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REPORT FROM THE COMMISSION TO THE COUNCIL AND THE EUROPEAN PARLIAMENT ON THE AGRI-MONETARY SYSTEM FOR THE SINGLE MARKET

1 July 1996 to 30 June 1997

CONTENTS

Abbreviations for national currencies:

BLF:	Belgian and Luxembourg franc	HFL:	Netherlands guilder
DKR	Danish krone	IRL:	Irish pound
DM:	German mark	LIT:	Italian lira
DRA:	Greek drachma	ÖS:	Austrian schilling
ESC:	Portuguese escudo	PTA:	Spanish peseta
FF:	French franc	UKL:	Pound sterling
FMK:	Finnish markka	$:	dollar

Other specific abbreviations:

1998 PDB:	preliminary draft budget for 1998
ACR:	agricultural conversion rate
RMR:	representative market rate

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Introduction

This report by the Commission has been drawn up pursuant to the commitment entered into at the Council meeting (Agriculture) of 19 to 22 June 1995, when the Commission undertook to draw up a report each year analysing the consequences for the common agricultural policy and the single market of monetary fluctuations and the agri-monetary system in force, accompanied by proposals for appropriate remedies to the problems that might ensue.

It also constitutes a response to the own-initiative resolutions of Parliament of 19 September 1995 on the agri-monetary system,[1] calling on the Commission "to make a detailed assessment of all implications of the Council Decision[2] and its financial impact."

This report relates to the economic sector of agriculture over the period 1 July 1996 to 30 June 1997 (1996/97). It comprises a main report summarising and commenting on the result of the investigations carried out, and indicates the proposed solutions to the problems identified. The main report is followed by a description of the analysis of agri-monetary events in 1996/97, and their effects. It is a sequel to the annual report for 1995/96.[3]

The first and second parts of the analysis, parts A and B, describe the currency and agri-monetary developments of the period under review, including the granting of compensatory aid.

Part C is an approach to the economic consequences at the level of agricultural markets and farm incomes. In view of the available statistics, the most convenient approach is to compare results for twelve-month periods from July to June for the analysis of prices and by notional year for incomes. The analysis of trade has been shortened, in view of the results described in the previous report.

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1 Joint resolution under Article 40(5) of Parliament's Rules of Procedure, No PE 193.731, of 19 September 1995 on the agri-monetary system.

2 Decision of Council meeting of 19 to 22 June 1995, on the basis of which two Council Regulations were adopted, namely Regulation (EC) No 1527/95 of 29 June 1995 regulating compensation for reductions in the agricultural conversion rates of certain national currencies (OJ L 148, 30.6.1995, p. 1) and Regulation (EC) No 2611/95 of 25 October 1995 establishing the possibility of national aid being granted in compensation for losses of agricultural income caused by monetary movements in other Member States (OJ L 268, 10.11.1995, p.3)

3 COM(96) 636 final

Part D assesses the effects of the agri-monetary system on Community expenditure. The impact is estimated on the basis of the 1997 budget in the course of execution, and the preliminary draft budget for 1998. Budget years cover twelve-month periods running from 16 October.

The basic data for this report are presented in tables and graphs appearing in a Commission staff working paper : document SEC(1998)87 available in french, german and english version.

I. MAIN REPORT

A. Agri-monetary effects observed

1. Conversion rates

Like the previous year, the period July 1996 to June 1997 (referred to as 1996/97) was relatively stable for most currencies. The salient feature was the strong revaluation of the UKL, partly followed by the IRL. Once again, traditionally strong currencies were slightly devalued.

The dollar appreciated by 7·89 % against the ecu, following the trend of the earlier period, during which it had appreciated by 6·8%.

In general, monetary gaps remained positive over the period, i.e. ACRs were higher than RMRs. The positive gap for the UKL was particularly wide from October 1996, regularly exceeding 6 points during the periods when the trend was confirmed. Except for one ten-day period, there was always at least one currency with a positive monetary gap of over 4 points. This meant that the permitted margin ("franchise") for negative gaps was very small, at less than 1 point. In this situation, no currency showed a constant negative gap.

Three "appreciable" reductions were made to the ACRs of the IRL and the UKL. The reductions in the ACR for the IRL had to be adjusted by a devaluation of the ACR on 26 May 1997. The ACR of the LIT was reduced once more on 1 October 1996 after four non-appreciable reductions in the previous period. These repeated reductions led the Council to consider that the conditions for an appreciable revaluation of 3·08% had been fulfilled on 1 March 1997.

The appreciable reduction in the ACR of the SKR on 11 January 1996 was followed by a further reduction of 3·280% on 7 July 1996. The second appreciable reduction was partly offset by an increase in the ACR of 2·78% altogether.

Increases in the ACRs for the BLF, DM, HFL, and ÖS from June 1996 to May 1997 completely offset the appreciable reductions recorded in 1995.

2. Ad hoc Council measures for appreciable revaluations

The Council adopted ad hoc measures for the period from June 1995 to December 1996, to deal with any appreciable revaluations. The measures in the basic regulation are replaced by compensatory aid on a flat-rate basis and a freeze on the agricultural conversion rates applicable to direct aid. Council Regulation (EC) No 724/97 renewed these arrangements until 30 April 1998, and extended their application to other cases of reduction in the agricultural conversion rate, so as to deal with all cases that might require the application of Articles 7 and 8 of Regulation (EEC) No 3813/92.

3. Freezing of ACRs

ACRs for the aid referred to in Article 7 of the basic agri-monetary Regulation are frozen at the value actually applied at the time of the appreciable revaluation. The freeze applies until 1 January 1999. In view of the operative events determining the ACRs applied to the aid concerned, several rates will remain frozen until 30 June 1999.

On 30 June 1997, ACRs were frozen for all but five currencies (the exceptions being the DRA, ESC, FF, FMK and PTA). The Council has decided that the difference between the frozen ACR and the ACR that would have obtained had there been no freeze should be limited to 11·5%, so that the ACRs applied to the aid concerned do not diverge too far from the conversion rates for the euro to be introduced on 1 January 1999. When the difference between the frozen ACR and the current ACR exceeds the limit, the frozen ACR is reduced to a level equal to the current ACR increased by a margin of 11·5%. As a result of this decision, the frozen ACRs for the SKR and the UKL had to be reduced on 1 July 1997, by 0·11% and 3·61% respectively.

4. <u>**Compensatory aid for appreciable declines in ACRs**</u>

The aid comprises three degressive tranches, the first of which may consist in up to 100% of the ceiling, while the second and third are limited, respectively, to 2/3 and 1/3 of the ceiling. The European Union finances 50% of the maximum, irrespective of the national contribution in the form of additional financing by the Member State.

In cases of reduction of the frozen ACR, complementary aid corresponding to the consequent loss of annual income may be granted to the farmers concerned. This aid is also made up of three twelve-month degressive tranches, 50% of which is financed by the European Union irrespective of the national contribution.

The second tranche of aid to offset the appreciable revaluations of June and July 1995 was activated in Belgium, Luxembourg, Germany, Denmark, the Netherlands and Austria. Almost ECU 210 million was granted under the second tranche, including ECU 135 million financed by the Community. In view of currency developments, the planned third tranche has been cancelled for the Member States in question.

Further aid may now be granted in view of the appreciable revaluations of the SKR, IRL, UKL and LIT; the first tranche will total almost ECU 993 million, half of which can be financed by the EAGGF.

Sweden has paid the first two tranches of compensation for the appreciable revaluation of 11 January 1996. The authorities have also notified their intention of granting aid to offset the effects of the appreciable revaluation of July 1996, which has been authorised. The second tranche of this aid was cancelled in view of the devaluations occurring after the appreciable revaluation.

Ireland granted the European Union's share of the first tranche of compensation for the appreciable revaluations of November 1996 and January 1997, which came to ECU 56·7 million. Moreover, in June 1997 Ireland notified its intention of granting the Community share of aid for the revaluation of March 1997. The maximum for the first tranche of that aid was fixed at ECU 57·5 million.

By 30 June 1997, Italy had not yet notified any plans for the amount of ECU 247 million available for granting under the first tranche of compensation for the appreciable revaluation of the LIT in March 1997.

By the same date, the United Kingdom had notified no plans for the ECU 454·4 million available under the first tranche of compensation for the revaluations of January, March and June 1997, or for the ECU 66·7 million to compensate for declines in area aid for arable crops in national currency on 1 July 1997.

5. General remarks on economic effects

In theory, the ACR will affect only those market prices that are closely linked to an intervention mechanism (mainly in the sectors of cereals, sugar, milk and beef/veal). The development of ACRs may thus have an impact on farm incomes through the prices of those products. Moreover, problems in trade may arise when divergences appear either between ACRs and RMRs, or between market prices and intervention prices in national currency.

The prices of other products, on the other hand, are not affected by ACRs. However, trade in those products may be distorted by sudden major changes in the RMRs. This happens, in particular, when market prices in national currency do not follow currency movements.

As well as the impact of currency movements on prices, farm incomes are subject to the direct effects of the ACRs applicable to direct aid to producers.

6. Effects on market prices

As there were no major devaluations, the movements in ACRs with the greatest potential repercussions in 1996/97 were substantial steady revaluations of the UKL (13·5%) and the IRL (8·5%).

For products with no intervention mechanism, there is, as expected, no observable link between movements of prices and movements of ACRs.

For the third consecutive marketing year, it is quite clear that market prices for cereals standing at over 10% higher than the intervention level are not affected by ordinary movements in ACRs. It is not possible, using available observations, to predict what agri-monetary effects might occur if market prices were closer to intervention prices. However, it seems likely that major changes in ACRs would lead to agri-monetary effects against a background of high market prices. In the wake of the reduction in the ACR for the UKL, 8% between July 1996 and February 1997, the gap between market prices and the intervention level developed on broadly the same lines in the United Kingdom and in the rest of the market.

Despite the fact that prices cluster around the intervention level in the milk products sector, agri-monetary effects do not appear systematically. The predominant trends on the market are usually followed by national prices, within a margin of 5% on either side, but movements of ACRs of less than 2% or 3% have no clear impact. Very sizeable price variations may occur for reasons unconnected with monetary considerations, and they may be confined to a single Member State. Wider movements of ACRs may be passed on accurately into national prices, as in the United Kingdom; but the example of Ireland shows that substantial interference from the parties concerned is also possible.

Prices for the meat of young bovine animals were especially low early in the period, generally some 60% to 75% of the intervention price, owing to the bovine spongiform encephalopathy crisis. In virtually all the Member States, market prices expressed as a percentage of intervention prices followed the same general trend. This means that the major changes in ACRs, especially for the UKL and the IRL, were on the whole passed on to national markets.

7. **Effects on trade**

Any monetary effects on trade are masked, in the short term, by wide variations in the monthly value of exports. Over longer periods, exports may be affected by competitiveness; this impact is countered by the impact of domestic demand, exporters' attitudes to their profit margins, and structural factors on both a sectoral and a wider scale; all these factors are so closely entangled in a complex web of reciprocal effects that it is virtually impossible to identify their individual impact.

8. **Effects on incomes**

According to calculations based on a theoretical model grouping all the consequences of ACRs over twelve months, it would appear that their impact on incomes was significant, and unevenly spread over the Member States.

Altogether, the effect on gross value added at factor cost apparently amounted to some 1·3%, or ECU 1 884 million, or almost 10% more than in 1995/96.

The incomes that have been increased most by the agri-monetary arrangements are those which would have declined following a currency appreciation if the arrangements had not existed. The arrangements have not made much difference to incomes in currencies that remained fairly stable over the period under review, since the agri-monetary loss was virtually nil.

In 1996/97, the Member States that benefited most from the effect of the agri-monetary arrangements by comparison with the situation that would have obtained without such arrangements were: Ireland (8%), Sweden (7·4%), the United Kingdom, Italy, Finland and to a lesser extent Denmark.

9. **The cost of agri-monetary developments**

The figures in the table below show an annual cost of about ECU 1 200 to 1 300 million (of the same order of magnitude as 1995/96).

Almost 60 % of this cost is due to the effects of permitted margins. The reason margins entail a cost is basically attributable to the asymmetry of the mechanism, whereby positive monetary gaps can rise to 5 points while negative gaps are usually limited by a variable threshold determined by the maximum positive gap minus 5 points. Moreover, in situations of steady and significant appreciation for several currencies, the duration of confirmation periods plays an important role in keeping the largest positive gaps in existence over time.

The cost of operative events is about ECU 160 million, or ECU 60 million more than in 1996. Irrespective of any ACR, this cost is due to currency movements between the date of the operative event and the accounting date for the expenditure. This result is unusually high because there was no offsetting, in 1996/97, between currencies that appreciated and those that depreciated.

The cost of the freeze on ACRs in 1997 is deferred to 1998 because of operative events. It will amount to ECU 500 million in 1998. As the freeze will continue until 1 January 1999, it also affects the budget for 2000.

(ECU million)

Cost of agri-monetary developments 1996/97	**1997**	**1998**
ACR freeze	160	499
Compensatory aid	214	382
Permitted margins	772	312
Operative events	160	-
Total	**1306**	**1193**

In 1997, the main beneficiary under the agri-monetary arrangements was the United Kingdom, with increased expenditure in UKL of 30·7%. There was also a significant increase in the agri-monetary cost of Ireland in relation to 1996. This is the result of the effects of the margins and operative events in a context of strong currency appreciation.

[redacted]

B. ANALYSIS, OUTLOOK AND PROPOSALS

1. General view

As in the previous period, observation of the agri-monetary arrangements over the period 1996/97 reveals difficulties with technical, economic and financial aspects. Some of these difficulties may become serious problems, although this will depend on how the situation develops. In general, the conclusions and recommendations in the previous report are still valid.

Three major developments need to be taken into account: economic and monetary union, enlargement of the European Union, and the future of the CAP, in particular Agenda 2000. The proposals to be made depend not only on the urgency and seriousness of the agri-monetary problems to be dealt with, but also on the options and timing resulting from these three developments.

2. Financial difficulties

In financial terms, the costs of the present arrangements are high, but considerably less than they would have been if the mechanisms originally planned for appreciable revaluations had been applied. This consideration fully vindicates the Council's ad hoc decisions on compensatory aid and the freezing of certain ACRs. The costs of the ad hoc measures can be seen to be fairly moderate, even though some of them could have been further compressed, since there is no clear economic necessity for flat-rate compensation for loss of income for price reductions that did not actually occur. This problem could be solved by a verification period, but that would mean deferring compensation for loss incurred immediately.

The costs linked to operative events are unavoidable in relation to the operation of the CAP, but the main costs, linked to permitted margins, depend on the choice of mechanisms under the agri-monetary arrangements. However, as margins constitute a sensitive system based on fragile equilibria, it would be dangerous to tamper with single components in isolation from the whole. But the system of permitted margins as a whole is in fact the mainstay of the present agri-monetary arrangements.

3. Economic difficulties

Almost all farmers benefit economically from the agri-monetary arrangements, although the extent of the benefit varies according to the currency situation and the reasons for it differ depending on the stability of the national currency concerned. Effects on markets vary from one product to another, and, for the most sensitive products, with the price level in relation to guaranteed institutional prices.

When currency developments are not passed on, which happens with the freeze on certain ACRs applicable to direct aid to producers, there is a risk of long-term structural divergence, either between Member States, or between agricultural sectors in the same Member State. Moreover, it may become increasingly difficult to envisage return to equilibrium at a common level in ecus.

When currency developments are passed on only partially and with some delay, which happens with products for which there is no intervention mechanism, divergences may emerge in the medium to long term, either between prices recorded in the different Member States or within overall trade.

When currency developments are fully passed on, through guaranteed prices, the movement in incomes and prices for the products concerned may diverge from the general development of prices and incomes.

In all cases, depending on the economic situation and circumstances, major difficulties may occur, mainly in the long term. This means that the best system is not one that is fixed for ever, but one that can be adapted to the agricultural and monetary background and to the risks most likely to materialise.

4. Technical difficulties

From the technical point of view, certain aspects of the present arrangements are somewhat incoherent and sometimes contribute to the economic and financial difficulties described above. They mainly relate to the impact of the revaluation, the conversion rate used for import charges and the timing of changes to ACRs.

Some measure of the impact of currency revaluation and decline in ACRs is required: it enables past currency developments to be taken into account when assessing the possible consequences of the present currency revaluation. However, experience has shown the present approach based on the definition of "appreciable" revaluations to be unsatisfactory and excessively complex.

An appreciable decline in the ACR is based on the confirmation of monetary gaps over five reference periods. It is important to set a limit on the period, given the risk of deflection of trade flows; but steps must be taken to prevent currency movements in the opposite direction just after the appreciable revaluation.

The use of the twofold conversion system for import charges on agricultural products is unnecessarily complicated, leading to economic inconsistency and to disputes. The Commission still considers valid the main idea in its proposal of February 1996 [COM (96) 40 final], i.e. the application of a single rate for import charges.

The rules for changing ACRs make up the fragile system of permitted margins. For example, under one of the rules, an exceptional three-day reference period is triggered when any aggregate bilateral monetary gap exceeds six points. Where this rule is applied, it contributes to the instability of ACRs: in particular, it upsets the established calendar for changes in rates. This rule has been criticised for its shortcomings. The rule was introduced for the practical implementation of the agri-monetary arrangements in order to avoid a delay of 10 days, or safeguard measures, in cases of sudden major currency movements. Experience of long reference periods before an appreciable revaluation has called into question the economic justification for this rule. But the rule does sometimes contribute to shortening the overall confirmation period before appreciable revaluation. It would once again be economically justifiable if a sudden and very substantial devaluation occurred, creating gaps even larger than those recorded in 1995. This rule too is very closely tied in with the whole system of permitted margins, on which the present agri-monetary arrangements are based.

5. Impact of monetary and agricultural outlook

The third stage of economic and monetary union, from 1 January 1999, is quite exceptionally important for the future of the agri-monetary arrangements.

Among the Member States that adopt the euro, agri-monetary arrangements will no longer be needed. However, the transition from the present arrangements to a system of direct payments in euros implies that monetary gaps between agricultural conversion rates and market rates will be eliminated.

The extent of the effort needed will depend, at the end of 1998, on the currency situation and the market prices of the products with a guaranteed institutional price.

For the other Member States, those which do not adopt the euro on 1 January 1999, agri-monetary arrangements will still be needed, if only so that payments of prices and amounts fixed in euros can be made in national currencies without distortion of the markets. The arrangements will also affect relations between the Member States which have kept their national currency on the one hand, and those which have adopted the euro on the other.

The agri-monetary arrangements need to be adapted to the new situation. First, as the new arrangements must take account of the risk of variations in national currencies against the euro, they must also allow for the relations that will be established between the Member States that do and those that do not use the euro, and for the possible role of new accessions. Secondly, the arrangements must be adaptable to possible developments of the CAP, in particular in terms of Agenda 2000 . The key factors here will be the level of guaranteed prices, and the level and uniformity of direct aid to producers.

6. Proposals

According to the calendar for economic and monetary union, the use of the euro by the Member States that qualify will be introduced on 1 January 1999. This date sets a time limit on revising the agri-monetary arrangements. An informed decision on adjustments to the agri-monetary arrangements and the requisite transitional measures cannot be taken until it is known which Member States will be adopting the euro, and a more accurate assessment of the gaps to be dismantled has been established. The decision on which Member States adopt the euro is planned for May 1998. Relevant Commission proposals must be presented towards the end of the first half of 1998 at the latest, for a Council decision in the light of the most recent available information on the monetary and agricultural situation.

With the prospect of major and imminent revision of the agri-monetary arrangements, it is not a very good idea, at the end of 1997, to consider any significant changes other than the strictly essential, which will in any case need to be reconsidered in the course of 1998. However, in view of the problems that will arise for the transition between national currencies and the euro, it is best not to aggravate situations and risks created by the freeze on ACRs when appreciable revaluations take place, in particular owing to the gap between the frozen and the current ACR.

Regulation (EC) No 724/97 dealing with measures to be taken in the event of appreciable revaluations applies until 30 April 1998 and will probably be extended until the introduction of the euro. For cases similar to appreciable revaluations in 1996/97, care should be taken to ensure similar treatment, that does not create discrimination between Member States.

Altogether, the conclusions can be summarized in four points:

- no change should be made to the general way the present agri-monetary arrangements function pending their revision with a view to the third stage of economic and monetary union on 1 January 1999;

- where possible and necessary, rules should be simplified without compromising the system as a whole, which means discontinuing the use of the agricultural conversion rate for import charges, as already proposed to the Council;

- future appreciable revaluations should be dealt with, but disparities resulting from freezing ACRs should not be aggravated, for they would interfere with the changeover to the euro;

- without prejudice to the Commission's proposals, study and analysis of the present agri-monetary arrangements and possible future approaches should continue.

Consequently, there is no immediate call for the Commission to present a new proposal for a Council regulation to adapt substantially the agri-monetary arrangements. The Commission will, however, need to present a proposal on measures to be taken in the event of appreciable revaluation in the period 1 May to 31 December 1998.

II. ANALYSIS OF AGRI-MONETARY EFFECTS IN 1996/97

A. Currency developments

1. Representative market rates (RMRs)

Like the preceding twelve months, the period from July 1996 to June 1997 (1996/97) was relatively stable[1] for most currencies. The main development was the strong revaluation of the UKL, partly followed by the IRL. Once again, traditionally strong currencies depreciated slightly.

During the period under review, the dollar rose by 7·89% against the ecu, continuing the trend of the previous period, during which it had appreciated by 6·8%[2].

Generally speaking, this stronger trend for the dollar was reflected in similar movements for the UKL and the IRL, with inverse movements for the other currencies, except the ESC, LIT and FMK, which were either more stable or more volatile.

The RMRs for the BLF, DM, HFL and ÖS rose by about 2·5%, a devaluation comparable to that of 1995/96, bringing the RMRs for these currencies back to within 1% of their levels of January 1993. The increase in RMRs for the FF and the DKR, 1·68% and 1·19% respectively, also brings them to within 1% of the RMR of January 1993.

After a few months of stability, the RMR of the DRA gradually increased by a total of 3·02%. The PTA followed a similar trend, depreciating by 2·33%.

Following appreciation of 12·6 % in 1995/96, the RMR of the SKR depreciated in 1996/97 by 5·08%, more than any other currency in the period under review.

The RMR of the UKL appreciated by 13·46% in 1996/97 thus continuing and accentuating the trend that began in January 1996, after a series of devaluations. The RMR of the UKL has now returned to the central rate of early September 1992.

Until March 1997, the IRL was developing in parallel with the UKL (appreciation of 7·24%), although at a certain distance; however, it fell back thereafter, and aggregate appreciation from the beginning to the end of the period 1996/97 was 4·06%.

The RMR of the ESC remained stable at the same level as during the preceding period. The RMR of the LIT remained virtually stable at the level it had reached by the end of the preceding period, during which it had declined by 11·42%.

The RMR of the FMK appreciated steadily until February. The trend subsequently reversed, and by the end of the period the FMK had depreciated by 1·32% from its initial level.

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1 See tables and graphs A1 to A4 in the Working Paper on Basic Information,.

2 Under the agri-monetary arrangements, the conversion rates express the value of one ecu in national currency. A devaluation against the ecu therefore corresponds to an increase in those rates, while a revaluation is equivalent to a reduction.

2. Agricultural conversion rates

Since the switch-over mechanism was discontinued on 1 February 1995, all agricultural conversion rates (ACRs) move up and down in line with representative market rates (RMRs)[3]. However, the mechanism for aligning ACRs on RMRs is not symmetrical. Larger monetary gaps, and longer reference periods for their observation, are needed to trigger a reduction in the ACR after a currency has appreciated (i.e. after a decline in institutional prices in national currency) than to trigger an increase in the ACR following depreciation.

In accordance with those mechanisms and movements in currencies, the ACRs for the FF, DKR, ESC, and FMK remained unchanged during the period under review. Apart from the discontinuation of switch-over on 1 February 1995, the last changes in the ACRs of the FF and the ESC date back respectively to 21 August 1993 and 1 June 1994. The DRA and PTA are close to this group of stable currencies, with slight increases at the end of the period under review (0·08% et 0·23%). The ACRs of the UKL and IRL declined substantially, respectively by 13·55% and 8·48%. Following confirmation of the earlier appreciation of the RMR, the ACR of the LIT was revalued by 2·78% at the beginning of the period 1996/97, remaining stable thereafter. The SKR declined by 3·28 %, but the revaluation had been virtually cancelled out by the end of the period, owing to numerous small increases in the ACR. The remaining currencies (BLF, DM, HFL, ÖS) increased by about 2·5% in various stages.

Monetary gaps were positive for the DKR, UKL, LIT and FMK throughout the period under review, and for the SKR, DRA, ESC, FF, IRL and PTA for most of the period, except towards the end. The positive gap for the UKL was especially wide from October 1996, regularly in excess of 6 points during the confirmation periods that must precede revaluation. With the exception of one ten-day period, there was always at least one currency throughout 1996/97 with a positive gap in excess of 4 points. At the beginning it was the FMK, IRL and LIT, with the UKL taking over from October. The available margin for negative gaps was thus always very small at below one point[4]. In the circumstances, no currency showed a negative gap throughout the period.

In the period 1996/97, the ACRs of the IRL and the UKL underwent three appreciable falls[5]: that of the IRL declined by 0·328% on 8 November 1996, 4·259%

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3 See graphs A4 to A5 in the Working Paper on Basic Information.

4 Where the "aggregate" gap made up of the largest positive gap and the largest negative gap exceeds 5 points over a certain number of reference periods, ACRs must be adjusted to reduce the monetary gaps.

5 An "appreciable" reduction in the ACR is one leading to a reduction in institutional prices in national currency that is greater than the effects of any devaluation occurring during the preceding three years. These effects are estimated as two thirds of the increase in institutional prices due to changes in the ACR occurring between 12 and 24 months previously, and one third of the increase between 24 and 36 months previously

on 11 January 1997 and 2·638% on 29 March 1997; that of the UKL declined by 3·274% on 21 January 1997, 3·256% on 29 March 1997 and 2·706% on 5 June 1997. The falls in the ACR of the IRL had to be adjusted by a devaluation of the ACR on 26 May 1997.

After four non-appreciable reductions in the preceding period, the ACR of the LIT declined once more on 1 October 1996, remaining stable thereafter. As the effects of earlier devaluations of the LIT grew weaker, the Council felt that in view of the aggregate declines in the ACR, the conditions for an appreciable revaluation of 3·08% had been met on 1 March 1997.

The appreciable fall in the ACR of the SKR on 11 January 1996 was followed by a further fall of 3·280% on 7 July 1996. The second appreciable fall was partially offset by the aggregate rise of 2·78% in the ACR over the rest of the period 1996/97.

Increases in the ACRs of the BLF, DM, HFL and ÖS from June 1996 to May 1997 fully offset the appreciable declines recorded in 1995.

B. Agri-monetary mechanisms

The currency developments observed in the period 1996/97 were such as to enable the management of agri-monetary mechanisms to concentrate on maintaining the general functioning of existing provisions and policy approaches, as recommended in the conclusions of the previous report on agri-monetary arrangements in the single market.

Measures in the period 1996/97 related to the conversion rates applicable to import charges, and also, more importantly, to the consequences of appreciable revaluations.

1. CONVERSION RATE FOR IMPORT CHARGES

Owing to the GATT agreements, many import charges have been fixed in ecus since 1 July 1995. Most of these charges were previously levies subject to agricultural conversion rates, or percentages of the value of the product expressed in national currency.

Commission Regulation (EC) No 1482/95[6] provided for the application, as a transitional measure, of a monthly rate where the annual rate provided for in the Customs Code should have applied[7]. From 1 January 1997, Regulation (EC) No 82/97 amending the Customs Code provides for the use of a monthly conversion rate generally. It was therefore possible to repeal Regulation (EC) No 1482/95 from 1 March 1997.

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6 OJ No L 145, 29.6.1995, p. 43. Amended by Regulation (EC) No 1224/96 (OJ No L 161, 29.6.1996, p. 70) and repealed by Regulation (EC) No 259/97 (OJ No. L 43, 14.2.1997, p. 8).

7 Article 18 of Council Regulation (EEC) No 2913/92 (OJ No L 302, 19.10.1992, p. 1), amended by Regulation (EC) No 82/97 (OJ No. L 17, 21.1.1997, p. 1).

However, the monthly rate is applicable only to import charges not fixed by an instrument under the CAP within the meaning of Article 1 of the basic agri-monetary Regulation. In other cases, the agricultural conversion rates are applied. The use of different conversion rates has resulted in certain economic inconsistencies and has very greatly complicated administration, with concomitant scope for errors and legal uncertainty. In February 1996 the Commission accordingly proposed amending the agri-monetary arrangements so as to eliminate the use of the agricultural conversion rate and to use only one rate for import charges on agricultural products[8]. Parliament expressed a favourable opinion on the Commission proposal, and suggested no amendments; but the Council was not able to reach a qualified majority on the matter.

2. REGULATIONS GOVERNING APPRECIABLE REVALUATIONS

Ad hoc measures in the event of appreciable revaluations were in force from June 1995 to December 1996 under Council Regulation (EC) No 1527/95[9] and, later, Council Regulation (EC) No 2990/95[10].

These measures, which were deemed necessary in particular with a view to compliance with obligations under the GATT agreement and budgetary discipline, suspend the application of Articles 7 and 8 of the basic agri-monetary Regulation[11]. Article 7 provides for an increase in ecus in most types of direct aid to producers[12] in the event of a revaluation which is greater than the devaluations of the two preceding years, with a view to avoiding any reduction in the value of the aid in the currency in question. In view of the scale of the aid concerned in terms of the budget (over 60% of the EAGGF Guarantee Section), such a measure would cost approximately ECU 250 million a year for each percentage point revaluation. Article 8 of Regulation (EC) No 3813/92 also provides for compensatory aid for income losses due to the effects on prices of reductions in the ACRs. The aid in question can only be granted after 12 months' observation showing that there is a lasting fall in the ACR. The amount of aid is established, where necessary, on the basis of the fall in farm incomes incurred, which is in principle an observable magnitude.

In place of the measures laid down in Articles 7 and 8 of the basic agri-monetary Regulation, Regulations (EEC) No 1527/95 and No 2990/95 introduce flat-rate

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8 COM(96) 40 final.

9 OJ No L 148, 30.6.1995, p. 1

10 OJ No L 312, 23.12.1995, p. 7. Amended by Regulation (EC) No 1451/96 (OJ No L 187, 26.7.1996, p. 1).

11 Council Regulation (EEC) No 3813/92 (OJ No L 387, 31.12.1992). Last amended by Regulation (EC) No 150/95 (OJ No L 22, 31.7.1995, p.1).

12 Flat-rate aid expressed in ecus per hectare or per livestock unit and aid of a structural or environmental nature.

compensatory aid and a freeze on the agricultural conversion rates applicable to direct aid covered by the abovementioned Article 7.

Under Council Regulation (EC) No 724/97[13] the application of these principles was prolonged until 30 April 1998, and extended to reductions in the agricultural conversion rate other than those defined in Article 1(e) of the basic agri-monetary Regulation, to ensure that they would catch all cases of application of Articles 7 and 8 of Regulation (EEC) No 3813/92. The detailed rules for applying these provisions were laid down in Commission Regulation (EC) No 805/97[14].

3. THE FREEZE ON ACRs

The freeze on the ACRs for aid provided for in Article 7 of the basic agri-monetary Regulation relates to the ACRs actually applied on the date of the appreciable revaluation and is valid until 1 January 1999 when the single currency comes into force. In view of the operative events[15] for the ACRs for the aid measures in question, several ACRs are frozen until 31 December 1999. Naturally, this entails a temporary variation in the level of Community support between the various Member States. In national currency, this may affect the balance of aid expressed in ecus between the various sectors of agriculture.

To avoid excessive monetary gaps between the ACRs applied to this aid and the conversion rate adopted for the euro on 1 January 1999, in view of existing gaps, the Council decided to limit the difference between the frozen ACR and the ACR that would have applied had there been no freeze to 11·5%. When the difference between the rates exceeds this threshold for certain types of aid, the frozen ACR for that aid is cut to the level of the current ACR increased by 11·5%. On 1 July 1997, the only ACRs that were not frozen for the relevant types of aid were those of the DRA, ESC, FF, FMK and PTA[16].

Currency developments following the freeze on the ACRs of the DM, HFL and ÖS in June and July 1995 have led to current ACRs almost 0·5% higher than the frozen ACRs. The current ACR of the BLF is about 1% below the ACR frozen in 1995, but higher than the ACR regarded as appreciable, which opens the possibility of compensatory aid.

The ACR of the DKR, frozen in 1995, and that of the LIT, frozen on 1 March 1997 for livestock or structural aid, are both almost 3% higher than the RMRs of 1 July

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13 OJ No L 108, 25.4.1997, p. 9.

14 OJ No L 115, 3.5.1997, p. 13.

15 The ACR on the date the operative event occurs is that applied to the amount in question. The operative event for aid per hectare under the reform of the CAP occurs on 1 July. For most other aid measures referred to in Article 7 of Regulation (EEC) No 3813/92, it occurs on 1 January

16 See Table A7 in the Working Paper on Basic Information.

1997: The disparities for area aid for arable crops in LIT, and for livestock aid and structural aid in SKR, are almost 5%.

The frozen ACRs showing the widest gaps in relation to RMRs on 1 July 1997 were:

- the ACR of the IRL, frozen in November 1996, a gap of about 9%,
- the ACR of the SKR for area aid for arable crops, frozen in January 1996, a gap of almost 11·5%,
- the ACR of the UKL, frozen in January 1997, a gap of almost 15%.

In view of the gaps between the ACRs previously applicable to area aid for arable crops on the one hand, and the current ACRs on 1 July 1997 on the other, the frozen ACRs of the SKR and UKL had to be reduced in order to obtain a difference of only 11·5% in relation to the ACR that would have applied without a freeze. The reductions required were 0·11% for the SKR and 3·61% for the UKL.

4. RULES ON COMPENSATION

Aid to compensate farmers for agri-monetary losses due to appreciable revaluations prior to 1 January 1997 is subject to ceilings fixed by the Council. For later revaluations, the ceilings are fixed by the Commission in accordance with the management committee procedure, following a very precise methodology and based on the latest available data. The ceilings must take account of the likelihood of devaluations occurring after the appreciable revaluation.

The aid comprises three degressive tranches, the first of which (covering the 12 months following that of the revaluation in question) may amount to up to 100% of the ceiling. The following two annual tranches may not exceed two thirds and one third of the ceiling respectively. The European Union finances 50% of the ceiling irrespective of the national contribution which the Member State may supply in addition.

The aid must be granted to agricultural holdings in annual payments. It must vary with the size of the holding at a given past period and must be in line with the macro-economic distribution of income loss between the various sectors of production affected. However, where annual payments per holding would be less than ECU 400, the aid may be granted for measures in the collective and general interest or those for which the Community provisions authorise national aid.

In the event of a reduction in the frozen ACR for aid covered by Article 7 of the basic agri-monetary Regulation, supplementary aid corresponding to the consequent shortfall in annual income may be granted to the farmers affected. This aid is also subject to a ceiling fixed by the Commission in accordance with the management committee procedure, and comprises three degressive annual tranches, of which the EU finances 50% irrespective of the national contribution.

5. COMPENSATORY AID[17]

The second tranche of compensation for the appreciable revaluations of June and July 1995 was applicable from 1 July 1996 for Belgium and Luxembourg, and from 1 August 1996 for Germany, Denmark, the Netherlands and Austria. As planned, these tranches represented 1/3 less than the first annual tranche. Altogether, almost ECU 210 million was granted under this tranche, including ECU 135 million financed by the EU. In view of currency developments in 1996/97, the third tranche of aid was cancelled for all the Member States except Denmark by Commission Regulation (EC) No 1137/97[18], and for Denmark in July 1997 by Regulation (EC) No 1473/97[19].

Appreciable revaluations in January 1996 for the SKR and in the course of the period 1996/97 for the IRL, UKL and LIT led to the possibility of granting further aid, the first tranches of which total almost ECU 945 million, half financed by the EAGGF.

Sweden[20] granted the first two tranches of compensation for the appreciable revaluation of 11 January 1996. This aid was notified in November 1996 and authorised by the Commission in December 1996.

Only the EAGGF financing of ECU 9·8 million under the first tranche has been granted. As this amount corresponds to just under ECU 100 per holding, it was allocated through collective measures, for which financing is not provided for in the national budget.

Most of the aid, about 63%, is for work managed by the Agricultural and Forestry Research Council into organic farming and the links between the agricultural sector and research. A further 21% is entrusted to the Foundation for Research in Agriculture, for research and development work and improvement of markets. The remainder, less than 2% of the aid, is for machinery syndicates, for outreach and training services.

A second aid scheme for the appreciable revaluation of 7 July 1996 was notified to the Commission in June 1997 and authorised the following month. The second tranche of the aid was cancelled by Regulation (EC) No. 1137/97 to allow for the devaluations that occurred after the appreciable revaluation; a decision on the third tranche will be taken in July 1998. Sweden plans to distribute EU financing under the first tranche of aid to farmers in the milk, beef and veal, cereals, sugar and potato starch sectors. The cereals and sugar sectors do better than the rest in the sectoral allocation of aid, but no sector is overcompensated for the losses taken into consideration on a flat-rate basis by the Council.

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17 See Table A8 in the Working Paper on Basic Information.

18 OJ No L 164, 21.6.1997, p.15.

19 OJ No L 200, 29.7.1997, p. 22.

20 See Tables A8 and A9 in the Working Paper on Basic Information.

Individual allocation of aid depends on output levels prior to 30 June 1996. For cereals and beef/veal, aid is based on the compensatory payments under the reform of the CAP. For milk, sugar beet and starch potatoes, aid is based on quantities supplied to processors.

Ireland[21] has granted the EU's share of financing under the first tranche of compensation for the appreciable revaluations of 11 November 1996 and 11 January 1997, i.e. ECU 56·7 million[22]. This aid was authorised by the Commission in May 1997.

The sectoral breakdown is proportional to the figures for output of milk, beef/veal, cereals and sugar taken into account to determine income loss. At individual level, aid for beef/veal is allocated as a function of premiums for male bovine animals and suckler cow premiums for 1996 and deseasonalisation premiums from 1 January to 10 June 1997 for animals present on the recipient's holding on 31 March 1997. For milk and sugar beet, the allocation between farmers is based on amounts supplied in the year up to 31 March 1997. For cereals, it is based on the allocation of compensatory payments under the reform of the CAP paid in 1996.

In June 1997, Ireland notified the Commission of its intention of adding a national contribution of ECU 30 million to supplement the above allocation financed by the European Union. The Commission had not yet responded to this request at the end of July 1997.

In June 1997, Ireland also notified its intention of granting the Community contribution to aid for the revaluation of 29 March 1997. The maximum for the first tranche of this aid was cut by the Commission from ECU 65·16 million to ECU 57·5 million, including ECU 28·75 financed by the EAGGF to take account of the devaluations of the ACR of the IRL in May 1997. The planned breakdown of aid notified by Ireland is close to that planned for the compensation financed by the European Union for the revaluations of November 1996 and January 1997. In this case, deseasonalisation premiums are not taken into account, but the sectoral breakdown is again proportional to the output taken into account for calculating income losses. Consequently, the Commission authorised this aid in July 1997.

On 30 June 1997, Italy had not notified any plans concerning the amount of up to ECU 247 million available for the first tranche of compensation for the appreciable revaluation of the LIT on 1 March 1997.

By the same date, the United Kingdom had not notified any plans, either for the sum of ECU 454·4 million under the first tranches of compensation for the revaluations of 11 January, 29 March and 5 June 1997, or for the sum of ECU 66·7 million to compensate for the fall in area aid for arable crops in national currency on 1 July 1997.

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21 See Tables A8 and A9 in the Working Paper on Basic Information.

22 Maximum sum fixed by Commission Regulation (EC) No 1129/97 (OJ No L 115, 3.5.1997, p. 16), as amended by Regulation (EC) No 1219/97 (OJ No L 170, 28.6.97, p. 56).

[redacted]

Both Italy and the United Kingdom may yet notify decisions to grant aid, up to the end of the twelfth month following that of the relevant revaluation.

C. Economic impact

Theoretically, market prices which are closely linked to an intervention mechanism (cereals, sugar, milk and beef/veal) may be affected by the ACRs. Through the prices for certain of the products concerned, the change in ACRs may therefore have repercussions on farmers' incomes. Furthermore, difficulties may arise in trade in the event of divergence between the ACRs and the RMRs or between market prices and intervention prices in national currency.

However, the prices of other products for which no intervention mechanism exists to provide market guidance are not affected by the ACRs. Nonetheless a sharp, sudden change in the RMRs may distort trade in such products. This is the case in particular where market prices do not follow currency fluctuations.

Lastly, in addition to the impact of monetary repercussions on prices, farm incomes are directly affected by the ACRs applicable to direct aid to producers.

1. PRICES

The analysis relates mainly to monthly movements during the period 1996/97.

In the case of products with no intervention mechanism influencing market prices, as may be expected no link is observed between the movements of such prices and those of the ACRs. For example, variations in the market prices of wine or olive oil are out of all proportion with the variations in the ACRs.

For other products, the analysis focuses on sectors where usable data are available and covers a single representative market per Member State concerned[23].

Movements in ACRs likely to have had most repercussions in 1996/97 correspond to the strong and steady revaluations of the UKL (13·5%) and IRL (8·5%).

For the other currencies, we need to compare prices in the context of a stable ACR (FF, PTA, ESC) with those in the context of slight revaluation (LIT) or slight and repetitive devaluation (SKR, BLF, DM, ÖS, HFL).

In general the analysis shows that when market prices are very high in relation to intervention prices only major changes in ACRs are passed on. When prices are low or very low, small changes in ACRs have no clear impact on prices. The repercussions of ACRs on markets thus seem to be passed on only beyond a certain threshold, which will be the higher as market prices are higher in relation to intervention. However, there are a number of factors that may interfere with these mechanisms.

1.1. Cereals[24]

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23 See Graphs B2 to B15 in the Working Paper on Basic Information.

24 See Graph B1(a) in the Working Paper on Basic Information.

Market prices for common wheat are substantially higher than intervention prices in national currency. During the 1996/97 marketing year from August 1996 to April 1997, market prices in the three main producer Member States (Germany, France and the United Kingdom) stood on average 20% above the intervention price. As in the previous two years (when they stood at 12% and 22% above the intervention price), at this exceptional level market prices are hardly affected by small fluctuations in the intervention price in national currency.

In the period from July 1996 to February 1997 market prices in national currency fell, or at best remained relatively stable. Prices recovered in March and April, especially in France, just before the upheavals of the end of the marketing year. Market prices in FF as a percentage of intervention prices in national currency, to which monthly increases apply, fluctuated between 110% and 118%, i.e. within a margin of around 8 points, without being affected by the ACR, which remained stable. Prices in PTA varied between 125% and 135% of the intervention level; the very slight increase in the ACR (+ 0·2%) had no impact.

From July 1996 to January 1997, the gap between the market price and the intervention level narrowed by 5% in FF and 7% in PTA. Over the same months, the gap narrowed by 11% in Germany and 6% in Sweden, despite increases in the ACRs of 2% and 3% respectively. Clearly, these levels of devaluation had no perceptible impact on market prices.

In the United Kingdom during the months concerned, the gap between market prices and the intervention level in UKL narrowed by 8%, a reduction comparable to that observed in the other Member States. The large reduction in the ACR of the UKL (8%) was thus passed on, so that the trend in relation to intervention prices remained broadly the same as in the other major Member States.

In Italy, the decline of almost 3% in the ACR in October 1996 was accompanied by a fall of 1·9% in prices in LIT from September to November, compared to a decline in prices of 2·6% in France, where the ACR remained constant. Between September and December 1996, i.e. during a period ending two months after the revaluation of the ACR of the LIT, market prices in LIT and FF declined by the same percentage of 0·6%.

For the third marketing year in succession, it is clear that market prices for cereals exceeding intervention levels by more than 10% are not affected by routine movements of ACRs. The observations made do not enable any conclusions to be drawn about possible agri-monetary effects if market prices were close to intervention levels.

However, it seems plausible that major changes in ACRs against a background of high market prices would lead to an agri-monetary impact.

As mentioned above, the effects on market prices in the United Kingdom of the decline in the ACR of the UKL, 8% between July 1996 and February 1997, were such that the gap in relation to the intervention level developed in the same way as over most of the rest of the market. Similarly, in the period

1995/96, the 12% fall in the ACR in Italy was accompanied by a substantial fall in prices in LIT (5%), which was not matched in other Member States.

From August 1994 to April 1995, the major devaluation of the LIT (23%) was accompanied by increases in market prices in Italy, which meant that the gap in relation to intervention levels followed the same trend in Italy as elsewhere. However, the impact on market prices of smaller devaluations, such as that of the PTA (+7%) and the UKL (+ 3%), was much less clear.

1.2. Milk products[25]

Market prices for skimmed-milk powder (SMP) in DM, FF and HFL remained fairly closely grouped. From a low level in relation to intervention prices, they increased by almost 10% between September 1996 and February 1997 before declining slightly again. Similar developments were observed in Belgium, Austria, Spain and Sweden.

In relation to France where the ACR did not change, prices in BLF, DM, HFL and SKR grew about 3% to 5% faster, matching the devaluations in ACRs. For the FMK and DKR, on the other hand, which did not follow the general movement, agri-monetary stability was accompanied by variability of about 6% in market prices.

Prices in the United Kingdom followed the revaluation, declining by a matching 10% in 1996/97. The general trend of gaps in relation to intervention prices in national currency is analogous to that of the other major Member States.

The price of SMP in Ireland at the beginning of the period 1996/97 was kept at an abnormal level about 5% higher than in the major Member States. The national price fell suddenly by 10% in October 1996, before the first revaluation of the ACR of the IRL (2%) in November 1996, thereafter remaining at about the same level until towards the end of 1996/97. The other falls in the ACR of the IRL, totalling 7 %, were not passed on in national currency. These revaluations lowered the intervention level for the IRL, bringing it close to the market price, which remained fixed in national currency. Finally, as a percentage of the intervention price, prices in IRL returned, after major divergences, to a more usual level, almost ten points lower than UK prices and almost five points lower than those of the other major Member States.

Butter prices on most markets settled in the second half of 1996 within a margin of 5 points around a level equal to 95% of the intervention price. The most notable exceptions were prices in IRL and UKL, which were much lower, and in LIT, PTA and SKR, which were much higher.

From November 1996 to March 1997, prices rose on the main markets: by 6% in the case of the FF, whose ACR remained constant. Prices in BLF, DM, FF, FMK, HFL and ÖS converged on a level equal to 97% to 100% of the

[25] See Graphs B1(b) and B1(c) in the Working Paper on Basic Information.

intervention price, irrespective of the small devaluations affecting some of those currencies.

Prices in Italy and Spain varied around their high levels, while those in Sweden were reduced by 12% despite the rise in the ACR of the SKR.

Market prices in the United Kingdom systematically followed declines in the ACR, thus keeping at almost 90% of the intervention price, and decoupling from prices on the other major markets. Butter prices in IRL developed in parallel to SMP prices in Ireland.

Agri-monetary effects do not appear systematically in the milk products sector, despite the background of prices grouped around the intervention level. Pronounced trends on the market are usually followed by national prices with variations in a margin of 5% above and below, with no clear impact when movements in ACRs are less than 2% or 3%. Very large changes in prices can happen irrespective of monetary causes, and are sometimes confined to one country. Wider movements in ACRs may be passed on accurately into national prices, as in the United Kingdom; but the example of Ireland shows that the parties involved may interfere with this process.

1.3. Beef/veal[26]

Prices for meat of young bovine animals at the beginning of the period 1996/97 were especially low, generally between 60% and 75% of the intervention price, owing to the bovine spongiform encephalopathy crisis.

From September 1996, markets in Ireland and the United Kingdom were decoupled from the others at a level some 10 to 15 points lower.

In virtually all the Member States, market prices followed the same general development, however, expressed as a percentage of intervention prices. This means that the major changes in ACRs, in particular those of the UKL and IRL, were passed on to national markets on the whole.

However, as in the milk products sector, market developments did not take account of small changes in ACRs. Prices in DM, FF and HFL rose in parallel from September 1996 to February 1997, which led to a wider gap in relation to the intervention price for the FF, whose ACR did not increase as much as those of the DM and HFL.

2. TRADE

Analyses of agri-monetary effects on trade in the two previous reports on the agri-monetary system for the single market[27] show that :

[26] See Graphs B1(d) in the Working Paper on Basic Information..

in the short term, in almost all cases the scale of the monthly variations in the value of exports masks the effects of any currency variations;

- over longer periods, exports can be influenced by competition; however, that impact vies with internal demand, exporters' attitudes to their profit margins and structural causes affecting some product groups more than others; the interplay of these factors is such that distinguishing the effects of any particular one is very tricky.

Available statistics for 1996/97 are not such as to affect these conclusions.

Deflections of trade may occur for products attracting export refunds; in 1996/97 the main risks incurred in this respect were due to the positive gaps of the UKL and IRL, which exceeded 5 points during the confirmation periods.

The risk was particularly acute in the case of the UKL, where aggregate gaps in excess of seven points, and momentarily in January 1997, as large as nine points, arose with, e.g., the BLF, HFL and FF. In view of the consequences of the BSE crisis and the high level of world cereal prices, the risks mainly related to the sugar sector.

Nevertheless, export statistics show no movement which can be put down to such agri-monetary gaps.

3. INCOMES

The latest statistics for farm incomes relate to 1996. In detail, the effects of the agri-monetary arrangements on incomes in 1996 are very difficult to gauge since they depend in particular on the actual impact of the agricultural conversion rates on market prices, on the operative events for ACRs, and on the periods for payment to farmers in respect of purchases, sales and aid. As a result some effects visible in 1996 are due to movements in ACRs in 1995, whereas the consequences of certain changes in the ACRs for 1996 will only be felt in 1997 or even later.

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[27] Analyses based on monthly statistics October 1991 to December 1993 (COM(94)498 final) and January 1992 to December 1995 (COM(96)636 final).

[redacted]

To assess the effects of the ACRs in the period 1996/97 on income over 12 months, certain approximations and assumptions were nonetheless needed:

- 1996 income arising from or related to the marketing of products is assumed to reflect income in the period 1996/97;

- to incorporate the findings set out in point C1, the value of total output is assumed to be affected by ACRs for sugar beet, beef/veal and, in Ireland and the United Kingdom, cereals and milk products; elsewhere, the impact of the ACRs is considered nil for cereals, and 50% for milk products;

- income taken into account for fruit and vegetables, starch potatoes, wine, olive oil, tobacco and seed is that arising from quantities for which there is a minimum price or aid per tonne of products put on the market;

- flat-rate aid to producers is as provided for in the 1997 budget, and thus related to the 1996/97 crop year for arable crops, 1996 livestock premiums for cattle and sheep, 1997 structural aid and agri-monetary compensation due for payment in 1997; agri-monetary aid in Italy and the United Kingdom has been adjusted to take account of the fact that no payment was made during the period under review;

- it is assumed that the intermediate consumption affected is equal to half the value of animal feed in the Member States where the ACR is regarded as having an impact on cereal prices (Ireland and the United Kingdom);

- the conversion rates assumed to apply to the various components of income taken into account are averages for 1996/97 with the following exceptions:

- for aid per hectare cultivated and for seed: the rate obtaining on 1 July 1996[28];

- for per capita livestock premiums, structural aid and tobacco premiums: the rate obtaining on 1 January 1997;

- for agri-monetary compensation: the rate in force prior to the relevant appreciable revaluation.

This theoretical model, which groups the full impact of the 1996/97 ACRs over 12 months, was used to measure the annual effect of the agri-monetary arrangements in 1996/97, multiplying the components of income by the gap between the ACRs applied and the corresponding RMRs.

Despite its abstract nature, this model does reveal a significant impact of the ACRs on incomes, and variation in that impact depending on the Member States[29].

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28 For the sake of simplicity, the rare cases where the operative event occurs on 1 August have been assimilated to the general case where it occurs on 1 July.

29 See Tables C1 to C3 in the Working Paper on Basic Information.

The overall impact on value added at factor cost is 1·3%, or ECU 1 884 million, i.e. almost 10% more than in 1995/96.

The overall impact on farming incomes is made up of:

- monetary gaps relating to prices and market-related amounts: 51%,
- monetary gaps relating to flat-rate aid to producers: 38%,
- agri-monetary compensatory aid: 11%.

On the assumptions made, the value of output and aid affected by ACRs corresponds to approximately half of gross value added at factor cost. This proportion is a sign of the sensitivity of the agri-monetary arrangements; it is particularly large in Ireland and Sweden, and quite large in Belgium, Luxembourg, Germany and the United Kingdom. It is smaller in Portugal, Italy and Spain.

Flat-rate aid to producers accounts on average for almost 30% of that share of their income affected by ACRs. The proportion is almost 40% in Portugal, Austria and Spain. It is very low in the Netherlands at 5%, and low (14% to 20%) in Belgium, Luxembourg and Greece.

The components of income that are increased most by the agri-monetary arrangements are, of course, those that would have contracted as a result of currency appreciations. For the currencies that were fairly stable over the period under review, the arrangements did not lead to compensation, since there was virtually no agri-monetary loss to offset.

In 1996/97 the Member States which benefited most from the arrangements in relation to gross value added were:

- Ireland (8%), because of the structure of farm incomes and the sizeable aid to compensate for revaluations;
- Sweden (7·4%), mainly because the ACR was frozen at the high level obtaining before the 1996 revaluations;
- the United Kingdom and Italy, because currency revaluations were not taken into account straight away, and there were large gaps before the appreciable decline in the ACRs; compensatory aid authorised has not been taken into account because it was not actually granted;
- Finland and to a lesser extent Denmark, which benefited from the system of permitted margins and a permanently large monetary gap, without undergoing a decline in the ACR.

[redacted]

D. Financial impact

1. METHODOLOGICAL ASPECTS

1.1. Classification of agri-monetary effects

In the agri-monetary area, the legacy of the switch-over (or green ecu) mechanism weighs heavy on the Community budget. Introduced in 1984, the mechanism was discontinued from 1 February 1995. A detailed description of the mechanism and its cost was presented in the report on the period 1 July 1995 to 30 June 1996. Its annual impact, of the order of ECU 8 000 million, does not vary much.

The financial impact of developments in 1996/97 stems from four mechanisms or measures, namely permitted margins, operative events, the freezing of ACRs and compensatory aid.

The cost of agri-monetary compensatory aid is identified in the 1997 budget and the 1998 preliminary draft budget. The fact that this cost is degressive is laid down in the regulations and the granting of the last tranches of aid decided in 1995/96 (Belgium, Luxembourg, Denmark, Germany and Austria) should affect the budget for 1997 only, since the third tranche of this aid has been cancelled. The budget forecasts for 1998 for this aid are therefore not included in this report.

By the end of the period 1996/97, Italy and the United Kingdom had still not notified any plans for compensatory aid related to the appreciable declines in their ACRs in 1997; consequently, the relevant budget forecasts for 1997 are not included in this report. If the compensatory aid is granted, it will affect not only the 1998 budget, but also the budgets for 1999 and 2000.

The freezing of ACRs results in a cost equal, in national currency, to the difference between the frozen ACR and that known on the date of the operative event concerned, multiplied by the amount in ecus of the aid to which it applies. As the ACRs are frozen until 1 January 1999, this will affect the 1999 and 2000 budgets.

The financial effects of the thresholds and operative events stem from the difference between:

- the agricultural conversion rate on the date of the operative event for the amount concerned,

and

- the rate applicable for the booking of expenditure in ecus (accounting rate), i.e. the rate for the 10th day of the month of entry in the accounts of the expenditure in national currency; this is generally the month following that of payment to the recipient by the Member State.

The effect of the permitted margins is due to the difference between the agricultural conversion rate and the accounting rate on the date of the operative event. The effect of the operative events relates to the difference between the accounting rate on the date of the operative event and the same rate on the date of the booking of the expenditure in ecus.

1.2. Method for estimating the cost of developments in 1996/97

Agri-monetary events and decisions in 1996/97 mainly affect the budgets for 1997 and 1998.

When estimating the agri-monetary effects on the 1997 budget, account was taken of the cyclical revision of February 1997, established on the basis of conversion rates available on 24 February 1997.

For the effects in 1998, calculations are based on the 1998 preliminary draft budget (PDB) as at 30 June 1997, drawn up using the conversion rates available on 30 April 1997.

The bases (1997 budget and 1998 PDB) were adjusted by replacing the ACRs used to draw them up with the ACRs available on 1 July 1997[1]. The accounting rate used was not adjusted as it is of minor significance among the agri-monetary effects due to variations in the ACRs.

- The adjusted 1997 budget and 1998 PDB on 1 July 1997 show the situation resulting from the latest ACRs available at the end of 1996/97. Expenditure is broken down on the one hand on the basis of the various operative events for the ACRs affecting it, and on the other hand on the basis of past expenditure, between the various currencies of the Member States.

- An estimate of Community expenditure irrespective of any agri-monetary arrangements is arrived at by replacing the ACRs used in the 1997 budget and 1998 PDB by the RMRs applying at the beginning of the month of booking of such expenditure and deducting agri-monetary compensation paid.

Note that the estimate for the month of booking of each type of expenditure is a fairly shaky approximation, subject to wide variations. The RMRs for 1 July 1997 are used for all dates of entry in the accounts thereafter.

- The overall effect of freezing the ACRs is calculated by replacing the ACRs actually used for the aid in question in the 1997 budget and the 1998 PDB by the current ACRs applying on the date of the operative events for such aid.

1 See Tables D1 to D2 in the Working Paper on E[illegible]

[redacted]

- The effect of the operative events is assessed on the basis of the difference between the results of the calculation outlined in the second indent and the outcome of a similar simulation using the RMRs applying on the date of the operative events for the ACRs actually applied. Given reservations regarding the identification of the month of entry in the accounts, that assessment is rather imprecise and it becomes impossible for 1998 as all the conversion rates applicable after 1 July 1997 are replaced by those available and applicable on 1 July 1997.

- The impact of the margins is gauged on the basis of the difference between the results of the situation with the current (non-frozen) ACRs as described in the third indent, and the outcome of the simulation using the RMRs valid on the date of the operative events, as outlined in the fourth indent.

The ACRs for 1996/97 affect 77% of expenditure in the 1997 budget. The conversion rates valid on 1 July 1997 are applied to the 3% of expenditure actually stemming from an operative event on that date but also to the expenditure covered by operative events occurring subsequently, from 2 July to 15 October 1997. The conversion rates valid on the dates of operative events prior to 1 July 1997, but not prior to November 1994, are applied to virtually all other expenditure in the 1997 budget.

Only 1% of expenditure in the 1998 PDB is affected by the ACRs with operative events occurring prior to the period under review. 14% of the expenditure is affected by the ACRs for early 1997 and 37% by those for 1 July 1997. Accordingly, almost 50% of the 1998 PDB hinges on the conversion rates applicable from 2 July 1997 to 15 September 1998. Those rates, which were not available when this report was drafted, are replaced by the conversion rates for 1 July 1997.

Overall, the agri-monetary situation at 1 July 1997 is of great importance in estimates for 1998. The salient features of this situation are the very large monetary gaps between the frozen ACR on the one hand and the current ACR on the other (11·5%) for the SKR and the UKL, and the large sums expected to be paid in compensation in the United Kingdom and Italy.

2. RESULTS OF ESTIMATES

The results set out in the table below show an annual cost of around ECU 1 200 to 1 300 million per year (a comparable order of magnitude to that shown for 1995/96 in the previous report)[2].

Almost 60 % of that cost is due to the effects of the margins. The cost of margins in 1998 will depend closely on future currency developments, and the estimate for 1998

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2 For details, see Table D4.

is half that for 1997. However, that estimate is mainly based on the agri-monetary situation as it stood on 1 July 1997.

The reason margins entail a cost is basically attributable to the asymmetry of the mechanisms, whereby positive monetary gaps can rise to 5 points while negative gaps are usually limited by a variable threshold determined by the maximum positive gap minus 5 points. Moreover, in situations of steady and significant appreciation for several currencies, as in 1996/97, the duration of confirmation periods plays an important role in keeping the largest positive gaps in existence over time.

The cost of operative events, which is difficult to compress without distorting markets, is around ECU 160 million in 1997, ECU 60 million more than in 1996. This result is unusually high because there was no offsetting in 1996/97 between currencies that appreciated and those that depreciated. It cannot be estimated at present for 1998, as we have no figures for the difference between the RMR on the date of the operative event and that in the month of entering in the accounts.

The freeze on ACRs in 1997 constitutes a cost deferred to 1998, because of operative events. It will eventually reach ECU 500 million in 1998. As the freeze will, in principle, continue until 1 January 1999, it also affects the budget for the year 2000.

Costs of monetary events in 1996/97	**1997**	**1998**
ACR freeze	160	499
Compensatory aid	214	382
Permitted margins	772	312
Operative events	160	-
Total (ECU million)	**1306**	**1193**

The Member State whose allocation under the agri-monetary arrangements has increased most in 1997 in relation to the 1996 budget outturn is the United Kingdom with an increase of 30·7% in expenditure in UKL. The agri-monetary cost of Ireland also increases significantly from the 1996 level. These increases are due to the effects of margins and operative events in a situation where the relevant currencies are appreciating.

On the whole, the agri-monetary costs of the other currencies are much lower in 1997, especially for those currencies whose ACR had declined substantially in 1995.

Forecasts for 1998 show that the United Kingdom's share of agri-monetary expenditure will increase substantially, to 60%, especially if the planned compensatory aid is actually granted. The other main beneficiaries of the agrimonetary arrangements will be Italy, Ireland and Sweden, mainly owing to the freeze on ACRs. Costs for the other currencies, on the other hand, will decline, and may even be negative for Germany, Belgium, France, Luxembourg, Spain, Portugal, the Netherlands and Austria.

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