instrument for reacting to developments in different markets.

2.61. Correctives are normally published weekly but may be changed more frequently. They serve a dual purpose:

- (a) to encourage exports to a specific destination (positive correctives);
- (b) to ensure that exports take place sooner rather than later (negative correctives).

2.62. Positive correctives are generally low in relation to the export refund itself, typically 3 or 4,5 ECU/tonne. However, the audit team noted that the exceptions had significant budgetary consequences. For example, in September 1987 a corrective of 20 ECU/tonne was granted for the export of 850 000 tonnes of barley and 650 000 tonnes of feedwheat to Russia. Similarly a corrective of 30 ECU/tonne was granted on the 900 000 tonnes of wheat exported to Russia under Commission Regulation (EEC) No 395/89 (paragraph 2.76 refers). The cost of these two correctives alone amounted to 57 Mio ECU. It is not known how much is spent on correctives generally since the Commission does not have this information.

2.63. The negative correctives are much greater: -30, -40 or -50 ECU/tonne. Typically they become operative two or three months after publication and are designed to encourage the trader to export his cereals sooner than the normal expiry date of the export licence would dictate.

Negative correctives are also intended to reduce speculation in licences between traders.

2.64. The bigger customers often get better rates, for example a corrective of 4,5 ECU/tonne has become the norm for exports to the USSR and was also granted to China for one day on 23 December 1988, when certificates for 1,3 million tonnes were requested.

### Special Rates

2.65. The markets for certain cereal derivatives are particularly restricted or subject to intense competition between the USA and the Community. In the case of flour for example, the USA paid bonuses of around 100 USD per tonne in August 1988. Community refund rates for flour are based on coefficients applied to the rates for wheat which vary according to ash content. The basic coefficients for flour are those given in Commission Regulation (EEC) No 162/67 <sup>(1)</sup>. For flour two coefficients apply to international trade, 1,51 for ash content less than 521 mg. per 100 grammes and 1,43 for ash content equal to or greater than this. However, since 1985 the Commission has applied what they call an internationally agreed average coefficient of 1,40. Applying the 1,4 coefficient to the refund rates for wheat as set by tender in August 1988 gives a refund rate of approximately 85 ECU/tonne. However, in order to match the American subsidy the rate has been enhanced for specific destinations, for example to Egypt the effective rate was 116,8 ECU/tonne.

2.66. For semolina the refund is calculated with a coefficient based on its cereal input. The official coefficient is 1,58 [Regulation (EEC) No 162/67], but since 1985 the Commission has applied a coefficient of 1,67. Semolina for export to Algeria (where it is used to make couscous) enjoys a specially favourable refund rate. The main supplier is Italy. Commission Regulation (EEC) No 330/89 of 9 February 1989 <sup>(2)</sup> fixed a refund of 230 ECU/tonne for export of semolina to Algeria, which is 51 ECU/tonne higher than that obtained by applying the official coefficient of 1,58. Under the terms of this regulation the Commission allowed the issue of export licences for

300 000 tonnes [Commission Regulation (EEC) No 355/89 of 13 February 1989] <sup>(3)</sup>. If all deliveries under this regulation went to Algeria [as is probable, though uncertain <sup>(4)</sup>], the extra cost for these exports would be 15 Mio ECU. For the export of the said 300 000 tonnes the Commission received export licence requests for a total of 5,01 Mio tonnes. These requests were from the two companies that dominate the export market for semolina from Italy to Algeria. The requests were made in the knowledge that the Commission would scale down the quantities accepted. The Council has in the past refused to allow tendering for processed products which might have introduced some competition.

### Tendering

#### Free Market

2.67. Tenders are initiated by the Commission in order to dispose of surplus produce resulting from the current year's harvest and thereby to reduce or avoid the need for intervention purchases later in the marketing year. There is normally only one tendering operation per year for each cereal unless the first operation fails to achieve the desired level of sales. The quantities of cereals put up for sale by tender can range from 100 000 tonnes to several million tonnes. The Commission usually places emphasis on this activity earlier in the marketing year and gives it priority over intervention sales for export. Weekly adjudications are held. Bids may be submitted to the appropriate agencies in any Member State who forward them, in anonymous format, to the Commission. The Cereals Management Committee meets on Thursday afternoons to consider the bids and the Commission then decides whether to set a ceiling on the rate of refund which it is willing to pay, and if so at what level.

2.68. All bids at or below this rate are accepted within the limits of the quantities available. If the trader's bid is lower than the maximum rate set, he will be entitled to the bid rate only. In 1987/88 the Commission tried to sell a total of

<sup>(1)</sup> Commission Regulation (EEC) No 162/67 of 23 June 1967 (OJ No 128, 27.6.1967, p. 2574), amended by Commission Regulation (EEC) No 1607/71 of 26 July 1971 (OJ No L 168, 27.7.1971, p. 16).

<sup>(2)</sup> Commission Regulation (EEC) No 330/89 of 9 February 1989 (OJ No L 38, 10.2.1989, p. 26).

<sup>(3)</sup> Commission Regulation (EEC) No 355/89 of 13 February 1989 (OJ No L 42, 14.2.1989, p. 13).

<sup>(4)</sup> In 1988, 484 000 tonnes were exported from Italy to Algeria. During the first six months of 1989 420 000 tonnes had been exported.

11,3 Mio tonnes of cereals by tender from the free market and achieved 8,5 Mio or 75 %.

2.69. As a cross-check on the results of free market tenders, the Commission calculates a guideline refund based on the theoretical refunds required to export wheat and barley from French and British ports. The calculation is based on the latest FOB price adjusted to arrive at a final port price. This price is compared with the current world price and the difference having been adjusted by the monetary co-efficient is the guideline refund. But the Commission can and frequently has chosen to set higher maximum refund rates, usually to match the subsidies offered by the USA under the terms of the EEP.

### *Intervention Sales*

2.70. Tenders may be invited on the initiative of the Commission or at the request of a Member State. Requests to tender are published in the form of Regulations in the Official Journal and set out the stockholding by depot/warehouse. Traders are required to bid for these lots in terms of the price delivered but not unloaded at the nominated port (ECU per tonne). *Mutatis mutandis* adjudication procedures are the same as those for free market tenders. The published refund rate is paid to all traders who have been successful, i.e. who have submitted bids at or above the minimum price determined by the Commission. In 1987/88 tenders were opened for a total quantity of 7,2 Mio tonnes against which the Commission recorded 'sales' of 6,1 Mio tonnes.

### *Bids*

2.71. The Court examined a sample of bids made for free market and intervention tenders at the Commission and carried out a detailed examination of these and further bids at three intervention agencies — BALM (FR of Germany) ONIC (France) and IBAP (United Kingdom). The Court makes the following observations.

- (a) deadlines: the regulations stipulate deadlines for the submission of bids to the paying agency — 10.00 hrs. (Brussels time) Thursdays for free market sales and 13.00 hrs. on Wednesdays for intervention sales. In several cases the Court's auditors were unable to verify the time bids were received because the telexes were

untimed and/or undated, wrongly timed or dated. Moreover, interpretation of the deadline varied from agency to agency. Thus one of the key principles of tendering (equal treatment of bidders) was negated, and the Court was unable to establish whether the bids had been received in time and were eligible for consideration by the Commission;

- (b) rejection of bids: in the context of Commission Regulation (EEC) No 2735/87 <sup>(1)</sup> (intervention sale of breadmaking wheat) three traders submitted bids at BALM for the adjudication of 9 December 1987. The lowest of these bids (53,25 ECU/tonne) was accepted whilst bids at higher prices (55,13 and 56,33) were rejected. The lowest bid related to destination USSR; the remainder were for other third countries. The Commission is not legally bound to accept the best bid and in this instance chose not to. The Commission apparently decided to pay a premium for exports to the USSR because it is an important customer and subject to American initiatives under the EEP;

- (c) transfer of licences: although some transfers take place in the beef sector, the trade in licences is modest in that sector by comparison with the cereals sector where export licences have become a 'commodity' in their own right. Frequently the large operators perform the role of 'brokers'. They do not themselves export (and may not possess) the grain in respect of which they have acquired entitlement to refund. Having been awarded the right to apply for export licences following successful bids for cereals put up for tender, they may transfer the rights to other traders in the form of 'extracts' or sub-licences. Traders can therefore submit bids for high rates of export refunds which they know will have little chance of being accepted on the assumption that they will be able to obtain sub-licences at a price agreed with the successful bidder. The Court found that often those receiving these extracts were traders whose bids had been rejected at the adjudication.

2.72. Another risk arising from the lack of genuine competition in this market is that a trader has little incentive to obtain the best price from his customer since he knows that the Commission must pay a refund sufficient to make exporting worthwhile for him if it wants the grain to be exported. In this scenario the third country buyer pays

<sup>(1)</sup> Commission Regulation (EEC) No 2735/87 of 11 September 1987 (OJ No L 262, 12.9.1987, p. 11).

less than he otherwise might and the trader's margin is covered by the granting of a larger refund than would be necessary under conditions of open competition.

### *Special Sales*

2.73. In 1987 there were two special export measures to avoid intervention: one for 200 000 tonnes of maize and another for 1,2 Mio tonnes of barley, both from Spain. In 1988 four measures were opened:

- (a) 100 000 tonnes of breadmaking wheat exported from the FR of Germany [Commission Regulation (EEC) No 633/88] <sup>(1)</sup>. This was initially restricted to Poland as a destination. The regulation was later modified to cover all zones. Sales subsequently took place with refunds of 112,50 ECU and 109,89 ECU/tonne at a time when sales from the free market attracted 104 ECU/tonne. The total quantity on offer was sold;
- (b) 200 000 tonnes of wheat to be exported to Algeria and/or Tunisia [Commission Regulation (EEC) No 2191/88] <sup>(2)</sup>. This measure failed to attract any interest and was abandoned;
- (c) 1 Mio tonnes of barley produced in Spain [Commission Regulation (EEC) No 2444/88] <sup>(3)</sup>. This measure specified that the barley must have been produced in Spain in order to qualify for a refund, and 407 300 tonnes were sold;
- (d) 600 000 tonnes of durum wheat from Greece [Commission Regulation (EEC) No 2751/88] <sup>(4)</sup>. 300 000 tonnes were sold under this measure of which 250 000 attracted a maximum refund of 130 ECU/tonne when free market sales were taking place at 122-123 ECU/tonne. The justification for the extra cost is uncertain.

2.74. During 1989 three special measures were introduced. Once again a tender referring to barley produced in Spain (300 000 tonnes) has been opened. The two other measures each relate to 900 000 tonnes of common wheat. One of these measures is the subject of the prologue to this report. The other is considered in detail below.

<sup>(1)</sup> Commission Regulation (EEC) No 633/88 of 8 March 1988 (OJ No L 63, 9.3.1988, p. 9).  
<sup>(2)</sup> Commission Regulation (EEC) No 2191/88 of 22 July 1988 (OJ No L 195, 23.7.1988, p. 31).  
<sup>(3)</sup> Commission Regulation (EEC) No 2444/88 of 3 August 1988 (OJ No L 211, 4.8.1988, p. 15).  
<sup>(4)</sup> Commission Regulation (EEC) No 2751/88 of 2 September 1988 (OJ No L 245, 3.9.1988, p. 13).

### **Tender for the refund for the export of common wheat to the Soviet Union**

2.75. In November 1988 certain traders signed a contract to export 1,5 Mio tonnes of wheat to the USSR for delivery in January — March 1989. The Commission does not appear to have been involved during the negotiations at this stage. At this time world prices were relatively low and this was reflected in the contract made with the USSR which is thought to have been concluded at 5 USD-10 USD/tonne below market prices. The traders believed that world prices would continue to fall. Nevertheless, they bought grain on the internal market in anticipation of acquiring export licences at higher refund rates. Contrary to expectations the grain market picked up, prices on the world market began to rise and the traders' bids for export refunds under the tender for free market wheat [Commission Regulation (EEC) No 2470/88] <sup>(5)</sup> proved uncompetitive and were rejected. In December some 2,2 Mio tonnes worth of licences were issued with a corrective of 4,5 ECU/tonne valid for China and the USSR. These licences were obtained by traders who were successful in the bidding for export refunds in the free market tender, but — a fact of which the Commission only subsequently became aware — these were not the same as the traders with the Russian contract. Nor were the latter able to buy licences on the market. They were therefore not in a position to meet the delivery requirements of the Russian contract and the grain remained in the silos of certain major ports, causing congestion, as it could not be loaded on the waiting Russian ships (some of which departed empty).

2.76. In January 1989 the Commission was prepared to cover the 'licence deficit' by a specific regulation. On 16 February Commission Regulation (EEC) No 395/89 <sup>(6)</sup> was published offering 900 000 tonnes for export to the USSR; at the same time the USSR was withdrawn as an eligible destination from the free market tender [Commission Regulation (EEC) No 2470/88].

2.77. The 900 000 tonnes up for offer was awarded to the sole bidder in the adjudication of 23 February 1989 for which day a corrective of 30 ECU was granted, giving an effective rate of 71 ECU/tonne. The special corrective was published on the same day as the adjudication took place. At the same time a bid of 61,9 ECU/tonne under the free

<sup>(5)</sup> Commission Regulation (EEC) No 2470/88 of 5 August 1988 (OJ No L 213, 6.8.1988, p. 7).  
<sup>(6)</sup> Commission Regulation (EEC) No 395/89 of 16 February 1989 (OJ No L 45, 17.2.1989, p. 13).

market tender [Commission Regulation (EEC) No 2470/88] was rejected as too high.

2.78. The Court was unable to obtain a satisfactory explanation for the corrective of 30 ECU introduced by the Commission, or to establish how the export deal was agreed. The Commission believes that the trader incurred losses on this deal despite the preferential rate granted.

#### *Planning and monitoring of export sales*

2.79. The Commission draws up a supply balance sheet at the beginning of each year. For the cereals campaign 1988/89 see *Table 6*. This contains global quantities which form the basis of an estimation of the financial cost of achieving the exports envisaged. Based on the average export pattern and prevailing refund rates, the Commission estimates the probable cost in terms of refunds.

2.80. The Commission produces the internal weekly reports referred to in paragraph 2.17 which record all decisions reached, both inside and outside the Management Committee meeting. They also highlight any significant events in the relevant markets. Member States provide regular returns showing the tonnage for which certificates have been requested/issued.

2.81. The Commission has to rely on Member States to keep them informed of progress on sales. In the past, this has not always happened. The Commission has had to make repeated requests for the information which has often been provided orally. Following the introduction of Commission Regulation (EEC) No 859/89 of 29 March 1989<sup>(1)</sup> which relates to the beef and veal sector, the situation for this market has improved. Member States are now required to send the Commission details of amounts sold from intervention analysed by sales Regulation. However, for mini-tenders no details of the split between tender and fixed price sales are given and prices are not communicated. Under Commission Regulation EEC

<sup>(1)</sup> Commission Regulation (EEC) No 859/89 of 29 March 1989 (OJ No L 91, 4.4.1989, p. 5).

Table 6 — 1988/1989 Cereals Campaign (1.7.88-6.6.89): Exports and Imports <sup>(1)</sup>

(1 000 tonnes)

|                             | Exports | Imports | Net Exports<br>(Imports) |
|-----------------------------|---------|---------|--------------------------|
| Common wheat                |         |         |                          |
| Grain                       | 12 700  | 1 546   | 11 154                   |
| Flour (wheat equivalent)    | 3 232   | 72      | 3 160                    |
| Barley                      |         |         |                          |
| Grain                       | 9 618   | 19      | 9 599                    |
| Malt (barley equivalent)    | 2 025   | —       | 2 025                    |
| Maize                       | 1 887   | 2 190   | (303)                    |
| Durum wheat                 |         |         |                          |
| Grain                       | 2 102   | 58      | 2 044                    |
| Semolina (durum equivalent) | 1 460   | 76      | 1 384                    |
| Rye                         | 129     | 6       | 123                      |
| Sorghum                     | —       | 749     | (749)                    |
| Total                       | 33 153  | 4 716   | 28 437                   |

<sup>(1)</sup> Excluding Food Aid.  
Source: 'Agra Europe'.

2377/80 of 4 September 1980 <sup>(1)</sup> [as amended by Commission Regulation EEC 3988/87 of 22 December 1987 <sup>(2)</sup>] Member States are required to report each week the quantities for which licences have been issued. This information is provided for 14 groups of combined nomenclature codes and would not therefore enable the Commission to monitor the export of specific cuts of meat within each of these groups.

### *The decision-making process*

2.82. Hitherto the proposals put by the Commission to the Management Committees have not been supported by full information about the financial implications, e.g. in terms of the budgetary impact of an increase (or decrease) in refund rates and the loss on sale resulting from setting minimum prices. The Commission is aware of this shortcoming and has gone some way towards addressing the problem. Proposals put before the Management Committee are now to be accompanied by a pro forma statement of the financial consequences of the measure concerned. This includes a section on financing and implications for the following financial year. The market division is required to complete this statement three days before the Management Committee is due to consider the measure. This document has only recently been introduced and did not exist for the transactions relating to 1987 and 1988 examined by the Court.

2.83. Within the Commission services the initiation and implementation of policy with regard to subsidization of exports is primarily (though not exclusively) the responsibility of the appropriate market divisions of DG VI. The Financial Controller follows and is represented at Management Committee meetings, and has on occasions raised questions about particular decisions after the event. At the external level the Management Committees in principle offer a forum for expert scrutiny of Commission proposals by Member States' representatives, but their effectiveness in this respect is difficult to gauge. There are no comprehensive minutes of discussion, the only record being a summary list of decisions taken.

2.84. The Commission intends to use a computer programme in order to follow up certain of its decisions (taken after consultation with the Management Committee) with regard to the cereals market. The programme is

based on a model established for sugar. The programme will permit the results of weekly tenders to be evaluated and will provide a continuous follow up of financial obligations resulting from the decisions. However, at the time of audit, the system for cereals did not work due to programming problems.

### *Conclusions*

#### *The cost of the policy*

2.85. The payment of subsidies on exports is one of the most important instruments available to the Commission for the management of agricultural markets. It is also complex and costly, roughly one-third of the whole Community budget being spent on export subsidies (i.e. refunds plus low-price sales). The complexity of the export subsidy system as it has evolved over the years is in striking contrast with the basic legislation. As regards the objectives of export refunds, the regulations contain broad statements of intent. The Community basic legislation is silent on the use of low-price sales as an instrument of export promotion.

2.86. In practice, the export refund system has developed into the principal instrument of internal market management. In addition, the export subsidy system has developed into a flexible instrument of commercial and external relations policy. Both developments carry risks for the Community budget. The risk in the former case (exemplified by the special measure for German wheat and the SMP for export initiative) is that the budget will be used to finance the export of products which the home market could have absorbed. Thus, the export subsidy system has a tendency to increase the level of Community prices in some markets and is one factor, along with the low value of the dollar, which helps to depress world prices in others, for example beefmeat. The result is that the gap which the system is designed to bridge is widened; hence increasing the cost of disposals.

2.87. In the latter case the risk is that by attaching geographical conditions (e.g. specifying a single country as destination or source) to export sales the Commission will reduce the level of trader interest and thus increase the cost to the Community budget. The prologue and several cases described in this chapter suggest that this risk is a real one, e.g. paragraphs 2.42, 2.73(a) and (b), 2.77.

<sup>(1)</sup> Commission Regulation (EEC) No 2377/80 of 4 September 1980 (OJ No L 241, 13.9.1980).

<sup>(2)</sup> Commission Regulation (EEC) No 3988/87 of 22 December 1987 (OJ No L 376, 31.12.1987).

2.88. In its management of the subsidised export of agricultural products the Commission is in effect responsible for a commercial operation on an international scale. By comparison with the commercial firms with which much of its business is conducted, the Commission suffers from several disadvantages. One disadvantage is that for most of the past decade it has been a forced seller in markets which tend to be dominated by a small number of big traders.

2.89. But some of the Commission's disadvantages are of its own creation: for example, the failure in many cases to document, monitor or evaluate decisions. The Commission's use of tendering and its analysis of price information to set the appropriate level of subsidy could be improved. Tendering has been carried out in the context of imperfect markets (i.e. with too few traders to facilitate real competition or only a single trader) or under conditions which may be classified as 'uncompetitive' (e.g. due to a requirement for large bid quantities such as in Commission Regulation (EEC) No 2415/88 which set the minimum bid at 25 000 tonnes of beef). The reliability and completeness of the Commission's price information are uncertain. Significant increases in the level of subsidy have occurred but the Commission was unable to provide the Court with any justification for such changes. The present chapter contains evidence that the cost of subsidy may often be higher than is necessary for the achievement of the Commission's export objectives (e.g. paragraphs 2.21, 2.33, 2.46, 2.66).

#### *Accountability*

2.90. By whatever means the Commission obtains the information necessary for determining the appropriate level of subsidy, the whole is subject to the Commission's judgement or discretion for reasons set out in paragraph 2.11. This would not necessarily be a point of concern if adequate documentation were maintained of the facts, the Commission's consideration of the facts, the decisions taken and of the outcome. However, this is not the case and the consequences are serious for independent control by third parties and for management. The Court has been unable to gather from Commission records the information necessary for more than the most elementary evaluation of many aspects of export subsidies. In view of the Court's findings it is unclear how management can function

properly and the various Management Committees can act as an effective check on the Commission.

#### *Tendering*

2.91. In theory the level of subsidy represents the difference between prevailing world and Community prices. In practice the equation is not quite so straightforward since factors such as US export initiatives, transport and handling costs, and the response of competitors are unlikely to be reflected adequately in available price information. In such circumstances tendering would appear to be the only solution available to the Commission to enable the independent yardstick of market forces to be brought to bear on the determination of rates and prices whilst ensuring that the level of subsidy provided does not exceed the minimum necessary to ensure export. Tendering in theory has the additional advantage of ensuring equality of treatment between bidders.

2.92. In the case of SMP exports (paragraphs 2.30 — 2.33) recourse to tendering would have alerted the Commission to the extent of market demand and possibly encouraged reconsideration of the need for the Community to subsidise the sale of SMP. There is little doubt, too, that the level of subsidy so determined would have better reflected market conditions than that which was actually set, at a considerable saving to the budget.

2.93. The Court recommends that the Commission consider extending the use of tendering, particularly for the bulk products. Bearing in mind the lack of genuine competition in certain markets, the Commission should decide on a minimum or reserve price in each case before the invitation to tender is issued. All such decisions should be documented but (in contrast with present practice in the beefmeat sector) minimum or reserve prices should not be published. In cases where exports to third countries are sold to a sole buyer, the Commission should negotiate directly to agree a price, tendering for other elements. For sales from intervention this would effectively mean the Commission tendering for transport and handling costs, the sale price out of intervention being within their competence.

## 3. NATIONAL CONTROLS

*Introduction*

3.1. Under the general arrangements for the management of EAGGF-Guarantee expenditure the primary responsibility for examining the goods exported and for vetting the refund claims lies with the Member States. The Community has, however, defined some of the essential central requirements. Commission Regulation (EEC) No 3665/87 of 27 November 1987 <sup>(1)</sup> consolidates common detailed rules for the application of the system of export refunds on agricultural products, including rules for the supporting documents needed to substantiate a claim: the required evidence of export and of arrival for home consumption in the country of final destination; the calculation of the rates of refund; and the special arrangements for the prefinancing of refunds. And Council Directive 77/435/EEC of 27 June 1977 <sup>(2)</sup> [replaced by Commission Regulation EEC 4045/89 of 21.12.89 <sup>(3)</sup>] requires Member States to carry out a posteriori checks of the commercial documents of undertakings receiving payments from the EAGGF, including payments of export refunds.

3.2. The present chapter summarises the results of the Court's audit of the controls exercised by Member States over the expenditure on export refunds for the three principal products of cereals, milk products and beef. The audit covered paying agency and customs controls in the United Kingdom, Ireland, the Netherlands, France, the FR of Germany, Italy and Denmark. In addition customs controls over export refund transactions were examined in Belgium and Greece. At customs stations selected as far as possible according to the importance of export refund transactions, the Court evaluated the theoretical and actual procedures for physical control of export refund consignments and the eventual certification of export. At paying agencies, the Court tested evidence of export and evidence of arrival at final destination.

3.3. The main issues considered were whether:

- (a) the appropriate evidence had been submitted in support of refund claims;

- (b) the refund payments were based on the correct rate for date, description, quantity and destination;

- (c) the appropriate controls leading to certification of date, description, quantity, quality and export were provided for and effectively performed;

- (d) the appropriate a posteriori controls over the authenticity of the transaction were effective both in their scope and frequency.

3.4. The cooperation received from Member States in carrying out this enquiry was good. However, in certain Member States the Court was unable to obtain full access to reports and documentation concerning the work carried out under Directive 77/435/EEC <sup>(2)</sup>. This problem arose in Ireland and the United Kingdom in 1987, and in France in 1988. In addition, one Member State (United Kingdom) refused direct access to accounting data relating to expenditure on export refunds. The United Kingdom authorities have since indicated their willingness to reconsider this restriction, case by case and the political authorities in Ireland, having had the matter brought to their attention, have directed the national administration to give the Court access to all necessary information in future. Conversely certain Member States (notably Denmark and the Netherlands) provided high quality management information. The scope of the observations in the succeeding paragraphs necessarily reflects the difference in the extent of the audit in the different Member States and cooperation and information received. In accordance with the Court's normal practice, the factual content of the observations concerning Member States contained in this chapter was formally brought to the attention of the competent national authorities on a bilateral basis and their comments have been taken into account.

3.5. Export refunds are a high risk area. This is due above all to the complexity of the governing legislation and the size of the sums which can be involved in individual transactions. A vivid illustration of the complexity of the legislation is provided by the rates applicable to certain types of cheese in December 1988, which were as follows:

- (a) Cheese, Parmigiano Reggiano, not grated or powdered, of a fat content by weight, not exceeding 40 %, and a water content calculated by weight, of the non-fatty matter not exceeding 47 % would attract a refund rate of 190 ECU per 100 kg if exported to Sweden but zero if exported to Norway and Finland, all three countries being members of the European Free Trade Association (EFTA);

<sup>(1)</sup> Commission Regulation (EEC) No 3665/87 of 27 November 1987 (OJ No L 351, 14.12.1987).

<sup>(2)</sup> Council Directive 77/435/EEC of 27 June 1977 (OJ No L 172, 12.7.1977).

<sup>(3)</sup> Commission Regulation (EEC) No 4045/89 (OJ No L 388, 30.12.1989).

- (b) the same cheese if not grated or powdered attracts a refund rate of 170 ECU per 100 kg if exported to USA but if grated attracts a maximum refund of 118,75 for that destination;
- (c) for other cheeses exported to third countries the difference of fat content by weight in the dry matter between 18,9 % and 19,1 % will increase the refund from 100,50 ECU per 100 kg to 114,22 ECU per 100 kg.

3.6. A first instalment of the Court's findings with regard to national controls over export refunds for beefmeat was published in the Court's 1987 Annual Report <sup>(1)</sup>. The Court believes that many of these findings gain added force and relevance in the wider context of the present report, and some of them therefore reappear in this context.

3.7. The Court notes that in recent weeks some important changes have been introduced in the regulations governing the control of export refunds. Annex III comprises a list of the main changes. The observations which follow should, of course, be read in the light of these recent developments. The Court is pleased to note the extent to which the Commission, in drafting these changes, has taken account of the suggestions of the Court in the present report and in earlier reports, in particular the 1987 Annual Report.

### *Customs Controls*

#### *The sequence of controls*

3.8. Customs in all Member States have responsibility for accepting goods into customs control prior to export and for certifying export. In fulfilling this responsibility Customs may carry out physical examinations to verify declared quantities and qualities of consignments at any point between the trader's premises and eventual export from the Community.

3.9. The acceptance of goods into customs control, signified by the application of a customs stamp and signature to the appropriate box on the export declaration, validates the declaration submitted by the exporter. It provides confirmation of the basic elements essential to determining the justification of a claim for, and the calculation of, an export refund, namely that goods of a declared quantity and quality exist on a given date.

3.10. The first point at which goods may be taken into customs control and may be subject to physical examination is at the point of loading, which is normally at the trader's premises. For this control to be effective the exporter should be required to provide advance notification of his intention to load, of the cargo and of the timing of the operation to his local customs office.

3.11. An alternative procedure in existence in some Member States is for the container to be presented fully loaded, along with the export declaration at the responsible local customs office, where customs may similarly confirm existence and carry out a physical examination.

3.12. In both these cases after acceptance the container will travel under seal to the customs office at the port of exit from national territory where export formalities will be completed.

3.13. A third possibility is for goods to be accepted into customs control directly at the customs office at the point of exit from national territory. Here again the container is presented fully loaded along with the customs declaration. Its arrival is registered so that the declaration can be certified with the date of acceptance into customs control.

3.14. The container will then be placed in a storage area pending loading on board ship. Physical examination of goods in containers presented directly at the customs office of exit may occur at any time between arrival and loading on board ship.

3.15. In order to qualify for payment of export refund under any of these three procedures the exporter must complete export formalities within 60 days from the date when the goods have been accepted into customs control. Customs' final responsibility therefore is to certify export within this period.

<sup>(1)</sup> Annual Report on the 1987 financial year, OJ No C 316, 12.12.1988, paragraph 4.20.

*The risks*

3.16. The risks inherent in the export operations of agricultural produce are:

- (a) that the quantity of the product may be overstated (in extremis, the product may not exist);
- (b) that the quality of the product may be misstated;
- (c) that the product may be misdescribed;
- (d) substitution by quality or quantity (or both) of the product taken under customs control in advance of actual export, at some subsequent stage, i.e. during storage or during transfer from stores to ship, train or other form of transport;
- (e) the non-export of goods and either their re-presentation for export or their entry on to the home market.

3.17. In all of these cases the Community budget may finance unjustified amounts of export refunds. In the case of (e) the operation is frustrated in its main objective of removing produce from the market for export to third countries.

3.18. In the course of the enquiry the Court noted a number of weaknesses in control procedures and administrative arrangements which accentuate the risks outlined above. These weaknesses are explained in some detail below and are illustrated by examples drawn from all the Member States visited. Whilst the weaknesses are presented individually, in practice the Court found that most applied at any one time to each of the customs authorities visited on both local and national levels.

*Notice of intention to place goods under customs control*

3.19. When goods are taken into control by an inland customs office sufficient advance notice should be provided by the exporter to customs of the description and quantity of the goods and of the times of starting and finishing of the loading to allow customs the opportunity to attend. This is particularly important if Customs are to make the most effective use of their physical controls, for the reasons given in paragraph 3.28. The deterrent value of customs controls is of course lost if the exporter is able to gauge the likelihood of customs attendance in advance.

3.20. This important principle was negated in the following cases observed by the Court:

- (a) in Ireland for companies with more than one set of premises, arrangements for prior notification of placing beefmeat under customs control did not allow customs sufficient time to carry out an examination should they have wished to do so. In these circumstances it is not surprising that a major exporter visited by the Court had never been subject to such an examination;
- (b) in the United Kingdom a major exporter of beefmeat visited by the Court was always allowed to wait until after the deadline for customs attendance before filling in the declaration;
- (c) in the FR of Germany, the customs officer for one major producer of milk products had never received prior notification; for another, 24 hours telephone notice was received but with no indication of quantities or descriptions;
- (d) in the case of the latter and of another customs office in the FR of Germany responsible for 4 major exporters of milk products, it was the practice to inform the trader by telephone when the customs officer wished to carry out a physical examination and to request a company car to collect the examining officer;
- (e) at Wilhelmshaven (FR of Germany), prefinanced goods removed from warehouse for export were only declared to customs when they had been loaded on board ship;
- (f) at St. Quentin (France) the first export refund consignments leave the factory at 9 a.m. each day. In order to meet this deadline, packing commences at 5 a.m. Since the customs office is 45 minutes from the factory, and since the control staff have no authority to work outside normal hours, there has never been a physical control at the start of a packing of goods scheduled to leave the trader's premises at 9 a.m.

*Acceptance of goods into customs control*

3.21. The act of placing goods under customs control determines the date for refund rate for non-prefixed

transactions. In cases where the rate has been prefixed (cf. Annex 1, paragraph 6), there is a time limit within which the exporter must place his goods under customs control in order to benefit from the prefixed rate. There is therefore a risk of manipulation of the date of acceptance either to benefit from the consequences of rate changes or to comply with the expiry date provided for on the prefixing certificate.

3.22. The Court noted the following examples where confirmation of the existence of the declared quantities was not obtainable on the date of acceptance:

- (a) in France cereals were accepted into customs control without the customs officer having verified from the silo operator's records that the declarant had sufficient cereals in store on the date of acceptance to match the quantity declared for export;
- (b) in Italy cereals stored at several distant locations were accepted into customs control on a single declaration without satisfactory confirmation of existence on the date of acceptance from the customs offices responsible for all of the locations;
- (c) in Italy total quantities of cereals were accepted into customs control on the date of presentation of the first part of the consignment even though the remainder of the consignment was presented over succeeding days;
- (d) in Belgium direct trader input declarations were recorded with the date of acceptance being that of computer input. In reality the exporters disposed of a further 6 days to present the goods for customs control.

#### *Documentary controls*

3.23. The purpose of current documentary controls is to ensure that the description and quantities on the export declarations are consistent with supporting commercial documentation. Inconsistencies noted at this stage will also assist in determining which consignments should be subject to physical control.

3.24. The Court found that, in contrast to the procedures regarding import duties and levies, where the average transaction size is much smaller, commercial invoices are only required to be presented with the declaration in two Member States, (Denmark, Netherlands). In the remaining Member States there is therefore no automatic check of export declarations against supporting commercial documentation.

3.25. Even in the two Member States where the invoices are required by law the Court noted weaknesses:

- (a) in Denmark certain large exporters are allowed to present their invoices on a monthly basis. The initial control point is already passed and in most cases the goods have been exported. Further, the Court found that when invoices were received it was not the practice to compare them with the export declarations even on a sample basis;
- (b) in the Netherlands the auditors found examples where photocopies of a single invoice were accepted in support of several claims. The originals were not even genuine commercial invoices but had been prepared specifically for the purposes of presentation with export declarations.

3.26. The performance of documentary controls was also far from convincing. For example:

- (a) in the Netherlands certain export refund declarations had been certified by customs although the supporting documents did not agree in regard to weight and export refund nomenclature. Some declarations had also been certified where the destination was intra-Community;
- (b) in Italy, certain declarations for cheese were certified by customs although the composition of the product according to the certificate of origin did not correspond to that defined by the declared export refund nomenclature.

#### *Physical controls*

3.27. The purpose of physical controls is to obtain assurance from a representative sample of the goods declared, that the classification, condition and weight are correctly declared: in other words, that the declaration accurately reflects reality. In all Member States visited responsibility for physical controls rests with the customs services.

3.28. 100 % physical control of exports attracting refunds is neither desirable nor feasible; there are too few customs officers and such an intensity of control would stifle the export trade. Physical controls should therefore be selective and directed towards consignments which present the highest risk in terms of refund value, product and

destination risk, and trader reliability. They should be of sufficient frequency and quality to have the desired preventive effect and to detect irregularities. The Court's examination of this key control however revealed the weaknesses described in the succeeding paragraphs.

#### *Criteria for selection for physical control*

3.29. There is a lack of defined criteria for risk identification to ensure that physical checks and sample taking with a view to analysis are directed towards high risk areas. The Court's auditors found only one Member State (France) which had set up an adequate — if perfectible — system of risk analysis. It includes criteria such as Common Customs Tariff classification but it excludes the export refund classification, financial importance of refund, and destination. All export declarations for a Customs authority are input directly through computer terminals to the local Customs computer which permits a limited risk analysis to be applied systematically to every declaration. The local nature of the arrangements enables criteria for risk identification to reflect local conditions.

3.30. In Belgium a similar initiative has been taken to select consignments for physical control. Selection by the computer does not necessarily mean that a physical control will be carried out, however, for the final decision is left to the examining officer. The only parameter in use at the time of the Court's visit to Antwerp was 'All CAP products' which is too vague a criterion to allow identification of risk transactions only.

3.31. In practice the lack of detailed criteria for risk identification has meant a rather haphazard targeting of transactions. The Court noted that some customs stations concentrated on products which:

- (a) did not attract refunds (France);
- (b) were so-called preparations and therefore attracted lower rates of refund (United Kingdom, Netherlands); and
- (c) were of a refund value so low that the exporter had often made no refund claim (France, Belgium).

#### *Frequency and quality of controls*

3.32. Until the 12th February 1990 when the Council finally adopted the regulation on monitoring of payments in respect of the export of agricultural produce there was no Community standard for the frequency and depth of physical controls. The risk to the Community is that in the absence of any agreed benchmark, the performance of physical controls will decline until the lowest level is reached. In other words, the more effective the controls of a particular Customs authority the greater the incentive to the trader to export to third countries via an alternative Customs authority where controls are known to be less frequent and less searching. This is true for Customs authorities on local, regional and national levels. Statistics concerning the frequency of physical controls did not exist at national level in any of the Member States visited. Of the customs offices at the major ports only United Kingdom ports and Rotterdam maintained statistics although even here there was no separation between CAP exports to other Member States and those to third countries. For the most part therefore the information concerning the frequency of physical controls was not known to management and it had to be established either at the specific request of the Court or by analysing information wherever available during the course of the audit. *Table 7* reveals rates of physical control which were well below the 5 % now adopted as the minimum acceptable level of check by the Council.

3.33. If frequency is an indicator of the quantitative aspect of physical controls, then it is the depth of testing which indicates quality. In this respect the Court notes an unsatisfactory position in all Member States visited with at best confusion and a lack of rigour in applying nationally set levels of checks and at worst the absence of any guidance, national or otherwise, for Customs Officers. In particular, the Court's auditors were concerned to note a general lack of understanding as to the importance of obtaining representative samples from consignments and as to the means by which this might be achieved. There are no statistics as to the type of checks at the national level and on an ad hoc basis only at local and regional levels. The following cases, observed by the Court's auditors, illustrate the extent of the problem with regard to frequency and quality of controls:

- (a) at Genoa (Italy) there had been no full turn-out of a container for at least 18 months;

Table 7 — Rate of physical examination

| Customs Station | Member States | Physical Control Rate (%) | Year or part year of reference | Comment                         |
|-----------------|---------------|---------------------------|--------------------------------|---------------------------------|
| Frederikshavn   | DK            | 0,2                       | 1988                           |                                 |
| Aarhus          | DK            | 0,4                       | 1988                           |                                 |
| Padborg         | DK            | 0,3                       | 1988                           |                                 |
| Copenhagen      | DK            | 1,5                       | 1988                           |                                 |
| Le Havre        | F             | 2,5                       | 1988                           |                                 |
| St. Quentin     | F             | 0,9                       | 1988                           | (Milk Products)                 |
| Breda           | NL            | 0,7                       | 1988                           |                                 |
| Rotterdam       | NL            | 1,8                       | 1988                           | (Average of 10 Customs Offices) |
| Harwich         | UK            | 2,0                       | 1988                           |                                 |
| Ipswich         | UK            | 3,0                       | 1988                           |                                 |
| Barnstaple      | UK            | 0,9                       | 1987                           | (Beefmeat)                      |
| Poole           | UK            | 0,2                       | 1987                           |                                 |

- (b) at Livorno (Italy), customs claimed to have a full turn-out rate of 5 %, details of which were recorded on export declarations. Examination of export declarations for the 4 month period ending 28 February 1989 revealed no evidence of full turn-outs;
- (c) at Salerno (Italy), Bari (Italy), Harwich Parkestone Quay (United Kingdom) and Navy Dockyard (United Kingdom), there had been no full turn-outs in 1988 nor at Barnstaple (United Kingdom) in 1987;
- (d) at Rotterdam (Netherlands) physical identification was usually obtained by examination of marks and numbers on the packages. Similarly net weights were rarely checked, reliance being placed on the quantities marked on the packaging;
- (e) at Berg Autoweg (Netherlands) and Rotterdam (Netherlands) it was evident from the absence of arrangements for the replacement of health seals in the event of removal for customs examination purposes, that the opening of vehicles/containers with health seals was a rare occurrence;
- (f) at Berg Autoweg (Netherlands), of the two vehicles subjected to physical control during the Court's audit mission, one involved no check weighing whatsoever and the other, checked by means of the weighbridge, revealed a gross weight difference of about 1 000 Kg;
- (g) at Leeuwarden (Netherlands), the choice of which carton to sample depended upon which cartons were dropped or broken during loading;
- (h) at Frederikshavn (Denmark) for the 12 month period ending December 1988, no check weighing whatsoever had been carried out;
- (i) at Padborg (Denmark) where 58,500 consignments of CAP goods were accepted into customs control in 1988, not one had been subjected to a weight check;
- (j) at Le Havre (France), the Court's auditors were witnesses to a problem with the weighing of three sacks of 25 kg of skimmed milk powder. The scales at the customs control office only weighed up to 10 kg. The scales at the nearest other control office were out of action and looked as if they had been for many years. The scales in the next nearest office had no batteries. When some had been obtained the check weighing was carried out. In all, this had taken nearly 1 hour and had demonstrated that control over quantity of products in packages of 25 kg and over by this office was not a regular occurrence. (The particular container from which these sacks were taken was also found to contain undeclared clocks and wine);
- (k) at Ulm, (FR of Germany) there was no test weighing, reliance being placed on the certificate provided by an auxiliary customs person (whose salary is paid by the exporter). He in turn relied solely on company internal

controls and never test weighed. At all other customs stations visited in the FR of Germany reliance was always placed on the auxiliary customs person. In other words, quantities were accepted as declared; indeed, at Leer the exporter was so confident of the outcome of customs controls that he completed the box reserved for details of customs examination with the word 'KONFORM';

(l) at Harwich Parkestone Quay (United Kingdom) there was no test weighing in 1988;

(m) at Vlissingen (Netherlands) the physical control of 216,000 x 50 kg bags of sugar with an export refund value of 5,4 Mio ECU, presented fully loaded on board ship, consisted of the examination of 3 bags from the top layer. This was not an isolated occurrence. In the 9 months ending 30 September 1988, 340 995 tonnes of wheat, 118 500 tonnes of barley, 144 000 tonnes of maize and 156 000 tonnes of sugar were declared in this way.

#### Laboratory analysis

3.34. The classification claimed by a trader for export refund purposes for nearly all milk products, cereals and certain beef products can only be verified by laboratory analysis. In these cases visual examination alone will not enable the Customs Officer to identify a product for the purposes of export refund classification. *Table 8* identifies rates of sampling which the Court considers are unacceptably low. As with the rates of physical examination the

information was frequently not readily accessible and had to be established from individual declarations.

3.35. Statistics concerning the error rate found as a result of sampling were not maintained either by customs offices or by the responsible laboratories. As a result of the Court's observations, three Member States have made some progress towards identifying error rates by export refund classifications, although none as yet can identify to the level of the customs office of origin. Nevertheless even these limited results demonstrate that laboratory analysis is essential in determining the export refund classification of a great many products and that knowledge of these results is essential in determining high risk areas. The results are as follows:

(a) in the Netherlands in 1988 of 338 samples of meat products attracting export refunds which were subject to analysis, 104 (31 %) resulted in incorrect export refund classification leading to an overclaim of export refunds;

(b) in the United Kingdom an analysis of the results of 172 samples from the year 1987/88 covering intra-Community and third country exports of CAP products, revealed an error rate in the classification of 48 %;

(c) in the FR of Germany the overall sampling rate for 1988 is acceptable (4,8 %). Nevertheless a close

Table 8 — Rate of sampling for laboratory analysis

| Customs Stations   | Nos CAP<br>Export<br>declarations | Year or<br>Part Year<br>of<br>Reference | No of<br>samples | % Rate<br>of<br>sampling | Observation          |
|--------------------|-----------------------------------|-----------------------------------------|------------------|--------------------------|----------------------|
| Harwich (UK)       | 1146                              | 1988                                    | 0                | 0                        | (Milk products only) |
| Ipswich (UK)       | 3554                              | 1988                                    | 21               | 0,6                      |                      |
| Rotterdam (NL)     | 26222                             | 1987                                    | 144              | 0,5                      |                      |
| Frederikshavn (DK) | 6500                              | 1988                                    | 2                | 0,03                     |                      |
| Aarhus (DK)        | 15800                             | 1987/88                                 | 3                | 0,02                     |                      |
| Padborg (DK)       | 58250                             | 1987/88                                 | 25               | 0,04                     |                      |
| Copenhagen 2 (DK)  | 1900                              | 1987/88                                 | 20               | 1,05                     |                      |
| Genoa (I)          |                                   | 1988/89                                 | 0                | 0                        | (Cheese)             |
| St. Quentin (F)    | 1400                              | 1988                                    | 0                | 0                        | (Milk products)      |
| Le Havre (F)       | 1406                              | Dec.1988                                | 6                | 0,4                      | (Milk products)      |

examination of the results demonstrates a lack of direction in sample taking, as can be seen from the examples in *Table 9*.

**Table 9 — Comparison of sampling rates by export refund classification**

| ER Classification | Refund per 100 kg at 31.12.88 | Sampling rate (%) | Error rate in sample taken (%) |
|-------------------|-------------------------------|-------------------|--------------------------------|
| 0402 2119 900     | 130,00                        | 8,45              | 43                             |
| 0402 2119 500     | 119,30                        | 5,1               | 80                             |
| 0401 3031 100     | 58,22                         | 2,1               | 27                             |
| whereas           |                               |                   |                                |
| 0402 9919 310     | 22,91                         | 53,0              | 1,69                           |
| 0402 0919 350     | 38,70                         | 41,0              | 2,1                            |
| 0402 1019 000     | 62,00                         | 45,0              | 0,2                            |

#### *Facilities for control purposes*

3.36. Traders are not prohibited from presenting export consignments for customs control where the necessary facilities for control are lacking. In one Member State (United Kingdom) the import of meat via a particular port is prohibited because of an acknowledged lack of basic facilities such as scales and a refrigerated unloading area and the absence of a Health Inspector. Common sense would dictate that exports should also be prohibited for the same reasons, yet traders are freely allowed to export meat via the same port. The Court also found that:

- (a) there were no scales at 2 customs stations in the port of Antwerp (Belgium);
- (b) weighbridges were out of action at Portsmouth (United Kingdom), Castellamare (Italy) and Aarhus (Denmark);
- (c) there were no facilities for unloading (and therefore checking) frozen or chilled goods at Immingham (United Kingdom);
- (d) export of live animals is allowed from Parkstone Quay and Portsmouth (United Kingdom) even though there are no lairage facilities;

(e) at Rouen Rive Gauche (France), at a new container terminal there was no examination shed, no scales and no weighbridge;

(f) at Rotterdam 8 station (Netherlands), cold stores and unloading areas were located at a distance of 6 km from the container depot where the goods were accepted into customs control.

#### *The location and timing of physical controls*

3.37. Particularly for containers and lorry and rail traffic, physical controls are most effective if they are carried out during the loading of a consignment. Customs controls can take place at the trader's premises, at a customs station, at storage facilities under customs control or at the point of export. The essential distinction is that in the case of the first mentioned location, Customs Officers are able to be present before and during loading of the goods, whereas in each of the alternative locations consignments are presented packed for export. At the trader's premises, the customs officer has ready access to each item of the whole consignment as it is loaded and he can therefore draw a representative sample of items for control purposes. Once a consignment is loaded, however, the Customs Officer can only have access to each item by requiring the consignment to be unpacked and repacked in his presence. Such an operation (a 'turnout') is expensive in time and effort for the trader and Customs alike and therefore occurs infrequently in practice. So if sampling does not take place during routine loading, it is highly unlikely that any sampling carried out subsequently may be representative (and therefore valid for the purpose intended), restricted as it is to those parts of the consignment which are most readily accessible. The best that may be hoped from the control of consignments which are already loaded is that the control will reveal either blatant fraud (i.e. the container is full of red beans instead of black beans) or give rise to sufficient suspicion to invite the Customs Officer to instigate a partial or full unloading when a valid control may be carried out.

3.38. Attendance at trader's premises for control purposes is not obligatory or even foreseen in all Member States. The Court found that in relation to the three products under review:

- (a) in Italy attendance at traders' premises occurred only in exceptional cases, due to the lack of a legal provision for this in normal circumstances;

- (b) in the Netherlands over 90 % of all export consignments are presented for customs control at the point of exit from Dutch territory;
- (c) in Denmark and in Belgium there is no attendance at traders' premises for control purposes;
- (d) in France, Ireland and the United Kingdom the majority of exports are presented for customs control at the point of exit;
- (e) in the FR of Germany the great majority of controls take place at inland customs offices where packed consignments are presented by local companies for the completion of export formalities. Attendance at traders' premises is foreseen also, although at two inland offices visited by the Court at Ulm and Oldenburg no such examinations had been carried out.

#### *Cut-off time*

3.39. Traders are often able to present consignments for export up to the moment of loading of the ship/aeroplane or other form of transport, thereby denying Customs officials adequate time in which to carry out anything other than a cursory check.

#### *Seals*

3.40. Seals are not systematically applied once customs procedures are complete; seal references are not systematically recorded on the export documentation; and seals are not systematically checked at the point of departure from the Community. Examples noted in the Member States visited include:

- (a) at an important customs post on a land boundary between the FR of Germany and Austria, the Court found that 20 % of vehicles and containers conveying produce under the Community Transit System had not been sealed in the Member State of departure. Despite this, the customs service at the point of final exit from the Community cleared them as presented without further physical examination and provided the exporter with a certificate to substantiate the refund claim. In the Court's opinion the weakness of these controls entails a high risk that export refunds are being paid on goods which never leave the Community. The Court found a similar situation at another German

border crossing, where, although aware of the problem, the local customs post had not brought it to the attention of the responsible authorities;

- (b) at St-Quentin (France), under a simplified procedure, a multinational company had been accorded the right to use commercial seals on vehicles, containers and wagons carrying export refund goods. Such approval entails the keeping of a record of the receipt and use of such seals by individual numbers. The company kept such a record. However the customs officer carrying out the physical control in the auditors' presence had no knowledge that the seals were individually numbered, nor was he aware that the trader had to keep a record of their use. Further, since the seal numbers were not noted on the export declarations, the officer at the point of exit from the Community territory checking that seals were intact had no knowledge that he was examining the same seal which had been applied at the point of loading;

- (c) at two offices in Denmark, Frederikshavn and Padborg, seal presses were in use which failed to imprint on the seal the identifying number of the customs office;

- (d) in the United Kingdom there was no systematic and consistent approach to checking seals;

- (e) in Ireland, where Department of Agriculture veterinary seals were applied to containers carrying beefmeat, there was no procedure for verification against Department of Agriculture records by the customs office at the point of exit from Irish Territory to ensure that the seals had not been removed and replaced.

#### *Evidence of export*

3.41. Customs Services face the practical problem at ports of obtaining 'first-hand' evidence of the export of a particular consignment. Apart from one Member State (Italy) where each consignment is tallied on board ship by the Guardia de Finanza, Customs Services do not have the resources to verify directly the export of consignments from the Community. They therefore have to rely upon the 'second-hand' evidence provided by the shipping companies, namely a final ship's manifest signed by the Captain or his representative which signifies acceptance on his

responsibility of the goods and containers listed as loaded on ship. The Court found, however, that:

- (a) in Rotterdam (Netherlands), Harwich (United Kingdom), Le Havre and Rouen, Rive Gauche (France) the check was carried out against either unsigned draft ships' manifests or loading lists;
- (b) in Denmark, generally there was no evidence of the checks being performed; and at Aarhus close examination of two declarations revealed one container which could not be identified on the manifest and another with a minor weight discrepancy;
- (c) at the inland customs station of St. Quentin (France) export was certified before confirmation had been received from the customs office at the point of exit from Community territory;
- (d) exports from the free port of Hamburg (FR of Germany) are certified by the free port administration. Certification is not, however, carried out on the basis of the port administration's records, but on the basis of ship manifests provided by shipbrokers.

#### *Paying agency control procedures*

3.42. Paying agency systems must provide for adequate verification of claims, for prompt payment and for the accuracy and reliability of records.

3.43. The verification of claims by paying agencies is based on documentary evidence which is provided by third parties, including the declarant, customs and various authorities in third countries. It is customs which provides evidence of export and third country authorities, evidence of arrival. Paying agencies themselves are not in a position to verify the documentation proffered against the consignment to which it relates for many of the key parameters involved in the calculation of the export refund payable, such as quantity, quality and destination. They are therefore obliged to proceed on the premise that in the absence of reasonable doubt the documentation provided by customs and third country authorities is reliable. It is the basic Commission Regulation (EEC) No 3665/87 <sup>(1)</sup> which

specifies the documentation which is relevant and sufficient for the purpose of establishing the accuracy and validity of claims. The principal risk is that claims may be paid on the basis of unreliable or insufficient evidence, or both.

3.44. The importance of the documentation provided by customs is clear in that it provides evidence of export. The importance of the documentation validated by third country authorities arises from the way in which the Commission has differentiated refund rates for many products by final destination. Thus varying rates of refund are payable for the export of the same product depending upon the country of import. The checking of evidence of arrival for destinations which attract high rates of refund is therefore particularly important.

#### *Evidence of arrival*

3.45. Obtaining evidence of arrival from third countries is not without problems. Principally this is because there is no obvious incentive for third country officials to raise or to validate a document which is of no bureaucratic consequence to them. There may be other more concrete reasons such as the absence of an appropriate official at the point of arrival and an unwillingness to cooperate without financial inducement. It was undoubtedly with some of these problems in mind that the Commission drafted regulations which define a limited, but not particularly stringent range of alternative documentary evidence acceptable for the purposes of establishing entitlement to payment of an export refund. Thus proof of arrival can be in the form of:

- (a) a primary customs entry document from the importing third country or an officially certified copy of it;
- (b) any other document endorsed by the customs service of the importing country which identifies the products and demonstrates that they have been imported for consumption in that country;
- (c) the common form of customs entry certificate (Annex II) <sup>(1)</sup> bearing the stamp of the customs service of the importing country. (Use of this document as proof of arrival has been abolished with effect from 16.2.90, see Annex III).

3.46. The Court has calculated that during the period under audit, over half of all the claims for export refunds which were based upon evidence of arrival, were supported by so-called Annex II documents. This is a disturbing statistic in the light of the reservations, enumerated below, held by the Court as to the adequacy of the Annex II

<sup>(1)</sup> Commission Regulation (EEC) No 3665/87 of 27 November 1987 (OJ No L 351, 14.12.1987).

document to provide the required assurance. The Annex II document is:

- (a) not an 'accountable' document of the third country;
- (b) as a general rule, completed by the exporter;
- (c) validated simply by a stamp and signature of the customs service of the importing country;
- (d) without provision for supplementary and important detail such as the customs import entry number and date, information about variances in quality and quantity, and customs and export refund classifications.

3.47. The Court's doubts about the reliability of Annex II documents are underlined by the fact that in one case of reported fraud it was discovered that two major exporters, operating in different Member States, were in possession of customs stamps identical to those in use by the customs services of the main countries with which they traded.

3.48. If owing to circumstances beyond the control of the exporter none of the standard documents can be produced, the regulation provides for specified substitute or secondary proofs. In the course of the Court's examination of these proofs, which were accepted in support of export refund claims, the following examples were noted:

- (a) a certificate of importation to Libya with a letter heading 'Foreign Office, Bucharest' (United Kingdom);
- (b) certificates of importation dated prior to the arrival of the goods concerned (France, United Kingdom);
- (c) certificates provided by a commercial superintendents company with apparently no presence in the country concerned nor expertise in the commodity traded, and dated sometimes long after the arrival of the goods concerned (United Kingdom);
- (d) bank certificates showing that the invoices for the goods had been settled but which gave no evidence as to the source of the funds (United Kingdom);
- (e) certificates which are issued by Member States embassies and similar bodies for a fee on the basis of an affidavit by the trader's representative. These bodies

have, of course, no direct knowledge of the transaction concerned (Denmark, FR of Germany, France, Italy, Netherlands, United Kingdom).

#### *Verification of claims*

3.49. A first step in verifying claims is to establish the authenticity of the documentation received for this purpose. The key factors are whether the documentation has been validated by the stated customs station or third country authority and whether it has been received without undergoing unauthorised alteration.

#### *Authenticity of validation*

3.50. The documentation forwarded by customs comprises validated export declaration forms. Validation by customs is signified by the signature of a customs officer and by a series of stamps on the form, the most important of which confirm the date of customs control and the date of eventual export from the Community. The documentation validated by third country authorities is signified again by a combination of stamps and signature.

3.51. Ideally, in checking the authenticity of validated documents paying agency staff should be able to refer to a catalogue of specimen stamps. For customs stamps, the audit team found that none of the paying agencies visited hold specimens.

3.52. For third country authorities' stamps it was found that paying agencies do maintain a catalogue of specimen stamps. However, with the exception of two paying agencies (FR of Germany and Netherlands), the catalogues were all out of date and incomplete, to the extent that it is extremely doubtful whether they could be used for the purpose intended. This is a serious weakness in control because it denies paying agency staff the only means they have routinely to verify the authenticity of third country validation. In cases of doubt or of receipt of a document bearing an unfamiliar stamp, the audit team noted that four paying agencies (FR of Germany, France, Ireland, Netherlands) had on occasion taken action intended to clarify the position. This took the form of a request for additional evidence from the importing country's customs authority, which is communicated usually via the claimant but sometimes directly. In addition a direct request for confirmation might be made to the local diplomatic mission of the third country concerned or to the appropriate diplomatic mission of the Member State concerned. Occasionally advice has been sought by all paying agencies from the Commission, but in the absence

of their own catalogue of stamps and network of overseas missions, it has comprised little more than a reminder of the need to fulfil the requirements of the Regulation.

#### *Unauthorised alteration*

3.53. The direct transmission of validated export declarations from customs to paying agencies in 5 Member States (Denmark, FR of Germany, Ireland, Netherlands and United Kingdom) reduces the risk of unauthorised tampering to a negligible level. In adopting the practice of returning the stamped and signed declarations from customs to the claimant for subsequent presentation by the claimant to the paying agency, the two Member States concerned (France and Italy) have had to establish control procedures to compensate for the risk of tampering entailed by such administrative arrangements. The greatest risk attaches to the export refund nomenclature which represents the codification of the product by type and quality (by up to 11 numeric elements) and determines the refund rate payable.

3.54. In France the controls are effected by a cross-check of paying agency information with export data provided by customs. For the most part the exercise is computerised. This system has the following defects:

- (a) the data provided by customs does not identify export refund nomenclature in full. This means that whereas cereals can be identified in sufficient detail for type and quality (because the final six elements of the nomenclature are redundant), products of a more complex composition, such as milk products, cannot;
- (b) in the case of major exporters who have adopted the so-called simplified procedure for export approval, the data provided by customs is derived directly from the exporters' own records rather than from the export documentation in customs' possession;
- (c) the key data of customs control and export can be reconciled by month but not by day which means that the validity of the specified refund rates (which are set on a daily basis) cannot be checked;

- (d) the administrative arrangements for cereals and beefmeat do not provide for the follow-up of discrepancies identified as a result of the cross-check.

3.55. In Italy a sample of declarations is sent twice yearly by the paying agency to customs to determine whether tampering has occurred. Each sample is drawn from unpaid claims which have been received in the 40 working days prior to the date of sampling. This method of selection systematically excludes all paid claims, and all unpaid claims which fall outside the four months (i.e. 2 x 40 days) in the year subject to sampling.

3.56. In the case of documents validated by third country authorities which are in all cases submitted to the paying agency by the claimant, it is likely that only the most blatant of unauthorised amendments would be identified.

#### *Reconciliation of supporting documentation*

3.57. The verification process rests upon a reconciliation of the documents submitted in support of an export refund claim. The reconciliation includes product classification, quality, quantity, departure and arrival details and correspondence of dates, for example. Much of the work is numeric but an important part involves an intelligent review of the narrative and comments added to the documentation by customs and third country officials. A fundamental problem for paying agency staff is comprehending the written comments which often accompany the stamps and signatures on the documents apparently validated by third country authorities. Commission Regulation (EEC) No 3665/87 of 27 November 1987 <sup>(1)</sup> rightly foresees the systematic submission of a translation of any remarks written on third country documentation. However, in practice the situation is far from straightforward as the following examples illustrate:

- (a) documents certifying lower quantities on arrival than those declared at export were not translated, therefore refunds were paid on the incorrect higher weight (Denmark, FR of Germany, France, Italy);

<sup>(1)</sup> Commission Regulation (EEC) No 3665/87 of 27 November 1987 (OJ No L 351, 14.12.1987).

- (b) customs documents certifying different descriptions on arrival from those at export were again not translated and refunds were therefore paid at the incorrect higher rate. (This case involves two companies and a substantial amount of refund: It is currently under fraud investigation as a result of the Court's observations);
- (c) documents accompanied by uncertified translations or translations which indicated that customs stamps, signatures and comments were illegible, and documents which were not translated at all (Denmark, FR of Germany, France, Italy, United Kingdom).

#### *Advance payment*

3.58. Community arrangements foresee that, on application by the exporter, advance payment of the refund is possible as soon as the export declaration has been accepted by customs, on condition that a security is lodged <sup>(1)</sup>. The security will be forfeited if proof of actual export from the Community within a specified time limit and proofs of arrival at final destination are not presented to the paying agency within 12 months of export.

3.59. In Denmark advance payments had been made to two companies without a proper claim solely against a computer list from the companies which simply signalled the intention of starting up an export transaction. The payments were subsequently to be regularised and supported by claims presented at customs and sent to the paying agency.

3.60. The system, which as a result of the Court's observations has now been suspended, was irregular because there was no application signed by the company and because at the time of making the advance the paying agency could have no certainty that the export declaration had been accepted by customs. The reference numbers referred to by the Commission in its reply are internal to the

company concerned and do not provide conclusive proof of prior acceptance by customs of the export declaration. In addition there were no double checks of approval for payment and no checks of the computer output because the processing of these claims was handled by just one person. These payments bypassed all the normal internal controls.

3.61. Since May 1988 when this system started, approximately 30 Mio ECU has been advanced to the two companies. Of this there was some 600 000 ECU for which the paying agency could not provide, at the time of the audit, the necessary documentation certified by Customs. For one of the claims no export declaration had been presented at the time of export and a special retrospective declaration was certified by customs some 6 months after the alleged date of export.

3.62. Examination of control records revealed many instances of securities apparently outstanding long after the final date for presentation of proofs. In some cases the securities should clearly have been forfeited yet no action had been taken. By way of example:

- (a) one trader in the United Kingdom had outstanding securities of 4,7 Mio ECU, some of which dated from 1984. The time limits for presentation of proofs had expired but the paying agency had taken no steps at the time of the Court's audit to recover the overdue funds;
- (b) as a result of a request from the Court a review of beefmeat guarantees was carried out by the UK paying agency in August 1988 which revealed a further 1 Mio ECU outstanding after the expiry date for presentation of proofs, some of which dated back to 1982, 1983 and 1984, where either recovery action had not even been commenced or where the exporters concerned had simply been invoiced for the reimbursement due. A further 2 Mio ECU dating back as far as 1982 again related to unpaid invoices in dispute but not yet at the stage of legal proceedings;
- (c) in France, where the control of securities is shared between customs and the paying agency, the securities outstanding according to customs amounted to 1,4 Mio ECU for one trader, whilst the paying agency records for the same trader indicated a nil balance. The authorities concerned had made no attempt to reconcile the two sets of figures outstanding.

<sup>(1)</sup> There are two procedures for the payment of advances on export refunds. The first, foreseen by Chapter 2 of Commission Regulation (EEC) No 3665/87, permits the payment of advances on refunds for direct exports as soon as the export declaration has been accepted. The second, foreseen by Chapter 3 of Commission Regulation (EEC) No 3665/87 permits the payment of an advance when a declaration has been accepted in respect of goods which are stored or processed under customs control prior to export. This procedure is commonly known as prefinancing.

*A posteriori controls*

3.63. As explained in para 1.8 above the Court has continued and extended its examination of the a posteriori controls carried out by Member States under Directive 77/435/EEC <sup>(1)</sup>.

3.64. In Denmark, where the policy is to place more emphasis on a posteriori controls than physical controls, the Court evaluated the a posteriori audits of 15 companies which in 1988 received more than 50 % of export refunds on milk. The Court found that:

- (a) the method of selection of transactions was entirely judgemental. Control officers receive no guidance on minimum standards concerning refund values, numbers of transactions, products, destinations or periods to be covered, nor on the requirement for representativity of transactions selected;
- (b) many companies in receipt of export refunds on milk products had not been audited for several years. For example company A which received 80 Mio ECU in 1987 and 60 Mio ECU in 1988 had not been audited since 1983; company B which received 7 Mio ECU in 1987 and 28 Mio ECU in 1988 had not been audited since 1984 until the week before the Court's audit mission to the responsible Customs office in 1988, and Company C which received 73 Mio ECU had not been audited since 1985, until the day before the Court's audit mission;
- (c) the scope of audit checks for the most part (with the exception of one Customs office) was limited to verifying the transactions by reference to commercial invoices, bills of lading, haulage invoices and payment thereof, and in some instances settlement of the transaction. In all, these checks provide little additional assurance to controls already performed at the current documentary control stage or to the evidence held by the paying agency. For example there was no evidence of verification of quantities from production and stock records nor of composition of products, in terms of fat content, etc., from the traders own quality control and laboratory test records.

3.65. In France, in 1988, 157 undertakings received payments for export refunds on cereals; 72 of these (which

all received more than 100 000 ECU) accounted for 99 % of expenditure. However, only 21 (29 %) had received their last Directive 77/435/EEC <sup>(1)</sup> audit by customs during the preceding four years. A similar situation existed with regard to export refunds on milk products.

3.66. In the United Kingdom, 20 % of the traders receiving more than 100 000 ECU p.a. in export refunds on beefmeat had never been audited, and there were numerous examples of other companies who had received no audit visits in the previous 5 years.

3.67. In the Netherlands, an enquiry was carried out as a result of a query raised during the Court's audit, which revealed that a major recipient of export refunds on milk products was in fact no more than a 'brass-plate' company set up to enable companies based in other Member States to claim refunds in the Netherlands. The company received 60 Mio ECU in 1987. The company office in the Netherlands had no evidence concerning transactions other than that relating to commission received. An effective audit could therefore not be carried out. No requests had ever been made to Member States to carry out a check at the head offices of the companies concerned.

3.68. In the FR of Germany, 7 companies who received more than 33 % of export refunds on milk products were based in other Member States. The responsibility for the control of these companies had been allocated to a Berlin-based department of the Ministry of Finance, who, the Court discovered, were unaware of this responsibility. The German paying agency had no record that refunds paid to these companies had ever been audited. A similar situation was found in the Netherlands where 3 companies which in 1987 alone had been paid some 100 Mio ECU in refunds, had not been audited at all.

3.69. The frequency of audit of German based companies also gave cause for concern. For example company A which received 41 Mio ECU in 1988 for exports of milk products had not been audited since 1982; Company B which received 69 Mio ECU in 1988 had not been audited since 1983; Company C which received refunds of 13 Mio ECU in 1988 had not been audited since 1984 and Company D which received refunds of 6 Mio ECU in 1988 had not been audited since 1980.

3.70. Evaluation of reports in the FR of Germany also revealed that audits were not extended to production and quality control records of producers.

<sup>(1)</sup> Council Directive 77/435/EEC of 27 June 1977 (OJ No L 172, 12.7.1977)

*Recommendations on national controls*

3.71. The Court considers it imperative that Member States should bring their controls up to an effective level and that the Commission should take a more active role in the monitoring of these controls including the validation of proofs of arrival. The Court is therefore pleased to note that in March 1989, the Commission undertook to adopt a series of measures to step up the fight against fraud. In May 1989 this was translated into an anti-fraud policy work programme. This programme covers three areas: prevention, cooperation and counteraction and contains subjects such as the simplification of differentiated refund arrangements; improved mutual assistance arrangements; fraud awareness seminars; use of analytical methods for fraud detection, etc. Many of the initiatives are still in their infancy. The Court is therefore not in a position to assess their impact on the control of payments of export refunds. However, the Court is pleased to see that recently in the framework of this programme a new Regulation has been adopted on the monitoring of payments granted in respect of the export of agricultural produce [Commission Regulation (EEC) No 386/90 of 12 February 1990 <sup>(1)</sup>]; that the proof of arrival in the form of Annex II to Regulation (EEC) No 3665/87 is no longer acceptable [Commission Regulation (EEC) No 137/90 of 4 January 1990 <sup>(2)</sup>] and that Directive 77/435/EEC <sup>(3)</sup> has been replaced by a strengthened Regulation which inter alia addresses for the first time the problem of transnational payments [Commission Regulation (EEC) No 4045/89 of 21 December 1989] <sup>(4)</sup>. (cf. paragraphs 3.67 and 3.68, also Annex III).

3.72. In this context the Court makes the following main recommendations for the improvement of the controls over export refund expenditure:

- (a) genuine commercial invoices should be required in support of every export refund declaration and should be scrutinised as part of the current documentary control;
- (b) when goods are taken into customs control at traders premises, declarations should be lodged at least 24 hours in advance;
- (c) physical controls during loading should always be unannounced and unpredictable;
- (d) facilities at all customs offices should be sufficient to enable effective physical controls to be carried out;
- (e) adequate cut-off times for presentation of declarations before loading or before closing of offices should be introduced at all ports;
- (f) physical controls should be selected according to risk analysis which should include criteria such as export refund value, product risk, destination risk and trader compliance;
- (g) as regards the frequency of physical controls, the Court supports the Commission's proposal for a minimum of not less than 5 %, but considers that this should be linked to the value of refunds rather than to the number of declarations;
- (h) samples for laboratory analysis should achieve the same frequency particularly where the export refund classification cannot be confirmed by visual examination;
- (i) the quality of physical controls should be improved by full or partial unloading of containers of sufficient order to obtain representative samples. In this context the Court notes that there are detailed rules for drawing samples for laboratory analysis in respect of certain products. For example, animal feedstuffs [Council Directive 76/371/EEC of 1 March 1976 refers <sup>(5)</sup>];
- (j) physical examination at traders premises should be the normal procedure in all Member States — if necessary backed by legislation at Community level;
- (k) all control activities relating to individual traders should be coordinated under the responsibility of nominated customs offices;
- (l) all export refund declarations once certified by customs in respect of exit from Community customs

<sup>(1)</sup> Commission Regulation (EEC) No 386/90 of 12 February 1990 (OJ No L 42, 16.2.1990).

<sup>(2)</sup> Commission Regulation (EEC) No 137/90 of 4 January 1990 (OJ No L 16, 20.1.1990).

<sup>(3)</sup> Council Directive 77/435/EEC of 27 June 1977 (OJ No L 172, 12.7.1977).

<sup>(4)</sup> Commission Regulation (EEC) No 4045/89 (OJ No L 388, 30.12.1989).

<sup>(5)</sup> Council Directive 371/76/EEC of 1 March 1976 (OJ No L 102, 15.4.1976).

territory, should be transmitted directly by customs to paying agencies;

- (m) the Commission should establish, maintain and circulate to all Member States information concerning valid and invalid customs entry forms and stamps for third countries;
- (n) all proofs of arrival should be translated into the language of Member States making the payments;
- (o) the frequency of a posteriori audit should be determined on the basis of risk analyses to include factors such as value of refunds involved; trader compliance, date of last audit, product risk and destination risk;
- (p) the scope of a posteriori audits should include examination of production and quality control records;
- (q) management information statistics should be maintained by customs offices by export refund classification summarising the number of declarations, refund value, the number of physical controls, error rates, number of samples for laboratory analysis and resulting error rates. These statistics should also be consolidated and summarised by each Member State and reported to the Commission annually;
- (r) centralised statistics should be maintained concerning the total population of traders to be considered for a posteriori audit, annual amounts paid to such traders and the dates of the last audits.

#### 4. OVERALL CONCLUSIONS

4.1. As one consequence of the emergence of structural surpluses in European agriculture, the Commission has in recent years been required to play an increasingly active and difficult role on the stage of the international trade in agricultural products. For this purpose it has selected its own priorities, for example with regard to targeting of destinations, matching US subsidised export prices, preserving traditional markets and promoting the export of value added products. The basic Community legislation on export refunds was designed to meet temporary fluctuations and antedates the emergence of structural surpluses. It therefore states the purpose of export refunds only in very broad terms and does not appear to envisage the use of

low-price sales in this context. The Council has never adapted the objectives of the basic legislation to the changed circumstances of the agricultural market.

4.2. Given the level of guaranteed prices in the Community, the export of surplus agricultural products will normally involve budgetary costs for the Community. But the cost effectiveness of the policy is unclear. Irrespective of the success of the stabiliser policy, doubts on this score will remain until Commission procedures for setting rates and determining prices are strengthened, in particular by the introduction of systematic documentation and evaluation. It is apparent to the Court that in the implementation of its export policy economy of operations has not been a priority objective for the Commission.

4.3. Reform of the Commission's procedures must be matched by rationalisation and simplification of export refund rates. The export refund system has two key characteristics: its complexity, and the size of individual refund payments, both absolutely and in relation to the value of the export consignment. It is this combination which makes the system so vulnerable to fraudulent exploitation. The bulk of export refunds are paid to a small number of substantial commercial operators. In designing a cost efficient system, therefore, account needs to be taken of the fact that large professional operators in international trade have the experience, the resources, and the opportunities to exploit at the Community's expense complicated provisions and control weaknesses. The rationalisation of zones and to a lesser extent the number of rates that has taken place in the beef sector has gone some way towards reducing the scope for misunderstanding and abuse, but needs to be extended to other markets.

4.4. It is Member States which are responsible, day to day, for ensuring compliance with Community requirements in the control and propriety of expenditure on export refunds. A fundamental requirement is that the Community funds for which Member States are responsible (and for which they are accountable to the Commission) are properly safeguarded with independent and effective control procedures. Customs Services ensure that adequate arrangements exist for securing effective control over consignments for which export refunds are claimed, and that the arrangements are properly and consistently applied. Customs Services are also responsible for the efficient and economical use of the resources allocated to the control of export refunds. In the case of the latter, however, Customs' responsibility is to the national administration as paymaster. In determining operational priorities, therefore, Customs Services are faced with the difficulty of obtaining national funds to meet the resource implications of control activities arising from Community

policies. Ideally, one would count upon Member States' enlightened self-interest to resolve any such difficulties. In its 1986 Annual Report <sup>(1)</sup> the Court drew attention to the reductions made by Member States in the manpower of customs services despite receiving from the Community, towards the costs of those services, ten per cent of traditional own resources (1 268,5 Mio ECU in 1988). The Court's latest findings raise serious doubts as to whether national support for Custom's staffing, training and other organisational arrangements is adequate to enable the required objectives and standards for Community controls to be met. The Court considers that positive action needs to be taken on the basis of Commission proposals for improving national customs' services to safeguard Community funds.

4.5. The Court's findings about the performance of paying agencies reveal as much about the fundamental weakness of their function in respect of export refunds as they do about weaknesses in procedures. The problem lies in the reliance paying agencies are obliged to place on the documentation provided by third parties, particularly third country authorities, which they are not in a position to verify for the key parameters in calculating the refund payable.

4.6. The Court starts from the premise that the Community has an obligation to protect its finances. This is best achieved by prevention through effective control measures. Public perception of a high chance of detection is

an important deterrent to irregular practices. Detection, although often after the fact, is useful in that it provides hard evidence that control risks and procedural weaknesses such as those identified in this report are not merely theoretical. Such evidence may also be useful in directing preventive action. Some of the results of such weaknesses can be seen in the cases of fraud and irregularities reported to the Commission in recent years which involve quantity, description and destination. Cases of suspected irregularities found during the course of the Court's audit have been reported to the appropriate national authorities for further investigation and report to the Commission.

4.7. In the Court's view the evidence of this report has established that the financial management of export subsidies by the Commission and Member States is defective in the following respects:

- (a) the level of subsidy represented by export refunds and low-price sales from intervention, although effective in disposing of much of surplus community agricultural production, has been determined with insufficient regard to the need for economy;
- (b) the Commission's management of export subsidies has not satisfied the requirements of public accountability as defined by the Court in paragraphs 2.11;
- (c) control of payments by national authorities provides insufficient safeguard against exploitation of the complex export refund system by fraudulent operators.

<sup>(1)</sup> OJ No C 336, 15.12.1987.

The present report was adopted by the Court of Auditors in Luxembourg at its meeting of the 5th April 1990.

*For the Court of Auditors*  
Aldo ANGIOI  
*President*

In his absence André MIDDELHOEK, Member

## ANNEX 1

*Export licences*

1. This Annex describes those aspects of the Community's export licensing system which are relevant to the payment of export refunds for exports of milk products, beefmeat and cereals in the context of the common agricultural policy (CAP). The following description is aimed at providing the reader with some background information about the legal framework applied. There are numerous special rules, which apply for small consignments, for which no export licences are required, or for special trades — such as ship and aircraft supply or further processing in the food industry or supplies to armed forces stationed in the territory of a Member State but not coming under its flag. These particularities are not described in this outline.

2. One of the objectives of the EC market organisation is to maintain a certain minimum price level in the Community. This requires a control of export and import activities which is done by licences. Commission Regulation (EEC) No 3719/88 of 16 November 1988 lays down common detailed rules in this respect <sup>(1)</sup>. Under this regulation an export licence authorizes and obliges the holder to export the specified quantity of the relevant product within the licence's period of validity. The licence may also specify quality and destination.

3. As far as the quantity is concerned there is, however, a certain flexibility. The general rule is that the obligation to carry out the export is fulfilled when 95 to 105 per cent of the quantity for which a licence is issued is exported (93 to 107 per cent in the case of cereals) <sup>(2)</sup>.

4. Licences are required generally for the export of cereals and beef meat by the corresponding basic regulations <sup>(3)</sup>. For the milk sector licences are required only for certain products, such as butter, milk powder and some selected products for export in bulk <sup>(4)</sup>. For other milk products, such as cheese, export licences are only required if the exporter wishes to prefix a current level of export refund <sup>(5)</sup>.

5. Export licences are issued on request by the competent national agencies. Licences are valid in all Member States. Rights deriving from licences can be transferred but the initial holder cannot transfer his obligations (for example, the provision of guarantees). At the request of the holder Member States issue 'extracts' of the initial licence, which are licences for smaller quantities in replacement for part or the whole of the initial licence. This facilitates the handling of the licence and also the transfer of rights. Where the application for an export licence is submitted in connection with an invitation to tender, the licence is issued only for those quantities accepted in the adjudication <sup>(6)</sup>.

*Prefixing*

6. An exporter in possession of a valid licence is entitled to the rate of refund in force at the date of export (defined for this purpose as the date of acceptance of goods into customs control). Alternatively, he can choose to fix his export refund at the published rate prevailing when he applies for a licence. This practice is known as prefixing and is used extensively in the milk/milk products sector where some 90 % of licences are prefixed. For

<sup>(1)</sup> OJ No L 331, 2.12.1988.

<sup>(2)</sup> Commission Regulation (EEC) No 891/89 of 5 April 1989 (OJ No L 94, 7.4.1989).

<sup>(3)</sup> For cereals Article 12 of Council Regulation (EEC) No 2727/75 of 29 October 1975; for beef meat Article 5a of Council Regulation (EEC) No 885/68 of 28 June 1968 (OJ No L 156, 4.7.1968).

<sup>(4)</sup> Council Regulation (EEC) No 804/68 of 27 June 1968 in connection with Commission Regulation (EEC) No 2729/81 of 14 September 1981 (OJ No L 272, 26.6.1981).

<sup>(5)</sup> Article 4 paragraph 2 of Commission Regulation (EEC) No 2729/81.

<sup>(6)</sup> Article 3 of Commission Regulation (EEC) No 891/89.

beef exports less than half of all exports were at prefixed rates during 1988. For cereals prefixing as such is largely redundant given that 90 % are exported at refund rates determined by tender.

7. Prefixing protects traders against falls in the level of refund rates during the validity period of the licences and enables them to negotiate contracts in which the rate is a known parameter. However traders also run the risk that refund rates will increase and that importers may demand to benefit from such increases. In order to dissuade exporters from deliberately allowing licences to lapse and prefixing replacement licences at the higher rates, guarantees (securities) are required. These guarantees are forfeit if the exporter fails to use the licence and vary according to product and circumstance. Clearly, if the increase in refund rates exceeds the guarantee required, the trader will benefit from allowing the licence to lapse. In practice the guarantees are relatively high and since February 1987 in the milk product sector refund rates have gradually declined.

8. Securities requested for the issue of licences without prefixing vary between 0,60 ECU/tonne for basic cereals and 20,00 ECU/tonne for beef meat. For licences with prefixing they vary between 16,00 ECU/tonne for basic cereals and 100,00 ECU/tonne for beef meat. The corresponding level for milk products varies from 25,00 ECU/tonne to 100,00 ECU/tonne, depending on the product involved <sup>(1)</sup>. The rates for milk products have been increased recently <sup>(2)</sup>.

9. It is necessary to restrict the period of validity of licences in order to exercise some control over export markets. There are significant differences in validity periods both between and within the markets. In the milk sector, export licences are normally valid 2 months without prefixation and 6 months with prefixation (advance fixing) of a refund rate. In the beef meat sector, licences are normally valid 5 months, whereas for basic cereals licences are valid 2 months.

10. Given that traders opt to prefix when they consider refund rates to be attractive (or anticipate later reductions), the Commission uses data on the level of prefixing as an indicator as to whether the refund rate is too high or too low. For the milk products and beef sectors prefixed licences for the export of basic products are not issued until 5 days after they have been requested. This enables the Commission to take appropriate action if it considers the level of prefixing to be too high. The Commission may decide either to suspend prefixing for up to three days or to alter the refund rates <sup>(3)</sup>.

11. For cereals, the regulation is slightly different. The Commission can also suspend prefixations but different rules apply according to the product. For example, for semolina export licences with prefixing of the refund are issued on the fourth working day following the day on which the application has been lodged. The aim of this provision is to allow the Commission to fix a uniform percentage reduction in the quantities where the quantities prefixed exceed the quantities the Commission wishes to be exported <sup>(4)</sup>.

<sup>(1)</sup> The amount of securities requested is subject to particular regulations for each market sector: for beef meat: Commission Regulation (EEC) No 2377/80 of 4 September 1980 (OJ No L 241, 13.9.1980); for cereals: Commission Regulation (EEC) No 891/89 of 5 April 1989; for milk and milk products: Commission Regulation (EEC) No 2729/81 of 14 September 1981.

<sup>(2)</sup> Commission Regulation (EEC) No 1651/89 of 12 June 1989 (OJ No L 162, 13.6.1989).

<sup>(3)</sup> Commission Regulation (EEC) No 2729/81 of 14 September 1981 and Council Regulation (EEC) No 885/68, 28 June 1968.

<sup>(4)</sup> Article 9 of Commission Regulation (EEC) No 891/89.

## ANNEX 2

*Criteria for determining export refund rates*

1. There are four basic criteria: '

(a) the existing situation and the future trend with regard to:

— prices and availabilities on the Community market and in international trade;

(b) the aims of the common organisation of the markets which are to ensure equilibrium and the natural development of prices and trade;

(c) the need to avoid disturbances on the Community markets, and

(d) the economic aspect of the proposed exports.

2. For beef and milk when prices within the Community are being determined, account should be taken of the ruling prices which are most favourable for exportation. When prices in international trade are being determined, particular account should be taken of:

(a) prices ruling on third country markets;

(b) the most favourable prices in third countries of destination for third country imports;

(c) producer prices recorded in exporting third countries, account being taken, where appropriate, of subsidies granted by those countries, and

(d) free-at-Community-frontier offer prices.

The factors to be considered for determining prices in the cereals market are similar.

## ANNEX 3

## Export Refunds: Legislation recently adopted

| Regulation                                                          | Summary                                                                                                                                                                                                                                                                                                                                     | Report ref. <sup>(1)</sup> |
|---------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------|
| Commission Regulation (EEC) No 3950/89 of 22.12.1989 <sup>(2)</sup> | On a special intervention measure for common wheat in Germany. The Regulation specifies that exports must be from the German market rather than simply exported from Germany.                                                                                                                                                               | Prologue                   |
| Council Regulation (EEC) No 4045/89 of 21.12.1989 <sup>(3)</sup>    | On scrutiny by Member States of transactions forming part of the system of financing by the Guarantee Section of the EAGGF. The Regulation replaces Directive 77/435, it sets out the nature and extent of such scrutiny and provides funds towards the payment of computerware associated with this enhanced level of documentary control. | 3.71                       |
| Commission Regulation (EEC) No 137/90 of 4.1.1990 <sup>(4)</sup>    | Concerning proof of arrival at destination in third countries.<br>This Regulation abolished the so-called Annex II document.                                                                                                                                                                                                                |                            |
| Commission Regulation (EEC) No 301/90 of 2.2.1990 <sup>(5)</sup>    | On communications between Member States and the Commission with regard to milk and milk products. This Regulation requires Member States to provide the following data:<br>(i) domestic prices (weekly);<br>(ii) import and external trade prices (twice per month);<br>(iii) trading prices for casein and derivatives (monthly).          | 2.10                       |
| Commission Regulation (EEC) No 386/90 of 12.2.1990 <sup>(6)</sup>   | On the monitoring of exports of agricultural products receiving refunds. This Regulation sets a minimum 5 % requirement for physical checks and associated scrutiny of documents in the payment application file.                                                                                                                           | 3.71                       |

<sup>(1)</sup> Numbers refer to paragraphs of present Report.

<sup>(2)</sup> 22.12.1989, OJ No L 379, 28.12.1989.

<sup>(3)</sup> 21.12.1989, OJ No L 388, 30.12.1989.

<sup>(4)</sup> 4.1.1990, OJ No L 16, 20.1.1990.

<sup>(5)</sup> 2.2.1990, OJ No L 32, 3.2.1990.

<sup>(6)</sup> 12.2.1990, OJ No L 42, 16.2.1990.

## REPLIES OF THE COMMISSION

### General remarks

The Commission notes first of all that the Court of Auditors' draft report on the management and control of export refunds is addressed both to the Commission itself and to the Member States, who share the responsibility for implementing the Community's export policy.

The Commission finds that the Court has drawn attention to certain facts and has described them in terms which, taken at their face value, throw suspicion, if not discredit, on all aspects of the Community arrangements for the fixing of export refunds and for checks on the granting of such refunds.

The Commission also finds that, in certain instances, the Court has adopted positions of principle which call into question the very basis of the Community's policy on agricultural exports or the rules for implementing that policy.

Whilst acknowledging that the common agricultural policy is by no means sacrosanct and that a number of the CAP mechanisms need to be reviewed (particularly those relating to export refunds), the Commission wonders whether the contents of the draft special report should not be subjected to fresh scrutiny in the light of the realities of the world market, to ensure that no hasty conclusions are drawn and that certain data are not exploited to the detriment of the Community and its fundamental interests.

Having said this, the Commission will now deal with all those points in the draft special report which are of such importance or have such serious implications that they call for some comment or reservation.

### 0. PROLOGUE

The Commission would point out that in 1988/89 the Community exported some 35 million t of cereals (and cereal products). The bulk of these exports qualified only for ordinary refunds, irrespective of their origin or destination. The one or two special measures which have attracted criticism from the Court (invitations to tender for the export of 0.9 million t of wheat from Germany and for the export of 0.9 million t of wheat to the USSR) applied to relatively small quantities.

The special measure whereby tenders were invited for the export of 0.9 million t from the German market does not therefore merit the particular attention which it has received from the Court. The wheat in question was to be exported from the German market as a special intervention measure. Since the intervention rules apply to the Community as a whole (French wheat may, for example, be placed in intervention storage in Germany), there is no requirement that the cereals exported under such a measure must have been produced in a particular Member State.

When the first deliveries were made it became clear to the Commission staff (who were of course following this operation with particular interest) that some operators were trying to circumvent the rules by taking advantage of the fact that the customs authorities at certain German ports did not require the wheat to have been released for consumption in Germany before it qualified for the export refund. Article 1 of the Regulation issuing the invitation to tender (Regulation No 212/89) merely stipulated that the wheat had to be exported from Germany. This incorrect interpretation was corrected once the problem came to light. The Commission immediately made it clear, by agreement with the Ministry of Financial Affairs and the Ministry of Agriculture in Bonn, that the wheat had to be physically exported from Germany itself and the customs authorities at the ports were informed accordingly.

If operators continued to apply for the special refund in respect of French or British wheat which was merely passing through German ports, they could be required to pay the cost of unloading the goods. On the other hand, there was no legal basis for refusing the refund on any wheat exported after it had been unloaded.

Since the unloading costs were at least as great as the 'profit' made from the refund, the operators did not gain from this ploy in the end. Their attempt to circumvent the rules was thus thwarted. To clarify the legal position the appropriate changes were made to any subsequent regulations issuing invitations to tender under a special intervention measure [see for example Regulation (EEC) No 3950/89, OJ No L 379, 28.12.1989, p. 41]; the new Article 1 explicitly stipulates that the cereals must be exported from the market of the Member State concerned.

The origin of the wheat exported under the tendering procedure in question cannot be verified from official statistics. According to the information obtained by the Commission the quantity of German wheat amounted to 350 000 t. This figure was confirmed by the Ministry of Agriculture in Bonn on the basis of its own assessment of the available wheat surpluses which had not been offered for intervention.

A total of 845 000 t was exported under the measure in question. The bulk of the first 500 000 t exported from German ports seems to have consisted of French wheat (about 80 %) and British wheat (about 20 %). The remaining tonnage consisted mainly of German wheat. The last 145 000 t must have been entirely German since by that time the minimum quality requirement was a 12,5 % protein content.

The figure of ECU 57,5 million quoted by the Court represents the total cost of the measure. To present this sum as an additional cost does not reflect the true position. Not only the German wheat for which contracts were awarded but also the French and British wheat would still have had to be exported because the purchase of these cereals by the intervention agency would have entailed even greater expenditure.

The Commission has also been informed by the German authorities that they have retained the securities for a proportion of the wheat exported since it did not meet the quality requirements laid down in the Regulation.

## 1. INTRODUCTION

### *General remarks*

In view of the Court's comments the Commission feels that it should draw attention to certain factors which influence world trade in agricultural produce. The question of the Community's export refunds must be seen in a wider context than the Community market alone.

Since world trade in agricultural products does not follow any organized pattern, the operation of the world market for a given product depends mainly on the proportion of total production represented by any surplus or shortfall. If necessary the Commission could find examples in the recent past to prove that the quantities which certain countries have available for export can suddenly show a five-fold or even fifteen-fold increase and that the import requirements of a single country can vary from one marketing year to another by the equivalent of 25 % of total imports.

Supply and demand thus offset each other on a world market which is in fact a residual market where price levels bear no relation to production costs. When surpluses are available, world prices are usually much lower than the

prices paid to farmers in the main producer countries. To see the world price as the ideal price for the European consumer (as the Court would seem to do) is unrealistic since supplies practically never reach the consumer at that price because of the numerous mechanisms (taxes, custom duties, quotas etc.) which have the effect of raising prices on the internal markets of the importing countries.

As far as the Community market is concerned, the mechanisms used to stabilize imports and exports (e.g. storage arrangements) are essential to the achievement of the objectives of the common agricultural policy.

The Community has been exporting cereal surpluses ever since the market organization was established in 1967. As far as possible, the policy has been to avoid intervention storage, first of all by encouraging low-price disposal to the internal market (e.g. butter, milk powder) and secondly, and again for budget reasons, by encouraging exports, subject to the Community's international commitments under GATT. It should be pointed out that in the cereals sector one of the reasons for the surpluses has been the importation (free of any levy) of large quantities of cereal substitutes for use as feedingstuffs, an arrangement which derives from the common commercial policy. Cereals sold from intervention stocks and from the free market must be considered in a similar light, in terms of selling prices.

In the beef sector the situation is somewhat different. Intervention sales ('at reduced prices') cannot be treated in the same way as sales from the free market because of the different characteristics of the product concerned. It would therefore be risky to draw any conclusions as far as export refunds were concerned. Under the active stock-reduction policy pursued by the Commission (and approved by the Court) sales from stocks increased appreciably over the period concerned. In this sector the Commission intends to encourage exports from the free market and from private storage since exports from public stocks entail considerably higher costs. To take account of the individual characteristics of the various products concerned, the Commission also has to employ different types of management arrangements in each case.

In this context the export refund system represents a means whereby the Community can easily adapt to the realities of the world market. Once the decision has been taken to export, the refunds enable the Community to establish a presence on the world market by offsetting the difference between the Community price (which is fixed for a given marketing year) and the variable world price.

Lastly, it should be pointed out that when the Community grants a given refund for a particular destination, this does

not oblige the purchasing country to place the product concerned on its own national market at the price for which it was bought.

The Court concerns itself too exclusively with the cost of the refunds themselves and not sufficiently with the effectiveness of the system.

1.4. The Commission cannot accept, either here or elsewhere, any suggestion that it simply follows its nose where refunds are concerned and has no methodical approach. This would apply, for instance, to the word 'judgementally'.

1.6. The conclusion drawn by the Court that 'the financial risks of the transaction are potentially bigger for the Community than for the purchaser' bears no relation to the five examples quoted.

In 1986 the Community took the only measures which were feasible at the time: producer co-responsibility was introduced to help meet surplus-disposal costs, stabilizers were introduced to curb the expansion of agricultural production; and the way was paved for the negotiation of international rules.

1.8. The situation will be improved now that the Directive has been replaced by Council Regulation (EEC) No 4045/89 (OJ No L 338, 30 December 1989).

## 2. COMMISSION MANAGEMENT OF EXPORTS

### *The regulatory framework*

2.1 and 2.3. Although there is some theoretical basis for the comment made by the Court at the end of paragraph 2.1, the Commission would point out that in practice it is rare for export refunds to be adjusted at times other than the agreed intervals and that, with some rare exceptions, these have been downward adjustments which the next Management Committee has then had to 'ratify'.

The Commission would also point out that some months ago it was decided that the agenda of each Management Committee meeting should include the item 'Export refunds' so that the mere inclusion of such an item on the Committee's agenda should not lead (as had been the case in the past) to anticipatory or speculative moves by

operators which could be detrimental to the satisfactory management of the EAGGF.

### *General Agreement on Tariffs and Trade (GATT)*

2.6. The Commission would point out that the Export Enhancement Programme is not the only export subsidy scheme used by the United States. The USA have consistently maintained their export prices at a level which is independent of the guaranteed price paid to producers.

2.7. When it says that the policy of matching subsidies appears to have entailed the granting of exceptionally high refunds, does the Court mean to say that the refunds were excessively high?

### *Setting the level of subsidy*

2.8. As the Court points out, the difficulty facing the Commission in the management of refunds is how to achieve the proper balance between effectiveness and economy, but the constraints imposed by the legislation and the data which it uses as the basis for its assessment of the situation are such that it is wrong to speak of over-compensation as do the non-member countries, although they have never been able to provide any specific proof of this allegation in the various attacks which they have mounted on the EEC within GATT over the past ten years or so.

Similarly, it is incorrect to speak of under-compensation as do the operators on practically every occasion.

The claim that the 'minimum necessary' is exceeded, thus entailing excessive expenditure under the Community budget, is no more valid than the claim that the level of compensation is insufficient. Admittedly, an operator could take advantage of favourable circumstances on a given day and then, in a transport of euphoria, lose large sums the following day.

2.10. There are regulations which govern the transmission of data from the Member States. The Commission takes care, moreover, to adjust its requirements at regular intervals. On 2 February 1990, for example, it adopted Regulation (EEC) No 301/90 on communications between Member States and the Commission with regard to milk and milk products.

On the other hand, the prices quoted in response to invitations to tender cannot always be considered a reliable source of information since operators may occasionally submit bids without any real intention of winning the contract.

The Commission does, however, have other sources of information, such as the trade itself, farmers' organizations and the specialized press.

In the case of cereals, for example, the Commission has reliable sources of information on which to base the calculation of export refunds. Firstly, there are the prices quoted (without a refund) at Community ports of shipment. Secondly, there is obviously the exchange rate between the national currency of the exporting Member State and the dollar. Thirdly, the world market level is determined by the FOB selling prices charged by competitors (e.g. prices FOB Gulf for United States wheat and maize).

As a rule, it is quite straightforward to ascertain the parameters for the export refunds, given the wealth of convergent sources.

2.11. The Commission would reaffirm that the calculation of export refunds is essentially based on objective data and that these data are much more numerous and varied than those mentioned by the Court. The said calculation is the fundamental basis for assessing what refund should be fixed, the discretionary powers of the Commission being necessary but limited, contrary to what has been claimed. In any case the Commission's responsibilities call for a degree of managerial flexibility so that it can adjust to the situation obtaining at any given moment.

2.12. The Commission considers that its departments possess sufficient documentation concerning the decisions taken on export refunds. In this context it attaches particular importance to the weekly market-situation reports drawn up by each of its markets divisions. The Commission will, however, investigate ways in which its documentation could be improved in those areas where this would seem necessary.

### *Milk and milk products*

2.14 to 2.17. Information on the world market for milk and milk products may indeed seem fragmentary, since no commodity-exchange prices are quoted around the world as they are for other basic products. Even so, the data obtained from trade organizations, the specialized press and other useful sources (the Community's competitors,

GATT etc.) make it possible to assess and monitor trends in prices, including those set by other producer countries.

Since the world market lacks transparency, however, it should be pointed out that in most of the non-EEC countries competing with the Community the decisions relating to the export of milk products are taken in each specific case by a single vendor (usually a marketing board) and the 'window prices' are not always those actually charged; the procedure used by the Commission, on the other hand, means that the Community's competitive position is generally known, thanks to the publication of the rates of export refund.

As regards the recording of its sources for world prices, the Commission would again stress the importance which it attaches to its weekly internal report on the market situation.

2.18 to 2.19. The Commission would first of all point out that the Community's export refunds are in no circumstances calculated merely as the difference between two price levels (the internal Community and the world market price). They also depend on an assessment of the market in terms which are difficult to define and still more difficult to express as a mathematical formula. There are many variables, including subjective variables such as the 'policy' to be pursued in the sector concerned. Particularly since the introduction of the 'milk quota' system the Commission has endeavoured, in view of the situation on the world market, to pursue a cautious export policy by restricting the quantity of milk exported, with a view to preventing price shifts on the Community market. The reference document which the Court mentions in support of the figures shown in Table 3 was only one of the sources used by the Commission. The data contained in that document cannot therefore be described as the sole basis for the calculation of refunds.

Secondly, the Commission is astonished by the Court's remark concerning the absence of records on the estimation of Community and world prices. The relevant information was provided to the Court's inspectors at the time of their second visit.

Thirdly, the Commission would point out that all decisions on export refunds fall within the competence of the Member of the Commission with responsibility for agriculture and rural development. It would also point out that the decision in question resulted in a lowering of the refunds and that this decision was taken in full awareness of the facts.

2.22. The Commission has provided the Court with examples of the documentation used as the basis for the decisions on the unpublished rates for a single destination. Each week the Commission staff also draw up reports which provide detailed information concerning the trends

on the Community and world markets. All this information is taken into account when the export refunds are fixed.

2.23. The Commission will propose legislation so that a closer track can be kept of the quantity exported in this way.

#### *Special sales*

Regulation (EEC) No 765/86: Butter for the USSR

2.28. The Commission has no powers to oblige the importing country to conclude joint contracts with several traders rather than a single trader.

Regulation (EEC) No 727/87 of 13 March 1987: SMP for export

2.30 to 2.33. Since the end of 1986, when the Council reached agreement on a number of reforms in the milk sector the Commission has pursued an active policy on the reduction of intervention stocks.

In 1987 and 1988 stocks of skimmed-milk powder diminished rapidly since the Commission had ruled out the keeping of public stocks as an instrument of market management.

The run-down of stocks made it possible to speed up certain inevitable structural changes and the restoration of balance to the Community and world markets. This in turn made for a more rapid adjustment of subsidies and refunds. A sharp decline in public stocks and the subsequent adjustments have had a very positive influence on expenditure, as may be seen from the trend in export refund rates.

On 21 December 1987, 80 000 t were sold, followed by a further 90 000 t on 4 January 1988. These sales considerably improved the situation on the world and Community markets. The rate of export refund for SMP, which had fluctuated between ECU 107 and ECU 100/100 kg during the 1987 financial year fell as a result of these massive sales to ECU 93 on 21 January 1988 and then to ECU 50 on 30 May 1989.

#### Rates of Refund

| Date of Decision | Amount in ECU/100 kg |
|------------------|----------------------|
| 1. 1.87          | 102                  |
| 16. 2.87         | 107                  |
| 17. 6.87         | 105                  |
| 27.11.87         | 100                  |
| 29. 1.88         | 93                   |
| 27. 4.88         | 80                   |
| 26. 8.88         | 70                   |
| 14.10.88         | 62                   |
| 18. 3.89         | 55                   |
| 30. 5.89         | 50                   |

#### *Beef*

##### *Introduction*

2.34 to 2.35. Exports of beef are by no means always handled by a small number of major trading companies. Large number of EEC operators are engaged in exporting from the 'free' market (including products covered by private storage aid schemes) and in trading processed products and live cattle. Until recently, however, the State buying agencies in Eastern Europe have had discretionary power as to which EEC operators to buy from. In making their choice of trading partner they tended to follow a rather conservative pattern based on well-established links over a number of years.

The fact that traders do not participate in a particular sale of intervention beef may thus stem from considerations other than the export guarantee as suggested by the Court.

— Firstly, the total amount of guarantees to be lodged would normally only have a discouraging effect when large minimum quantities are laid down in the selling provisions. If so, there are specific reasons for this (e.g. control, need for rapid removal from storage, delivery of large quantities, etc.). Only relatively large trading companies or a group of traders can provide the necessary transport and expertise to handle export operations according to the above-mentioned specifications.

— Secondly, profound knowledge of a market with its various specifications in respect of policies, culture, finance and commercial aspects gives a trader an immense advantage vis-à-vis his competitor without such expertise.

— Thirdly, in general, buyers in third countries tend to return to those Community traders who have proved reliable and trustworthy in the past.

### *Setting the level of subsidy*

#### **Published rates**

2.39. It is difficult to confirm or refute the Court's conclusion that the lowering of the rate had little or no effect on the volume of exports from December 1986 onwards, since export licences (with or without advance fixing of the refund) are valid for almost six months and the effect of a lower refund is not reflected immediately or in every respect.

Moreover, operators still held export licences issued before 26 November 1986 at the earlier rate of refund. These licences covered substantial quantities of fresh meat which had been placed in storage to qualify for private storage aid (over the period from 1 September to 7 November 1986 such aid was granted on 150 000 tonnes, over 90 % of which was intended for export).

Depending on the year concerned, a quantity of this magnitude can represent between 30 % and 40 % of all beef exports other than those from intervention stocks.

Exporters thus had at their disposal substantial quantities with which they could cover the requirements of non-EEC countries for several months.

2.41 to 2.42. The Commission would point out that exports are not just the outcome of some mathematical calculation. Past experience (which cannot be expressed as a formula), is usually the best way to avoid the errors which can arise from a purely scientific approach.

In this context it should be pointed out that the higher refunds were only paid on fresh meat from adult male cattle, since only this type of meat can be bought in. Exporting an additional 120 000 t over and above normal export sales greatly eased the pressure on prices in the Community, at a time when the market is usually very sluggish. As a result the total quantities entering public storage between November 1988 and February 1989 amounted to only 43 300 t, in terms of carcase weight (as compared with 390 000 t in 1988). In France and Ireland, which exported the bulk of the said 120 000 t, intervention purchases over the four-month period in question totalled

3 000 t and 2 200 t respectively. It may therefore be concluded that the operation proved less costly than any alternative.

#### **Intervention sales**

2.43. The two-stage system is designed to meet a commercial need for a tender scheme while maintaining as far as possible the possibility of buying intervention beef over a certain length of time at fixed prices. Normally, an operator cannot afford to run the risk of buying through tender sales without having secured his re-selling operation in a third country. In general, trade negotiations take quite a long time to be concluded and the Community trader must have some, if not full knowledge of the ex-coldstore selling price from intervention. Therefore, the minimum price published is not only a reserve price but indeed an operative price which takes account of specific aspects of international trade, while being adjusted at regular intervals in the light of the prevailing price conditions on the world market. The tender part provides the operator concerned with a tool to secure himself with a pre-determined quantity if his bid is sufficiently high whereas under a fixed price sale he might see his quantity being reduced in case of oversubscription.

Obviously, the financial benefits for the Commission are related to the advantage taken of the tender prices and the flow out of intervention under the fixed price stage, a flow which most certainly would not take place without that stage, resulting in further storage costs and ageing of the beef. Notwithstanding the normal play of supply and demand the fact that some sales were made either at the minimum price or at prices marginally above it proves, *inter alia*, that the minimum prices have been set at appropriate levels and furthermore, that operators tend to minimize their risk in a situation where no binding prices have yet been negotiated with a potential third-country buyer.

The Court indicates that 35 % of quantities offered for sale in 1989 were sold through tenders. However, a similar quantity was actually sold at fixed prices, showing the importance of both selling operations and indicating the success of the two-stage system.

2.44. The deadline of 14 days does not apply to sales under Regulation (EEC) No 2539/84 which is now always used when selling beef for export.

The minimum selling price as fixed in each export Regulation reflects the appropriate price level at the time of

voting in the Management Committee. Postponing the start of the sale by almost one month could lead to unrealistic prices at that point in time and in many cases be counterproductive with prolonged storage of the beef. The Commission, however, accepts that an appropriate period should elapse between the publication and start of the sale to enable traders to respond to the call for tenders. In general that period is aimed at 5-7 days which, moreover, is accepted by the European trade organizations as being sufficient. The Commission deplores the fact that due to procedural difficulties, the above-mentioned period for a limited number of sales was shorter than 5 days but experience showed that irrespective of this fact, the sales turned out quite normal. Procedures are now tightened up and the 5-7 day period is being respected for all tender sales for export.

### *Special Sales*

#### **Brazil**

2.46. The proposal made by the Court that the Commission should enter into commercial negotiations directly with a country or an importer in a third country seems to be rather hazardous. Firstly, there are legal difficulties in the light of the Commission's legal status in such trade. Secondly, a contract will not only include a price but also an obligation to deliver before a certain date, non-compliance with which entails the 'usual commercial sanctions. Because the Commission is unable to control intermediate transactions and because operators who can actually manage large-scale operations will know about the Commission's commercial obligations, bids for the intermediate transactions could therefore very well reach exorbitant levels. Thirdly, what would the Commission's possibilities be in case of legal proceedings in a third country (dispute over quantity, dispute over payment, etc.)?

2.47 to 2.50. The Court raises the question of the special sale to Brazil but draws no conclusions, except to suggest that preference may have been given to two companies. Here again the Commission can merely point out that a non-member country buying from the EEC is free to deal with one, two, five or ten companies and that the Commission has no means of altering this practice other than by interfering in the internal affairs of a non-member country.

#### **Eastern European countries**

2.54. The sale provided for by Regulation (EEC) No 2415/88 should be seen in the light of extremely large stocks in Germany and France. The Commission considers the tender sales as successful, with a rather stable price of ECU 500/tonne of compensated quarters throughout the sale.

Rather than comparing two things which are not at all related to each other (as done by the Court in the last sentence) one should evaluate the financial effect of prolonged storage of substantial quantities, of which a large part could even turn out to be unsaleable or, alternatively, the financial effect of dumping the products on the home market with the obvious devastating implications.

### *Cereals*

#### *Introduction*

2.57. The Commission does not agree with the Court's view that the cereals market is dominated by a limited number of multi-national companies. Other operators are also present on the market and competition is very keen. Nor does the Commission have the impression that the multi-nationals have a monopoly of exports to the Community's main customers (USSR, Algeria, Poland, Egypt). Lastly, when cereals are exported from the Community there is in most cases a change of ownership. At the same time it is difficult to see what interest the Community would have in making a change of ownership compulsory.

#### *Setting the level of subsidy*

#### **Published rates**

2.59. If there is any instance in which an export refund is calculated mathematically then this is it, for the ordinary refunds which are fixed for the export of cereals from the free market cover the difference between the Community and world market prices.

Ordinary refunds are also fixed for exports from intervention stocks, in particular so that the destinations for which tenders are submitted can be identified and so that the operator can then be required to export to the destination specified. Although there is no formula for fixing such refunds, which do not reflect the difference between the Community and world market prices, no formula is required since the operators submitting tenders for exports from intervention stocks must offer as their purchase price the world price plus the refund which they are to be paid on the export of the cereals concerned.

### Correctives

2.60 to 2.61. As has already been explained to the Court's representatives on several occasions, the correctives are an integral part of the refund. They are additions to or deductions from the refunds fixed for each month of delivery during the period of the export licence's validity. The correctives apply both to ordinary (basic) refunds and to the (basic) refunds fixed by tendering procedure. Their purpose may be to encourage exports to a specific destination or to reflect price fluctuations on the world futures market, so that a correspondingly differentiated refund (basic amount + corrective) is granted for each month of delivery. Positive or negative correctives may be fixed, where necessary for a particular destination. This is done to ensure that all the cereals are delivered within the period of the export licence's validity.

2.62 to 2.63. The positive correctives of ECU 3/t and ECU 4.50/t which the Court gives as examples are additions to the refund granted for specific destinations, the basic refund being applied to other destinations.

Where larger correctives are applied (such as the + ECU 20/t or + ECU 30/t mentioned by the Court), the situation is completely different and no comparison can be made between the two types of case. The larger correctives are applied when the tenders invited for a list of countries have to be temporarily restricted to a single destination or when it is necessary to ensure that delivery is made within the period of the export licence's validity (as in the case of the invitation to tender issued by Regulation 395/89, which applied only to the USSR). Since the correctives applied in such cases are large, the operational refund (basic refund + corrective) is in fact fixed only for the destination or delivery dates to which the correctives are applicable. When tendering, the operator must take the correctives into account because the basic refund which will be fixed (and is theoretically applicable to other destinations and other delivering dates) will not be sufficient in itself. It must also be pointed out that the total amount of the refund,

including the corrective, is not always a special preferential amount which is greater than that which would have been granted for other destinations or other delivery dates. Since the correctives are an integral part of the refund the Commission has not calculated the budgetary cost separately and sees no reason to do so.

2.64. Special refunds, which may take the form of a positive corrective for the destination concerned or a special basic refund, are not automatically granted for the more important customers. It all depends on the degree of competition on the world market, and in particular any American measures under the Export Enhancement Programme which, by its very nature, is aimed at the Community's main traditional markets.

### Special rates

2.65. The Commission hereby gives an undertaking to amend Regulation No 162/67 in the near future, to take account of the new processing coefficients.

It is true that the USA granted some particularly large bonuses on exports of processed products such as flour and that these bonuses were unrelated to those for wheat. If the Community was to compete, it was insufficient to calculate the refund on flour in the normal way, i.e. on the basis of the refund for wheat and the wheat/flour processing coefficient.

2.66. Algeria is the Community's only traditional customer which buys semolina on a large scale. For reasons of international competition beyond the Community's control, and to meet the competition arising from the fact that European mills can use North American durum wheat under the inward processing arrangements, refunds had sometime had to be fixed at rates higher than the usual level.

### Bids

2.71. (a) The Commission acknowledges that the time limits for the submission of tenders to national administrations (10.00 on Thursdays for free market sales and 13.00 on Wednesdays for sales from intervention stocks) have not always been observed by the latter and that this has given rise to distortions of competition.

When carrying out checks for the clearance of accounts, the Commission has insisted on the need to observe these time

limits (the directive issued by the ONIC last autumn provides evidence of this). The Commission will once more impress on the Member States that tenders submitted after the time limit cannot be considered and that the date and time of arrival must be shown on the tender.

(b) In the case mentioned by the Court, 8 tenders submitted for exports at normal prices (to other non-member countries) were indeed rejected although they quoted a price higher than that which was accepted in the case of the tenders relating to the USSR. At the same time, however, 14 even better tenders had been submitted for the other non-member countries and these had been accepted. A special price for the USSR was necessitated by the keen international competition (particularly as a result of the Export Enhancement Programme).

(c) In practice there is usually keen competition between the companies exporting cereals. The fact that export licences are transferrable does not make the bids submitted less competitive, as the Court would claim. Operators can take more risks if they know that they can cut their losses by transferring their licence to others, particularly if they do not have or are unable to conclude a contract.

2.72. The Court seems to suggest that the Commission allows itself to be manipulated by operators obtaining cereals at the price set by their customer. If this were the case, why do buyers not simply ask for the cereals to be delivered free of charge?

The real situation is quite different. Refunds are calculated on an objective basis. Competition between companies is sufficiently keen for them to take the refunds calculated on that basis. Where companies have concluded sizeable contracts with traditional customers who are buying large quantities (e.g. the USSR) the Commission has consistently set a refund which corresponds to the price justified by the international context, even if this meant losses for the companies selling below that level (the press has given such cases considerable publicity in the recent past).

#### *Special sales*

2.73. (d) Regulation (EEC) No 2751/88 issued an invitation to tender for the export of Greek durum wheat as a special intervention measure, with a view to preventing such wheat being placed in intervention storage in that Member State. Such measures call for a higher refund than that fixed under the general tendering procedure, where the bids accepted usually entail deliveries from the most competitive cereal-exporting countries. In this particular case, moreover, some of the wheat dated from the 1986 harvest, which had suffered as a result of the Chernobyl accident.

2.74. Detailed answers are given in response to the 'Prologue' (p. 2) and in sections 2.75 to 2.78 below.

#### **Tender for the refund on the export of common wheat to the Soviet Union**

2.75 to 2.78. In February 1989, the Commission issued a special invitation to tender for the export of 0.9 million t of wheat to the USSR, this quantity being partly covered by a contract concluded at the end of 1988 for 1.5 million t to be delivered over the period January-March. By February 1989 the necessary export licences had still not been issued, with the result that deliveries had been delayed, giving rise to protests from the USSR. The refund fixed as a result of the tendering procedure (basic refund + corrective = ECU 71/t) was calculated in the normal way on the basis of current data (internal price and rate of exchange), and the export price obtained was perfectly in line with those charged at that time by the Community's competitors for exports to 'sensitive' destinations.

As a result of competitors' efforts to take a larger share of the Community's main traditional markets, and in particular as a result of the Export Enhancement Programme, the world is no longer uniform. In some cases, therefore, the Community has to grant special refunds in order to keep an important customer.

The invitation to tender for the export of 0.9 million t to the USSR from all Member States was issued by Regulation No 395/89 in February 1989 in order to cover a contract for 1.5 million t which certain firms had concluded at the end of 1988, originally for delivery over the period January-March but delayed for lack of export licences. Under the general procedure all the tenders which the operators concerned had submitted since December had been refused, despite a corrective of + ECU 4.50/t for the USSR, since they were not in line with the world market.

By issuing a special invitation to tender the Community made a gesture towards the USSR which had been protesting because of the delay and thus ensured that the deliveries could be made. The aim was not therefore to help the operators out of their difficulties but to prevent any further inconvenience to a traditional buyer whose custom was essential to the balance of the Community market.

When the first time limit for the special invitation to tender (for the USSR) expired on 23 February, a bid for 0.9 million t was accepted at ECU 41/t. To this was added a USSR corrective of + ECU 30/t for April/May, as published earlier in the Official Journal. On the same day, under the general tendering procedure all bids for 0.53 million t, at refunds of ECU 61.90 and ECU 75/t, were rejected with the agreement of all the Member States on the Management Committee. The best offers received under the general procedure had not been submitted to cover sales

to the USSR. As announced beforehand priority was given to the special procedure. The refund was nevertheless calculated in the normal way, on the basis of the data recorded on the day when the refund was fixed. The refund of ECU 71/t gave an FOB price of USD 144/t on 23 February (about USD 5/t above the price agreed for the 1.5 million t in November). Admittedly, the price for US wheat (SRW non-EEP) was USD 152/t at that time but the USA had also sold some wheat to Algeria at USD 140/t FOB. The EEC selling price was therefore perfectly in line with the real world market price. If the full facts are to be known, it should be pointed out that the operators never managed to compensate for their failure to cover their contract under the general tendering procedure held in December 1988, when refunds of almost ECU 69/t were awarded. With the positive corrective of ECU 4.50/t set for the USSR at that time, the refund would have amounted to ECU 76.50/t in February (accounting being taken of two monthly increments).

The corrective of + ECU 30/t, which the Court singles out for criticism, was fixed for the purposes of the special procedure whereby contracts were awarded on 23 February for exports to the USSR over the period April-May and was intended to restrict cover to that period. The important point is that the corrective added to the basic refund (i.e.  $30 + 41 = \text{ECU } 71/\text{t}$ ) was in line with the world market. Although the corrective appeared to be a huge concession to the country concerned, in fact it merely had the effect of restricting deliveries to the months in question.

Since the special invitation to tender had been issued for only 0.9 million t, the remaining 0.6 million t for delivery in March had to be covered by other licences, and in particular those issued in December under the general procedure with a positive corrective of + ECU 4.50/t for January-February-March (total quantity awarded in December: 2.2 million t). Since the operators who had concluded the contract with the USSR did not have such licences, they had to buy them on the market (at a loss).

### *Planning and control of export sales*

2.80. The Commission notes that the facts which are mentioned in this paragraph and which are therefore acknowledged by the Court could invalidate a good number of the comments and criticisms in the earlier part of the report.

2.81. The Commission has no alternative but to 'rely on Member States to keep it informed of progress on sales' since only the Member States have information on the movement of goods as they pass through customs. The Commission does, however, obtain other information on Community exports from the private sector and from the importing countries.

It is incorrect to say that the Commission is unable to monitor exports of specific cuts and categories of meat. For

example, the Member States are required to forward the following information under Regulation (EEC) 2377/80:

- Twice per week, the quantities of fresh and frozen meat for which export licences have been requested or issued, providing a breakdown for each subheading or group of subheadings in the Combined Nomenclature.
- Before the fifth day of each month, the quantities of beef products eligible for refunds for which export licences have been issued during the past month, again providing a breakdown by subheading.
- In addition Member States must inform the Commission each month of the quantities of meat from adult bovine animals on which special refunds have been granted.

The Commission does not consider it necessary to collect such detailed information, particularly if the rate of refund is unchanged.

### *The decision-making process*

2.82. The Commission feels that the Court is not justified in claiming that 'hitherto the proposals put by the Commission to the Management Committees have not been supported by full information about the financial implications'.

The EAGGF Directorate and the Directorate-General for Budgets have always maintained a close watch over the day-to-day decisions taken by the Commission with regard to exports. Given the amounts involved, moreover, the difference between the expenditure forecast (forecasts are made during the previous budget year) and the expenditure actually incurred is very small; this could not be the case unless the budgetary implications of any change in the refund were carefully analysed on each occasion.

2.83. A record of each Management Committee meeting is kept, outlining the main points discussed and not simply listing the decisions taken.

## Conclusions

### *The cost of the policy*

2.85. As the Court points out, the refund system has become one of the main instruments for the management of agricultural markets, as well as being extremely costly and complicated. There are many reasons for this state of affairs, however: Community production has increased; importers have made new claims on the world market; importers are endeavouring to diversify their sources of supply and thus avoid dependent relationships; the world markets for agricultural producers have become disorganized; intervention arrangements have been dismantled because they were leading to a build-up of unsaleable stocks; the Community's open-door policy on imports (the EEC is the world's main importer of agricultural and food products) has resulted in the need to re-export. These are some of the most important reasons.

The Commission does not share the Court's view that detailed legislation should cover all the measures taken with regard to exports, since this would prevent the Community from adapting to any given situation.

In the beef sector low-price sales are not considered to be an instrument of export promotion. In the framework of a sound stock management, profits should be taken from appropriate outlets available on the world market as well as on the internal market. In cases of disposal to export markets, quantities, prices and destinations have been carefully defined in order to apply an active destocking policy as smoothly as possible. For instance, in setting a given price level, attention should be paid not only to potential world market competitors in beef but also to the risk of potential buyers switching to other sources of protein such as poultrymeat. Furthermore, large overhanging stocks will have a much more detrimental effect on prices than any ad-hoc sale. Consequently, hanging on to the stocks will have a serious impact on world trade as well as on EEC trade while at the same time being extremely costly for the Community budget.

2.86. The Court states, firstly, that certain exports could have been absorbed by the Community market and that, consequently, the financing of exports has a tendency to increase the level of Community prices.

This statement by the Court must be refuted since it does not take account of the following considerations:

- a supply balance is drawn up for each sector at the beginning of the marketing year and is regularly updated;
- if there was any chance of a surplus being absorbed over a given period, there would be signs of the corresponding shortage beforehand and the mechanism for adjusting Community prices would come into play.

The purpose of the exports is, after all, to dispose of those quantities which the Community's internal market cannot absorb.

Secondly, the Court repeats the claim (never supported by evidence) that the refund system tends to depress world prices. The Commission would like to see evidence of any cases where this may have occurred, if only to take the necessary measures.

The Commission does not share the Court's view that the lines along which the system is developing could carry risks for the Community budget.

2.87. It is the exception rather than the rule to specify a single country as destination or source when fixing export refunds. The reasons for such exceptions are given in the answers to other points such as the Prologue and points 2.75 — 2.78. The Commission does not consider that the cost to the Community budget has increased in the cases referred to by the Court, as is made clear in the relevant answers.

2.89. The Commission does not consider its market information to be inadequate but is constantly endeavouring to improve the quality of that information (2.10).

As regards the claim that inappropriate recourse is had to tendering procedures (the use of which is recommended by the Courts in 2.94) the Commission would refer the reader to its answers to 2.28 and 2.35. The Court's analysis does not take account of the need to ease the market situation in certain sectors by means of special sales (e.g. to the countries of Eastern Europe).

Lastly, the Commission disagrees with the Court's findings that 'the present chapter contains evidence that the cost of subsidy may often be higher than necessary'. Evidence to

the contrary has been given in the answers to earlier points made by the Court.

### 3. NATIONAL CONTROLS

#### *Accountability*

2.90. In the first place, the Commission considers that, where its own work is concerned, sufficient documentation is available on important decisions.

It intends, however, to consider ways in which the transparency of the documents concerned could be further improved so that fuller inspection may be carried out by the Court.

The Commission does not agree with the Court's conclusion that 'it is unclear how management can function properly' in view of the lack of information.

Nor does the Commission agree with the Court's conclusions regarding the role of the Management Committees. It would point out that in these Committees the Member States are usually defending their national interests, whereas the Community interest is defended by the Commission. To anyone who has attended the Committee meetings, it will be clear that the Commission does not always gain the upper hand.

#### *Tendering*

2.93 (a) The Commission is not convinced that tenders should be invited for all export sales of bulk products. Such a procedure would not reflect normal commercial practice and could easily become counterproductive.

The Court also recommends that minimum prices should not be published but, as previously explained, such prices are absolutely necessary 'in real life'.

(b) Direct negotiations between the Commission and the importing country, as suggested by the Court, would have several disadvantages. The Commission is not in a position to negotiate prices with importing countries since it cannot oblige firms to conclude contracts for delivery at a particular price. Serious doubts exist as to the Commission's legal capacity in such operations, in particular in respect of entering into contractual commitments.

#### *General remarks*

The Commission notes that the Court's observations and conclusions are based on a large number of specific cases which have come to the Court's attention in the course of on-the-spot checks on custom offices and paying agencies. The Commission would request the Court to forward full details of these cases so that it can study them in depth with a view to follow-up.

The Commission is of the opinion that the cases in question must be assessed in the light of existing Community legislation and national implementing rules, due account being taken of particular situations at regional or even local level.

Since the Commission became aware of the Court of Auditors' report, some of the cases mentioned have been traced back in the course of EAGGF controls. In-depth investigation of these files does not lead, however, to a sharing of the Court's conclusions. Details of this matter are included in the Commission's answers given below.

The Commission, which is aware of the shortcomings in the arrangements for checks on refunds, is now carrying out an inspection programme, which includes checks on the customs authorities in the Member States. The inspections carried out so far (F, NL, D, DK, and IRL) for the clearance of accounts and for the detection of frauds and irregularities have borne out most of the Court's findings. Particularly worrying is the extremely low percentage of physical checks, both on the quantities declared and on the nature and characteristics of products. In addition, a question mark hangs over the number and quality of the controls applied, given the lack of relevant instructions and the shortage of staff and equipment.

It was for these reasons that the Commission recently took the following initiatives:

(a) On 12 February 1990 the Council adopted Regulation (EEC) No 386/90 (OJ No L 42, 16.2.1990) on the monitoring, at the time of export, of agricultural products qualifying for refunds. This Regulation requires physical checks to be made on a representative selection of at least 5 % of the export declarations in respect of which applications have been submitted for refunds.

- (b) The Commission also decided that Member States should incur severe financial penalties if they did not carry out the necessary controls (guidelines adopted by the Commission on 20 December 1989).
- (c) Commission Regulation (EEC) No 354/90 of 9 February 1990 (OJ No L 38, 10.2.1990) amends Regulation (EEC) No 3665/87 as regards proof of arrival at destination in third countries of agricultural products qualifying for a variable refund. Annex II of the latter Regulation has been repealed.
- (d) Directives 81/177 and 82/347 deal with the general harmonization of customs rules relating to export formalities. In the specific case of agricultural exports qualifying for refunds, Regulation (EEC) No 3665/87 is applicable. The Commission departments are now investigating the possibility of amendments which would strengthen the arrangements for documentary and physical controls.
- (e) On 21 December 1989 the Council adopted Regulation (EEC) No 4045/89 (OJ No L 388, 30.12.1989, p. 12) on scrutiny by Member States of transactions forming part of the system of financing by the EAGGF Guarantee Section. This Regulation repeals Directive 77/435/EEC (OJ No L 172, 12.7.1977, p. 17). It is concerned with a posteriori checks on the commercial documents of undertakings receiving payments from or making payments to the EAGGF Guarantee Section, with particular emphasis on the prevention and detection of fraud and irregularities.

As compared with the Directive which was applicable hereto, the new Regulation contains several important changes: the number of controls is considerably increased; the national control programmes for harmonization at Community level are to be submitted to the Commission; in each Member State a specific body will be responsible for controls or the coordination thereof.

#### *Customs controls*

3.8 to 3.26. The Commission is currently reconsidering the procedures for the exportation of agricultural products qualifying for a refund, with a view to strengthening and harmonizing the rules followed by the Member States. It is planning to introduce a number of provisions concerning the presentation of the documents used to obtain a refund on exports and concerning the arrangements for the examination of the products to be exported.

As regards the notice of intention to place goods under customs control (3.19 — 3.20), the Commission agrees that from a pragmatic viewpoint the control on goods to be exported can be best performed at the place of packing and loading. The Commission's experience on this, gained in the course of the EAGGF missions, confirms that in France and Germany the intention to commence this operation has to be communicated to the customs authorities. This information has to reach these authorities early enough to allow them the opportunity to carry out a control if they decide to do so.

An in-depth control on the customs authorities in Ireland and the United Kingdom is scheduled for this year.

The date on which export declarations are accepted (3.21 — 3.22) is defined in Article 6 of Council Directive 81/177/EEC on the harmonisation of export procedures for Community goods. Where necessary the Member States concerned will be reminded of this specific rule.

3.27 to 3.25. The criteria and rules governing physical checks on exported goods have been the subject of an in-depth investigation by the Commission. As already mentioned, the Council adopted on 12/13 February 1990 a Regulation on the monitoring, at the time of export, of agricultural products qualifying for a refund [COM(89) 294 final of 16 June 1989]. This Regulation deals both with physical checks on goods and with checks on documents.

Article 3 lays down the following rules:

- the physical checks must take the form of spot checks conducted frequently and without prior warning and must cover not less than 5 % of the export declarations in respect of which applications are submitted for a refund, such percentage being applied:

- per customs office;

- per calendar year; and

- per product sector;

- a scrutiny rate greater than 5 % may be fixed for specific cases and period, on the basis of objective findings which indicate an increased risk of fraud.

Article 6 provides for the adoption of implementing rules relating to:

- the method for calculating the minimum percentage;
- the coordination of controls between the national authorities and the Commission staff.

The implementation of these principles should correct many of the shortcomings found by the Court.

On the subject of physical controls (3.29) the Commission also wants to underline that turnouts of goods are very difficult to perform, time-consuming and expensive. For those reasons any decision to operate them can only be based on serious presumptions of fraud, and has to be assessed in conjunction with other possible control measures applied in each ongoing export operation.

3.36 to 3.41. The implementation of the above-mentioned Regulation should eliminate the shortcomings which beset physical controls. The Commission staff and the delegations of the Member States are also reconsidering Article 3 of Commission Regulation (EEC) No 3665/87 with a view to introducing a more effective system of controls.

Article 5 of the International Convention on the Harmonization of Frontier Controls on Goods [adopted by Council Regulation (EEC) No 1262/84] defines clearly the infrastructure which customs offices should have at their disposal. The Commission is prepared to remind each Member State involved of this obligation.

As regards the location and timing of the physical checks (3.37 — 3.38) the Commission would refer the reader to its answers to points 3.8 — 3.26.

Sealing (3.40) is an important means of control which provides a reliable guarantee as to the identity of goods transported. Article 18 of Council Regulation (EEC) No 222/77 on Community transit clearly defines the cases where sealing is compulsory as a method of identification. The Commission is prepared to remind Member States involved of their obligations in this area.

The Commission's experience has been that evidence of export (3.41) is often gained not only from manifests but also through information obtained from the harbour

authorities and from specific customs units located near the open sea.

### *Paying agency control procedures*

3.42 to 3.52. In cases where the refund is differentiated according to the destination of the goods, payment of the refund is subject to the production of evidence that the customs formalities for release to the market in the third country concerned have been completed. The so-called 'Annex II documents' provided for in Regulation No 3665/87 proved to be unreliable, largely because there was no link with the administrative and customs procedures applicable in the third country of destination. The Commission has now altered the arrangements relating to proof of arrival at destination and has repealed Annex II [Regulation (EEC) No 354/90 of 9 February 1990 — OJ No L 38, 10.2.1990].

A catalogue of the specimen stamps (3.50 — 3.52) in use at customs offices can be a useful tool for paying agencies. The lack of such a catalogue does not make controls impossible, however. Paying agencies can, in cases of doubt, appeal to customs administrations, establish contact via embassies or international representations or even call on their own administration to make comparisons with other files concerning the same countries of destination. It is important to encourage the Member States to make full use of these possibilities.

The Commission will investigate the feasibility of drawing up such a catalogue.

### *Unauthorized alteration*

3.53 to 3.56. The Commission agrees that the most appropriate way to avoid alteration of customs documents is their direct transmission to paying agencies. In most of the Member States, and not only the five mentioned in the Court's report, this is standard practice. The necessary dialogue with those Member States where this is not yet current practice is now in progress.

As regards alterations to data contained in documents coming from third countries, it has to be emphasized that any doubt whatsoever should automatically lead to further examination of the files concerned [Article 5 of Regulation (EEC) No 3665/87].

*Advance payment*

3.58–3.62. The two cases mentioned in the Court's report reveal a particular weakness in the advance payment procedure. The Member State involved has already taken steps to prevent a recurrence of similar situations. The cases in question have also been audited by the EAGGF in order to establish whether any irregularities to the detriment of the Fund had occurred. The outcome of this audit does not lead the Commission to share the conclusions of the Court, however. Contrary to what the Court states, the listings on which advance payment was made were systematically drawn up with a reference to each customs export declaration concerned. Except for one case quoted by the Court, the paying agency did not grant any advance prior to the actual completion of export formalities. In the absence of further evidence the amount paid on that particular export declaration will not be financed by the Community. The audit on all other expenditure involved indicated that no overpayments were made.

The problems relating to long-outstanding securities have already been covered by an investigation carried out in the Member State concerned. The Commission agrees that files should be processed within a reasonable period of time. On the matter of securities reference may also be made to Article 29 of Regulation (EEC) No 2220/85, which gives the precise time sequence to be followed and specifies the action to be taken when securities are to be forfeited.

*A posteriori controls*

3.63 to 3.70. See the general remarks under (d).

*Recommendations on national controls*

3.72. The Commission will give careful consideration to the Court's suggestions and to how they could be incorporated into the Community rules.

(a) In the Commission's opinion, merely requiring commercial invoices to be submitted in support of each application for a refund would not provide any additional safeguard (3.23 — 3.26).

- (b) The commencement of loading operations must be notified to the customs authorities with sufficient advance notice (not necessarily 24 hours) for them to carry out any checks which they consider necessary.
- (c) The Commission has found that, as a general rule, physical checks are unannounced. By the time that the exporter is informed, the produce declared for export can no longer be altered in any way.
- (d) Council Regulation (EEC) No 1262/84 gives a satisfactory definition of the facilities which should be available at customs offices. The Commission's review of its Regulation (EEC) No 3665/87 will take account of the Court's remarks concerning this matter (points 3.36 — 3.41).
- (e) Directive 81/177/EEC defines the period for the submission of export declarations (point 3.39).
- (f) to (i) The Commission will take the Court's recommendations into account when drawing up the rules for the implementation of the Council Regulation on the monitoring of agricultural exports qualifying for refunds [COM(89) 294 final] (see points 3.27 — 3.35).
- (j) The review of Commission Regulation (EEC) No 3665/87 will take this point into account.
- (k) Article 11 of Regulation (EEC) No 4045/89 provides for the coordination of a posteriori controls by a single body.
- (l) The Commission agrees that it would be preferable if the customs office of departure forwarded the export declaration directly to the paying agency. Talks are already being held with those Member States where this procedure is not yet followed (points 3.53 — 3.56).
- (m) A catalogue of forms and seals would indeed be a useful instrument but the feasibility of such a catalogue has still to be investigated (points 3.50 — 3.52).
- (n) The national bodies which make the payments must ensure that the basic documents are properly understood; translation may not be necessary in every case.
- (o) to (r) These recommendations will also be taken into account for the purposes of implementing Regulation

(EEC) No 4045/89 as well as the Regulation on the scrutiny by Member States of transactions forming part of the EAGGF Guarantee Section system of financing and the Regulation on the monitoring of agricultural exports which qualify for a refund [see points (f) to (l) above].

#### 4. OVERALL CONCLUSIONS

4.1 As already stated, the Commission will investigate whether it is necessary and appropriate to adjust the objectives of the basic regulations in line with current conditions on the Community market. It should be noted that, from the beginning, the rules included provision for exports and the mechanisms necessary for that purpose.

The multilateral trade negotiations within GATT could provide an opportunity for amending the rules.

4.2. The Commission cannot accept the criticism that economy has not been one of its priority objectives. The Commission attaches particular importance to budget discipline and keeps a close watch, by means of the early warning system, on the trend in expenditure throughout the entire period of the budget's implementation.

4.3. The Commission agrees with the Court that, as far as possible, export refund rates must be rationalized and

simplified. It has already initiated this process in the beef sector and intends to pursue the same policy in other sectors. It would point out, however, that the purpose of the refund nomenclature is to prevent substantial refunds being granted on products which do not require such refunds and to prevent refunds being granted on certain qualities. The itemized nomenclature enables the refund to be paid in proportion to the basic products exported rather than on quantities as such. The nomenclature has been made more specific whenever any shortcomings have been discovered.

The Commission, being aware of the control problems involved, has submitted proposals for legislation which it intends to follow through. At the same time it has initiated a programme of checks on how the rules are applied in the Member States.

4.4 – 4.6. For Commission initiatives on control matters, the reader is referred to the general remarks made in section 3. above.

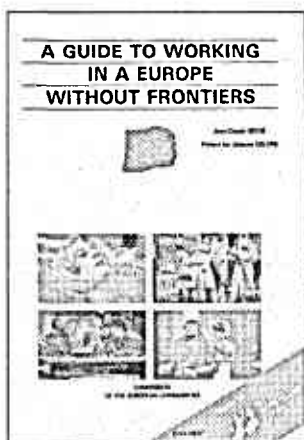
4.7. The Commission acknowledges that nothing is perfect and will do its best to make further improvements to the arrangements with regard to refunds.

The Commission cannot, however, accept the criticism that it has failed in its task by not taking sufficient account of the need for economy and not meeting the requirements of public accountability.

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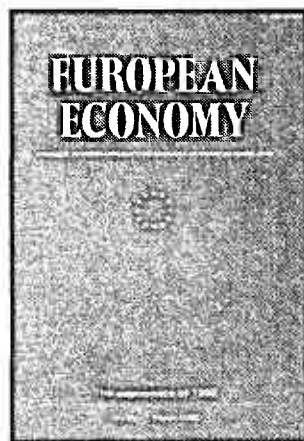
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