COMMISSION OF THE EUROPEAN COMMUNITIES

COM(87) 410 final.

Brussels, 3 August 1987

REVIEW OF ACTION TAKEN TO CONTROL THE AGRICULTURAL MARKETS AND OUTLOOK FOR THE COMMON AGRICULTURAL POLICY

(Communication from the Commission)

TABLE OF CONTENTS

I. INTRODUCTION

1. In the Programme it presented when it took office in 1985, the Commission stressed its intention to press forward with the reform of the common agricultural policy: "The Commission intends to stick to the chosen path. There is no realistic alternative to tough action as long as massive imbalances persist for most agricultural products". It added that "rigorous rationalization of the common agricultural policy, necessary though it may be, is not enough. New prospects must be opened up for European farming."

   It proposed the organization of a comprehensive discussion among the Community institutions and with the farming organizations, and this was held on the basis of a "Green Paper" it presented in July 1985. The Green Paper had the great merit of presenting the problem of the common agricultural policy in the setting formed by the other Community policies and operations, and of involving the farming community and the other groups and categories concerned in a general policy review of European agriculture, its place in society and its future.

   The action then taken, reflected in each decision forming part of, or supplementing, the prices package, was implemented step by step, making proper allowance for the points of view expressed when the Green Paper was discussed.

2. The document released by the Commission early this year entitled "Making a success of the Single Act: a new frontier for Europe" (COM(100)) provided the Commission with an opportunity to relate the common agricultural policy to the world context and to emphasize the outlook for the future of European agriculture, indicating the framework in which it could work (supporting measures and Cohesion).

3. Alongside the process of internal adjustment of the CAP, the need for reform of agricultural policies has been generally perceived at international level as well.
This was formally confirmed by the Ministers at the OECD in Paris, and then by the Heads of State or Government in Venice. Last June, the European Council in Brussels noted that the approach adopted in the work of the Agricultural Council was in line with the commitments accepted in these international forums, stressing "the need for better adjustment of supply to demand through measures enabling the market to play a greater role".

With a view to "completion of the modernization of the common agricultural policy", the Council called for "a review of all the adjustments made to the policy" so that, on this basis, "the requisite supplementary measures" could be adopted, including action to ensure full compliance with budgetary discipline. This Memorandum constitutes a response to the European Council's request.

II. REVIEW OF THE REFORMS

4. In some respects European agriculture has altered almost out of recognition in recent years, and this, with the far-reaching change in the general economic context of which agriculture is a part, including that in world agricultural markets, has necessitated adjustments to the policy.

The adjustments have been related to the following four objectives:
- control of production and expenditure,
- reduction of stocks,
- preservation of the European pattern of agriculture and a definition of the outlook for European agriculture,
- international concerted action.

5. In the course of the drive launched to control production and expenditure, the Commission has consistently stressed that it was in the interests of the farmers themselves that this goal should be achieved: a balanced market, unencumbered with surpluses, will ensure the best outlook possible for European farmers, for it will offer them more satisfactory remuneration for their work and more freedom of manoeuvre. Without such control, given the scope for increasing productivity and the cost of disposing of surpluses, the policy could well break down altogether, simply because it is too expensive, dragging down with it the other common policies.

Nor should it be forgotten that since the inception of the policy the Community has emerged as the world's second largest exporter of agricultural products. Its future as an exporter could well be threatened if action is not taken to restore equilibrium between supply and demand.

The rigorous policy now introduced affects farm incomes only in part, as farmers' earnings are not solely dependent upon the official prices agreed in Brussels.

Farm incomes are in fact determined by a wide range of factors, including the volume and cost of farmers' inputs, land prices and rents, taxation, and social security and welfare schemes. Also, for much of the Community's production, there is only limited support (pigmeat, eggs, poultry, fruit and vegetables) or even no support at all (potatoes, certain vegetables, and certain types of meat).

At all events, since 1980, farmers' incomes, expressed in real terms, have either held steady or actually shown an improvement; the index of net value added at factor cost, expressed per work unit, was 104.9 for 1985 and 106.5 for 1986 (1979-1981 = 100).

Differences from year to year are partly a matter of the impact of the weather on harvests. The maintenance of farm incomes is all the more remarkable if we bear in mind that the farmers in the main countries competing with the EEC on the world markets have fared far less well: their incomes have dropped by 15 to 20% in a single year.

6. The corrective measures adopted by the Council since the early eighties with a view to bringing production and expenditure under control have affected almost all the market organizations. They can be classified under the following three main headings:

(a) More restrictive pricing

Since self-sufficiency for most products was achieved or even exceeded, the Community has tightened up its policy on prices. Thus, in recent years, the support prices as expressed in national currencies for all agricultural products coming under market organizations have, on average, been reduced by 0.5% per year in real terms. The rate of reduction has gathered momentum since the end of the seventies, and the cuts in institutional prices over the last four marketing years have totalled about 10%. These have thus more than offset productivity gains.

(b) Less permanent and more restrictive intervention

Intervention, which was once meant to be a "safety net", had gradually developed into something else: it had become an outlet in its own right, particularly attractive because it spared the farmer all effort and risk involved in actual marketing, but particularly harmful since it constituted an artificial, open-ended incentive to production.

There have been many adjustments to the intervention rules, varying according to product. They are described in more detail in Chapter III, "Existing stabilizers and new machinery".

(c) Restriction of support by the establishment of binding quotas and guarantee thresholds, strengthening the co-responsibility of producers

There have been three phases:

- the first, with the assignment of quotas for sugar, and the introduction, ten years later, of a co-responsibility levy on milk;

- the second, from 1982 onwards, with the introduction of guarantee thresholds for a number of surplus products. From 1982 to 1984, almost half of the final agricultural production coming under market organizations, accounting for about two-thirds of EAGGF guarantee expenditure, has thus been made subject to guarantee thresholds or similar systems;

- the third, with the introduction of the quotas for milk and tomatoes and the adjustment of intervention arrangements for major products.

The action taken is also described in detail in Chapter III, "Existing stabilizers and new machinery".

Also, the support measures (differentiated measures, compensation, and socio-structural measures) adopted since 1985 whenever corrective action has been taken in respect of production are recalled below (p. 23 et seq.).

7. In view of the adjustments made since 1984, it is fair to say that at least one stabilizer designed to curb production and limit the cost to the budget has now been built into most of the EEC market organizations.

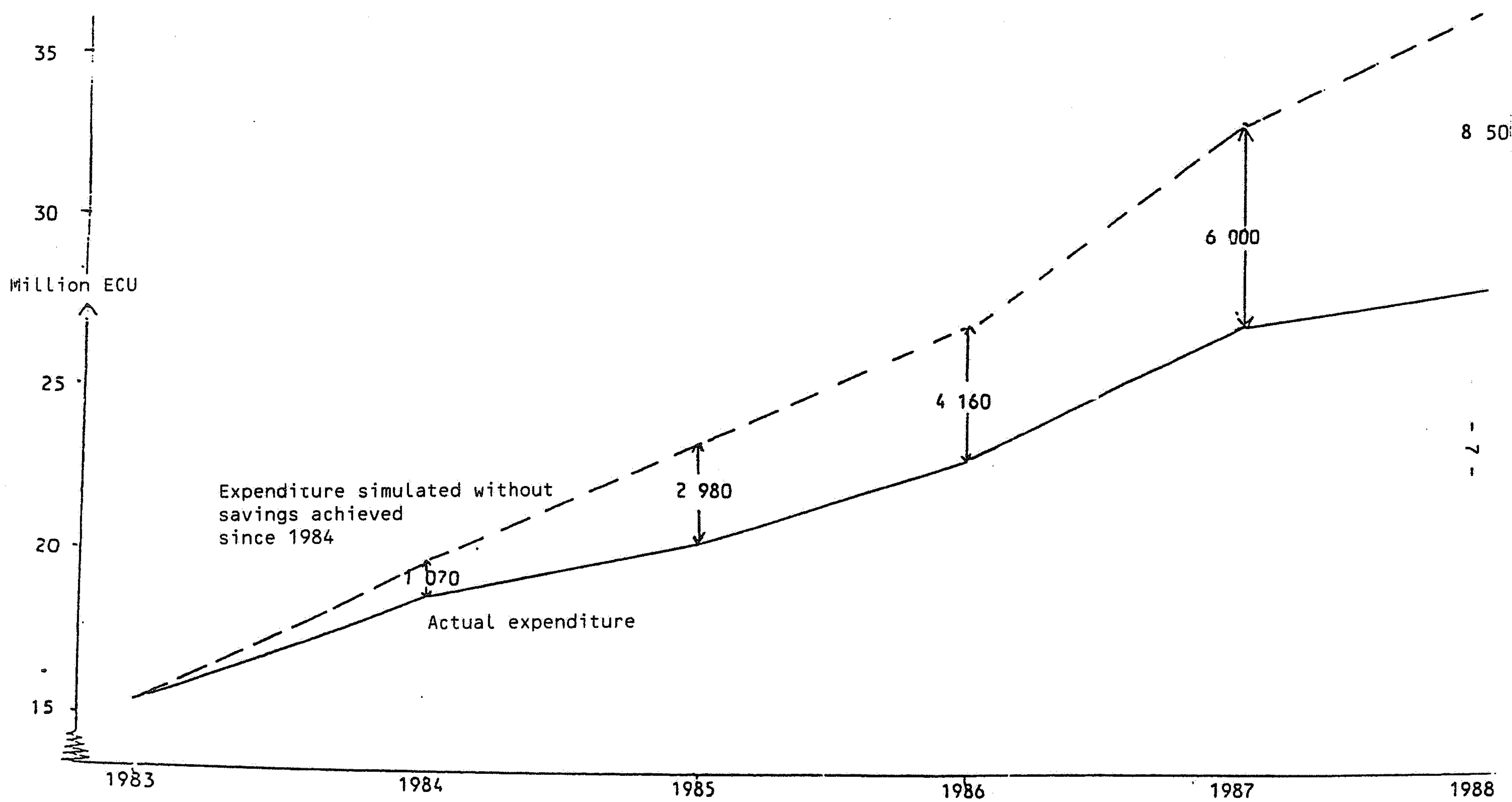
As regards the impact of the budget, a great deal has been achieved. The savings, actual or expected (see graph), are the following:

- 1984: 1 070 million ECU
- 1985: 2 980 million ECU
- 1986: 4 160 million ECU
- 1987: 6 000 million ECU
- 1988: 8 500 million ECU

It is none the less a fact that between 1984 and 1987, EAGGF guarantee spending rose from 18 371 million ECU to 27 305 million ECU, i.e. by more than 40%. However, the figure for 1987 is an estimate and includes a carryover of 693 million ECU from 1986, appropriations for that year having run out.

The rise in expenditure despite the reform of the market organizations has been mainly due to events occurring outside the area of the CAP, such as the deterioration in world markets (the costs of market organizations not enjoying external protection, like oilseeds, increasing substantially) and particularly the decline in the ECU rate of the dollar. A calculation at constant dollars (USD 1 = 1.10 ECU) shows that, at that rate, expenditure would have been 1 170 million ECU higher in 1984 but 1 600 million ECU lower in 1987. Thus, if the dollar had held steady, the growth in expenditure from 1984 to 1987, would not have been 40%, but only 24%.

But further savings must be made if the Community is to comply with the principle of budgetary discipline in 1988 and thereafter.



Million ECU
35
30
25
20
15
Expenditure simulated without savings achieved since 1984
Actual expenditure
1 070
2 980
4 160
6 000
8 50
1983
1984
1985
1986
1987
1988

8. One of the purposes of adapting the market organizations was to curb buying-in.

But heavy stocks were already - and still are - in the silos and warehouses. These stocks, because of an outdated accounting system and lack of appropriations, are still valued in the books at cost when bought in, although on sale they could not fetch much more than a quarter of this figure.

By the end of 1986, the situation was as follows:

	(m ECU)
- value of stocks shown in the accounts	11 419
- value in accounts of "normal" stocks	2 351
- value in accounts of surplus stocks	9 068
- value on market of surplus stocks	2 258
Loss	6 810

Half of this loss is accounted for by stocks of butter. For this product, the Council has approved a special disposal programme for 1 million tonnes for a total cost of 3 200 million ECU, to be reimbursed to the Member States in four instalments of 800 million ECU over the period 1989 to 1992.

To cover the rest of the loss on stocks, the Commission has proposed in the preliminary draft 1988 budget an amount of 1 240 million ECU, and is contemplating, for future years, a flat-rate sum of 700 million ECU per year for depreciation.

By these means, provided stocks do not build up further in the future, it should be possible to eliminate the "weight of the past" by 1992.

9. As regards developments concerning quantities taken into store in the last two years, the following observations must be made.

The new rules on the buying-in of butter and milk powder, and especially the reduction in milk quotas, have cut sharply the quantities offered to the agencies.

	Bought in, January-June (tonnes)	
	1986	1987
- butter	433 000	250 000
- milk powder	390 000	40 000

On the other hand, quantities of beef bought in have not so far declined. Rather more beef was bought in during the first six months (228 000 tonnes) than in the first six months of 1986. This is due to the "milk-quota effect" (slaughtering of cows). However, it is expected that in the second half of the year there will be a decline of 100 000 tonnes compared with the same period of 1986. In order to reduce the effect of slaughterings of dairy cows, a special direct meat disposal scheme has been included in the preliminary draft budget for 1988 (370 m ECU).

As regards cereals, it is too early to estimate the effect of the decisions adopted on sales to the agencies. But the stocks have not increased in the last marketing year.

10. Action to control production and agricultural expenditure and measures to reduce stocks taken in recent years have not been isolated operations.

They have dovetailed into a coherent policy making proper allowance for considerations concerning farmers' incomes, the maintenance of family farming in all the regions, the cohesion of the Community, and the need to ensure that European agriculture is properly related to the world context. Action taken in this connection is described in the Chapter IV, "The preservation of the European pattern of agriculture and the outlook".

III. EXISTING STABILIZERS AND NEW MACHINERY

11. Over the years, the machinery used for the management of the common agricultural policy has undergone major changes, although the fundamental principles on which the policy is based have been maintained unimpaired.

The changes have been made in response to a single objective, that of ensuring that farmers assumed a greater share of responsibility in respect of output and markets; the long-term aim has been to achieve a better balance between supply and demand and to ensure that producers bear part of the cost of disposing of surpluses. Moreover, they have been in line with the objective which the Ministers have set themselves - namely "no longer ..... to provide unlimited guarantees of price and intervention when there is doubt about the possibility of outlets...".

12. Although the concept of co-responsibility in agriculture had been mooted more than 10 years ago, it was only in 1981 that the Commission put forward the idea of a budgetary stabilizing system (viz. its proposed production guarantee thresholds, firstly for milk and later for crop products). The proposal was only gradually taken up by the Council and did not prove very effective.

Starting in 1984 but mainly much more recently, a number of reinforced stabilizers have, however, been introduced, aimed at bringing both agricultural production and budget expenditure under control. For some groups of products the stabilizers thus introduced are both binding and definitely effective in controlling expenditure.

Elsewhere the effect, though real, has been patchy and has not provided sufficient certainty that spending will in fact stop increasing, if only because of import commitments, which are constraints preventing the achievement of complete control over production and expenditure.

13. The Commission has undertaken to make additions to the market-organization regulations "with a view to ensuring that the planned overall levels of budget expenditure are not exceeded". The relevant measures are summarized below.

However, a number of general points must first be made.

There is doubtless room for stricter application of most of the mechanisms, but, the limits to more rigorous Community action are determined not only by technical or economic considerations peculiar to agriculture, such as climate, production cycles, and capital tied up, the effect of which is that farmers cannot react promptly or automatically to policy developments. Nor are these limits determined solely by the need to ensure that farmers do not react merely by shifting their operations from one farm enterprise to another, thus relieving difficulties in one sector only to create them in another. They are also, indeed mainly, determined by political imperatives, and depend on what it is felt should be or can be imposed on Community farmers, given the present circumstances with regard to incomes and employment.

Secondly, stabilizers are bound to differ according to the type of market support. Products covered by market intervention must be dealt with in a different manner than those supported by direct subsidies; likewise, products for which a production-quota system is applicable are less likely to need additional budget stabilizers, especially if the quotas in question are at the market-balance level.

Also, different arrangements are sometimes needed in the case of "multiannual" products.

Accordingly the measures which have been introduced include production quotas (sugar, milk), production-guarantee thresholds (oilseeds, cotton), processing-guarantee thresholds (for certain fruit and vegetables) and intervention thresholds (fresh tomatoes, butter and milk powder).

A system of direct financial co-responsibility has been introduced for certain groups of products. It is applied in full in the case of sugar but only partially (about 10%) to milk and cereals. Moreover, the system of guaranteed intervention has been somewhat restricted for beef, milk products, cereals and oilseeds. For "multiannual" products (e.g. wine), there are grubbing premiums and restrictions on replanting rights, in line with the decisions of the European Council of December 1984.

Stabilizing mechanisms are generally compulsory in character. Buth they seldom prove effective in the short term because of the way in which the decisions are taken (Council) and time-lags before actual implementation, and this severely hampers effective control of expenditure during the same marketing year.

To ensure that the planned overall budgets are not exceeded, <u>the respective powers of the Council and the Commission</u> should, as pointed out in doc. COM(101) (and later endorsed in the conclusions of the European Council of 30 June 1987), <u>be adjusted</u>, in certain cases, to allow sufficient flexibility as regards management and to enable the institutions to comply with budgetary discipline. The adjustment of the respective powers of the Council and the Commission is set out in detail in the Communication on "Budgetary discipline".

The proposals set out below in respect of each product group also refer to this. Their particular objective is to enable the Commission, under rules to be defined by the Council, to adapt the financial co-responsibility facilities and/or the regulations relating to intervention.

In the light of these considerations and of results obtained so far as regards the stabilizers, the Commission is planning, in as far as is necessary, to amplify and improve as follows existing regulations for all the agricultural product groups, allowing for constraints that must be complied with as regards timing.

14. <u>Proposals (by product group)</u>

<u>Sugar</u>

This is the only product group which, apart from the costs arising from preferential imports from ACP states, operates under a system of full financial autonomy.

Under the present arrangements, financial autonomy is ensured only into the medium term, however, which is why the Council has in recent years had to introduce "elimination" levies.

The Commission feels that financial autonomy should be ensured on an annual basis. It is therefore proposing that the rules be amended to allow the Commission to adjust the levy during the marketing year, in the light of expenditure trends.

Moreover, the slump on world markets calls for a lower level of sugar production, something which, at Community level, can be considered only if it can be achieved jointly with the world's other producers, under the International Sugar Agreement.

The Commission is proposing adoption of this course and, in September, it will put forward amendments to the regulations in line with this approach. The proposals will also cover other changes in the market organization.

Milk

The changes in policy on milk which have been introduced since 1984 will, for the first time, enable market balance to be achieved, from 1989 onwards.

Moreover, the stabilization mechanisms introduced - the co-responsibility levy and the intervention thresholds for butter and milk powder - already allow some reductions in expenditure.

The 1984-89 aggregate reduction in deliveries to dairies resulting from these measures is roughly equivalent to a year's production.

Thanks to the decisions taken as regards the financing of destocking operations, the Community has been able to launch a major storage reduction programme, thus helping to alleviate pressure on the market and, hence, reduce current operating expenses.

In September the Commission will lay before the Council a report on the operation of and outlook for the quota system.

The Commission feels that, under the arrangements applicable from 1989 onwards, the production cuts resulting from the suspension of the quotas must be consolidated.

It feels that any additional reduction should be counterbalanced by a similar commitment at international level by all the Community's partners. This would also call for a very real effort on their part to match what has already been done by Community producers.

In the light of the experience gained under the present arrangements during the last two marketing years the Commission will, moreover, propose any improvements to the intervention system which may prove necessary.

Oilseeds and olive oil

Expenditure on vegetable oils and fats has soared in recent years as oilseed production has forged ahead and world market prices have plummeted, the latter development impacting in full on the Community's expenditure since there is no external protection.

To remedy this situation, a production-guarantee threshold - applicable with effect from 1986/87 - has been introduced in the case of rape and sunflower seed: under this system, production aid is guaranteed in respect of a specified maximum quantity but is proportionately reduced if production exceeds that level.

For 1987/88 the Council has raised the existing cut-off from 5 to 10% and has introduced a similar system for soya.

The Commission asks that the Council take, before the end of 1987, a final decision on its proposals to phase out the cut-off for these three groups of products. Adopting the said proposals - they have already been given sympathetic consideration by the Council - would help to stabilize expenditure in each of the three cases.

In the case of olive oil the Council has adopted a system - superseding co-responsibility measures - whereby a limit is placed on quantities attracting full aid, the aid to be reduced where the limit is exceeded.

As regards the stabilizing mechanism, the Commission will also present, next October, its conclusions on the supplementary study and on the consultations with the Community's main partners requested by the European Council. Financial equilibrium for the oils and fats sector as a whole, including olive oil, will depend on the action the Council takes with regard to these conclusions. The Commission would recall in this connection the important implications of the failure to set up such a system, both for budgetary equilibrium and for the content of the measures of adjustment of internal policy.

Protein crops

Budget costs have also increased sharply in the case of protein crops (peas and field beans): they have almost doubled in two years.

No form of stabilization has so far been introduced. The Commission is proposing a production-guarantee threshold similar to that for oilseeds.

Cotton

There is, in the case of cotton, a guaranteed quantity in respect of which the aid - the difference between the Community price and the world market price - is payable. If production exceeds the guaranteed quantity, the price is reduced (the cut-off for the next three marketing years is 15%, 20% and 25% respectively, and will be abolished thereafter).

This system stabilizes expenditure to a sufficient degree.

Beef/veal

While it has significantly restricted the intervention rules, the reform of the market organization does not constitute a true budget-stabilization system.

None the less, the activating threshold for intervention and the adjustment of buying-in prices have saved a good deal of money, some of which is channelled directly back to producers in the form of a premium for male animals.

Tighter milk quotas and the resulting increase in slaughterings of cows tend to mask the true impact of the reform and rule out any further adjustment of this market organization, for fear of forcing specialized farms out of business altogether.

The Commission will in good time put forward, for implementation after the transitional period, which ends in December 1988, a proposal to discontinue the variable slaughter premium and the calf premium. In parallel, it will propose the introduction, for this group of products, of an intervention threshold similar to that now in force for butter. Such a move would allow the Commission to suspend buying-in while stabilizing markets and incomes by other means (generalized single premium for male animals).

Sheepmeat

There is no stabilizer for this group of products, of which the Community is a net importer but which is nevertheless a heavy charge on the budget. The system of premiums, which is extremely complex, keeps national markets separate within the Community while allowing certain farmers only very low margins.

The prospect for a single market in 1992 will necessitate the gradual introduction of a single system which could be based on a single premium per ewe, the amount of which would be reduced where a maximum guarantee threshold is exceeded. During September 1987 the Commission will submit a a report on the operation of the system, with proposals to this effect.

In the meantime, proposals will be put forward with a view to stabilizing the cost to the budget of operating the market organization in its present form.

Cereals and rice

Expenditure on cereals has risen sharply in recent years and could well reach 6 000 million ECU in 1988, boosted by the affects of an increase in world production and the collapse of world market prices.

During the last two marketing years action has been taken with a view to bringing production under control and stabilizing expenditure. Significant adjustments to the intervention arrangements were accordingly introduced (quality, restricted buying-in period, smaller monthly increases, and rules on the activation and the level of intervention).

The co-responsibility levy, which has superseded the earlier system of guarantee thresholds (these were never applied in practice) brings in about 400 million ECU each year.

Although designed as a stabilizing mechanism, the system as a whole is too rigid to be really effective.

The Commission's proposal is accordingly that these measures be supplemented in such a way as to allow them to be adjusted during the marketing year and thus exert a genuine stabilizing effect on expenditure.

It is therefore proposing: (a) the fixing, annually, of a maximum production quantity (155 million tonnes) beyond which certain corrections of the co-responsibility levy and/or of prices would be activated, and (b) adjustments in the intervention rules.

In the first case, if the Commission finds that there is a risk of the maximum quantity being exceeded, it would apply the correcting adjustments in accordance with general rules to be laid down by the Council.

In the second case, if the maximum quantity is exceeded and there is a risk of sales to the agencies exceeding an intervention threshold to be specified (maximum intervention quantity), the Commission should be empowered to suspend buying-in while ensuring market stability by other means.

As stated below (paragraph 20), in the autumn of 1987 the Commission will lay before the Council a report, accompanied by precise guidelines, on the non-utilization of farmland (this will include any potentially viable set-aside schemes), which could well have some impact on the production of cereals.

As regards rice, the Council introduced the same adjustments to the intervention mechanism as for cereals. As quite negligible quantities have been sent to the intervention agencies since the inception of this market organization, there is no case, at the present time, for strengthening existing stabilizers.

Wine

No budget-stabilizing mechanism as such has so far been introduced in respect of this group of products, the budget expenditure for which is expected to reach about 1 500 million ECU in 1987.

A number of measures do, however, help indirectly to bring expenditure under control: the premium for the abandonment of wine-growing land, the ceiling set on "voluntary" distillation operations, and the reduction in the price for compulsory distillation on the basis of the volume to be distilled.

In order better to control expenditure and solve the problem of wine surpluses, the Commission is proposing that the degressive scale applicable to the price paid for wine covered by compulsory distillation should tail off more steeply, even beyond the limit set at present.

It is also proposing that some measures introduced with a view to stabilizing short-term fluctuations should be discarded because of their cost and relative inefficacity (aid to wine relocation, special special price support guarantee for long-term storage contract holders).

The Commission also feels that the Council should, on the basis of a report it will be submitting, consider whether chaptalization (the addition of sugar) and the aid to concentrated must are justified.

Finally, the proposal to restrict replanting rights should be approved by the Council without delay.

<u>Fruit and vegetables</u>

There are guarantee thresholds for certain processed fruit and vegetables (e.g. tomatoes and some types of fruit). A withdrawal threshold (with a cut-off of 20%) was recently introduced for fresh tomatoes.

This has significantly reduced expenditure on the relevant products. The Commission is proposing that similar stabilizing mechanisms be introduced for other products in this group.

Accordingly, the system of withdrawal thresholds, accompanied by a proportionate reduction in prices, should be extended to other fresh products which are in surplus (e.g. cauliflowers) and certain types of tree fruit (apples, pears, apricots, peaches and citrus fruit).

In the case of processed products, a production threshold should be introduced for all products not yet covered by this device.

Tobacco

Although the basic regulation allows the buying-in price to be reduced if the quantities sent to the agencies rise above a certain level, this is a stabilizer which is not applied in practice, since buying-in is made unnecessary through (costly) premiums.

The Commission is proposing the introduction of a maximum guaranteed quantity for each group of varieties, which would be similar to that proposed for oilseeds and which would allow for the specific regional characteristics of tobacco-growing.

The Commission is also proposing a clearer demarcation of the areas of production of the varieties eligible for the premium, with a view to confining the production of certain varieties to certain areas.

15. This set of - interrelated - proposals shows that, for many products, budgetary expenditure can and should be further stabilized.

A financial assessment of the adjustment measures proposed in this document depends on a large number of hypotheses concerning future developments on the agricultural markets - not only within the EEC but also outside (including changes in exchange rates). In many cases, essential parameters lie entirely outside the Community's control. For these reasons, it is impossible to produce entirely reliable budget estimates for agriculture.