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on the effects of the CAP reform in the cereals sector accompanied by the Commission's replies

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

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SUMMARY

The report deals with the impact of the 1992 CAP reform on the cereals sector. It provides a summary of the history of the common organisation of the market (COM) in cereals, followed by a reminder of the key elements of the reform. It then traces the evolution of the COM's budget and of the main economic variables present in the cereals sector after the reform. In the light of this evolution, it evaluates the results of the reform.

The old COM, which was based on price support and external protection, resulted in growing public stocks at rising cost to the Community budget. In addition, ever-increasing export refunds had to be granted to dispose of surplus cereals on the world markets. EC trade partners were also pressing the Community to further liberalise its agricultural markets. This finally resulted in the CAP (common agricultural policy) reform of 1992, mainly directed at the cereals sector (see paragraphs 2.1 to 2.12).

This reform attempted to deal with internal and external problems by increasing the competitiveness of EC-grown cereals. The principal instrument was drastic reduction of intervention prices. Farmers were compensated for income losses resulting from price reductions by means of direct area aid. Market balance was to be achieved by paying lower prices and thereby discouraging production, by making area aid independent of the actual production volume and by setting aside production areas (see paragraphs 3.1 to 3.5).

Although the Commission expected a certain increase in budgetary expenditure, as the burden of farm support was gradually transferred from the consumer to the taxpayer, expenditure, as a result of management decisions taken at Commission or Council level, grew faster than foreseen. The decrease in expenditure forecast for 1997 did not take place (see paragraphs 4.1 to 4.5).

Decreases in production in the first year of reform were rapidly followed by increases that brought production back up to pre-reform production levels. The evolution differed greatly from one Member State to another, indicating that the volume of production was influenced more by climatic changes and continuously increasing yields than by price reductions and the compulsory set-aside of arable land (see paragraphs 4.6 to 4.10).

Internal consumption increased as a result of the price reductions, which increased the attractiveness of using cereals for animal feed. However, the animal-feed sector's ability to adapt shows that there is also a risk of it reacting and moving in the opposite direction, for example whenever the price ratio between cereals and their substitutes becomes unfavourable for cereals again (see paragraphs 4.11 to 4.14).

It was expected that producer prices would follow the decrease in institutional prices. This did happen to a varying extent in the Member States, but due to shortages on the world market, EU market prices for common wheat, the main cereal produced in the EU, stayed above the new institutional prices, which resulted in global over-compensation of actual income losses. The Court has already reported on this phenomenon in its Annual Report concerning the financial year 1996 (see paragraphs 4.16 to 4.18 and 4.33).

In 1997 and 1998, after the transitional period, prices dropped and had to be supported by intervention once again (see paragraphs 4.19 and 4.23).

The drop in producer prices was expected to lessen the burden on the consumer of supporting the agricultural sector. However, significant falls in the price to the final consumer could either not be established (e.g. for bread) or could not be related specifically to reduced cereal prices (beef and pork). Thus, the burden on the taxpayer increased considerably, with no particular gain to the consumer (see paragraphs 4.20 to 4.21).

With respect to the farm income, the sector as a whole benefited from the reform. As market prices stayed above the newly fixed institutional prices during the transitional period, real losses were over-compensated on a global level. The higher the market prices were in Member States, the higher the overall returns to the farmers concerned following the introduction of the new system. The system was never tailored to compensate for losses either at the level of the individual farmer or at country level. Therefore, there are two sources of over- or under-compensation. The first is due to the fact that aid is linked to average areas and yields that are frozen at their historical level which led to under-compensation of efficient farmers and over-compensation of less efficient ones. On the other hand, differences among countries in market prices for the same products caused over-compensation for farmers in some countries and under-compensation for those in others in specific years (see paragraphs 4.31 to 4.35).

Furthermore, the compensation system does not differentiate support according to farm size or yield and thus does not improve the position of smaller producers. The large farms and those situated in regions with the highest yields continue to benefit from the highest subsidies (see paragraphs 4.37 to 4.46).

As an actual policy change, the 1992 CAP reform was certainly a step in the right direction. However, in order to safeguard the gains made as regards competitiveness and market balance, further steps are necessary. Measures suggested in Agenda 2000 are insufficient to combat recurring production surpluses, to react appropriately to falling prices on the world market and to safeguard farm incomes. Given the increasing difficulties associated with production and area-related subsidies, it may be appropriate to examine the possibility of replacing the present system by some form of direct income support (see paragraphs 5.8 to 5.11).

1. INTRODUCTION

1.1. In many respects cereals are the Community's most important crop. They occupy around 38 million hectares, about 25 % of the Community's agricultural area. Quantity-wise they account for the highest production at about 200 million tonnes a year. They constitute the main product for intra-Community trade amounting to approximately 38 million tonnes. The operation of this common organisation of the market (COM) alone cost the Community budget more than ECU 14 000 million in 1997, i.e. 34 % of the EAGGF Guarantee budget. This is by far the largest amount for a single COM, in terms of EU budgetary support. In terms of production value excluding on farm consumption, however, in 1995 cereals ranked fourth at ECU 18 379 million after milk products (ECU 38 176 million), beef (ECU 24 583 million) and pigmeat (ECU 23 123 million) ⁽¹⁾.

1.2. In 1992 the Community reformed parts of the common agricultural policy (CAP). The main thrust of the reform was devoted to the cereals market, where the new provisions were applied from the 1993/1994 marketing year onwards. It was expected that the reform would be implemented in full by the end of a three-year transitional period i.e. June 1996. Thus the 1996/1997 marketing year was the first year in which the reform was applied fully. This report deals with some of the major effects the reform had on the cereals sector. It is based on audit work carried out during 1997 and 1998, including analyses of economic and financial data compiled by Eurostat, presented in other Community documents and obtained during interviews with national administrations and representatives of producers, processors and consumers that were conducted in the five most important cereal-growing Member States: France, Germany, United Kingdom, Italy and Spain ⁽²⁾.

1.3. The report contains a brief summary of the history of the COM in cereals, followed by a reminder of the key elements of the reform. It then traces the evolution of the COM's budget and of

the main economic variables that applied to the cereals sector after the reform, evaluates the results of the reform in relation to its objectives, and comments on whether Agenda 2000 is likely to remedy the weaknesses of the 1992 reform and drive the reform process further. The report does not cover the evolution of the special scheme for durum wheat, as this was dealt with in the Court's Annual Report concerning the financial year 1997 ⁽³⁾.

2. HISTORY

Price support and external protection

2.1. Cereals were the first product to become the subject of a COM under the CAP, because of their fundamental importance to human and animal nutrition, and to intra-Community trade. After long negotiations, which began with the conference held in Stresa in 1958, the Council finally decided to establish a COM in January 1962 the main instruments of which were as follows:

- (a) *target prices*, which were fixed by the Council at the beginning of each marketing year for each kind of cereal (mainly common wheat, durum wheat, barley, oats and rye); target prices were defined as the farm-gate prices a farmer should receive; the negotiations concerning this price were difficult from the very start; Germany in particular refused to accept any drastic cut in its farm prices and it was not until 1967 that common cereal prices entered into force, although their level was somewhat higher than the market prices applied in the other five Member States and far above the level of world-market prices;
- (b) *intervention prices* which were fixed at a certain percentage of the target prices marked the minimum level to which market prices could drop; when this minimum price was reached, national intervention boards were required to buy cereals at the State's expense; the logic of the intervention system was that in times when cereal supply exceeded demand (normally at harvest time) supply would be reduced through State buying into intervention stores, thereby keeping market prices above intervention price levels; when the opposite occurred, normally towards the end of the marketing year, i.e. supplies

⁽¹⁾ The situation of agricultural markets in the European Union, Report 1996, Tables 3.1.5, 3.5.2.2, 3.6.16, 4.1.4.4.

⁽²⁾ In descending order, according to the extent of cereals production, based on 1995 production figures, as set out in the 1996 Eurostat report, Table 4.1.1.3.

⁽³⁾ OJ C 349, 17.11.1998, chapter 2.

became short and prices rose, sales from intervention stores would keep market prices at the target-price level; moreover, in order to give producers and traders an incentive to store cereals themselves and not place them in intervention stocks immediately after harvest, intervention prices were increased by monthly increments over a certain part of the marketing year. The Community's budget bore storage cost and later depreciation of cereals on stock, but not the initial buying.

2.2. By applying this price-support system the Community had implicitly responded particularly to three objectives of Article 39 of the Treaty of Rome ⁽⁴⁾:

- (a) the income objective, i.e. to ensure a fair standard of living for the agricultural Community via the target price;
- (b) the market-stabilisation objective, as prices were allowed to fluctuate only between the target and intervention prices;
- (c) the structural objective, for farms to produce enough to provide a sustainable income for the farmers concerned at the prices that had been fixed.

2.3. Target prices were set at such a high level that market prices tended to be significantly lower and were even below the 10 % margin which separated the target and intervention prices. Intervention therefore, became a permanent feature of the Community's market management, keeping prices for producers at the artificially high intervention-price level. The target prices became

completely meaningless as far as farm income was concerned and served as nothing more than a theoretical basis for determining intervention prices. Furthermore, consumer interests were neglected; from the very start consumers had to bear the burden of the difference between high internal and low world prices.

2.4. Such a system of guaranteed minimum prices can only function if competition from cheaper cereals on the world market is excluded from the internal market. To achieve this end the Community supplemented the internal price-support system with an external sluice-gate system. Internal prices were protected by variable levies on imports of cereals from third countries. These levies were based on threshold prices, which were fixed in such a way that the price of imported cereals at the Community major consumption centres were slightly above target prices, and the difference between these prices formed the basis of what is termed Community preference. Variable import levies accrued to the Community budget as an own resource.

2.5. Export refunds worked in the opposite direction to import levies. Surpluses threatening the internal market were exported and the exporters could be refunded the difference between the higher internal market price and the lower sale price obtained on a third country's market. However, when internal market supplies fell short, export taxes could be used to discourage exports and/or levies on imports could be lowered, a situation which has occurred only twice in the history of the COM. The sluice-gate system was initially conceived as a self-financing system in the sense that receipts from import levies would cover export refunds over an average of several years.

⁽⁴⁾ Article 39 of the Treaty of Rome:

- '1. The objectives of the common agricultural policy shall be:
 - (a) to increase agricultural productivity by promoting technical progress and by ensuring the rational development of agricultural production and the optimum utilisation of the factors of production, in particular labour;
 - (b) thus to ensure a fair standard of living for the agricultural community, in particular by increasing the individual earnings of the persons engaged in agriculture;
 - (c) to stabilise markets;
 - (d) to assure the availability of supplies;
 - (e) to ensure that supplies reach consumers at reasonable prices.
- 2. In working out the common agricultural policy and the special methods for its application, account shall be taken of:
 - (a) the particular nature of agricultural activity, which results from the social structure of agriculture and from structural and natural disparities between the various agricultural regions;
 - (b) the need to effect the appropriate adjustments by degrees;
 - (c) the fact that in the Member States agriculture constitutes a sector closely linked with the economy as a whole'.

Evolution of the cereals market

2.6. When the COM in cereals was introduced there were only six Member States and a substantial proportion of basic foodstuffs was imported to ensure an adequate supply to the EC population. In 1968 the Six imported over 17 million tonnes of cereals and exported 6,5 million tonnes, which meant that a net requirement of 10,5 million tonnes, i.e. 10 % of the Community's cereal demand had to be covered by imports.

2.7. The oil crises in 1973 and 1979 led to worldwide inflation, and by the mid 1980s continuing US budgetary deficits aggravated the monetary instability caused by the two oil shocks. Inflation led to a series of substantial increases in institutional prices (target, intervention and threshold) and the devaluation of the dollar further widened the gap between Community and world market prices for cereals. The high support prices provided a strong incentive to farmers to increase production, whereas Community consumption grew at a slower rate. Artificial outlets, funded by intervention buying or high export-refund rates, gave a false picture of the real market situation for producers. Thus, in 1980 the Community of nine Member States as it was then, became a net exporter of cereals (see *Table 1*). From 1981 onwards, production remained higher than internal consumption, imports fell, and subsidised exports increased continuously. Intervention stocks also continued to grow. The disposal of surpluses on the internal market and abroad became increasingly expensive for the Community budget.

2.8. Attempts to brake the upward trend in expenditure by freezing or decreasing institutional prices and taking other stabilising measures (maximum guaranteed quantities, coresponsibility levies and a set-aside scheme for taking land out of production ⁽⁵⁾) were introduced in the second half of the 1980s. All these measures failed to curb production and surpluses significantly and budgetary expenditure (mainly intervention costs and export refunds) therefore remained high. The agrimonetary system which was supposed to protect agricultural prices by means of green rates against increasing monetary instability, further increased prices in Member States whose national currencies were undergoing depreciation and led to only small off-sets through price cuts in Member States whose national currencies were rising in value ⁽⁶⁾. The incentives to increased production, caused by relatively high internal prices, remained strong, and increasing yields aggravated the problem of structural surpluses.

2.9. Price support via intervention buying-in and outside protection provided by import levies, export refunds and the agrimonetary system thus managed to insulate cereal producers and traders from the reality of the world market. Furthermore, increasing self-sufficiency and, ultimately, cereal surpluses on the internal

market led to lower imports and an ever-increasing proportion of export refunds remained uncovered by import levies. Finally, not only did consumers have to fund the system by paying cereal prices well above world prices, but taxpayers' coverage of intervention and export refunds also increased.

2.10. At the end of the 1992/1993 marketing year, the situation culminated in 32,2 million tonnes of cereals, about 20 % of the year's production, being in intervention warehouses (see *Table 1*). This tonnage represented more than four months' internal consumption and in the same year cost the taxpayer ECU 2 724 million in storage and depreciation (see *Table 2*). Over the same period export refunds also increased to ECU 2 789 million, while levies on all agricultural products imported amounted to no more than ECU 1 000 million. Thus, taking into account the constraints introduced by the agricultural guideline within the framework of budgetary discipline decided in 1988, it became increasingly difficult to finance the agricultural budget.

2.11. Moreover, the bulk of this ever-increasing budgetary expenditure did not go directly to the farming sector, but to warehouse owners and grain traders — often comprising the same companies. The farming sector benefited from a system which kept internal prices above world prices artificially, and trading companies collected the export refunds and intervention payments necessary to sustain internal prices. In the last pre-reform year this expenditure amounted to ECU 5 512,6 million out of a total cereals budget of ECU 6 923,2 million.

2.12. At the same time the Community's trade partners pushed for the inclusion of agricultural products in the General Agreement on Tariffs and Trade (GATT), the opening of Community markets for their agricultural products, and the phasing out of all subsidies that directly or indirectly affect trade.

3. THE REFORM

3.1. Having come under pressure from two sides, i.e. internally, due to budget constraints, and externally, under the Uruguay Round of GATT negotiations, the CAP had to be reformed and

⁽⁵⁾ See the Court of Auditors' Annual Report concerning the financial year 1989 (OJ C 313, 12.12.1990, pp. 75 and 89).

⁽⁶⁾ See the Court's Special Report No 1/89 on the agrimonetary system (OJ C 128, 24.5.1989, paragraph 6.13).

Table 1
Total cereals balance sheet, 1972/1973 to 1997/1998

(million tonnes)

Marketing year	Community size	Usable production (¹) (²)	Imports (³)	Exports (³)	Domestic uses (³)	Change in stocks	Total ending stocks (⁴)	Of which intervention stocks	Of which market stocks	Self sufficiency
1997/98	EU-15	205,0	4,9	23,4	174,7	11,8	37,2	14,5	22,7	117 %
1996/97	EU-15	205,3	4,8	28,3	172,9	8,9	25,4	2,4	23,0	119 %
1995/96	EU-15	176,6	8,0	20,4	166,7	- 2,6	16,5	2,6	13,9	106 %
1994/95	EU-15	172,8	6,6	32,0	159,6	- 12,2	19,1	9,7	9,4	108 %
1993/94	EU-12	164,8	5,2	35,2	144,9	- 10,2	31,3	20,1	11,2	114 %
1992/93	EU-12	168,3	4,1	36,8	134,6	0,9	41,4	32,2	9,2	125 %
1991/92	EU-12	181,0	5,5	34,7	140,6	11,3	40,5	26,4	14,1	129 %
1990/91	EU-12	169,4	5,1	30,0	141,5	3,1	29,2	18,8	10,4	120 %
1989/90	EU-12	162,8	6,5	33,8	135,5	- 0,1	26,2	11,8	14,4	120 %
1988/89	EU-12	163,6	7,3	35,3	135,9	- 0,2	26,3	n.a.	n.a.	120 %
1987/88	EU-12	154,2	7,9	26,8	137,0	- 1,7	26,5	n.a.	n.a.	113 %
1986/87	EU-12	153,8	7,1	27,2	138,0	- 4,3	28,2	n.a.	n.a.	111 %
1985/86	EU-12	160,2	11,1	25,8	144,1	1,5	32,5	n.a.	n.a.	111 %
1984/85	EU-10	151,3	7,3	29,1	119,2	10,4	31,0	n.a.	n.a.	127 %
1983/84	EU-10	123,6	8,9	22,9	116,5	- 7,0	20,6	n.a.	n.a.	106 %
1982/83	EU-10	131,4	11,1	23,0	114,7	4,8	27,5	n.a.	n.a.	115 %
1981/82	EU-10	122,3	15,3	23,8	115,4	- 1,7	22,7	n.a.	n.a.	106 %
1980/81	EU-10	125,0	16,7	24,1	117,8	- 0,2	24,4	n.a.	n.a.	106 %
1979/80	EU-9	113,8	17,0	17,4	115,7	- 2,2	24,6	n.a.	n.a.	98 %
1978/79	EU-9	115,6	20,8	16,7	115,9	3,8	26,8	n.a.	n.a.	100 %
1977/78	EU-9	102,6	21,8	13,4	111,4	- 0,4	23,0	n.a.	n.a.	92 %
1976/77	EU-9	90,0	30,5	10,6	109,7	0,1	23,4	n.a.	n.a.	82 %
1975/76	EU-9	96,4	26,1	17,1	110,3	- 4,9	23,3	n.a.	n.a.	87 %
1974/75	EU-9	107,3	24,2	13,8	113,2	4,5	28,2	n.a.	n.a.	95 %
1973/74	EU-9	104,7	24,4	12,2	115,5	1,4	23,7	n.a.	n.a.	91 %
1972/73	EU-9	102,2	25,1	14,4	113,8	- 0,8	22,4	n.a.	n.a.	90 %

(¹) Usable production: production net of farm losses and harvest losses.

(²) For 1997, the usable production figure was not available. It has been replaced by the production figure which is a little bigger.

(³) Figure estimated by DG VI for 1996/1997 and 1997/1998.

(⁴) Ending stocks as at 30 June of the marketing year. They are calculated per difference.

na: non available.

NB: Before 1990/1991 the figures for the Community do not contain the figures for the New German *Länder*.

Source: Eurostat, New Cronos (up-date as at September 1998).

Table 2
Evolution of the expenditure for cereals and other arable crops from 1990 to 1997

(million ECU)

	Before new CAP				New CAP								
	1990	1991	1992	1993	1994	1995		1996		1997		1994 to 1997	
	EU-12	EU-12	EU-12	EU-12	EU-12	EU-12	EU-15	EU-12	EU-15	EU-12	EU-15	EU-12	EU-15
Export refunds for cereals	2 443,4	3 601,5	3 139,7	2 788,8	1 513,2	1 062,2	1 092,7	301,2	312,8	484,6	532,3	3 361,2	3 451,0
% of the total cereals expenditure	64,0 %	70,0 %	56,2 %	40,3 %	16,7 %	9,1 %	9,3 %	2,5 %	2,4 %	3,7 %	3,8 %	7,3 %	7,2 %
Storage intervention for cereals	1 251,4	1 419,4	2 497,4	2 723,8	186,7	36,7	62,7	- 39,7	- 46,5	67,1	71,5	250,8	274,4
% of the total cereals expenditure	32,8 %	27,6 %	44,7 %	39,3 %	2,1 %	0,3 %	0,5 %	- 0,3 %	- 0,4 %	0,5 %	0,5 %	0,5 %	0,6 %
<i>Other intervention</i>													
Cereals	341,4	464,7	462,2	532,3	391,9	347,6	357,3	279,2	304,6	273,4	300,7	1 292,1	1 354,5
Cereals co-responsibility levy	- 656,2	- 924,3	- 1 098,7	89,6	- 0,9	- 0,8	- 0,8	- 0,5	- 0,5	0,0	0,0	- 2,2	- 2,2
Total	- 314,8	- 459,6	- 636,5	621,9	391,0	346,8	356,5	278,7	304,1	273,4	300,7	1 289,9	1 352,3
% of the total cereals expenditure	- 8,2 %	- 8,9 %	- 11,4 %	9,0 %	4,3 %	3,0 %	3,0 %	2,3 %	2,3 %	2,1 %	2,1 %	2,8 %	2,8 %
<i>Area aid for cereals</i>													
Compensatory payment	0,0	0,0	0,0	0,0	4 723,7	7 222,6	7 222,6	8 919,9	9 611,7	9 787,1	10 524,1	30 653,3	32 082,1
Set-aside on cereal area ⁽¹⁾	18,0	65,4	125,5	362,8	1 456,0	2 050,7	2 050,7	1 771,6	1 930,7	1 475,0	1 618,1	6 753,3	7 055,4
Supplementary aid for durum wheat	419,5	516,1	456,4	425,9	816,6	944,0	944,0	947,6	948,3	1 079,9	1 080,6	3 788,1	3 789,5
Total	437,5	581,5	581,9	788,7	6 996,3	10 217,3	10 217,3	11 639,1	12 490,7	12 342,0	13 222,8	41 194,7	42 927,0
% of the total cereals expenditure	11,5 %	11,3 %	10,4 %	11,4 %	77,0 %	87,6 %	87,1 %	95,6 %	95,6 %	93,7 %	93,6 %		
Total expenditure for cereals	3 817,5	5 142,8	5 582,5	6 923,2	9 087,2	11 663,0	11 729,2	12 179,3	13 061,1	13 167,1	14 127,3	46 096,6	48 004,8
% increase compared to the previous year		34,7 %	8,5 %	24,0 %	31,3 %	28,3 %	29,1 %	4,4 %	11,4 %	8,1 %	8,2 %		

⁽¹⁾ Calculated on the basis that 85 % of arable area concerns cereals (1992 figure).

Source: Commission's financial reports from 1990 to 1997.

the cereals sector was, again, one of the areas most affected. In early 1991 the 'Mac Sharry reform' (named after the Commissioner responsible for agriculture at the time) was presented ⁽⁷⁾.

3.2. Given the awareness of the CAP's problems and failures up to that time, the objectives for a reform of the cereals sector were easily identified. The means, however, were the subject of lengthy and difficult discussion and in May 1992 the Council finally agreed to a less radical reform than the Commission had proposed.

3.3. In June 1992 the two basic Council Regulations (EEC) No 1765/92 and (EEC) No 1766/92 of 30 June 1992 were adopted ⁽⁸⁾. The first dealt with the creation of a new support system (area aid) for producers of arable crops in general (cereals, oilseeds and protein plants, later supplemented with linseed) and the second renewed the COM in cereals. A transitional period was introduced running from the 1993/1994 marketing year to that of 1995 to 1996, over which time the main features of the new COM were to be introduced. The subsequent period, up to 1999 was viewed as a 'cruise' period, and the modifications proposed in the Commission's Agenda 2000 mark the end of this cruise period.

3.4. The COM thus pursued the following main objectives through the introduction of specific measures:

(a) *the competitiveness objective*: this was to be achieved over the transitional period by gradually decreasing the average intervention price from ECU 155/t ⁽⁹⁾ to ECU 100/t for all cereals mixed; lower intervention prices were supposed to lead to lower internal market prices; Community-grown cereals would thus be more competitive on the internal market in relation to duty-free imported substitutes used for animal feed (e.g. manioc, corn gluten, etc.); on the external market, cereals would be disposed of at lower or even no export refunds, since the difference between international and internal prices, which determines the rate of export refunds, would be reduced;

(b) *the objectives stipulated in Article 39 of the Treaty*, in particular:

(i) *the income objective*: to compensate farmers for income losses due to decreases in institutional prices, as market prices were supposed to follow this decrease; a subsidy, based on the area declared as being under cereals by the farmer, supplemented the revenue the farmer received from selling his cereals on the market; the subsidy was, in principle, calculated by multiplying the compensation rate (difference between the average pre-reform intervention price and the new target price fixed for the current year) by the area in question and by a historical regional yield figure fixed by the Member States;

(ii) *the stabilisation objective*: to reduce production in order to achieve a better market equilibrium; this was to be achieved by decreasing the incentive to production (via lower prices) and by fixing a historical base area for arable crops; if the base area was exceeded, area-aid payments were reduced proportionately; compulsory set-aside, i.e. the taking out of production of a certain percentage of arable land, was introduced as a condition for receiving aid; this measure applied only to producers growing more than 92 tonnes a year; below this level producers were considered to be small-scale and were exempt from the set-aside condition for receiving area aid; as an 'emergency brake' intervention was maintained at 90 % of the new target prices under uniform conditions throughout the Community;

(iii) *the structural objective*: to build larger farm units via a pre-pension scheme ⁽¹⁰⁾, but also prevent a rural exodus by the mainstream policies and other accompanying measures ⁽¹¹⁾;

(c) to realise the *objectives of Article 110 of the Treaty*; this objective was directly linked to international trade policy, as it compelled the Community to contribute to the 'harmonious development of world trade, the progressive abolition of restrictions on international trade and the lowering of customs barriers'; the requirement to evaluate the CAP under this objective was laid down in the Marrakesh Agreement, which closed the GATT Uruguay Round in April 1994.

⁽⁷⁾ COM(91) 100 final of 1 February 1991.

⁽⁸⁾ OJ L 181, 1.7.1992, p. 12.

OJ L 181, 1.7.1992, p. 21.

⁽⁹⁾ Before application of the price stabiliser relative to marketing year 1991/1992.

⁽¹⁰⁾ Council Regulation (EEC) No 2079/92 of 30 June 1992 (OJ L 215, 30.7.1992 p. 91).

⁽¹¹⁾ Council Regulations (EEC) No 2078/92 and (EEC) No 2080/92 of 30 June 1992 (OJ L 215, 30.7.1992, pp. 85 and 96).

3.5. For the six-year period of implementation of the Uruguay Agreement (1995-2000) the following measures were agreed:

- (a) *reducing outside protection*: import levies (quantity-based) were to be replaced by customs tariffs (value-based) and these were to be reduced in six equal instalments by 36 % in relation to the reference period 1986 to 1988; the starting point was calculated as the difference between the export prices of major suppliers outside the Community and the Community threshold price; by way of a concession it was agreed that the import duties on cereals would not lead to prices of imported cereals higher than 55 % above the intervention price, thus safeguarding so-called 'Community preference'; in addition, 'current access' ⁽¹²⁾ quotas for maize and sorghum imports into Spain and 'minimum access quotas' ⁽¹³⁾ for wheat, oats and maize (for Portugal only) were agreed at reduced or nil rates of duty;
- (b) *limiting subsidised exports*: with the exception of food aid, budgetary expenditure on export refunds was to be cut by 36 % and the volume of subsidised exports by 21 % over the six-year implementation period using the reference period 1986 to 1990;
- (c) *reducing domestic support*: based on 'Aggregate measures of support' for each product being the difference between an external reference price and an internal support price, multiplied by the volume of production during the reference period 1986 to 1988, internal market support was to be reduced by 20 % over the six-year period in respect of all products, taken together; exemptions were granted in respect of certain aid categories that did not distort competition (the so-called 'green box'), such as research, pest and disease control, etc.; in the case of cereals, area aid was made exempt from the reduction obligation under the so-called 'blue box', provided that such payments were based on fixed areas and yields, i.e. decoupled from real production.

4. EFFECTS OF THE REFORM

The cereals budget

4.1. The Mac Sharry plan included among its objectives the curbing of the growth of budgetary expenditure, i.e. the volume of expenditure incurred by the year 2000 was to be below the level forecasted prior to the reform. Although the Regulations introducing the Mac Sharry reform made no reference to the budgetary objective, the question of the cost of the reform is legitimate. Just prior to the reform (1993) total expenditure on cereals amounted to ECU 6 923,2 million (see Table 2). In the four financial years following the reform expenditure on cereals almost doubled growing by a yearly average of 17,4 % to ECU 13 167,1 million (1997). With regard to the structure of expenditure, the proportion of total expenditure on cereals taken up by export refunds and storage costs fell from 79,6 % in 1993 to 4,2 % in 1997. On the other hand, the proportion of area-aid paid increased from 11,5 % to 93,7 % over the same period.

4.2. As outlined in the Court's Annual Report concerning the financial year 1996 ⁽¹⁴⁾, budgetary expenditure was expected to increase as the burden of farm support was gradually passed from the consumer to the taxpayer. Indeed, the Commission forecast an expenditure increase of ECU 4 003,8 million (EU 12) between 1993 and 1997 (see Table 3). However, the final cost outstripped the forecast by about ECU 2 240 million.

4.3. The difference between the outturn and budget estimates is due to the fact that some cost elements were higher than estimated. Agrimonetary adjustments, the later inclusion of aid for silage other than that of maize, a higher premium for set-aside, higher base areas and yields ⁽¹⁵⁾ and the increase in the area eligible for special aid in respect of durum wheat ⁽¹⁶⁾ explain the increase in area aid. On the other hand, export refunds and storage costs amounted to less than expected during the period 1994 to 1997 as a result of high international prices. These high prices enabled the Commission to recover some depreciation costs by selling off previously devalued intervention cereals.

⁽¹²⁾ Current access quotas are the transcription of levy or duty concessions which the EC has made in the past on certain products for specified countries.

⁽¹³⁾ Minimum access quotas are import opportunities which must be opened at 36 % of the basic duty for the equivalent of 3 % rising to 5 % of internal consumption.

⁽¹⁴⁾ OJ C 348, 13.11.1997, paragraphs 3.5 to 3.8.

⁽¹⁵⁾ The Court of Auditors' Annual Report concerning the financial year 1996 (OJ C 348, 13.11.1997, paragraph 3.6).

⁽¹⁶⁾ The Court of Auditors' Annual Report concerning the financial year 1997 (OJ C 349, 17.11.1998, Chapter 2, Title 2).

Table 3

Comparison of estimates and real expenditure on cereals for EU-12 since the reform

(million ECU)

	Expenditure 1993	Expenditure 1994			Expenditure 1995			Expenditure 1996			Expenditure 1997			Cumulated difference 1994-1997
	Real	Real	Estimates	Difference	Real	Estimates	Difference	Real	Estimates	Difference	Real	Estimates	Difference	
1. <i>Area aid</i>														
Cereals and supplementary aid for durum wheat	425,9	5 540,3	5 890,0	- 349,7	8 166,6	7 854,0	312,6	9 867,5	9 817,0	50,5	10 867,0	9 817,0	1 050,0	1 063,4
Set-aside on cereals areas ⁽¹⁾	362,8	1 456,0	969,0	487,0	2 050,7	969,0	1 081,7	1 771,6	969,0	802,6	1 475,0	969,0	506,0	2 877,3
Total 1	788,7	6 996,3	6 859,0	137,3	10 217,3	8 823,0	1 394,3	11 639,1	10 786,0	853,1	12 342,0	10 786,0	1 556,0	3 940,7
2. <i>Other cereal expenditure</i>														
Export refunds	2 788,8	1 513,2	1 529,0	- 15,8	1 062,2	1 089,0	- 26,8	301,2	274,0	27,2	484,6	- 21,0	505,6	490,2
Storage costs	2 723,8	186,7	754,0	- 567,3	36,7	519,0	- 482,3	- 39,7	199,0	- 238,7	67,1	39,0	28,1	- 1 260,2
Other intervention	532,3	391,9	336,0	55,9	347,6	303,0	44,6	279,2	209,0	70,2	273,4	123,0	150,4	321,1
Co-responsibility levy	89,6	- 0,9	- 40,0	39,1	- 0,8	0,0	- 0,8	- 0,5	0,0	- 0,5	0,0	0,0	0,0	37,8
Total 2	6 134,5	2 090,9	2 579,0	- 488,1	1 445,7	1 911,0	- 465,3	540,2	682,0	- 141,8	825,1	141,0	684,1	- 411,1
3. <i>Grand total</i>	6 923,2	9 087,2	9 438,0	- 350,8	11 663,0	10 734,0	929,0	12 179,3	11 468,0	711,3	13 167,1	10 927,0	2 240,1	3 529,6
% difference to estimate				- 3,7 %			8,7 %			6,2 %			20,5 %	

⁽¹⁾ Calculated on the basis that 85 % (1992) of arable area concerns cereals.

Source: Commission's financial reports for EAGGF Guarantee from 1994 to 1997.

Council: Evaluation des incidences financières de la décision sur la réforme de la PAC, Agrifin 187, Agriorg 241, 8188/92 of 9.9.1992, table 2, part A.

4.4. With particular regard for 1997, the Commission predicted a decrease in total cereals expenditure of ECU 541 million by comparison with 1996 but the revenue and expenditure account shows an increase of ECU 988 million. However, the accounts do not present the real increase between the two years, because of cut-off problems. In 1995 the Commission paid an advance of ECU 738,5 million on the 1995 harvest to Spain and Portugal in order to compensate the negative financial impact the drought had on farmers in these two countries. Under normal circumstances this amount would have been paid under the 1996 budget. Furthermore the 1996 expenditure contains an amount of ECU 181,1 million and the 1997 expenditure an amount of ECU 160 million which are linked to late payments in certain Member States who were not able to conclude their prepayment controls in time. These amounts should have come under the budgets of previous years. If one reallocates all these amounts to the budget year which generated them, expenditure for 1996 would have amounted to ECU 12 892,7 million and for 1997 to ECU 13 010 million. Thus the real increase in expenditure would have been less important (ECU 117,3 million) but still quite different from the predicted decrease. Moreover, export refunds and storage costs increased again after three years of continuous decrease.

4.5. Although budgetary expenditure increased after the reform, the new system makes the real cost of agricultural support more transparent. Before the reform a large part of support did not enter the budget, as it was provided by consumers who had to accept prices which were substantially higher than world market prices. This burden was passed on to taxpayers, when area aid replaced much of the price support.

Production

4.6. Aside from the bumper crop in 1991 to 1992, *Table 1* shows that the EU 12's production in tonnes in the three transitional years 1993 to 1995 remained at levels close to those of the pre-reform period, fluctuating at around 165 million tonnes. In 1996 to 1997, after the transitional period, the EU 12's production rose to 191,2 million tonnes, thus outstripping the bumper crop of 1991 by about 10 million tonnes. The three new Member States added another 14 million tonnes, so that global production in the EU 15 reached 205,3 million tonnes in 1996/1997 and stayed at approximately the same level in the following marketing year. In 1998/1999, a new record harvest in the EU 15 of 208 million tonnes has been reached. The introduction of a single aid rate for oilseeds and cereals, as suggested in Agenda 2000, runs the risk of oilseeds being partly replaced by cereals, as the crop yields and prices of the latter are higher than those of oilseeds.

4.7. This global situation hides quite different developments within the Member States (see *Table 4*). The relative stability of total production during the transitional period was due to the fact that the significant increase in German production by comparison with the pre-reform 1989-1992 period was counterbalanced by a corresponding decrease in Spain (drought) and France. In the first two years of full application of the reform (1996-1997) France and Spain returned to pre-reform production levels, while Germany's rising trend continued. This shows that, had it not been for the exceptionally unfavourable production conditions in Spain and France, the observed jump in total production would already have occurred during the transitional period.

4.8. Given the fact that cereal yields are continually increasing, the main means of limiting production is by imposing compulsory set-aside. Indeed, since set-aside was introduced, it has reduced production by about 86 million tonnes in total (between 1993 and 1997). The argument that world prices that were temporarily higher than internal prices would cause supply shortages in the EU led to the set-aside rate being reduced from 15 % to 12 % in the third year of the reform. In the fourth year the rate went down to 10 % and was then fixed at 5 % for the 1997/1998 and 1998/1999 marketing years. When compared with a production of more than 200 million tonnes (1997/1998), the effect of such a low set-aside rate is minimal. However, it also becomes clear that reducing production to levels closer to internal-market needs (i.e. at present, a reduction of about 30 million tonnes would be required) by means of set-aside alone may call for drastic set-aside levels, which would encourage farmers to further intensify production on the remaining land thus offsetting the intended reduction of production.

4.9. In addition, the set-aside rates are submitted for a Council decision one year in advance and are based on an estimated cereals balance of marketing year n and projected figures for marketing years $n+1$ and $n+2$. However, at the end of marketing year n (in June) the Commission will not have reliable information on the year concerned (reliable Eurostat figures are available only two years later), nor can the future situation be forecast with sufficient accuracy. The arbitrariness of this system was revealed in 1997, when the Council demanded that the Commission present a proposal fixing the set-aside rate at 5 % ⁽¹⁷⁾.

⁽¹⁷⁾ Council document No 9462/97 of 27 June 1997, compromise package on prime and related amounts for 1997/1998.

Table 4
Cereals (excluding rice) production data from 1989 to 1997

	1989	1990	1991	1992	1993	1994	1995	1996	1997 ⁽¹⁾
	EU-12	EU-12	EU-12	EU-12	EU-12	EU-12	EU-15	EU-15	EU-15
Area (1 000 ha)									
Belgium	349,6	334,6	315,0	310,7	312,3	309,4	308,8	294,8	303,2
Denmark	1 577,8	1 581,7	1 573,3	1 611,9	1 437,9	1 406,2	1 454,0	1 523,2	1 573,0
Germany	4 639,5	4 470,7	6 559,9	6 514,5	6 223,6	6 235,4	6 526,7	6 707,4	7 023,5
Greece	1 432,5	1 453,8	1 480,1	1 392,2	1 340,3	1 321,7	1 209,9	1 270,5	1 279,5
Spain	7 851,1	7 463,0	7 719,7	7 318,1	6 378,0	6 422,6	6 638,1	6 625,1	6 872,5
France	9 420,2	9 040,5	9 207,3	9 320,8	8 507,9	8 137,6	8 266,8	8 817,5	9 142,0
Ireland	321,7	300,5	301,5	300,3	285,0	270,0	273,9	293,5	308,7
Italy	4 421,0	4 192,6	4 196,7	4 011,7	3 844,1	3 867,7	3 986,0	4 016,8	3 944,8
Luxembourg	34,3	33,0	31,0	29,7	29,5	29,6	28,8	29,8	28,7
Netherlands	202,3	196,3	181,6	183,4	186,6	194,1	198,0	205,7	207,4
Austria	na	na	na	846,9	834,4	830,6	754,3	809,9	848,1
Portugal	873,9	723,5	794,3	730,5	699,0	657,0	667,0	640,6	668,0
Finland	na	na	na	na	922,2	944,6	977,7	1 075,3	1 112,5
Sweden	na	1 287,2	1 148,3	1 140,7	1 124,7	1 173,1	1 104,5	1 216,3	1 269,5
United Kingdom	3 874,3	3 658,4	3 500,9	3 488,8	3 030,8	3 041,8	3 180,2	3 356,6	3 512,0
Total EU-12	34 998,1	33 448,6	35 861,3	35 212,7	32 275,0	31 893,2	32 738,2	33 781,6	34 863,4
Total EU-15	na	na	na	na	35 156,3	34 841,5	35 574,7	36 883,0	38 093,4
Usable production (1 000 t)									
Belgium	2 220	1 964	2 050	1 997	2 141	2 025	1 981	2 380	2 350
Denmark	8 795	9 530	9 232	6 954	8 197	7 800	9 150	9 218	9 683
Germany	26 113	37 580	39 267	34 758	35 547	35 824	39 220	42 136	45 408
Greece	5 195	4 042	6 055	4 946	4 275	4 790	4 213	4 151	4 556
Spain	19 047	17 904	18 596	13 731	16 893	14 605	11 073	21 217	18 583
France	57 465	54 876	60 219	60 450	55 498	53 283	53 425	62 349	62 493
Ireland	2 051	2 110	1 964	2 017	1 626	1 616	1 796	2 142	1 937
Italy	15 961	16 065	17 983	18 641	18 096	17 661	18 290	19 692	18 396
Luxembourg	144	148	156	152	151	134	147	175	156
Netherlands	1 365	1 359	1 255	1 350	1 465	1 356	1 504	1 660	1 536
Austria	4 872	5 137	4 913	4 323	4 207	4 436	4 455	4 494	5 009
Portugal	1 688	1 272	1 628	1 236	1 392	1 533	1 340	1 470	1 317
Finland	4 296	3 429	2 603	3 340	3 399	3 367	3 333	3 698	3 799
Sweden	5 490	6 404	5 160	3 760	5 242	4 472	4 792	5 953	6 120
United Kingdom	22 729	22 576	22 630	22 064	19 484	19 946	21 861	24 576	23 620
Total EU-12	162 773	169 426	181 035	168 296	164 765	160 573	164 000	191 166	190 035
Total EU-15	177 431	184 396	193 711	179 719	177 613	172 848	176 580	205 311	204 963
Yield (t/ha)									
Belgium	6,35	5,87	6,51	6,43	6,86	6,54	6,41	8,07	7,75
Denmark	5,57	6,02	5,87	4,31	5,70	5,55	6,29	6,05	6,16
Germany	5,63	8,41	5,99	5,34	5,71	5,75	6,01	6,28	6,47
Greece	3,63	2,78	4,09	3,55	3,19	3,62	3,48	3,27	3,56
Spain	2,43	2,40	2,41	1,88	2,65	2,27	1,67	3,20	2,70
France	6,10	6,07	6,54	6,49	6,52	6,55	6,46	7,07	6,84
Ireland	6,38	7,02	6,51	6,72	5,71	5,99	6,56	7,30	6,27
Italy	3,61	3,83	4,29	4,65	4,71	4,57	4,59	4,90	4,66
Luxembourg	4,20	4,49	5,03	5,11	5,12	4,52	5,11	5,86	5,44
Netherlands	6,75	6,92	6,91	7,36	7,85	6,99	7,60	8,07	7,41
Austria	na	na	na	5,10	5,04	5,34	5,91	5,55	5,91
Portugal	1,93	1,76	2,05	1,69	1,99	2,33	2,01	2,29	1,97
Finland	na	na	na	na	3,69	3,56	3,41	3,44	3,41
Sweden	na	4,98	4,49	3,30	4,66	3,81	4,34	4,89	4,82
United Kingdom	5,87	6,17	6,46	6,32	6,43	6,56	6,87	7,32	6,73
Total EU-12	4,65	5,07	5,05	4,78	5,11	5,03	5,01	5,66	5,45
Total EU-15	na	na	na	na	5,05	4,96	4,96	5,57	5,38

⁽¹⁾ For 1997, the usable production figure was not available, It has been replaced by the production figure which is a little bigger.

na: Not available

Source: New Cronos (up-date as at September 1998).

4.10. The consequence of this system is that the Commission cannot act with immediate effect. If figures subsequently proved incorrect, the system would be destabilised rather than stabilised and a supply shortage or surplus could result. Indeed, at the end of the 1997/1998 marketing year the low set-aside rate of 5 % again led to higher production and resulted in intervention stocks amounting to 14,5 million tonnes, the second highest level since the 1993 to 1994 period. Based on the production for 1998 to 1999 (see paragraph 4.6), intervention stocks may again reach pre-reform levels.

Consumption

4.11. Table 1 shows a clear increase in internal consumption from the 1993/1994 marketing year onwards. While average consumption in the four years before the reform was about 138 million tonnes, it increased within the EU 12 to 152,1 million tonnes in the four years after the reform.

4.12. The greater proportion of Community cereals is used for animal feed (62 %) and the increase in internal consumption is due mainly to the fact that their use for animal feed and industrial purposes has increased. The increase between the four years prior to the reform and the four years following it averaged at about 12 %. Human consumption accounted for just 24 % of total consumption in 1996/1997. It rose by 6 % within the EU 12.

4.13. The increasing use of Community cereals for animal feed is explained by the growing production of compound animal feed (11 % increase since 1992/1993) and the narrowing price gap between the price of Community cereals and the world market price for cereal substitutes (e.g. corn gluten, manioc, and sweet potatoes), which made EU cereals more competitive. While in 1992 to 1993 the average price of cereal substitutes was just 68 % of the average price of cereals, the ratio increased to 83 % in 1996 to 1997. The result was that in 1997 animal feed consisted of 55 % cereals, 20 % substitutes and 25 % of proteins. In the year prior to the reform these ratios were 46 %, 26 % and 28 % ⁽¹⁸⁾ respectively.

4.14. The comparison shows that Community cereals benefited by increased production of animal feed. However, the change in the composition of animal feed also shows how readily one ingredient may be substituted with another, when relative prices change.

Prices

Producer prices

4.15. One of the principles on which the CAP was founded at the Stresa Conference was that of a Single Market. Price support was organised on the unjustified assumption that a single market would require, *inter alia*, uniform prices ⁽¹⁹⁾. However, a single price for cereals is not a condition for a single market; it would occur only if cereals were a homogeneous product traded under conditions of perfect competition. Reality proved and continues to be different ⁽²⁰⁾. The market prices of the various cereals and of the different qualities of any one cereal varied between and within Member States within the margin between artificial target and intervention prices. Trade is organised by a very limited number of large trading companies, hence the primary market meets the criteria governing an oligopsony, rather than those for perfect competition. Intervention in the form of public storage was needed to keep prices high via the artificial reduction of market supply. Because intervention suppressed the price signals which would have transferred supplies from areas with surpluses to those with shortage, regional imbalances in cereal supplies had to be redressed by means of transfers of intervention cereals organised by the Commission at high cost. The introduction in 1992 of a single target and a single intervention price for all kinds of cereals, albeit at a lower level, did nothing to make the COM work better.

4.16. On the basis of the unrealistic assumption of uniform prices, it was expected that market prices would follow closely the reduction in institutional prices. However, owing to bad harvests worldwide in 1994 and 1995, world market prices remained exceptionally high. Consequently, EU market prices also remained well above the new target price. Graph 1 illustrates this with regard

⁽¹⁹⁾ Commission, Documentation Européenne Périodique 6/1982: *La politique agricole de la Communauté européenne*, troisième édition, Luxembourg ISBN 92-825-3001-8, p.15.

⁽²⁰⁾ Tangermann Stefan, Eurostat, *Agricultural price trends in the EC*, ISBN 92-826-5049-9.

⁽¹⁸⁾ DG VI working document VI-7316-96.

to the average producer prices for all cereals (unit values calculated by Eurostat).

4.17. Nevertheless, market prices in the various Member States did not follow this general trend to the same extent. The market price for common wheat, the main cereal, remained quite high in Spain and Italy, and even above the average intervention price of ECU 155/t ⁽²¹⁾ in 1992, which was used as the reference level for the reform (see *Graph 2*). In addition, currency movements worked against the drop of institutional prices in national currencies thus putting the level of price guarantee higher. The high price levels in Italy and Spain are mainly due to the traditional supply deficit of home-grown cereals in these two Member States' markets. The drought which hits Mediterranean countries every three or four years (Spain) and the initial set-aside (Italy) further aggravated the supply situation. Low public stocks in the other Member States and relatively high transport costs in relation to cereal prices appear to have prevented cereals from other Member States from being put on the Spanish and Italian markets and thereby bringing prices down.

4.18. The reform also equalised target and intervention prices for different cereals, even though market prices continued to vary quite substantially between one kind of cereal and another (see *Graph 3*). On average, durum wheat is the most expensive cereal on the market, being 40 % more expensive than the cheapest, rye. Owing to differing production structures and market situations, cereal prices also differ between Member States, as *Table 5* shows.

4.19. It can be seen that the trend in market prices indicates rather different features from one Member State and one cereal to another. In 1997 and 1998, owing to good harvests in Europe, cereal prices dropped to the intervention-price level and intervention buying recommenced. Under such conditions it is not the market which determines what cereal is produced, but the intervention price. At this fixed price the farmer will choose the cereal which gives him the highest yield at the lowest production cost, irrespective of the level of market supply.

Consumer prices

4.20. One of the reasons for replacing price support by direct-income support for farmers by means of area-aid payments was to shift the burden of financing farm incomes from the consumer to the taxpayer. Without doubt cereal purchasers benefited from decreased prices after the reform; for final consumers, however, it is rather difficult to measure the effects of lower cereal prices on food prices. Too many other factors influence consumer end-prices and, except in the case of animal feed, cereals account for only very small value percentages in the price of products for human consumption. Even in the case of bread, its share of the sale price is between 2 % and 4 % only ⁽²²⁾. Indeed, prices for principal foodstuffs, such as bread have followed the same trend as before the reform (see *Table 6*). Prices for pasta, however, seem to have decreased slightly, but according to Italian producers this was the consequence of harsh competition between them, rather than a direct consequence of lower cereal prices. Although cereal prices affect the price of compound feed more than the price of goods for human consumption, actual lower meat prices may be influenced more by exceptional situations (BSE crises ⁽²³⁾ and swine fever), rather than by cheaper inputs for compound feed. Lower prices noted for chicken, however, may be the result of lower feed prices ⁽²⁴⁾.

4.21. A recent report by the Commission bringing together the findings of a series of impact analyses of the reform proposals made in Agenda 2000 ⁽²⁵⁾ predicts that the price reduction for cereals, beef and milk products will reduce consumers' food bills by about 1,9 %. The absolute advantage is estimated to be about ECU 12 500 million per year. However it appears to the Court that in practice the benefit to the consumer is unlikely even to

⁽²¹⁾ This amount is in 'green' ecu. To obtain budgetary ecu, this figure has first to be converted with the 'green' exchange rate applying to agricultural products into the national currency and then, re-converted with the official market exchange rate into ecu. From 1 February 1995 onwards the existing difference of 20,75 % between the 'green' ecu and the budgetary ecu has been abolished by increasing the amount by the same difference.

⁽²²⁾ According to information collected from consumer associations.

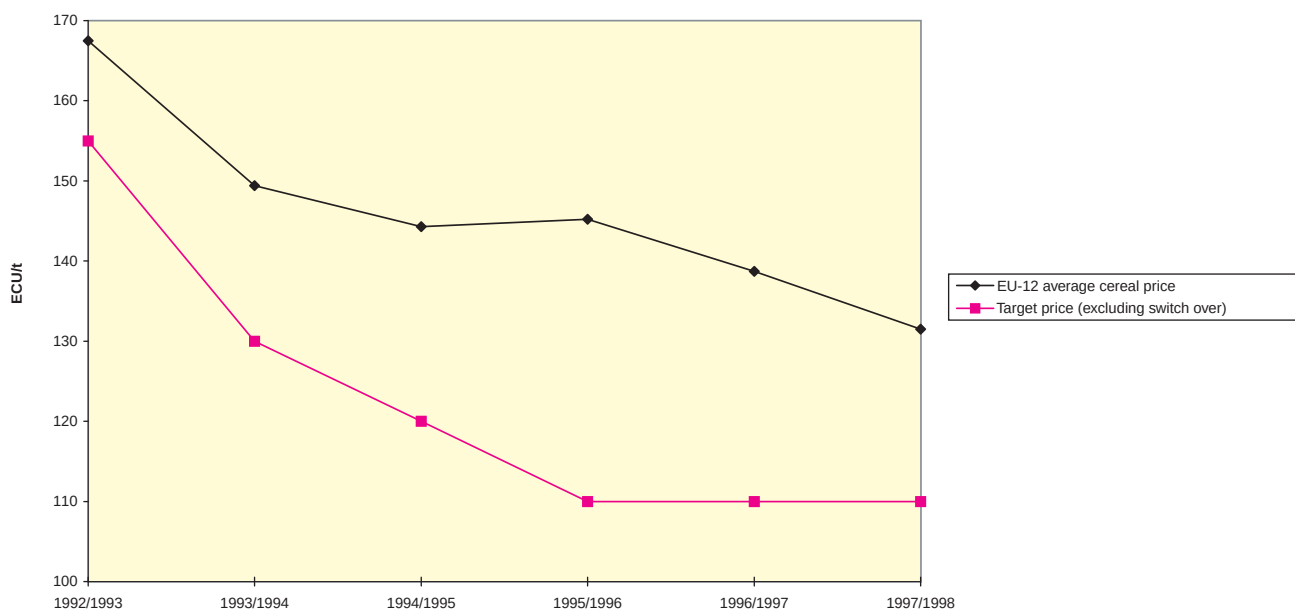
⁽²³⁾ See the Court's Special Report No 19/98 of 4.12.1998 on BSE (OJ C 383, 9.12.1998).

⁽²⁴⁾ The Court was unable to find any significant reduction in consumer prices which could have been clearly linked to the reduction in institutional prices. A recent audit of the Swedish National Audit Office of the consumer price problem came to the same results for Sweden.

⁽²⁵⁾ European Commission, DG VI — CAP Reports — CAP reform proposals, Impact analyses — October 1998 — Luxembourg.

Graph 1

EU-12 average producer cereal price and target price (ECU/t)

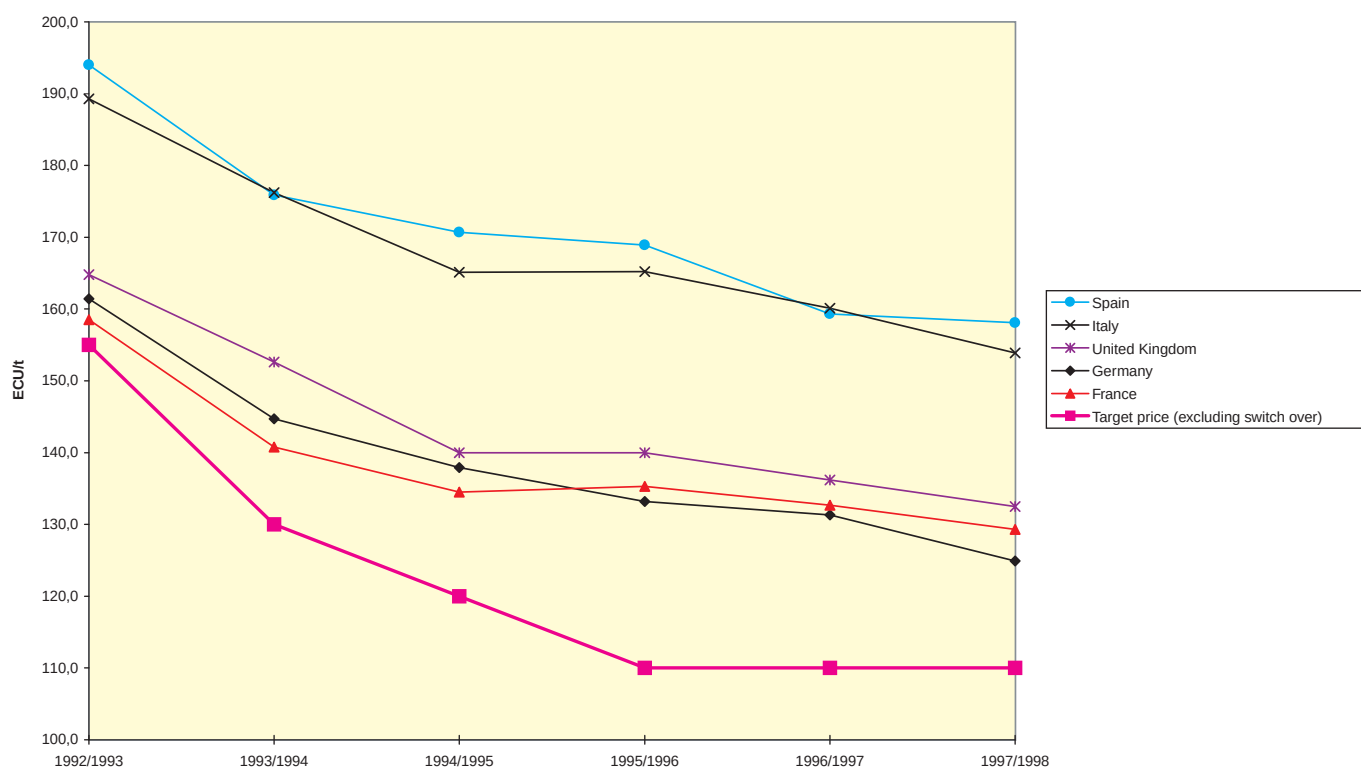


Note: The target price was abolished after it reached its foreseen lowest level.

Source: Eurostat, annual unit values turned into marketing year unit values.

Graph 2

Target price and producer soft wheat price in the five main Member States (ECU/t)

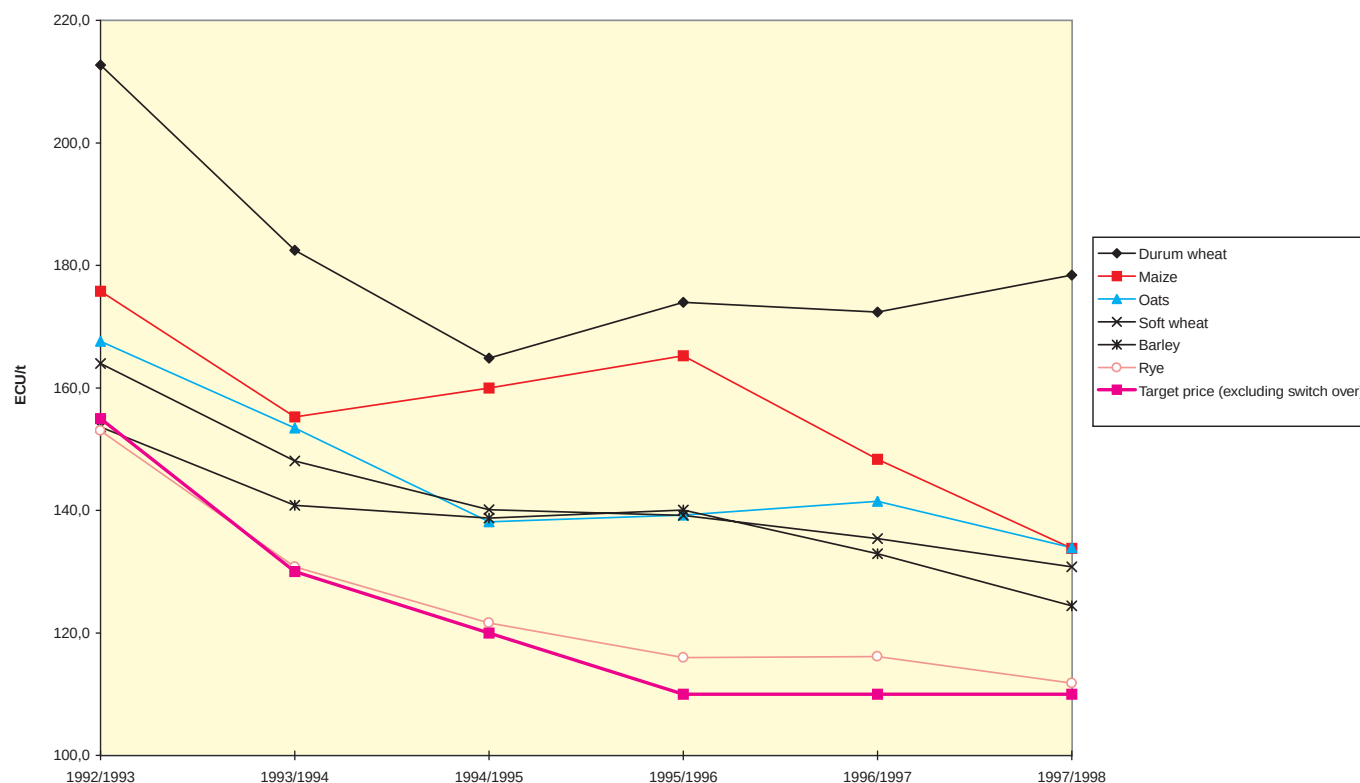


Note: The target price was abolished after it reached its foreseen lowest level.

Source: Eurostat, annual unit value turned into marketing year unit values.

Graph 3

EU-12 average producer price of different cereals and target price (ECU/t)



Note: the target price was abolished after it reached its foreseen lowest level.

Source: Eurostat, annual unit values turned marketing year unit values.

reach the additional burden to taxpayers of an extra ECU 10 000 million a year (see Table 7 which compares the cost per inhabitant of public support to the cereal market before and after the reform).

Stocks

4.22. A distinction needs to be drawn between private storage and public storage (intervention). While private storage serves, primarily, commercial purposes, and therefore forms part of internal demand, public storage comprises an artificial outlet for production not absorbed by the market at given prices. Table 1 provides some information concerning both types of storage. The figures show that private stocks were fairly stable from marketing year 1989/1990 onwards. However, in 1992/1993, the last year before the reform took place, private stockholders feared the price reductions involved in the reform and sold private stocks into intervention. Private stocks were therefore 'emptied' and intervention stocks grew to their record level of 32,2 million

tonnes, with the corresponding budgetary consequences.

4.23. Following the reform, private stocks resumed their normal levels again. As a consequence of market prices being above intervention prices and of increased internal demand, in 1996/1997 intervention stocks fell to their lowest level for a long time at 2,4 million tonnes. In that year increasing market prices made traders expand their private stocks to 25,6 million tonnes, as compared with 19,7 million in the previous year, in the hope of further price increases. Given the marked downturn in market prices from 1996/1997 onwards, there is a risk that those quantities kept for speculative purposes will later end up in intervention stores. Indeed, the Commission predicted intervention stocks of up to 10,7 million tonnes ⁽²⁶⁾ for 1997/1998. However, this figure was still too optimistic. Intervention stocks at the end of June 1998 amount to 14,5 million tonnes, as compared with 2,4 million tonnes in 1996/1997.

⁽²⁶⁾ CAP 2000 Commission's working document, Long-term Prospects, April 1997, page 23.

Table 5
Cereal producer prices per Member State for EU-12

(ECU/t)

	Before the reform					Since the reform				
	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
Soft wheat										
Belgium	180,4	172,0	172,8	169,1	164,3	135,9	130,5	135,1	128,0	n.a.
Denmark	172,6	171,4	157,6	162,5	168,3	145,6	136,2	135,9	132,5	121,0
Germany	186,3	177,0	168,7	167,0	169,3	146,7	140,9	132,4	134,7	124,9
Greece	161,7	185,7	179,1	176,8	172,0	163,4	162,2	174,9	153,2	154,7
Spain	n.a.	n.a.	197,7	215,4	201,8	179,5	169,1	173,7	n.a.	n.a.
France	179,5	176,1	173,3	168,8	166,0	144,6	133,8	135,8	134,5	129,3
Ireland	163,0	158,7	151,9	152,5	143,3	136,5	115,9	141,4	123,8	103,9
Italy	210,1	216,5	201,1	210,7	193,1	182,5	164,6	166,2	163,4	153,9
Luxembourg	169,8	164,2	159,1	155,1	154,6	127,3	129,8	132,8	124,7	118,2
Netherlands	175,6	171,3	160,0	164,4	158,2	133,3	134,4	133,4	126,2	108,6
Portugal	295,5	290,6	280,7	250,9	231,7	185,3	160,0	165,2	151,7	133,4
United Kingdom	166,2	164,1	161,0	175,7	167,6	159,6	139,5	140,9	138,2	132,5
Durum wheat										
Belgium	180,4	172,0	172,8	169,1	164,3	135,9	130,5	135,1	128,3	n.a.
Greece	212,7	245,5	242,1	200,0	190,3	161,3	134,9	173,1	149,7	150,3
Spain	n.a.	n.a.	227,7	222,1	215,8	142,6	162,5	179,6	n.a.	n.a.
France	259,4	276,5	255,6	225,7	215,4	191,6	164,0	174,4	162,4	175,9
Italy	261,5	298,6	282,5	264,1	237,6	216,2	165,6	178,4	177,6	187,6
Rye										
Belgium	168,4	162,4	154,3	154,8	150,8	118,0	119,6	121,3	109,9	n.a.
Denmark	156,0	160,0	149,1	152,8	160,9	135,3	126,5	123,6	124,9	117,3
Germany	179,6	171,6	162,9	155,5	162,6	130,8	124,1	112,4	116,3	110,6
Greece	142,8	153,1	150,7	150,7	160,4	145,2	132,3	139,3	170,2	171,2
Spain	n.a.	n.a.	174,3	177,2	180,5	153,2	143,0	148,3	n.a.	n.a.
France	174,8	164,3	158,9	159,3	154,0	132,2	125,4	123,0	119,8	113,8
Italy	197,8	199,3	184,6	181,9	167,4	160,2	146,2	140,8	158,2	151,4
Luxembourg	166,8	161,5	154,0	145,6	145,5	121,6	117,7	111,2	107,3	95,4
Netherlands	167,0	175,6	155,7	138,5	145,1	128,7	120,5	109,6	121,5	99,5
Portugal	268,7	263,5	252,3	187,1	183,5	162,8	145,8	146,4	143,0	120,9
United Kingdom	168,6	165,0	167,4	171,8	160,5	145,6	136,2	127,9	130,3	126,7
Barley										
Belgium	166,9	160,1	153,8	152,6	150,5	125,1	125,6	120,5	118,7	n.a.
Denmark	163,8	164,5	155,4	155,7	164,0	144,4	138,9	146,4	142,1	128,0
Germany	184,2	174,4	170,6	159,6	164,5	138,3	134,5	133,6	137,3	118,0
Greece	152,6	169,4	170,1	172,1	167,5	158,0	147,6	164,2	172,4	171,2
Spain	n.a.	n.a.	173,8	177,3	169,3	148,1	138,8	156,6	n.a.	n.a.
France	165,4	163,9	161,0	157,6	151,1	131,0	130,8	138,4	133,4	122,2
Ireland	150,8	155,1	151,2	148,2	142,0	126,8	112,7	136,8	123,8	103,8
Italy	189,9	194,6	190,5	192,4	176,8	168,4	160,4	160,6	162,3	153,4
Luxembourg	157,7	154,5	137,9	132,7	137,5	118,6	128,0	112,8	106,8	98,9
Netherlands	175,6	184,1	173,0	160,1	162,6	137,9	143,6	147,7	135,5	108,6
Portugal	268,7	263,5	252,3	187,1	183,5	162,8	145,8	146,4	143,0	125,9
United Kingdom	167,9	169,9	169,4	168,7	158,8	155,7	146,7	144,9	138,0	122,6
Oats										
Belgium	168,3	161,4	146,5	161,0	175,6	135,1	118,3	111,1	115,9	n.a.
Denmark	168,7	152,8	152,3	154,8	180,1	162,9	125,8	120,3	133,0	124,3
Germany	169,9	160,7	152,0	146,6	159,3	144,7	124,5	116,2	121,3	111,3
Greece	175,6	209,2	197,2	198,9	193,2	186,2	244,8	188,5	186,4	187,5
Spain	n.a.	n.a.	161,3	167,4	176,0	158,6	139,8	159,6	n.a.	n.a.
France	187,2	162,3	167,3	173,1	171,6	152,0	148,7	155,4	162,7	161,3
Ireland	152,6	148,2	145,7	139,7	144,1	137,4	104,8	121,3	119,6	101,3
Italy	230,9	251,6	223,4	226,3	222,5	211,8	188,1	183,1	217,0	204,7
Luxembourg	154,2	156,0	133,0	138,3	158,8	128,4	123,9	103,9	112,0	101,4
Netherlands	179,9	149,9	164,3	177,4	180,2	156,3	129,7	128,6	121,5	90,5
Portugal	199,9	196,1	182,2	197,1	200,1	187,0	145,4	178,5	183,9	201,4
United Kingdom	166,2	154,6	155,9	159,6	159,4	165,6	136,7	121,7	130,1	115,8
Maize										
Germany	170,5	165,3	173,0	183,0	168,5	137,3	141,8	151,1	139,0	117,4
Greece	173,1	188,5	192,3	170,5	175,0	164,3	141,5	174,6	130,7	129,6
Spain	n.a.	n.a.	219,1	220,4	197,2	194,9	169,1	171,3	n.a.	n.a.
France	191,4	184,7	226,2	187,1	185,7	145,2	153,6	173,1	153,7	129,5
Italy	199,7	195,3	210,3	217,8	191,2	172,7	158,8	169,0	166,9	137,4
Portugal	238,2	233,5	223,6	196,9	192,9	171,5	150,3	150,9	153,2	141,0

n.a.: Not available.

Source: Eurostat unit values of agricultural products.

Table 6

Consumer price index in nominal terms of bread and cereals for EU — 12

(1985 = 100)

	1987	1988	1989	1990	1991	1992	1993	1994	1995
Belgium	105,8	106,8	111,8	114,0	117,1	120,7	123,4	124,9	n.a.
Denmark	109,9	118,2	123,6	126,5	130,4	134,8	138,1	140,4	142,4
Germany	102,2	103,5	105,2	108,4	113,4	119,4	123,5	126,1	n.a.
Greece	140,2	155,1	179,1	221,0	261,4	315,3	360,3	382,6	408,5
Spain	108,3	117,6	137,7	148,5	163,1	178,5	190,8	197,8	206,0
France	107,2	111,0	114,7	118,7	122,7	126,8	129,6	131,0	132,4
Ireland	114,2	116,8	113,3	116,5	122,6	126,1	124,9	128,0	n.a.
Italy	111,5	116,2	123,5	131,0	139,3	147,0	156,8	164,4	169,0
Luxembourg	106,3	112,3	113,4	116,9	122,6	124,3	126,1	128,9	131,8
Netherlands	101,9	102,4	103,0	104,8	107,7	112,5	115,0	115,9	117,1
Portugal	124,9	127,6	140,2	169,7	203,4	229,5	239,4	250,9	249,9
United Kingdom	109,0	116,2	122,9	131,1	140,7	145,4	145,7	146,7	148,1

n.a.: not available.

Source: The agricultural situation in the European Union — 1989 to 1997 report.

Table 7

Estimation of the average budgetary expenditure for cereals per inhabitant

	Before new CAP				New CAP			
	1990	1991	1992	1993	1994	1995	1996	1997
	EU-12	EU-12	EU-12	EU-12	EU-12	EU-15	EU-15	EU-15
Total expenditure for cereals (million ECU) ⁽¹⁾	3 817,5	5 142,8	5 582,5	6 923,2	9 087,2	11 729,2	13 061,1	14 127,1
Total population as at 1 st January (1 000) ⁽²⁾	342 572	344 072	345 527	347 281	348 595	371 589	372 670	373 687
Average cost per inhabitant (ECU/inhabitant)	11,14	14,95	16,16	19,94	26,07	31,57	35,05	37,80

Source:

⁽¹⁾ See Table 2.⁽²⁾ Eurostat (New Cronos up-date as at June 1998).**External trade**

4.24. The annual figure for world cereals production is about 1 500 million tonnes. Only 12 % of these cereals are traded worldwide and relatively small changes in quantities traded have a significant influence on world market prices. The Community is the third largest producer of cereals in the world and the second largest trader in cereals internationally after the USA.

to its own production. Since the reform imports have continued to decrease, reaching less than 3 % of Community production. More than 50 % of these imports consist of tariff quotas at reduced custom duties for 2,5 million tonnes of maize and 0,3 million tonnes of sorghum which were introduced for Spain and Portugal after they had become members of the Community. The remaining imports comprise mainly special qualities of wheat which are not produced in the EU ⁽²⁷⁾.

Exports

4.26. Prior to the reform, the Community constantly increased its exports, which reached 36,8 million tonnes in 1992/1993. The

Imports

4.25. Before the 1992 reform the Community had continually decreased its imports of cereals in absolute terms and in relation

⁽²⁷⁾ 0,3 million tonnes of these quantities can be imported duty free.

cost of these exports for the Community budget amounted to an average of ECU 3 000 million over the years 1992 and 1993. During the transitional period, world prices for cereals were close to or even above internal market prices in some Member States. Therefore, in 1995/1996, 11,2 million tonnes of mainly wheat could be exported without paying export refunds. For 9,2 million tonnes of mainly coarse grains, export refunds had to be paid costing the budget about ECU 700 million on average over 1995 and 1996. The EU could have exported even more, if the Commission had not introduced export taxes thus discouraging the export of cereals and preventing internal prices from rising too far above the target price. Under these circumstances it was easy to comply with the WTO Agreement, i.e. to decrease both the total amount of export refunds and the quantity of subsidised exports.

4.27. From 1995/1996 onwards subsidised exports rose again, reaching 23,4 million tonnes in 1997/1998. This reflects the drop in world prices below the EU price level and the return of surpluses on the internal market. Indeed, in July 1998 world prices stood at USD 90/t, below the price on which the Commission had based its proposal for a new intervention price in Agenda 2000.

4.28. Exports are sometimes considered to comprise part of the demand that is to be taken into account when establishing market balance. It is claimed that the Community has a vocation to export, at least in the cereals sector, and that such exports provide foreign currency that benefits the Community's balance of payments. However these arguments appear to be not convincing at all:

- (a) if cereals are sold by Community traders on the world market at a price which is below the purchase price, the gap is bridged by export refunds; exceptionnally, such subsidies are accepted, under certain conditions, by the WTO;
- (b) subsidised exportation of this nature is an artificial outlet created by the Community budget, rather than by autonomous demand based on the EU's competitive edge; the world market would not absorb the quantities exported at their purchase price; producing for export under such circumstances is not the best use of Community economic and financial resources.

Farm income from cereals

4.29. From the very start the overriding objective of the CAP has been 'to ensure a fair standard of living for the agricultural community, in particular by increasing the individual earnings of persons engaged in agriculture' ⁽²⁸⁾. According to the Treaty this should have been a consequence of increased agricultural productivity ⁽²⁹⁾, rather than of interventions in the market process that alter its genuine parameters (prices and farm income).

4.30. In 1991, when the reform proposals were published, the European farmers' organisations (COPA and Cogeca) predicted that in 1997 farmers would have an average income loss per work unit of almost 40 % by comparison with 1991. This would indeed have aggravated the cereal sector's situation, as its income was already the lowest within the agricultural sector ⁽³⁰⁾. In reality the cereals sector gained quite considerably under the reform as a combined result of persons leaving farming, increasing yields and subsidies. *Graph 4* shows that in 1995 the family farm income per working unit in the cereals sector increased by 95 % by comparison with the prereform 1990 to 1992 period. In cases where grain merchants and trading companies owned major cereal farms they made even more substantial gains.

Compensation in the cereals sector

4.31. The relative prosperity of the cereals sector is due to the introduction of area aid, known as compensatory payment, to compensate farmers for income losses attributable to the reduction in institutional prices. Although the preamble of the Regulation provides that compensatory aid should compensate farmers for income losses resulting from the reduction in institutional prices, the intended compensation rates per tonne were fixed in the same Regulation without any reference having been made to income losses and institutional prices thereby leaving some uncertainties. However, it becomes clear from reports drawn up by the Council's Agrifin group in September 1991 ⁽³¹⁾ and July 1992 ⁽³²⁾, that the rates were set at the level of the differences between the

⁽²⁸⁾ Article 39(1)(b) of the EC Treaty.

⁽²⁹⁾ Article 39(1)(a) of the EC Treaty.

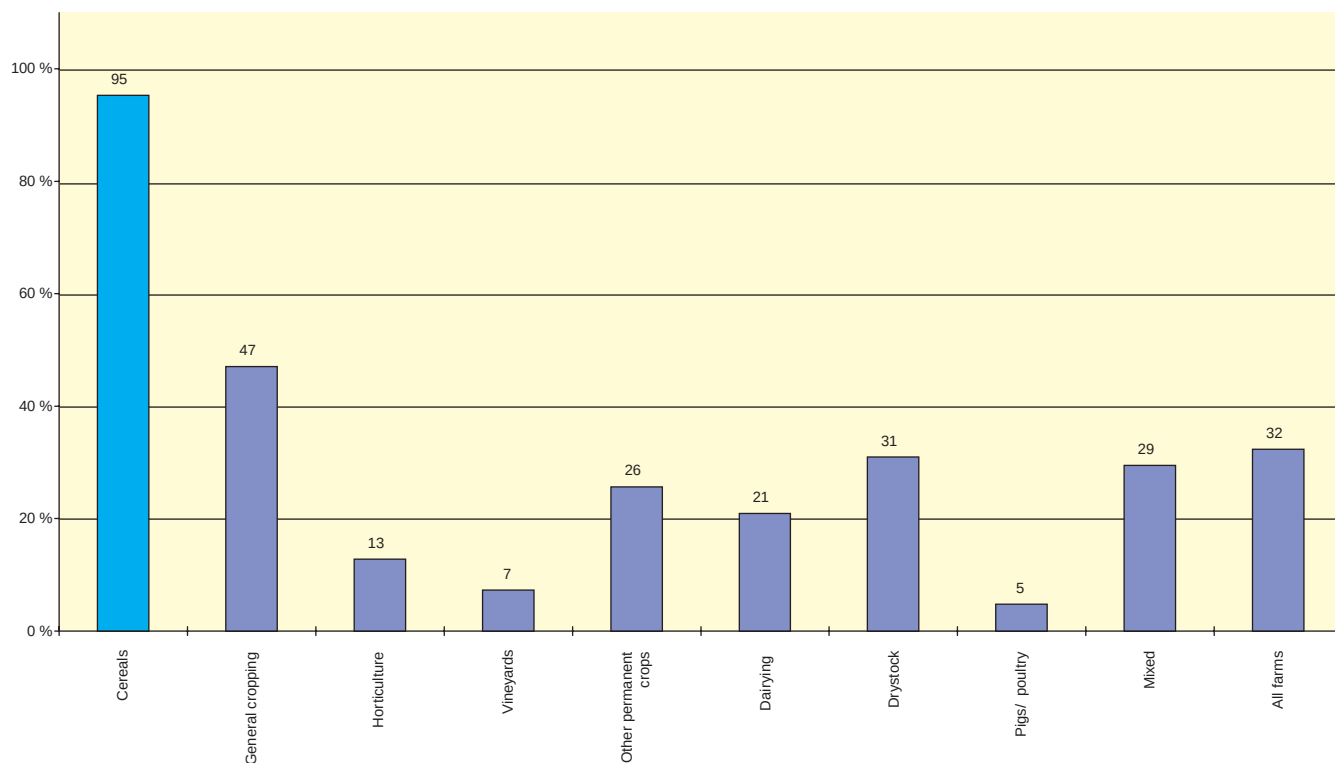
⁽³⁰⁾ Commission, FADN, Farm income results in the EU 1990-95.

⁽³¹⁾ Council Document No 8156/91 of 19 September 1991.

⁽³²⁾ Council Document No 8188/92 of 9 September 1992.

Graph 4

Change in family farm income per working unit and per type of farming for EU-12 in 1995 as compared to 1990 to 1992 (in percentage)



Source: Commission, FADN, Farm income results in the EU 1990 to 1995 (real 1995 ECU).

average guaranteed price at which cereals were bought into intervention during the 1991/1992 marketing year (ECU 155/t) and the reduced target prices set by the Council for marketing years 1993/1994 at ECU 130/t, 1994/95 at ECU 120/t and 1995/1996 at ECU 110 ECU/t⁽³³⁾ ⁽³⁴⁾. These target prices were meant to approximate the average of the market prices of the Member States.

4.32. The above provisions imply the following:

(a) compensatory payments were not meant to compensate farmers according to individual market prices of each Member

⁽³³⁾ The target price was abolished from the 1995/96 marketing year onwards, as it had become redundant; Council Regulation (EC) No 1528/95 of 29 June 1995 (OJ L 148, 30.6.1995, p. 3).

⁽³⁴⁾ This amount is in 'green' ecu. To obtain budgetary ecu, this figure had first to be converted with the 'green' exchange rate applying to agricultural products into the national currency and then, reconverted with the official market exchange rate into ecu. From 1 February 1995 onwards the existing difference of 20,75 % between the 'green' ecu and the budgetary ecu has been abolished by increasing the amount by the same difference.

State; otherwise, it would be difficult to defend the decoupled nature and thus comply with the WTO requirements (see paragraph 3.5(c));

(b) the payments neither sought to compensate for the impact of other factors, such as climatic conditions, increasing yields, currency movements, nor were they designed to compensate differences in income determined by farm size, soil quality and individual farming skills;

(c) set-aside was to be compensated only at the level of the compensation rate for cereals.

4.33. The compensatory aid based on an average price (target price) fixed at a level irrespective of any movement in actual market prices led to over-compensation at global level. As market prices did not fall as much as the difference between pre-reform intervention prices and new target prices (see paragraph 4.16), the

Table 8

Estimation of the global impact of the reform on the cereals farmers' revenue for EU-12

(million ECU)

Marketing year	Estimated revenue without reform ⁽¹⁾	Estimated revenue after the reform ⁽²⁾	Normal compensatory payment ⁽³⁾	Currency effect on the compensatory payments ⁽⁴⁾	Total revenue after the reform	Global increase in revenue	Increase in revenue due to market prices
	(a)	(b)	(c)	(d)	(e)=(b)+(c)+(d)	(f)=(e)-(a)	(g)=(f)-(d)
1993/94	27 289,4	24 719,6	3 888,5	224,8	28 832,9	1 543,5	1 318,7
1994/95	26 518,6	23 502,2	5 446,4	420,2	29 368,8	2 850,2	2 430,0
1995/96	26 727,6	23 734,3	7 417,4	870,8	32 022,5	5 294,9	4 424,1
1996/97	31 301,9	26 576,8	7 840,5	814,4	35 231,7	3 929,8	3 115,4
1997/98	31 135,4	24 890,2	8 065,0	795,9	33 751,1	2 615,7	1 819,8
Total	142 972,9	123 423,1	32 657,8	3 126,1	159 207,0	16 234,1	13 108,0

Method of calculation:

⁽¹⁾ The estimated revenue without the reform is the quantities of cereals for each marketing year multiplied by the average 1992/93 producers' prices (unit values).⁽²⁾ The estimated revenue after the reform is the quantities of cereals for each marketing year multiplied by the average producers' prices of the marketing year (unit values).⁽³⁾ Expenditure per marketing year before currency effect and net of the special aid for silage.⁽⁴⁾ Agrimonetary cost.

Source: All basic data are from Eurostat or from the Commission, DG VI.

amount of area aid finally paid was higher at a global level than the true amount of income loss in the cereals sector by about ECU 13 100 million ⁽³⁵⁾ (see Table 8). The Court has already highlighted this phenomenon in its Annual Report concerning the financial year 1996 ⁽³⁶⁾.

4.34. This does not mean that such payments in excess of income losses were irregular since the Regulation had not foreseen a mechanism to adjust the amounts of compensation paid to reflect actual market prices rather than the previously set target price. Nevertheless, the levels of compensation paid in excess of actual income losses account for the greater part of the increase in the cereal budget.

4.35. As all other factors influencing farm income from cereals could be eliminated (see paragraphs 4.32(b) and (c)), a calculation to determine whether area aid compensated for the losses for

which it was intended could be limited to the differences in market revenue resulting from price reductions:

- (a) the market returns on cereal production were obtained by valuing the output for each year after the reform according to Eurostat's unit values for each country and each type of cereal; the use of unit values has the advantage of removing inconsistencies which would otherwise result when using directly raw national price statistics;
- (b) the actual market returns on cereals, calculated in this manner were compared with the market returns that would have been received had prices stayed at their pre-reform levels in each Member State; this method takes account solely of changes in market revenue due to price changes, and the aggregate differences thereby derived provide the basis for compensation within the meaning of the Regulation's objective;
- (c) the differences between market returns at pre-reform prices and at current prices were compared on a year-by-year and Member State-by-Member State basis with the amounts of area aid actually paid; increases in the aid arising from the

⁽³⁵⁾ The Commission estimates an even higher over-compensation of about ECU 17 000 million. Indeed the Commission has estimated for the four year period 1993/1994 to 1996/1997 an over-compensation of ECU 8 500 million to which it is necessary to add the abolition of the co-reponsability levy effect representing, for the five year period 1993/94 to 1997/98, another ECU 8 500 million (see replies of the Commission).

⁽³⁶⁾ The Court of Auditors' Annual Report concerning the financial year 1996, Chapter 3, paragraph 3.31 (OJ C 348, 8.11.1997).

cost of the agrimonetary system is shown separately, i.e. they were considered to be a component of budgetary cost which has no bearing on the question of compensation as it is treated in this report (see *Table 8*);

(d) as the unit values used relate to calendar years, but the production figures used for the calculation relate to cereal marketing years (1 July to 30 June of the following year), unit values were adjusted on the assumption that 65 % of one year's production had been sold between 1 July and 31 December and 35 % between 1 January and 30 June; this hypothesis is supported by the Commission and a number of Member States;

(e) lastly, the effect of set-aside was not considered specifically, as it can be assumed that the effect on income of reduced production resulting from set-aside has already been partly taken into account in the market prices used for the calculation; in any case, because of the reduction in the rate, set-aside was of minor importance following the start of the reform in the 1993/1994 marketing year.

4.36. The amendment to Council Regulation (EEC) No 1765/92 proposed in the Commission's Agenda 2000 no longer uses the term 'compensatory payment', but merely area-aid payments. The compensation rate of these payments has been fixed at half of the value of the reduction in the intervention price once the 'cruise' period has ended. In formal terms it will no longer be correct to use the term 'compensation', once the new aid rate has been introduced.

Distribution of income from cereal growing

4.37. The concept of compensation was based on historical base areas, historical average yields, a single historical average intervention price and a single target price for all cereals fixed for the three-year transitional period. It is evident that a compensation system which does not differentiate support according to farm size or yield does nothing to improve the position of smaller producers in the cereals sector.

The influence of market prices

4.38. As market prices stayed generally above the new target price, Member States received more compensation than was justified by the actual losses attributable to price reductions. The higher this difference was in a country, the more the farmers in

this country benefited. For those countries which, immediately before the reform, were recipients of only small amounts of export refunds, storage and other interventions, the introduction of the new area aid resulted in an increase in their share of total EU budgetary expenditure on cereals (see *Table 9*).

4.39. At the level of the individual farmer, it is clear that the new system was advantageous to farmers who were in a position to withhold their cereals from the market until prices reached their maximum. This strategy may not always achieve its objective, but is encouraged when it is certain that area aid payments will be made at the beginning of the period. It is mainly the larger producers with sufficient financial means and private storage facilities who are in a position to benefit from such strategy.

4.40. Agenda 2000 suggests that the area-aid payments should be made later (January to March of the following year, instead of October to December of the harvest year) and that the monthly increments to the intervention price should be abolished. Both suggestions are intended to counter withholding of cereals from the market and to even out market supply. On the other hand, when the market operates at intervention price levels, the lack of monthly increments results in increased intervention buying at the beginning of the intervention period (1 November). Subsequent increases in market prices then benefit storekeepers alone.

The influence of yields

4.41. According to Council Regulation (EEC) No 1765/92, the specific structural characteristics that influence yields are to be taken into account when farmers are compensated. Indeed, each Member State was allowed to use its own average yields. Regional characteristics were taken into account when Member States fixed their regionalisation plans, in which they established differentiated yields by region ⁽³⁷⁾.

4.42. Regulation (EEC) No 1765/92 did not require that this differentiation should lead to a redirection of funds to disadvantaged regions or States. On the contrary, it was intended that farmers in regions or States with traditionally higher yields should not be under-compensated by comparison with their counterparts in traditionally lower-yielding areas. France alone introduced a factor which decreased yield differences between regions in its regionalisation plan.

⁽³⁷⁾ The Court expressed some criticism in this regard in its Annual Report concerning the financial year 1996.

Table 9

Evolution of the expenditure for cereals from 1993 to 1997 for EU-12 by Member State and kind of expenditure

(million ECU)

	B	DK	D	EL	E	F	IRL	I	L	NL	P	UK	TOTAL
1993 (Before new CAP)													
Export refunds for cereals	201,5	105,9	303,2	16,1	148,7	1 139,6	7,0	419,4	0,0	184,3	0,8	262,3	2 788,8
Storage intervention for cereals	36,8	163,3	1 008,2	36,0	- 17,0	1 270,6	29,0	21,8	- 0,1	0,0	- 17,6	192,8	2 723,8
Other intervention	16,3	27,6	162,5	0,6	21,4	172,8	3,5	33,2	0,2	83,2	58,8	41,8	621,9
Per hectare aid ⁽¹⁾	0,4	1,2	98,5	82,4	119,4	82,0	0,2	380,2	0,0	2,9	0,5	21,0	788,7
Total expenditure for cereals	255,0	298,0	1 572,4	135,1	272,5	2 665,0	39,7	854,6	0,1	270,4	42,5	517,9	6 923,2
Member States' part in % (a)	3,7	4,3	22,7	2,0	3,9	38,5	0,6	12,3	0,0	3,9	0,6	7,5	100,0
1997 (new CAP)													
Export refunds for cereals	39,5	20,3	80,7	5,1	18,4	189,4	0,8	34,3	0,0	28,4	0,3	67,4	484,6
Storage intervention for cereals	- 0,4	2,2	77,0	- 5,2	- 4,0	- 1,5	3,5	- 4,7	0,0	0,0	- 0,8	1,0	67,1
Other intervention	1,3	25,2	88,7	0,1	2,0	43,4	0,1	4,2	0,0	71,0	33,3	4,1	273,4
Per hectare aid ⁽¹⁾	137,7	549,8	2 733,7	450,6	1 292,4	3 746,8	114,8	1 698,4	8,5	128,5	152,3	1 328,4	12 342,0
Total expenditure for cereals	178,1	597,5	2 980,1	450,6	1 308,8	3 978,1	119,2	1 732,2	8,5	227,9	185,1	1 400,9	13 167,1
Member States' part in % (b)	1,4	4,5	22,6	3,4	9,9	30,2	0,9	13,2	0,1	1,7	1,4	10,6	100,0
Difference (b)-(a)	- 2,3	0,2	- 0,1	1,5	6,0	- 8,3	0,3	0,8	0,1	- 2,2	0,8	3,2	0,0

⁽¹⁾ Includes 85 % of the set-aside expenditure.

Source: Commission's financial reports 1993 and 1997.

4.43. In general the area-aid system, based on average yields frozen at their historical value, resulted in the following:

(a) at regional level, the system did not greatly change the distribution of aid; *Annexes 1 and 2* show the largest farms and highest yields in the Community; the combination of the two gives an indication of the distribution of compensatory payments; almost half of the cereals produced in the EU-15 are grown in 20 regions out of a total of 127; it also becomes clear that these 20 regions are in no way less-favoured regions; support for cereals continues to be concentrated in regions which may be considered reasonably prosperous;

(b) at the individual level it is clear that compensation based on average yields frozen at their historical values could never compensate each individual farmer accurately; farmers with a yield higher than the historical average are relatively less well-off under the new system; those who had lower yields gain; higher yields result from many factors: where such yields can be attributed to more fertile soil and/or to more efficient farming methods, the new system works against structural improvements by treating less-efficient farmers more favourably; it may be concluded that the system even contravenes Article 39(a) of the Treaty, as it tends to discourage the global

increase in productivity.

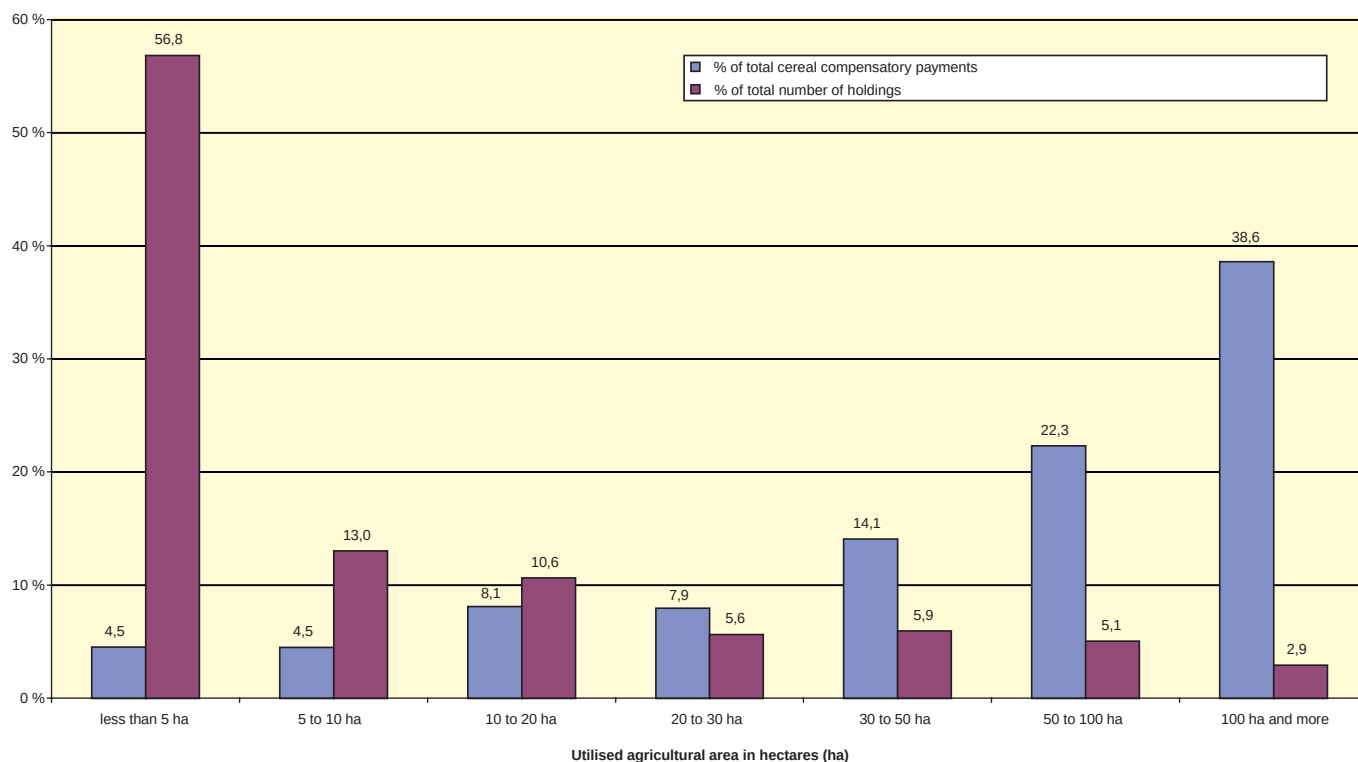
4.44. The 1992 reform offered Member States the option of establishing individual base areas. In view of the administrative burden which such a system would entail, no Member State introduced it. This option has been withdrawn under Agenda 2000.

The influence of farm size

4.45. In its communication COM(91)100 final of 1 February 1991 the Commission concluded that the rising budgetary expenditure, devoted in large part to a small minority of farms, provided no solution to the problem of uneven distribution of farm incomes. The reform did not change this situation either. Indeed in 1995, almost 40 % of the compensatory payments were paid to less than 3 % of the beneficiaries. At the other end of the scale, small farmers with less than 5 ha, who represent 57 % of beneficiaries get only 4,5 % (see *Graph 5*). But these figures hide big disparities in the Community. In the United Kingdom, the Member State with the biggest farms, farms with 100 ha and more represent 17 % of total farms and get 66 % of the payments. In Italy, 78 % of farms have less than 5 ha but get only 20 % of the aid.

Graph 5

Estimation of the concentration of cereals compensatory payments per holding size for EU-15 in 1995 (excluding the supplementary aid for durum wheat)



Source: Eurostat, 1995 survey of the structure of agricultural holdings and DG VI, expenditure for harvest 1995.

4.46. Needless to say, the larger a farm is, the greater the return from the market and area-aid will be. The reform did not therefore fundamentally change the fact that large amounts of public money are spent on the largest farms ⁽³⁸⁾. It would appear that the only solution to this problem is to make area-aid payments degressive in relation to farm size. It should be noted, however, that such a system would be vulnerable to abuse, if large farms were broken down into smaller ones for the sole purpose of qualifying for higher amounts of aid.

Value of agricultural land

4.47. A major determinant of wealth, and thus of standard of living, is the value of land owned by farmers. As the stream of income expected from this land is a principal determinant of the selling price, the reform, which attributes a fixed and definite income to the land, will certainly have an impact on land values.

4.48. Owing to the lack of empirical data, the Court was unable to estimate this impact. Only the UK was able to provide some data, which suggest there will be an increase in the sale price of farm land. However, a scientific approach shows that the CAP reform may lead to an increase in the selling price of poor land and a decrease in that for good land ⁽³⁹⁾. This is due to the fact that compensatory payments form a larger share of the income of farms with poor land and unreliable yields, and help farmers to overcome uncertainty concerning income to a relatively greater degree.

5. CONCLUSION

5.1. During the transitional period cuts in internal prices and the latter's convergence with international prices rendered EU cereals relatively more competitive than other cereals on the world market and cereal substitutes on the internal market (see paragraph 4.13). Whether this favourable effect will persist will depend on the extent to which intervention and, therefore, internal market

prices continue to converge with world market prices. Contrary to the expectations at the time of the reform, the world price level during the transitional period was exceptionally high due to supply shortages on the world market. It therefore seems reasonable to consider this favourable effect on competitiveness as being the result of historically, a, rather exceptional market situation during the transitional period.

5.2. Indeed, international prices between 1996 and 1998, i.e. the first years of full application of the reform, decreased quite sharply. Agenda 2000 proposes further cuts in the intervention price which would allow internal market prices to follow the expected downward trend in world prices. If it were not possible to make these further reductions in intervention prices, the competitiveness of EU cereal production would be at risk. Of course, other factors, such as quality improvements, could play a role in this regard but for bulk goods, such as cereals, the price remains the major determinant of competitiveness.

5.3. With regard to the effect of the reform on stabilising the market, within the meaning of the Mac Sharry reform, i.e. ending the cereal crisis and establishing market balance, the reform achieved its objective over the transitional period. Production was kept at pre-reform level, storage was reduced to almost zero, and more than half of the exports were achieved without export refunds. It might have been expected that set-aside and price cuts would reduce production to a greater extent than it actually did: the former by reducing the area under cereals and the latter by lowering market revenues in relation to production costs thus reducing inputs like fertilisers and pesticides. However, looking at the global production trend and, in particular, at the divergent trends in Member States, it is quite difficult to ascertain any lasting effect of the reform on production. The production-reducing effects of the price cuts and set-aside were weakened by the following factors:

(a) favourable weather conditions in 1995 and 1996 in broad areas of northern Europe, where the main production areas are located (see paragraph 4.7);

(b) area-aid payments, which motivated farmers to grow arable crops, of which cereals are the most important (see paragraph 4.19);

⁽³⁸⁾ See also paragraph 3.30 of the Court's Annual Report concerning the financial year 1996 (OJ C 348, 8.11.1997).

⁽³⁹⁾ Rob Fraser, land heterogeneity and the May 1992 reform of CAP cereal price support, *Journal of Agricultural Economics*, Vol 48, No 1, p.69, Falkirk 1997.

- (c) increasing prices on the world market as production lagged behind consumption due to the decline in world area allocated to cereals and to the slow down in world yield increases since the mid-1980s ⁽⁴⁰⁾ (see paragraph 4.16);
- (d) currency movements against the ecu, which offset the price cuts in the national currency of some Member States (see paragraph 4.17).

5.4. Looking at the recent evolution of the market it is evident that the stability achieved during the transitional period cannot be sustained. In fact, in 1996/1997 Community production already exceeded pre-reform levels and remained high in 1997/1998. Stocks have also increased as a result. Furthermore, the introduction of a single aid rate for cereals and oilseeds could affect the relative attractiveness of cereal production (see paragraph 4.6).

5.5. The maintenance of high prices on the home market by comparison with world prices combined with surpluses of home-grown cereals, presents the Community with a very difficult problem. Disposal of surpluses is constrained by WTO limits on the total amounts of export refunds and on the volume of cereals which may be exported with the aid of refunds. These limits are likely to be further reduced during the next round of negotiations. Agenda 2000, apart from a price cut which could prove inadequate, contains no alternative proposal as to how this problem may be solved. Allowing surpluses to be dealt with by means of intervention storage alone is not a sustainable solution.

5.6. The effect of the reform on farm income is described in paragraphs 4.29 to 4.46. The objective of the reform was to compensate farmers for income losses due to the reduction in institutional prices to an average Community level. The reform did not seek to cover potential losses caused by the fact that compensation was based on average yields and cultivation areas that had been frozen at their historical levels and on a single average target price for all cereals, rather than on the specific market prices in each Member State. The reform carried the objective of compensating farmers for income losses too far. In fact, over the five-year

period 1993 to 1997, on a global level farmers were over-compensated by about ECU 13 100 million. However, even if over-compensation had not taken place at Community level, the actual manner in which area aid was calculated would have led to over-compensation in some Member States where market prices were higher than the fixed average target price, and vice versa. Furthermore, individual farmers with historical yields that were higher than the average were penalised while farmers with lower yields benefited from this system. The reform did not take account of this effect.

5.7. Moreover, the reform did not address the point that the larger a farm is, the greater is the public support it receives, thus jeopardising the political intention to help small farmers first and foremost. This problem can only be solved by placing a ceiling on public farm support. Agenda 2000 proposes ceilings and a degressive system of area aid. However ceilings and degressive aid systems engender the risk of large farms being split up into smaller ones so that more aid may be obtained.

5.8. The Court is fully aware that it is difficult to achieve all the objectives of Article 39 of the EC Treaty simultaneously. The income objective has been one of the predominant ones in all the years since the introduction of the CAP. However one could envisage a solution whereby farm support could be determined on a basis which is different from prices, production or area. It could be based on, for example, a standard net income per farm household or working unit. If sufficient income were not earned on the market, farm support would be triggered to make up part of the difference.

5.9. It is clear that any policy approach should, in part, meet the requirement of Article 39(1)(b) of the Treaty: '*... to ensure a fair standard of living for the agricultural community ...*'. Any increase in individual farm earnings beyond the 'standard net income' however, has to come from increasing productivity through technical progress, the rational development of agricultural production, the optimum use of factors of production, as required by Article 39(1)(a) and the adjustment of structures as required by Article 39(2)(b).

5.10. To summarise, it can be said that the Mac Sharry reform has taken a small step in the right direction. It has served the aim of rendering public support of the COM in cereals transparent by replacing price support with direct aid paid by the taxpayer. This resulted, as anticipated, in a significant increase in budgetary expenditure as of the first year of implementation of the reform. The increase in expenditure, was, however, higher than forecast, i.e. actual expenditure has turned out to be higher each year. Fur-

⁽⁴⁰⁾ European Commission, CAP working notes: *The outlook of world cereal markets*, ISBN 92-827-8813-X, Brussels-Luxembourg October 1996, p.2.

thermore, the forecast drop in expenditure for 1997 did not take place.

5.11. The fact that stocks and export refunds reappeared in 1996 to 1997, following the transitional period, does not reduce the significance of the reform. It merely demonstrates that the reform is an ongoing process and corrective measures should be taken to remedy the weaknesses identified. Agenda 2000 proposes a further reduction in intervention prices as a measure to remove the risks connected with the recurrence of increasing stocks and export refunds. The effectiveness of set-aside could not be properly evaluated because world-wide supply shortages called for considerable reductions in the set-aside rates after the transitional period.

5.12. In order to move towards the approach suggested in paragraph 5.8 at least in the medium term, the Commission should

initiate studies to evaluate the level of competitiveness actually achieved by the Community cereals sector following such protracted public support. The potential risks of unemployment, the segmentation and abandonment of land, environmental damage, etc. should be addressed by effective means, such as integrated rural development aid.

5.13. On the other hand, inadequate reference is made to measures for improving competitiveness by means of structural measures that also comply with the WTO Agreements (green box). Consumer interests are somewhat neglected in the reform process. Taxpayers bear an increased burden, which is not followed by any significant reduction in final consumer prices. The effect of market structure on transmission of benefits to the consumer requires further examination.

This report was adopted by the Court of Auditors in Luxembourg at its meeting of 6 May 1999.

For the Court of Auditors

In the absence of Jan O. KARLSSON

President of the Court

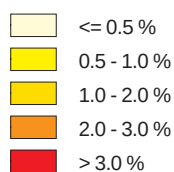
Bernhard FRIEDMANN

Acting President

ANNEX 2

EUROPEAN UNION

Regional cereal production
in % of EU-15
(average 3 most recent
years available)

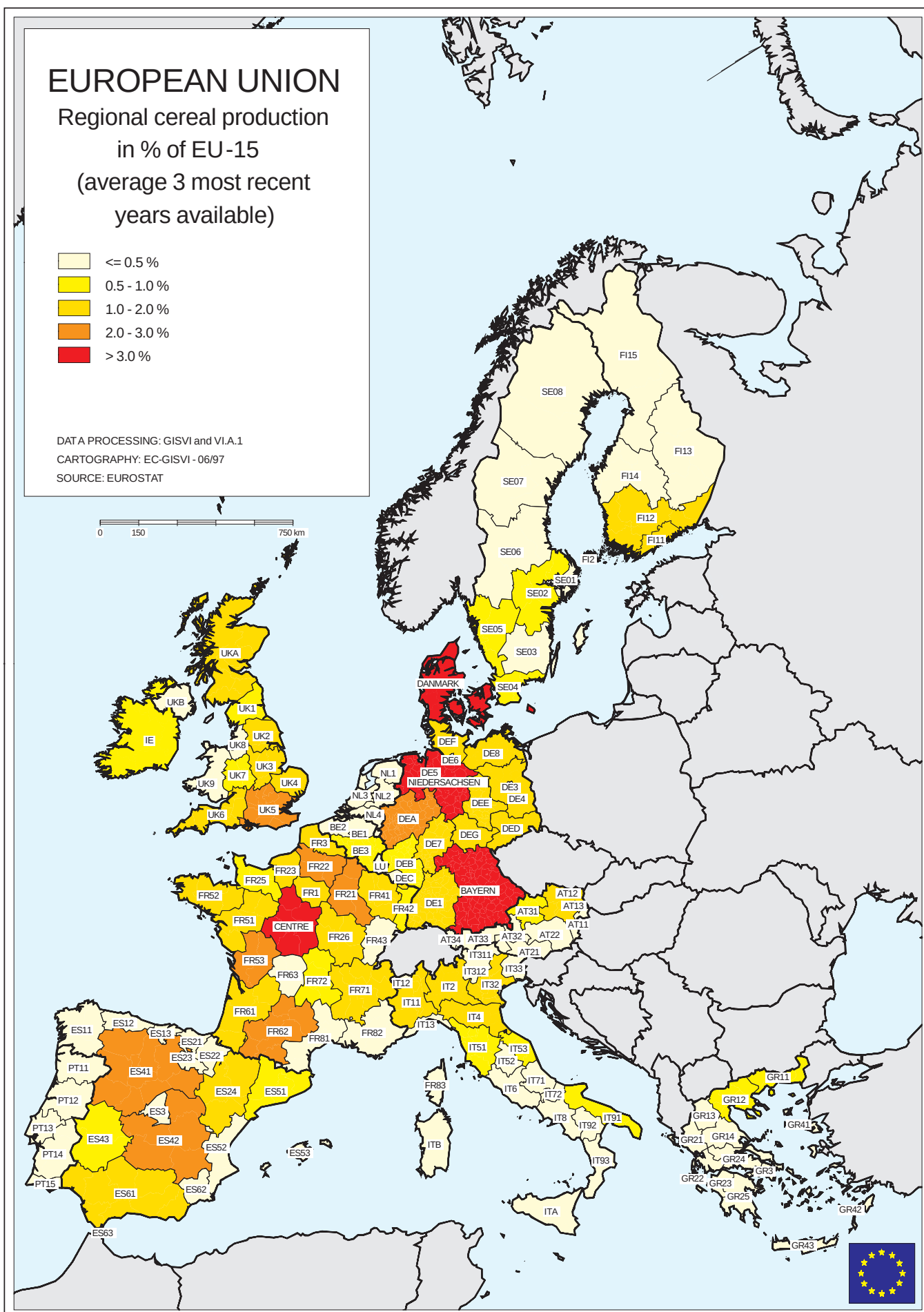


DATA PROCESSING: GISVI and V.I.A.1

CARTOGRAPHY: EC-GISVI - 06/97

SOURCE: EUROSTAT

0 150 750 km



COMMISSION'S REPLIES

SUMMARY

The 1992 reform of the CAP aimed to render cereals grown in the Community more competitive both internally in the Community and on the world market. During the 1980s and early 1990s, home-grown cereals continuously lost market share on the internal market for animal feed to the benefit of imported cereals substitutes. A simple continuation of past trends over the 1993/1994 to 1995/1996 period would have led to a reduction of cereals uptake in animal feed of some 5 to 7 million tonnes. At the time it was also clear that the on-going GATT negotiations would result in restrictions on the quantities of cereals which could be exported with export refunds.

The reform, by the end of the transitional period, successfully re-established the market balance for cereals. The internal consumption of Community-grown cereals increased and intervention stocks disappeared, although they have been starting to build up again in recent months.

However, the Commission in its Agenda 2000 proposals recognised the need to build on the 1992 reform by proposing an additional reduction of 20 % in institutional cereal prices, in order to improve the Union's competitiveness on internal and external markets. The Berlin European Council concluded that the price cut should be 15 % over the marketing years 2000/2001 and 2001/2002 (7,5 % per year) and that a decision on a further reduction in the intervention price to be applied from 2002/2003 onwards should be taken in the light of market developments. In addition, the reference rate for compulsory set-aside has been fixed at 10 % for the period 2000 to 2006. This percentage may also be changed in the light of market developments. The combined effect of price cuts and set-aside should allow the Union to maintain market balance.

The Court repeats its earlier findings (Annual Report 1996) that the direct aids introduced by the 1992 reform actually over-compensated cereal growers. This was acknowledged by the Commission, which in 1996 proposed to reduce the compensation paid to farmers. However, neither the Council nor the European Parliament endorsed the proposal. Agenda 2000 addresses this by offering only a partial compensation for the price reduction. Following the European Council's decision, in case of a further reduction in intervention price, any increase in area payments will provide the same degree of compensation as in 2000/2001 and 2001/2002.

A differentiation of compensation payments according to farm size was part of the initial 1992 reform proposal and was also included in the Agenda 2000 proposals, but neither of these proposals has been accepted by the Council.

The Court states that neither the price reductions from the first reform, nor those in Agenda 2000, can be shown to benefit the final consumer. Even though measuring the effect on consumer prices is not an easy task as prices are influenced by a number of factors, the Commission has studied price transmission in other sectors and reached the conclusion that in general terms there is a positive effect. Both econometric models and economic analysis support the conclusion that price reductions in a sector central to human consumption and animal feed can only have a positive impact on prices paid by consumers.

4. EFFECTS OF THE REFORM

Production

4.6 to 4.10. The principal factors behind the stabilisation of the market for cereals were

- (1) a reduction in production by the means of set-aside and
- (2) an increase in internal consumption of cereals by reducing cereal prices.

The differences among Member States in terms of the reduction in production during the first years of the reform are explained by the application of a compulsory set-aside rate of 15 % from which small producers are exempt. Also, the adjustment of the agriculture sector in the new *Länder* to the market economy has continued.

Oilseed production will not necessarily decrease under Agenda 2000. The market prospects for oilseeds are better than for cereals and should make it possible to recoup the loss in aid following alignment via higher market prices. In addition, under the preliminary agreement on Agenda 2000 it is planned to subject the oilseed sector to separate monitoring so as to be able to react to any possible substantial reduction in area sown.

The Commission accepts that it is impossible to foresee the production and consumption of cereals at Community level or at world level two marketing years beforehand. However, as the Court itself recognises, the introduction of obligatory set-aside was the main element which contributed to a better equilibrium in the Community market.

The fixing of the set-aside rate for the 1997 and 1998 harvests, respectively, in September 1996 and June 1997 has to be seen in relation to the state of the world market at that time, which saw stocks at an extremely low level. This situation caused prices to be very volatile and compelled the Commission to introduce export levies for different wheats.

The system for fixing the set-aside rate might not be ideal but is nevertheless the best found so far.

Prices

Producer prices

4.15 to 4.19. Market price disparities are not inconsistent with the principle of the single market. Community preference makes it possible to sell cereals from surplus regions to the deficit regions without intervention by the public authorities. The EU has a single institutional price but different market prices reflecting the segmentation of the market.

Where the Community has in the past organised transfers or sales of intervention stocks to specific regions, these measures have been justified by special circumstances such as serious droughts affecting feed production and livestock farmers' incomes.

Before the 1992 reform, intervention prices were the main factor determining the prices of cereals on the internal market. In surplus areas, the market aligned on that level; in deficit areas, the market price included the additional marketing and transport costs. The introduction of a significant set-aside rate brought production and consumption back into balance. Some regions in surplus before the 1992 reform became deficit regions, enabling producers to secure prices higher than the intervention price.

The Commission took account of this effect in the context of the reform by calculating compensation on the basis of a target price 5 % above the intervention price.

The base rate for compulsory set-aside (15 %) took account of the need to dismantle intervention stocks and of the trend rise in yields. Production projected for 1993 and 1994 was smaller than the likely outlets on the internal and external markets. The drought in Spain and Portugal as well as the fall in world stocks accentuated this situation.

In order to take account of this necessity, the Commission initially proposed extending the co-responsibility levy scheme temporarily. Neither the Council nor Parliament backed this proposal.

Consumer prices

4.20 to 4.21. The Commission is of the opinion that a price reduction at producer level generally has a positive effect at the

consumer level. Its recent analysis of the pigmeat sector demonstrates it. Models developed by the University of Bonn, the Centre for World Food Studies at the University of Amsterdam and the Commission have been used for the estimates. They are presently the best econometric tools available in the EU.

When evaluating the price transmission for cereals it must be recognised that the cereal share of the final consumer price is very limited for most food products, for example the share of wheat in the price of bread is approximately 5 %.

Exports

4.26. The introduction of an export levy has as its principal aim the protection of the internal market against speculative price increases. This measure is justified within the context of a market organisation which seeks to rebalance the interests of producers and consumers.

4.28. The setting of the refund rate is based on the difference between the internal market price and the level of those prices on the world market which are the most representative for the same quality as Community production. In this way the Community offsets the effect of the price increase on the internal market due to the intervention system.

Farm income from cereals

4.30. Although the income increase in percentage terms is significant, due to the exceptional market situation, cereals producers' income reached a level only 14 % above the average for all farmers.

Compensation in the cereals sector

4.31 to 4.36. The Commission explained in its reply to the Court's Annual Report for the financial year 1996 why a 'flat-rate' approach was chosen for compensatory payments. A flat-rate payment system, decoupled from production levels and based on historic data, is needed in order to benefit from opportunities arising from developments on the world market. Moreover, it reinforced the EU position in the negotiations then in progress for a new GATT agreement.

The Commission has conceded that there was over-compensation over several years. It has put this over-compensation at ECU 8,5 billion for the period from 1993/1994 to 1996/1997. However, the situation differs depending on the type of cereal, the region and the marketing year considered. In 1996 the Commission proposed a cut in arable crop payments which was not accepted by either the Council or Parliament. However, market prices dropped in 1997 and 1998, offsetting to a large extent the problem of over-compensation. Moreover, Agenda 2000 addresses this by only offering partial compensation.

As to the method of estimating this over-compensation, the Commission would like to add the following information. A calculation based on producer prices includes the impact of the co-responsibility levy, amounting to ECU(B) 10/t. This levy, abolished by the Council without any change in the method of fixing compensatory payments, accounts for about ECU 8,5 billion in the calculation of over-compensation for the period from 1993 to 1997.

Distribution of income from cereal growing

The influence of market prices

4.40. Agenda 2000 brings the intervention price closer to the projected price on the world market for wheat. In this case, intervention remains only a safety net.

The influence of yields

4.43 to 4.44. The reform had the effect of reducing the incentive to higher yields arising from market support via high prices. This was one stated aim of the reform. In this context, a system of compensatory payments based on individual yields would be counter to the goal sought.

The influence of farm size

4.45 to 4.46. The Commission included the plan to differentiate aid according to the number of hectares of individual producers in its proposals for the 1992 reform, but the Council decided against the idea at the time (see 3.72 in the 1996 Report (OJ C 348, 18.11.1997, p. 95)). Within Agenda 2000 the Council did not include the degressivity of direct aids in its compromise package.

5. CONCLUSION

5.1 to 5.3. The Commission shares the Court's view that the 1992 reform achieved its aims during the transitional period. The reform contributed in large part to rebalancing the cereals market by introducing the set-aside scheme and cutting prices. The set-aside scheme has the added advantage of adjusting to fluctuating conditions in the world market.

However, the Commission in its Agenda 2000 proposals recognised the need to go further than the first reform. In this context, a 15 % cut in cereals intervention price has been agreed on. A decision on a further reduction will be taken in the light of market developments. In addition, the reference rate for compulsory set-aside has been fixed at 10 %. This percentage may also be changed in the light of market developments. The combined effect of price cut and set-aside should allow the EU to maintain market balance.

5.6. As indicated in the Commission's reply to the Court's Annual Report for the financial year 1996 (OJ C 348, point 3.31, p. 93), the Commission's own calculations confirmed that there had been an over-compensation in the cereals sector, estimated at ECU 8,5 billion, over four years excluding the effect of the abolition of the co-responsibility levy. The direct aid scheme never aimed to provide 100 % compensation for the price cuts suffered by individuals. It was brought in to offset some of the distortions of a high-price intervention system, in particular over-intensification.

5.13. The Commission fully agrees about the risks mentioned by the Court. This is why a new Regulation on rural development is part of Agenda 2000.

The two reforms of the CAP entail very substantial price reductions. The Commission emphasises that analyses carried out within the meat sectors indicate a positive price transmission to the benefit of the consumer, although with a certain time lag.
