EU Agricultural Policy in 1993-94: Implementing CAP Reform

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1. Introduction

Recent developments in agricultural markets and policy in the EU have been driven by a number of key political events[1]. The two years following the CAP reform decisions of May 1992 saw a spate of legislation and new administrative procedures necessary for implementing the reforms. Given the different agricultural circumstances and national political agendas of member states, not to mention the characteristics of the Union's decision-making procedures, it is not surprising that the pressures which blunted the Commission's original reform proposals to produce the compromise of May 1992 have been at work seeking ways to weaken further the impact of the reform measures. This is the background against which the effect of the reforms on farmer behaviour and market outcomes must be assessed.

Of special importance for agriculture was the Blair House agreement on agricultural trade reached by EU and US negotiators on 20 November 1992. This agreement was an important step towards reopening the stalled multilateral discussions of the Uruguay Round later in 1993. Blair House also marked a truce to the long-running bilateral dispute over the EU's oilseed support policies, already the object of several adverse GATT panel rulings.

Next, the Union's Single Market officially began on 1 January 1993. This deadline forced the Council to adopt at least temporary solutions to various outstanding agricultural issues, most notably the need for a common banana policy and the dismantling of Monetary Compensation Amounts (MCAs) for intra-Union agricultural trade.

With the new Uruguay Round deadline of 15 December 1993 looming, talks resumed in September 1993 between the EU and the US, ostensibly to "clarify" the Blair House agreement, and in December a "final deal" was reached. Its effect was to accelerate the momentum towards the multilateral, multisector agreement which was achieved literally as the deadline expired.

These events have been so decisive in shaping agricultural policies and the current policy debate in the EU that they are dealt with in detail in the next two sections of this review. Section 2 reports on the implementation of the reform measures and other new policy developments. Section 3 itemises the key points of the Blair House Agreement and the final GATT accord from the perspective of EU agricultural politics and policy. Section 4 reviews market developments for the main agricultural products. The last section reports on various other ongoing issues.

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The following average market exchange rates (units of national currency per ECU) may be used to convert monetary amounts denominated in ECUs. The value of the ECU used in the CAP (the "green ECU") is higher than indicated by the market rates. The green ECU conversion rate is market exchange rate x switchover coefficient (see section 2.2).

Currency Year	$Aus	$US	£stg	Switchover Coefficient
1990	1.632	1.273	0.714	1.1449
1991	1.591	1.239	0.701	1.1451
1992	1.688	1.298	0.738	1.1612
1993	1.725	1.171	0.780	1.2003
19 December 1994	1.561	1.212	0.778	1.2075

[1] The entry into force of the Maastricht Treaty on 1 November 1993 marks the start of a new era concerning the name given to the European institutions. Various matters of policy are now regulated under the provisions of the Maastricht Treaty, in the name of the European *Union*. In order to conform with what has already become standard usage, this paper uses the designation "European Union" or "the EU" throughout, even when referring to the pre-Maastricht period. "EC" denotes the European Commission.

2. CAP Reform and Other New Measures

2.1 Implementing CAP Reform

Set-aside

The arable crop regime adopted in 1992 replaces a proportion of price support with a payment per hectare, derived for each region or country by multiplying a fixed payment per tonne by the regional reference yield in the base period (Manegold). To be eligible for this payment, "professional" producers (with a base area capable of growing 92 tonnes or more of cereals) must set aside 15 per cent (20 per cent for non-rotational set-aside) of their base area. Small producers qualifying for the "simplified regime" receive the area payment without any obligation to set land aside.

The efficacy of set-aside as a means of controlling output is uncertain. Slippage between area and yield reductions can occur if farmers set aside their least productive land (especially with non-rotational set-aside) and produce more intensively on the land remaining in cultivation, and soil productivity increases in the year after fallow. During 1993 the Council agreed on various options designed to increase the flexibility of set-aside, which will hardly improve its effectiveness as a supply control instrument: mixed rotational/non-rotational set-aside at the non-rotational rate, voluntary set-aside of up to 50 per cent of base area for the standard set-aside payment, or up to 100 per cent in special circumstances, at a lower rate of payment, and transfer of the set-aside obligation to another farm within a 20 km radius. In addition, the rules for the growing of non-food crops on set-aside land without loss of set-aside compensation were drawn up[2].

The total EU base area for 1993/94 was 48.6mha (average for the base years 1989, 1990, 1991). The majority of member states opted to allocate their base area by region, in some cases a different subdivision for maize than for the other crops as permitted by the regulation. Producers have to apply for area payments by mid-May each year, declaring their cropped and fallowed areas for the following harvest. In 1993, the first year of the scheme, claims by producers accounted for 46.1m ha, comprising 1.5m ha already enrolled in the 5-year set-aside scheme initiated in 1988, 4.6m ha set aside under the CAP reform compensation scheme, 38.6m ha under one of the designated crops, plus 1.4m ha planted to fodder crops. About 5.3 per cent of the base area was not covered by any scheme.

This shortfall is accounted for by about 1.8m "small" producers who failed to apply for compensation payments[3], and some larger producers (particularly in the UK and France) who opted out of the programme. A number of producers with output not far above the 92 tonne threshold enrolled under the simplified scheme, limiting their compensation claim to an area sufficient to produce 92 tonnes and thus avoiding set-aside. Only German farmers claimed for more than their aggregate base area, with significant overshooting in the five new eastern states. To ease this problem, these states received an extra 0.181m ha of permanent base area as from 1994/95, plus a temporary addition of 0.151m ha that will be phased out over five years.

Provisional figures for the second year show an increase of over 2m ha enrolled in the arable aid scheme, consisting of an extra 2.7m ha enrolled by "professional" producers, and a *reduction* in the area enrolled under the simplified scheme. The result is that an additional 1.3m ha have been set aside compared with 1993/94, making a total of 12 per cent of the total EU base area. To this must be added a much smaller area still under the 5-year set-aside scheme[4]. It should be noted that payments made to cropped area increased by 40 per cent in the second year of the scheme, and to set-aside area by nearly 27 per cent[5].

[2] Producers must have a contract with a processor or trader, who must sell more than 50 per cent of the economic value of all products derived from the raw material for non-food use. However, any by-products may be sold for food and feed, although without any EU support such as export refunds or price guarantees (*Agra Europe*, 25/4/94, E/5).

[3] 0.9m of these were in Italy, where the area on which aid was claimed in 1993 came to less than 75 per cent of the base area.

[4] In England, which is registered as one "region" of the UK, total set-aside under all schemes including 5-year set-aside in 1994/95 was 16.8 per cent of base area. Apart from having a high proportion of "professional" producers, England has a relatively high rate of non-rotational set-aside (at the rate of 18 per cent) and guaranteed set-aside (50-100 per cent).

[5] On cropped areas, from 25 ECU/t to 35 ECU/t as foreseen in the reform agreement. On set-aside area, from 45 ECU/t to 57 ECU/t as decided by the Council in December 1993, at an estimated extra cost to the budget of more than 352m ECU per year.

Although the total area claimed for in 1994/95 did not exceed the EU base area, Belgium, Germany, France and the UK overshot their national base area. As the 1994 harvest got underway, France began campaigning to reduce the penalties for overshooting[6]. In October 1994, the Council cut the base rate of set-aside (to which the penalties will be added) from 15 per cent to 12 per cent for the next two years. The Commission estimates that this is equivalent to an extra 3.5m t of production annually.

It is hard to assess the extent to which these modifications will weaken the impact of the scheme. However, it has clearly become more complex administratively and more difficult to monitor effectively.

Livestock Premiums

Under the CAP reform, headage premiums were increased in value and ceilings were placed on the number of animals eligible for premiums, either at regional level (steers) or at individual farm level (suckler cows, ewes). In the case of steers, the regional reference herd of each member state was to equal the number of steers receiving a premium in the reference year. Member states could select as reference year 1990, 1991 or 1992. In the event, eight countries chose 1992 as reference year but in some cases put forward figures which were more than 45 per cent in excess of claims in previous years. Indeed, total EU steer numbers recorded for 1992 were 26 per cent above 1991 figures. Producers appear to have retained animals on the farm in 1992 in order to maximise their right to claim in future years (EC 1993a).

Consequently, the Commission tried to make 1992 ineligible as a reference year, but met with strong resistance in the Council of Ministers. In mid-1994 it was decided to substitute the average of 1991/92 for 1992 for the countries concerned. This had the effect of reducing the total EU reference herd from 11.48m head to 10.28m head.

Accompanying Measures

The 1992 CAP reform created a fund for country-specific policies to promote environmental protection, afforestation of agricultural land and early retirement. These measures will be jointly funded by the member state concerned and the EU budget. In 1994, an extra 1.3b ECU was made available for schemes under this heading, bringing the total amount to 3.6b ECU. By mid-1994, over 200 agri-environmental schemes had been put forward of which about 40 had already received approval.

2.2 Agrimonetary Measures

Institutional prices under the CAP are set in terms of ECUs, and translated into national currencies at special conversion rates known as "green rates". Green rates were traditionally set at discrete intervals by the Council of Ministers, creating a situation where "monetary gaps" between market and green exchange rates could develop. For example, a country whose currency was appreciating against other EU currencies would find that its agricultural commodities became less competitive in price vis-à-vis other EU countries. Such a country has a *positive* monetary gap as long as the green rate is not adjusted in line with the change in its market rate.

MCAs were set up in 1969, originally to allow France to maintain a negative monetary gap following a currency devaluation. They are effectively a system of border taxes intended to preserve differential national price levels for agricultural products. In theory, when currency parities fluctuate modestly around stable long-run rates, MCAs remain small and self-correcting. However, when parities are diverging over the longer term, MCAs can only be kept at sensible levels by regular updating of green rates. A country whose currency is appreciating over time would have periodically to *revalue* its green rate, creating a falling trend in agricultural prices expressed in terms of its national currency (for more explanation, see Cramon-Taubadel). Given such countries' reluctance to accept a green rate revaluation, the agrimonetary system has since 1984 incorporated the "switchover" mechanism, whereby the value of the ECU used for setting agricultural prices is itself adjusted so as to remove the need for an individual country to revalue its green rate. Thus agricultural prices are set in terms of the "green ECU", whose value differs from that of the real ECU by the amount of the correction factor[7].

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[6] An equiproportionate decrease in each producer's area eligible for aid in the current year, and in the next year an increase in (uncompensated) set-aside equal to the overshoot.

[7] 1 green ECU = correction factor x 1 ECU. When the switchover mechanism was introduced, the correction factor was set at 1.033651. By 1 August 1992, it had risen to 1.145109.

Under the agrimonetary regulations operating up to the end of 1992, any realignment of the central rates for currencies within the narrow band of EU's Exchange Rate Mechanism (ERM) would, without the switchover mechanism, have required strong currency countries periodically to revalue their green rates whilst others devalued. However, by increasing the correction factor appropriately, revaluations could be avoided whilst devaluations (and hence, increases in the agricultural prices in weak currency countries) were greater than otherwise. The switchover mechanism acted as a ratchet, since the correction factor could only increase, and imparted an inflationary bias to agricultural prices in national currencies. Currencies within the ERM narrow band could only fluctuate within 2.25 per cent of their central rates. Thus, for the countries concerned, any monetary gaps that developed were small and did not give rise to MCAs, whereas the occasional parity realignments amongst these currencies activated the switchover mechanism and the required devaluations of some green rates. Currencies within the wide band (6 per cent) and currencies outside the ERM still needed MCAs.

Clearly, MCAs violate the principle of common prices throughout the EU. Moreover, with the completion of the Single Market and the abolition of all border checks and controls on intra-EU trade, the MCA system could no longer operate. Therefore, new agrimonetary measures were required as from 1993. Rather than adopt the clean-slate solution proposed by the Commission (abolition of the switchover and the green ECU along with MCAs), the Council decided to retain the switchover at least until 1 January 1995, establishing rules for calculating green rates for both narrow band and "floating" currencies and an automatic mechanism for dismantling monetary gaps so as to preserve the permitted spread of monetary gaps (between 2 per cent, that is, 4 points) (Swinbank). It was also agreed that if the correction factor increased following an ERM realignment, ECU prices would be cut by 25 per cent of the increase at the start of the following marketing year, whereas farmers in countries with floating currencies would be compensated for price losses in the case of a revaluation lasting into the medium-term[8].

In August 1993, with turbulence on currency markets, the narrow band parity grid of the ERM was suspended and currencies were allowed to move within a band of 15 per cent of their central rate. Since central rates themselves were unaffected, the correction factor did not change (by then equal to 1.207509). However, with a fluctuation band of 15 per cent, all currencies were now effectively floating. Thus, there was a prospect of much larger monetary gaps arising, which, according to the rules, would lead to more frequent changes in green rates, including revaluations by those countries with the strongest currencies which had for years enjoyed the protection of the switchover mechanism.

Just days after the suspension of the narrow band grid, the rules indicated a revaluation of the green rates of both the Deutschmark and Dutch guilder, due to the appreciation of these two currencies. However, Germany and the Netherlands insisted that green rates should be frozen until new rules could be agreed that would give greater protection to their domestic agricultural prices. The December 1992 regulation was amended in December 1993 so as to widen the spread of monetary gaps to 5 points, and to allow this franchise to float (for example, a positive monetary gap of 4.5 per cent would be allowed without requiring this country to revalue its green rate providing the largest negative monetary gap was not more than -0.5 per cent).

Although this solution avoids reactivating the switchover mechanism as such, it too contains an inflationary bias: the temporary appreciation of a minor currency can provoke devaluations which are unlikely to be fully reversed. Indeed, between mid-1992 and 21 August 1994, Greece, Italy, Portugal, Spain and the UK had net devaluations of over 15 per cent (in the case of Italy, 33 per cent). At the same time, since the floating franchise favours the persistence of positive monetary gaps, it inflates the payments made from the agricultural budget to farmers in these countries.

In an attempt to reintroduce some realism into agrimonetary policy, the Council agreed new rules at the end of 1994 whereby the switchover and the green ECU are finally scrapped, the maximum spread between monetary gaps is slightly widened and it no longer "floats".

These developments help to explain how agriculture ministers have for the last two years managed to operate a price freeze in green ECUs whilst at the

[8] The compensation to be financed 50-75 per cent from the EU budget.

same time institutional prices in national currencies, and budget expenditure in "real" (that is, market) ECUs, have continued to receive an inflationary policy-induced stimulus. The complexity of the agri-monetary system, together with the increasing importance of area and headage payments, make international comparisons involving EU prices a difficult and controversial exercise. It should be noted that the EU's commitments under the GATT agreement have been expressed from the outset in terms of real ECUs. This means that, in order to compare the EU's schedule of tariff commitments or permitted subsidy expenditure with the CAP price and subsidy structure (typically expressed in green ECUs) the GATT values must be divided by 1.207509.

2.3 Other Reforms and New Measures

Sugar

Sugar was omitted from the 1992 reform package since the expiry of the regime in mid-1993 offered an appropriate opportunity to overhaul the policy. Although modified in its detail over the years and extended by the creation of production quotas for isoglucose in 1981, the sugar regime has remained essentially unchanged since it was established in 1968. Sugar policy has escaped the Commission's periodic reforming zeal largely because it was perceived as "self-financing", with the costs of running the policy met by a producer levy on A and B quota sugar (Roberts and Whish-Wilson). In fact, market support for sugar is a burden on both the EU budget and the final consumer[9] (ECA 1991).

Both consumers and industrial users of sugar have long favoured more market-oriented policies, advocating price reductions and the abandonment of quotas, or at least their transferability between and within countries. The disparities in production costs are such that market-led relocation of EU production could reduce total production costs substantially[10]. By contrast, producers and processors strongly support a renewal of the current policy, while insisting that all caloric sweeteners should be included in a continuing quota system. This demand has been partly met by establishing quotas for inulin syrup[11], beginning in 1994/95.

Despite active lobbying from interest groups, it was twice decided to prolong the existing sugar regime for an extra year. In late 1994 the Commission produced plans to maintain the current quota system for a further fixed term, the duration of which is to be decided. Refunds of storage costs for carryover C sugar stocks will be largely phased out. Should the GATT volume or value limits be exceeded during this period, adjustments would be made to quota levels, maintaining the existing balance between A and B quotas, rather than to intervention prices. To cater for this eventuality the plans include a set of country-specific quota reduction coefficients to be applied for sugar, isoglucose and inulin.

Whatever the details of the final agreement, expected early in 1995, it is clear that the opportunity has been lost to bring sugar into line with other reformed crop products by reducing prices and providing hectare payments. Consumer interests appear to have lost out to the powerful sugar lobby.

Wine

The Commission's views on reform of the wine sector were first unveiled in 1993. Despite strong negative reactions from producing countries, these plans have been finalised and are currently under discussion (EC 1994a). EU-12 is about 115 per cent self-sufficient in wine, some of which is of extremely poor quality. With expenditure on wine support budgeted at 1567m ECU in 1994, the long-term aim of the reform is market balance. An overall production quota of 154m hectolitres is proposed for 1995/96, to be allocated among the seven wine-producing countries in proportion to their average production during 1989/90-1992/93. The quota would be reduced annually until 1999/2000. Savings on storage, refunds and distillation would be reallocated to fund structural measures. Over-quota production would incur a price cut and

[9] In 1991-2, export refunds, intervention and storage cost storage costs for sugar were about 6 per cent of CAP spending (ASIC, 1993). The per cent CSE for sugar is one of the highest in the EU.

[10] Mahler found that optimal relocation of quota within Germany alone would reduce average production costs by more than 20 per cent. Bureau and Butault found a cost increase of 80 per cent between the lowest- and highest-cost sugar-producing countries in the EU.

[11] A high fructose syrup that can attain fructose levels of 80 per cent or more, made from chicory or other vegetable raw materials. Although similar to isoglucose, it does not come under its definition, and thus, as an unregulated competitor for sugar, offered attractive opportunities for large-scale production, of particular interest in Belgium, Frane and the Netherlands.

compulsory distillation. These proposals have received a particularly hostile response from Italy, France and Spain.

However, the Commission and Council may find their resolve strengthened by a recent Court of Auditors' Report (ECA 1994) that catalogues a series of administrative and policy failures in the wine sector. It draws attention to the fact that although the EU budget spent a total of 1.21 billion ECU on premiums for the permanent abandonment of vineyards during 1989-1993, table wine production actually increased by nearly 21 per cent over the same period. Although the report clearly implicates national governments and local officials in this saga of maladministration, the unrealistic level of institutional prices is also blamed for creating strong incentives to over-produce.

Bananas

Until 1993 the EU banana market was segmented. Some countries relied on EU supplies or had preferential trading arrangements with ACP[12] countries. Some imported non-ACP country bananas at a 20 per cent tariff. Only Germany had duty-free entry. Completion of the single market required a common EU policy for bananas. Since July 1993 there is a duty-free quota of ACP imports of 857.7 th t, with a tariff of 750 ECU/t for above-quota volumes, and a 2m t tariff quota for non-ACP bananas with in-quota tariff of 100 ECU/t, rising to 850 ECU/t for supplies above this quantity. Quotas are managed by a system of import licenses. Thus bananas have joined the list of products regulated under the CAP.

These arrangements were challenged in the GATT by a group of Latin American exporting countries and amended in March 1994, with the tariff quota raised to 2.1m and 2.2m tonnes for 1994 and 1995 respectively, and the in-quota rate reduced from 100 to 75 ECU/t. Despite continuing discontent with the scheme within the EU, particularly in Germany, at the end of the first year the Commission reported finding no evidence of adverse effects on availability of bananas or consumer prices.

Potatoes

For some years, a subsidy has been paid on starch manufactured from either potatoes, wheat or maize. A steady increase in potato starch production, leading to a build-up of stocks and large export refund payments, prompted a proposal in 1994 for a potato starch quota of 1.5m tonnes (based on production in 1990/1-1992/3) with any excess to be marketed like C sugar. The quota is allocated to just five producing countries beginning in 1995/96, and a ceiling will also be applied to cereal starch production.

The setting up of a common market regime for potatoes for human consumption has been on the agenda for some years. With the area of cereals, oilseeds and protein crops now effectively frozen since the 1992 CAP reform, and the sugar sector still heavily regulated, potatoes are the only major arable crop that remains unregulated[13]. The bumper harvest and low prices of 1992 aroused fears in the potato industry that a structural surplus was emerging and led to renewed pressures for EU regulation to balance the market. The Commission has consistently preferred a "light" regime, if any, for this sector, limited to setting common standards, encouraging producer groups, establishing import surveillance and anti-dumping measures. Italy, Spain and Portugal are calling for a "heavy" regime with common prices and EU-funded market intervention. A decision is expected in time to implement new measures by mid-1995.

3. International Trade Arrangements

After the GATT panel ruling against EU oilseeds policy in March 1992, the EU offered compensation but refused to make adjustments to the oilseeds regime. Despite US threats of trade sanctions and threatened retaliation from the EU, bilateral talks on outstanding trade differences got under way in the autumn of 1992, culminating in the Blair House agreement.

3.1 Blair House Agreement

This consists of two parts: a solution to the EU-US oilseeds dispute, and a bilateral accord on reducing agricultural subsidies and trade barriers in the context of the Uruguay Round negotiations.

[12] African, Caribbean and Pacific countries, as designated under the Lomé agreement.

[13] A number of countries, including the UK and France, already operate national market support schemes for potatoes.

EU-US Agreement on Oilseeds

The essential points of the agreement are:

- The EU will establish a separate base area for supported oilseeds, equal from 1995/96 onwards[14] to 5.128m ha (the average oilseed area for 1989-91). This area will be reduced by the current set-aside percentage as long as the rate is greater than 10 per cent.

- Over-planting will incur a penalty in the same year equal to a reduction in the subsidy in proportion to the overshoot.

- Oilseeds for non-food use (NFU) planted on set-aside land are not included in the oilseeds base area. However, NFU production of oilseeds is limited to 1m tonnes of soyameal equivalent[15].

- The US waives any further compensation claim for impairment of the GATT oilseeds bindings.

EU-US Uruguay Round Pre-accord

The main points are summarised as follows:

- Border protection measures are tariffied, and the (unweighted) average of the tariff equivalents is reduced by 36 per cent over 6 years (individual tariffs by at least 15 per cent). The base period is 1986-88.

- The "special safeguards clause": if the EU import price in ECUs is more than 10 per cent below the average for the base period, the basic tariff may be increased in proportion to this difference.

- Minimum access opportunities (3 per cent rising to 5 per cent of EU consumption) are made available in the form of tariff quotas (with a tariff equal to 32 per cent of the basic tariff).

- Special import arrangements (such as the EU-New Zealand butter and sheepmeat agreements) are maintained in a revised form at present levels.

- Internal support is measured globally by the Aggregate Measure of Support (AMS) based on 1986-88, with credit given for reductions in support since 1986. The AMS is to be reduced by 20 per cent compared with the base period.

- EU area and headage payments, along with green box measures as specified in the Dunkel Final Act (GATT 1991) are excluded from the AMS (Manegold, Chadee and Johnson).

- The volume of subsidised (non-food aid) exports is reduced product by product from its 1986-90 average level by 21 per cent over 6 years.

- Export subsidy outlays are reduced per product by 36 per cent over 6 years from their 1986-90 average.

- The "peace clause": Internal subsidies are exempt from actions under Article 16 of the GATT during the six years up to 2000.

On the issue of rebalancing the EU's tariff structure between protected and non-protected animal feed ingredients, there were no formal concessions in the EU's favour, but there was an agreement to review the situation if increases in imports of non-grain feed ingredients were to undermine the CAP reform measures.

The agreement conforms on most points to the Dunkel paper (GATT 1991). What is new is that the EU's area and headage payments, the cornerstone of the 1992 CAP reform, are excluded from the AMS and therefore exempt from reduction over time, even though they do not correspond to the green box definition. Moreover, the export volume reduction is agreed at 21 per cent rather than Dunkel's 24 per cent.

Reactions

France was quick to repudiate the agreement, and announced its intention of blocking the deal in the Council of Ministers, invoking the Luxembourg compromise if necessary[16]. There was widespread concern about the compatibility of these terms with the 1992 CAP reform. The Commission insisted that they were compatible, implicitly interpreting compatibility to mean that the basic framework of the CAP reform was not threatened, even if it meant that ad-

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[14] 371 th ha more in 1994/95 due to the accession arrangements for Spain and Portugal.

[15] Equal to about 2.2m t or 700 th ha of rapeseed in European conditions.

justments to set-aside rates or other parameters might have to be made in later years in order to accommodate the export commitments. Farmers' organisations throughout the EU condemned the agreement: for example, the Danish farming industry deplored it as a "catastrophe", the British farmers' union demanded guarantees that farmers would receive EU-funded compensation when the GATT terms began to erode farm incomes beyond what was implied by the CAP reforms, and French farmers again paralysed Paris traffic with their tractors.

Elections took place in France in spring 1993. The new French government announced that it was willing to suspend its veto if the EU would renegotiate certain elements of the Blair House agreement. In mid-1993, France accepted the Blair House agreement on oilseeds, while insisting that this matter was separate from the Uruguay Round Pre-accord, which they still found unacceptable.

The French authorities undoubtedly realised that the Blair House pre-accord incorporated the minimum reductions that could be accepted by other parties in the multilateral negotiations, and that the French economy as a whole was likely to gain from a successful outcome to the Uruguay Round. Nevertheless, as the largest agricultural exporter in the EU, France was concerned that, by focusing on reducing export subsidies, the agreement inflicted a disproportionate share of the adjustment on the EU. French demands included a longer duration for the Peace Clause (to protect the future of CAP compensation payments), more aggregation of products as regards both minimum access and export commitments (to allow a trade-off between individual products with different levels of self-sufficiency within product categories such as meat or dairy products), stronger assurances on the rebalancing issue (to protect the domestic cereals market), adjustments in the export reduction schedule (in recognition of the EU's current high stock levels) and flexibility so that the EU would not be frozen out of any future world market expansion.

Many of these concerns were shared to some extent by other member states, although they spoke publicly of reinterpretation rather than renegotiation. It is probable that without sustained pressure from the French over 10 months, the EU would not have reopened what Commission negotiators, empowered to act on behalf of the Union, had presented to ministers as a final agreement, as it was undoubtedly viewed in Washington. In the event, at the end of September 1993, EU and US trade representatives began talks to seek "clarification" of the agreement.

3.2 The Final GATT Agreement

The most important changes introduced into the revised EU-US accord reached in early December 1993 and subsequently into the multilateral Uruguay Round agreement are that (a) the US gained concessions on market access for some products, in exchange for allowing the EU to adopt a degree of product aggregation, and (b) the terms for export reductions were respecified in order to permit "front-end loading" of the EU's export reduction schedules. That is, if exports were much higher in 1991-92 than in 1986-90, the phased reductions would begin from the later higher levels, although the total reduction by the end of the period would still be 21 per cent of the 1986-90 average. In addition to these crucial modifications, the peace clause was extended for an extra three years, and the special safeguards clause was clarified.

Front-end loading enables the EU in avoid massive reductions in the early years of the implementation period for exports of wheat, cheese, beef, poultrymeat and tobacco[17] and so creates some flexibility for stock clearance. For example, this concession will allow the Union to subsidise the export of at least 8 million extra tonnes of cereals during the implementation period (*Agra Europe* 10/12/93, P/1). Front-end loading will also apply for the phasing-in of cuts in export subsidies for all products except eggs and "other" milk products. The EU has opted to apply the standard 36 per cent cut in tariff equivalents for most products. Notable exceptions are sugar and skimmed milk powder, most fruit and vegetables, and wine (cut by 20 per cent). On the other hand, some minor products with low rates of protection will have their tariffs reduced by 50, 75 or 100 per cent.

At the end of 1994 the implementation details for the EU's Uruguay Round commitments were still being drawn up for each product. Two major outstanding issues concern whether the preferential access provi-

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[16] A blocking mechanism, used more in threat than in practice, whereby an individual country vetoes a Council decision on the grounds that it threatens a vital national interest.

[17] A number of products, including sugar, butter, skim milk powder, wine and pigmeat are subject to *negative* front-end loading.

sions for imports from Central and Eastern Europe under the EU's Europe Agreements (see section 5.4) are accepted as part of the 3-5 per cent minimum access commitment, and what the effect of the accession to the Union of three new member states will be on the EU's GATT commitments.

4. Agricultural Markets

4.1 Cereals

World production of cereals was 5.3 per cent higher in 1992/93 than in the previous year, with feed grain production nearly 7 per cent up, but fell it in 1993/94, largely due to a fall in the production of coarse grains; world wheat trade declined sharply. World cereal stocks were estimated at 333m t at the end of 1994, 46m t lower than their level 12 months earlier.

EU 1992 cereal harvest of 168m t was more representative of recent trends after the record 1991 harvest of 180m tonnes. Total EU intervention stocks of cereals stood at 33.34m t at the end of the 1992/93 marketing year, of which almost half was common wheat. Although EU exports were considerably higher in 1992/93, intervention stocks also increased 26 per cent over the year. This apparent contradiction is explained by the continuing decline in the use of cereals for animal feed, accompanied by the growing use of cereal substitutes and protein-rich feeds, much of which is imported. These are the trends that must be reversed if the 1992 policy reforms are to be sufficient to achieve the targets set by the Uruguay Round agreement.

EU cereal production in 1993/94 was only 3 per cent lower despite a fall in the harvested area of 8.5 per cent (Table 1). The second half of 1993 saw a fall in total exports, although the proportion of grain exported from intervention stores was considerably higher than during the same period in 1992. This trend continued into 1994, with both the EU and US making active use of wheat export subsidies in order to reduce stock levels in advance of the GATT implementation period. In August, the Commission decided to release 1.6m tonnes of intervention grain onto the domestic market during the autumn in order to hold down market prices, thus stimulating feed industry demand, and to further reduce stock levels. By the end of December 1994, intervention stocks stood at 9.82m t, about 46 per cent of their level 12 months earlier. The lower 1994 harvest has helped this trend: the official estimate of the harvest is 161m t, although cereals traders forecast 2m t less.

The area sown to cereals declined between the 1992 and 1994 harvests in all member states except Germany and Greece. The largest falls were in the UK (nearly 14 per cent), Belgium/Luxembourg (12.5 per cent) and France (10.5 per cent). These differences are largely due to the differential impact of compulsory set-aside but it should be noted that producers are not required under the new policy to reduce the area planted to each crop by the same proportion. If the additional constraint on the total EU oilseeds area stipulated by the EU-US oilseeds agreement increases the perceived price risk associated with oilseed production, the cereals area is likely to benefit.

Table 1: Supply and Demand for Cereals (excluding Rice) in the European Union (EU-12)

	1991/92	1992/93	1993/94^{e}	1994/95^{e}
Area harvested (1000 ha)	35,886	35,239	32,268	31,613*
Production (1000 tonnes)	180,249	168,150	163,044	161,000
Opening stocks (including intervention)	33,600	45,000	45,750	36,300
Imports	5,113	4,048	3,800	4,300
Exports	31,442	37,363	33,200	n.a.
Internal use	143,041	134,086	143,000	142,400
of which: animal feed	83,679	77,096	86,600	86,200

e estimates by the Commission, reported in *Agra Europe* (2/12/94).
* forecast: COCERAL. Opening stock figures are from various sources and are not necessarily consistent with the previous year's flows.

Sources: Eurostat, *Crop Production*, 1993, 1994; *ASIC*, 1993, 1994;

The 1993 and 1994 harvest results suggest no clear relationship between area and output reductions. In 1993, area was down by 8.4 per cent and production by only 3.0 per cent, seeming to confirm fears about set-aside "slippage". But at least part of the explanation is that 1992 yields had been below normal due to weather. The medium-term trend in cereal yields is a key element in projections of cereals market balance until the end of the decade and is crucial in the debate about whether the 1992 reforms can keep export volumes and subsidies within the GATT ceilings[18]. The other key element is the consumption of cereals in animal feed. In its calculations intended to demonstrate CAP-GATT compatibility, the Commission assumes an underlying yield growth of 1 per cent per year, and an extra 12m t of cereal use for animal feed by the year 2000/1. But it is widely considered that the Commission's yield forecast is too low[19], and that the animal feed target can be met only if livestock numbers expand significantly (causing problems elsewhere) or cereal prices are reduced below the levels for 1995/96 set by the 1992 CAP reform. Commission estimates for 1993/94 indicate that the fall in cereals use for animal feed has halted whereas both cereal substitutes and energy-rich proteins are lower (by 0.8m t and 1.6m t respectively (Agra Europe, 1/7/94, E/7)). These changes are in the right direction but of feeble magnitude. If the Commission's predictions turn out to be too optimistic, increasing the set-aside rate and/or exporting surplus production in excess of the GATT limits without subsidy are the policy options.

4.2 Oilseeds and Protein Crops

World oilseed supplies fell in 1993/94 and by mid-1994, stocks of oilseeds and oils were very low. However, record levels were set for both rapeseed and soyabean production in 1994/95 (8.7 per cent and 14 per cent above 1993/94 respectively).

Within the EU, the new support payment system for oilseeds (see Manegold 1992, p.118) was first implemented in 1992/93. The projected reference price in 1993/94, originally predicted to be 163 ECU/t, was well below the actual reference price of 193.1 ECU/t. Since this discrepancy exceeded the 8 per cent allowable margin by about 10 per cent, oilseed aid was cut by 10 per cent. The 8 per cent margin works in both directions, and may penalise producers if world prices slump in 1994/95.

From 1993/94 onwards, oilseeds come within the new EU crop regime; oilseed area is part of the total base area, which for professional producers is subject to set-aside. In addition, EU oilseed area is subject to a ceiling fixed by the Blair House agreement. At the end of 1993, this maximum GATT-permitted area was subdivided into national reference areas for each member state, plus a reserve. If the EU as a whole overshoots its ceiling, only those member countries who have exceeded their reference areas will face penalties. Some member states want a further regional subdivision within countries, so that if overshooting is concentrated in just one region (as happened last year in Germany), producers outside this region will be protected from penalties.

EU oilseeds output fell in 1993, but appears to have partly recovered in 1994 (Table 2). Provisional figures suggest that Germany, France and the UK have breached their national reference areas in 1994. It is predicted that German producers will face a subsidy cut of 22 per cent and UK producers of 6 per cent.

The 1994 harvest saw a large increase in oilseeds grown on set-aside land for non-food use (NFU)[20], mainly for biodiesel. NFU rapeseed area increased from 188 th ha to 429 th ha, with a 380 per cent increase in France. NFU sunflower and industrial linseed have also increased strongly. These areas receive the set-aside payment of 57 ECU/t. Subsidies are also paid to biofuel processing plants by national governments, and some countries plan to introduce tax concessions on biofuels. Compared with current fossil fuel prices, biodiesel is uneconomic and the burgeoning biofuel industry appears to be wholly dependent on subsidies for survival. However, for environmental reasons (biofuel is a renewable energy source, avoids releasing carbon emissions stored in fossil fuels, and involves lower emissions of sulphur dioxide and hydrocarbons) EU taxpayers may well prefer to support this activity rather than more sterile forms of agricultural subsidy.

[18] Export volume and subsidy targets for 2000/1 are 24m t and 2060m ECU respectively.

[19] Productivity growth has averaged 1.9 per cent per year in recent years.

[20] Industrial oilseeds on set-aside land are limited to the equivalent of 1m t of soyameal. It is estimated that the 1994 non-food crop will be close to 730,000t meal equivalent.

Table 2: Production of Oilseeds and Pulses in the European Union (EU-12)

		1990/91	1991/92	1992/93^p	1993/94^p	1994/95^e
		Area harvested (1000 ha)				
Total oilseeds		5,888	5,803	6,110	5,619	5,835
of which:	Rapeseed	2,140	2,449	2,340	2,227	2,605
	Sunflower	2,645	2,404	2,750	3,173	2,946
	Soybeans	665	486	470	224	363
of which:	for NFU				204	622
Dried pulses		1,983	1,761	1,870	1,610	n.a.
		Output (1000 t)				
Total oilseeds		13,057	13,580	12,900	10,420	11,922
of which:	Rapeseed	6,244	7,730	6,500	6,297	6,634
	Sunflower	4,325	4,045	4,100	3,443	4,437
	Soybeans	2,065	1,511	1,600	650	1,030
Dried pulses		6,199	5,226	5,300	5,800	n.a.
Dried fodder		3,769	3,931	4,280	4,313	n.a.

p = provisional.
e = estimate.

Sources: *Agrarbericht*, 1994, p.104; Eurostat, *Crop Production*, 1994/4; 1993/4 and 1994/5: Commission,

Dried fodder (dehydrated or sun-dried lucerne and grass), grown especially in France and Spain, has expanded from 1.8m t in 1987/88 to 4.3m t in 1993/94 (Table 2). Output is roughly in balance with demand, and at the end of 1993/94 stocks were zero. However, this product too receives price support. Because of its increasing claim on the budget (about 370m ECU in 1993), the Commission has proposed for several years to remove the subsidy. However, the small but effective lobby group representing the industry has persuaded the Commission to agree to maintaining support (at 57 ECU/t) in exchange for a Maximum Guaranteed Quantity limit of 4.4m t, to be allocated among member states. Aid would be reduced if the production limit is exceeded. The Council is expected to approve this regime in time for implementation in 1995/96.

4.3 Sugar

After three years of surplus on the world sugar market, the situation improved in 1992/93 because of poor harvests and continued consumption growth. But with stocks still above one third of annual global consumption in mid-1992, world market prices remained depressed. The European Union maintained its overall export share at 17.3 per cent, just below 1991/92, increasing its exports to former socialist countries. World sugar supplies for 1993/94 were 2 per cent below annual world consumption. By early 1994, the market situation was tighter than for some years; stock levels continued to fall and prices rose significantly. A further shortfall in world supply of just under 2 per cent is forecast for 1994/95.

Despite a significant drop in EU sugar beet area in 1993, production was maintained due to higher yields (an average of 8.3 t/ha white sugar equivalent) (Table 3). Total sugar production was nearly 3m t in excess of the combined A and B quotas, and EU self-sufficiency increased. Early estimates of total 1994 production are well down on previous years, due to a smaller harvested area and average yields below 7.6 t/ha of white sugar. In September 1994, the Commission cut by 40 per cent the minimum stock levels required to be held by beet sugar manufacturers in the expectation of a supply shortfall in Germany and the Netherlands. Of the 2.5m t of C sugar forecast for 1994/95, it is expected that about 1.5m t will be exported without subsidy during the year and the remainder carried over. With the accession of Austria, Finland and Sweden internal demand will in-

Table 3: Supply and Demand for Sugar in the European Union (EU-12, 1000 tonnes white sugar equivalent)

Item	1990/91	1991/92	1992/93^{p}	1993/94^{p}	1994/95^{e}
Area harvested (1000 ha)	2,085	1,974	1,988	1,913	1,892
Production (1000 t)	15,870	14,703	16,015	16,235	14,270
Beginning stocks	531	1,023	904	1,314	1,261
Imports	1,887	1,922	1,946	1,998	n.a.
Exports	5,508	4,980	5,924	6,358	n.a.
Domestic consumption (1000 t)	11,753	11,966	11,900	11,875	n.a.

p = provisional.
e = estimate.

Sources: *ASIC*, 1992, 1993; *Agrarbericht* (1994), *AgraEurope*, various issues. Note that in most recent years carryover stocks do not match those derived from the previous year's figures, due to use of estimates from different sources.

crease by about 0.97m t, as against an increase in A and B quotas of about 0.92m t.

The Uruguay Round GATT commitments place little pressure on the existing sugar regime. World sugar prices were very low during 1986-88 resulting in a base tariff equivalent of 524 ECU/t; moreover, the EU has proposed a reduction of just 20 per cent in its sugar tariff equivalent, after which it is likely that current levels of domestic prices will still be well protected from erosion by imports. Minimum access requirements can easily be met, since levy-free imports of ACP sugar already constitute over 10 per cent of internal consumption. It is thought that, providing internal consumption growth rates are maintained, export volumes could be cut by the required 21 per cent without cuts in production quotas, whereas small cuts in either intervention price or quotas would be needed to meet commitments on export subsidies.

4.4 Milk and Dairy Products

World milk production fell by 1 per cent in 1993. Global cheese and butter production hardly changed but milk powder production was 2.5 per cent lower. Within these totals, significant reductions in the US, particularly for butter and milk powder, and in the former Soviet Union, were offset by sharp production increases in Oceania and Asia.

EU butter and skimmed milk exports were substantially lower in 1993 (Table 4), whereas cheese exports at 521 th t were 12.4 per cent up on 1992. Under the GATT agreement, subsidised cheese exports are limited to 406 th t for 1995/96 and must fall to 305 th t by 2000/2001. It is worth noting that unsubsidised cheese exports in recent years have averaged just 45-50 th t annually. However, the prospects for increasing unsubsidised exports are not too grim: with world demand for cheese still apparently outstripping production, high prices and continuing export growth is forecast at least for 1995 (GATT 1994). EU cheese production, which has been growing at an annual rate of about 2 per cent since the mid-1980s, increased only marginally in 1993, but figures for the first six months of 1994 show a rise of 2.9 per cent relative to the same period in 1993. The growth in internal demand continued at about 1.8 per cent per year in 1993.

In May 1994 the GATT minimum prices for butter and butteroil were suspended for 12 months at Australia's request. This was expected to increase the difficulty of exporting EU butter. Just before the suspension, the Commission was accepting export offers for intervention butter at a minimum selling price of just 685 ECU/t, which was already very unfavourable compared with the buying-in price of 2522 ECU/t. In fact, world butter prices remained relatively steady after the suspension, although the volume traded was low. Given the situation, it is surprising that the Commission managed to reduce intervention butter stocks from 161 th t to 63 th t over the 12 months prior to December 1994. It is notable

Table 4: Supply and Demand for Milk in the European Union (EU-12, 1000 tonnes)

Item	1990	1991	1992	1993^p	1994^e
Dairy cows (1000 head, December)	24,281	22,808	21,822	21,305	21,125
Total production cows' milk	119,042	114,773	112,192	112,087	112,499
Cows' milk deliveries	107,945	105,263	103,740	102,893	102,586
Total domestic demand	95,019	95,051	95,155	945,933	94,286
of which liquid milk[1]	26,021	26,189	26,924	26,738	26,700
Butter					
Production	2,026	1,824	1,676	1,696	1,647
Domestic consumption	1,654	1,654	1,568	1,626	1,626
of which at market prices	1,283	1,203	1,126	1,080	1,030
Imports	90	68	56	54	55
Exports	280	361	223	170	155
Ending stocks[2]	335	302	290	250	160
Skimmed milk powder					
Production	1,775	1,519	1,191	1,226	1,213
Domestic consumption	1,027	1,175	1,137	1,090	1,000
of which at market prices	260	272	265	271	270
Exports	330	253	391	290	175
Ending stocks[3]	333	414	47	33	30

p = provisional.
e = estimate.

1 Including direct sales.
2 Intervention and private subsidised stocks.
3 Intervention stocks only.

Sources: *Agrarbericht*, 1993, 1994, 1995; *Dairy Facts and Figures*, 1990-1993; *Agra Europe*, various issues.

that the volume of subsidised butter sold on the domestic market, mainly for use in bakery products and icecream, was already significantly higher in 1991-93 than in 1989-90. One has to assume that this disposal strategy has been pursued more keenly during 1994.

Currently, the EU bans the use of BST and the import of milk products from BST-treated cows. This regulation comes up for renewal at the end of 1994. It is likely that the US would use the new GATT clause forbidding trade barriers on health grounds that are unsupported by scientific criteria in order to challenge any extension of the import ban. The Commission is resolutely against authorising BST for domestic production. It fears that, with output constrained by quotas, BST-induced yield increase could unleash socioeconomically undesirable restructuring in the dairy industry. It has support from animal welfare and consumer groups. At the end of 1994, the Commission was considering the option of continuing its ban on domestic use and requiring labelling of BST-treated imports.

In December 1992 it was decided to extend the milk quota scheme until the year 2000. As part of the package, eight countries received 0.6 per cent in additional quota to meet further claims from SLOM producers[21]. In addition, extra quota totalling 1.59m t was allocated to Italy, Greece and Spain for 1993/94, to become permanent when the Commission is satisfied that the quota regime is being correctly applied in these countries (Manegold, p.134 for the background to this decision). It had emerged in the early 1990s that these countries had never fully applied the

[21] Producers who had no production in the base year determining quota allocations because they participated in EU schemes for herd conversion and non-marketing of milk.

quota scheme and had been underestimating the full extent of their milk output. Their combined superlevy bill for the years 1988-1993 was about 5b ECU. Their request that the award of additional quota should be backdated to cover this period, which would reduce the amount payable, was accepted by the Commission but strongly opposed by some other member states. Italy's insistence on a 10 per cent quota increase had already threatened to derail the CAP reform decision in 1992. At the end of 1992, Italy enacted the national legislation necessary to implement the quota scheme but the UK appealed to the European Court of Justice concerning the legality of backdating of quota increases. The issue dragged on and was not settled until late 1994[22].

Under the terms of the new quota scheme, the principle of milk quota transfer without land is accepted. Moreover, member states may set their own rules for quota transfer. Various member states have used or plan to use this opportunity to introduce more flexibility into their arrangements for quota transfer. Member states are now also required to set up a quota leasing scheme, although (at the insistence of Denmark) they are not compelled to put it into practice[23].

The 1992 CAP reform specified a 2 per cent cut in quota over two years. In fact, the total adjustments to quota allocations that were agreed in 1993 effectively *increased* total EU quota by 2 per cent, from 106.88m t to 109.05m t. With the wrangle over Mediterranean countries' allocations continuing, agriculture ministers were unwilling to accept any cuts for 1994. Thus, it was decided in July 1994 that milk quota would remain unchanged for 1994/95 and 1995/96, although the butter price was cut by 3 per cent for the second year running. The three new entrant countries will receive a total quota of 8.61m tonnes, somewhat above their current consumption.

4.5 Beef

EU beef production peaked in 1991, followed by a cyclical fall (Table 5). EU beef consumption is also still falling. Intervention stocks of beef reached 1.12m t at the end of November 1992. This prompted a lowering of the price threshold which triggers intervention buying (from 75 per cent to 60 per cent of the intervention price). The 1992 CAP reform had fixed a gradually reducing ceiling on intervention purchases and this was applied in 1993 at 750 th t. In addition, a stepped reduction in the maximum carcase weight was imposed beginning at 380kg/head in 1993/94[24].

These measures, plus the fall in production and massive cut-price exports of frozen beef to the former Soviet Union in 1993 and 1994, have permitted systematic destocking. By the end of December 1994, just 80 th t of beef remained in intervention stores. However, the beef cycle is expected to move into its upward phase in 1995 and it remains to be seen whether measures taken so far are sufficient to keep the exportable surplus within the GATT limits.

Trade within the EU was disrupted in 1994. The German authorities had become increasingly concerned about the safety of UK meat because of the persistence of BSE in British herds[25,26]. After German pressure and threats of a unilateral import ban, the Commission brought in tougher anti-BSE regulations for UK exports of bone-in carcases, whereby carcases must be certified as coming from herds that have been BSE-free for at least 6 (previously 2) years. Within a few months of the new regulations, UK bone-in beef exports had recovered, and resumed their rapid rate of expansion of the previous two years. From the end of 1994, anti-BSE certification is no longer required for animals born after the start of 1992.

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[22] In mid-1994 Italy linked the success of its quota claim to its willingness to ratify the Council's 1992 undertaking to raise member states' contributions to the EU budget to 1.21 per cent of GDP in 1995. In order to unblock the progress of the draft 1995 budget, a compromise was found enabling the quota increases allocated to Italy and Spain to be backdated to the last two years for which fines were payable.

[23] In 1992/93 the UK, which has the most mature scheme for 12-month leases, saw over 46 per cent of registered milk producers involved in quota leasing transactions, involving nearly 6 per cent of quota. Lease prices for milk quota (average butter fat) at the end of the last leasing period (December 1994) were 20 p/l (compared with a producer price for milk of 23-25 p/l and superlevy for excess production of 28.97 p/l).

[24] Average carcase weight has increased significantly in recent years (to about 308 kg in 1992). With the market for the heaviest carcases limited, some producers appeared to be rearing heavy animals specifically for intervention (EC, 1993a).

[25] 42,274 new cases of BSE (bovine spongiform encephalopathy) were reported in the UK in 1993, 15 per cent below the 1992 rate. The number of BSE cases reported in other member states has been minimal.

[26] There has been a ban on the incorporation of ruminant carcase tissue in animal feed (thought to be at the origin of the epidemic) since 1988, and an export ban on live cattle over 6 months of age has been in force since 1990.

Table 5: Supply and Demand for Beef and Veal in the European Union (EU-12, 1000 tonnes slaughter weight)

Item	1990	1991	1992	1993p	1994e
Gross EU production	8,247	8,712	8,396	7,820	7,650
Livestock imports	144	105	83	85	85
Livestock exports	90	88	83	170	160
Net EU production	8,301	8,730	8,396	7,735	7,575
Meat imports	390	436	506	400	390
Meat exports	841	1,320	1,249	1,070	920
Change in stocks	+322	+267	+150	-460	-380
Domestic consumption	7,528	7,578	7,503	7,525	7,425

p = provisional.
e = estimate.

Source: *Agrarbericht* 1993, 1994, 1995.

4.6 Sheepmeat

The EU is the world's largest consumer and importer of sheepmeat. One third of the EU's production originates in the UK, whereas France has recently overtaken the UK as the Union's main consumer. About 77-80 per cent of the EU's imports come from New Zealand, which are the subject of a voluntary restraint agreement (as are imports from other sheep-exporting countries in the southern hemisphere and eastern Europe). Exports from the EU are negligible.

France is the destination of about 60 per cent of intra-Community trade, with the four southern member states accounting for another 20 per cent. This trade has increased under the unified support regime which has operated within the EU since the ending of the variable slaughter premium for British lamb at the end of 1991 (see Manegold for details of this policy change).

Rising demand on the Continent later in 1992 and throughout 1993 was met mainly by increased imports of sheepmeat and live sheep from the UK, helped by cheaper prices due to the weaker pound sterling. Based on the number of ewe premium rights awarded under the 1992 CAP reform, the Commission expects ewe numbers to remain at about 72m head (EC 1993b), However, breeding ewe numbers have been falling and are projected to continue to do so in 1995. This is attributed to the fact that, in late 1992, the Commission changed the definition of animals eligible for the ewe premium.

With New Zealand imports subject to a GATT ceiling of 225 th t from 1995 onwards and an effective ceiling on domestic production, sheepmeat supply appears to be more or less frozen for the medium term. Given increasing trends in demand, prices are expected to remain buoyant.

Ewe "quota" (the right to claim the annual premium on eligible ewes) became tradeable in the UK in the first quarter of 1993 and at the end of the 1993 transfer period £56/head was recorded[27]. Meanwhile, there continues to be a significant quantity of unused quota in France.

5. Other Current Policy Issues

5.1 Farm Incomes

Real income[28] from farming in the EU rose by 0.5 per cent in 1993, and by an estimated 5.7 per cent in 1994 (Eurostat 1994) despite the output decline. Real prices stabilised in 1994 after falling steadily since

[27] Compared with an annual payment for 1993 of about 21 ECU/head=£19.30 (approx).

[28] Real net value added per annual work unit.

1989. Strong price increases for potatoes, fruit and vegetables and wine offset the reductions in prices in the reformed sectors. Farm subsidies rose overall by 10.3 per cent in real terms in 1994, due to the increase in CAP reform compensation payments. These results are not surprising: various studies had predicted that CAP reform would hardly damage farmers' incomes. Indeed, an unpublished Commission report (*Agra Europe* 19/5/93, E/6-7), based on data from the Commission's farm accounts data base, suggested that only the largest cereals farms were likely to experience a drop, albeit a substantial one, in family farm income. This last finding suggests that, despite criticisms that CAP reform with its area and headage payments dependent on farm size, has done little to reduce the inequality with which EU income support is distributed between farmers, some movement in this direction has been achieved. Moreover, in 1994, the Commission was again considering imposing a ceiling on the total amount of direct EU aid that an individual farmer could receive. Farmers in the UK, where the average farm size of 68 ha is the largest in the EU (twice that of Denmark, with the next largest farm size average)[29], would feel such a move most keenly.

Policy makers are now more aware of the dwindling importance of income from farming as a determinant of the living standards of many farm households. During the second part of the 1980s, the proportion of average farm household income originating from outside farming was substantial, and in Germany, Denmark, Italy and Spain greater than that from farming (Eurostat 1992). Moreover, the average disposable income of households mainly involved in farming exceeded that of non-farm households in most member countries (although when these figures are expressed per household member the ranking changes in some countries). Moreover, the year-to-year stability of the total income of farm households is much greater than that of income from farming alone. In 1987, 41 per cent of farmers and 67 per cent of farm family members spent less than 25 per cent of their time working on the farm (Eurostat 1991). Although these figures conceal considerable variation between member countries, farm types and age groups, it is clear that farm income alone may be a poor barometer of the economic well-being of the rural population, and farm income support an ineffective and badly targeted instrument for maintaining the rural economy. In 1992, 24 per cent of farmers were over 65 years of age, and an astonishing 54 per cent were older than 55. The consequences of demographic change in EU agriculture during the 1990s, together with a clearer definition of the target group for support measures, should allow a fundamental reorientation of EU agricultural policy.

5.2 The Agricultural Budget

EAGGF guarantee expenditure[30] was kept within its financial guideline in both 1993 and, it is predicted, 1994. The 1994 budget was modestly underspent thanks mainly to large savings in the beef sector and under-claiming on area payments. The guideline changes each year by 74% of the annual increase in real EU GDP with allowance for inflation, but it can only be breached after unanimous agreement by farm and finance ministers. The Commission is also legally prevented from proposing a budget that exceeds the guideline. In recent years, much accounting expertise has been required both *ex ante* and *ex post* to adapt budgets and actual spending to this discipline. This is likely to be the case again in 1995.

Fraud represents a continuing drain of unknown magnitude on the budget. It has been estimated at 7-10 per cent of the EU budget, although this figure is hotly disputed by officials (Ruimschotel). Nevertheless, in 1993 alone, 1298 cases of "irregularity" in EAGGF spending totalling over 248m ECU were reported to the Commission. Averages for recent years show that Germany and the UK both have a high number of cases, but the amounts involved tend to be quite small, due perhaps to incompetence in dealing with complex CAP regulations. Elsewhere, the number of reported cases is smaller but the amounts involved are substantial. Moreover, there are differences between member states in rates of reporting and follow-up, with the recovery rate being lowest in Italy (2.5 per cent).

Fraud against the CAP includes claims for subsidy payments on non-existent products, misrepresentation of a less valuable form of a commodity as a more valuable one, and false declarations concerning the destination of exports or origin of imports. Given the complexity of the CAP regulations, and the fact that agricultural spending essentially involves claims by a large number of individuals and trading companies,

[29] But note that the average family farm in the new German states is about 79 ha.

[30] That part of the total agricultural budget devoted to market management policies and income support.

the scope for fraud is considerable. The CAP also stimulates so-called "exploitative trading" (House of Lords 1994a) which, whilst not fraudulent, involves wasteful operations carried out for the sole purpose of exploiting a regulation in order to claim payment.

In response to a series of revealing reports from the Court of Auditors and growing public concern, the Commission is considering moves to standardise penalties for defrauding the EU budget across member states and to have a special offence defined as "fraud against the financial interests of the EU" written into the criminal law of each member state. In addition, it has doubled the staffing of its anti-fraud unit. However, the detection and prosecution of fraud remains a matter for member governments.

5.3 EU Enlargement

Negotiations began in 1993 with Austria, Finland, Norway and Sweden on their accession to the European Union. The terms of accession were finalised early in March 1994. The agricultural sectors of these four countries amount to about 7 per cent of EU-12 agriculture, and domestic production is roughly in balance with demand for most northern CAP products. Quota levels, the speed of transition and permanent safeguards protecting their climatically disfavoured agriculture were key areas in the accession discussions. The applicants did not succeed in gaining a transition period for the alignment of producer prices with EU levels, although temporary compensation was agreed to ease the consequences of immediate alignment. Their budget contributions will, however, be phased in progressively up to 1999, when the net budget contribution of the four applicants (with Finland as a modest net beneficiary) would have amounted to 1.7 billion ECU. Moreover, the applicant countries succeeded in gaining some ground in their demands for permanent structural and regional funding under the new category of "Nordic" aid.

In the event, the people of Norway voted against accession in November 1994, so only three new countries enter in 1995. Without Norway, the net budget contribution of the new entrants is only 1.3 billion ECU at the end of the decade, and EU-12 loses the opportunity to supply Norway's deficit markets (including about 165 th t of sugar) without recourse to export subsidies. Details of how to accommodate the new entrants in the EU's GATT commitment schedule have not been finalised. Meanwhile, the US is seeking compensation under Article 24 of the GATT for impairment of its trade with the new entrant countries as a result of their accession to the EU.

5.4 Agricultural Trade with Central and Eastern Europe

In 1993 the European Union concluded Association Agreements with Bulgaria and Romania, following agreements signed in 1991-92 with Poland, Hungary, the Czech and Slovak Republics. In each case, the agricultural trade concessions granted to these countries involve the opening of tariff quotas on every product they exported to the EU during the reference period (defined as two or three years during 1988-1991, depending on the country); the basic quota quantities are imports to the EU during the reference period, increasing by 10 per cent over 5 years, whilst the tariff is reduced by 60 per cent over the first 3 years and then frozen. In fact, the coverage has not been extended to all agricultural exports and various trade barriers against these countries' food exports remain (Tarditi *et al*). It is generally agreed that the results have been disappointing: many tariff quotas have not been filled and, while these countries' agricultural exports to the EU have fallen, trade flows in the opposite direction have increased, often with the aid of EU subsidies[31].

Unstable marketing conditions, poor returns and competition from imports in domestic markets are creating pressures in some of these countries for protectionist policies modelled on the CAP although it is clear that such policies could be ruinous for their fragile economies. These countries are keen to qualify for EU membership as soon as possible. However, the cost of extending the current CAP eastward would be prohibitive (House of Lords 1994b; for some estmates, see Tangermann and Josling). Some experts believe that in the long term, and with the right economic environment and market infrastructure, agricultural production from Central and Eastern Europe could compete at world market prices. However, in the absence of these conditions, countries such as Poland and Romania) have set up price support schemes for key commodities hoping to ensure that farmers' production costs are covered.

[31] In 1990, EU agricultural imports from these 6 countries were 2.23b ECU, EU exports were 1.23b ECU; for Jan-Nov 1993, these flows were 1.81 and 2.23b ECU respectively (EC, COM(94) 361 final).

In 1995 the EU will seek to renegotiate changes in the Association Agreements that increase the attractiveness of the tariff quotas and accelerate their schedule. Better cooperation on sanitary and phytosanitary matters affecting trade will be developed. Obviously, stimulating agricultural trade opportunities, even if less half-hearted than at present, can only be a small part of the solution for the Central and Eastern European economies.

5.5 Closing Comments

Over the last two years EU agricultural policy began adjusting to the 1992 reform. The uncertainty and tensions of the Uruguay Round ended in an outcome that is compatible with the broad thrust of the reform, although probably requiring further adjustments in some CAP parameters beyond 1995/96. Stability and steady demand on world markets have enabled EU agricultural policy managers to reduce intervention stocks of cereals, butter and beef to their lowest levels for at least four years. Budget crises have been avoided.

However, the price paid for this apparently favourable situation is considerable and is clearly documented in this review. The EU agricultural sector is now locked into a set of rigid physical controls that are unprecedented in the history of the CAP. EU output of most agricultural commodities is constrained either by production quotas or by capacity limits whilst the markets for the few remaining uncontrolled products are affected by distortions originating in the controlled sectors. External trade volumes, whether exports or imports, are also now more or less fixed under the GATT Uruguay Round agreement, in the sense that for the foreseeable future the export upper limits and minimum access requirements are likely to be binding for most products.

There is a direct link between the efficacy of a supply control measure and the extent to which it constrains the individual producer. It is difficult for a producer to incorporate regional or national constraints into his decision making, even though he knows he will be penalised when these constraints are violated by aggregate behaviour. Quotas on individuals are more effective but have serious consequences for the development and dynamism of the industry: production structures are frozen and the movement of resources to more enterprising and competitive farmers is stifled. These effects are reduced when quotas are tradeable between individuals. However, support then becomes capitalised into the value of the quota, creating an artificial asset which acts as a barrier to entry or expansion for those without access to credit.

The decoupling of support from product prices and its delivery in the form of a direct income payment means that the entitlement to support has to be fixed on some basis other than output. As long as eligibility is linked to the ownership or use of an agricultural resource, this type of support is capitalised into the value of the resource concerned with the same consequences as for individual production quotas. Moreover, the payment acts as an incentive to retain the resource in agriculture when it would be uneconomic to do so according to the logic of market prices.

Supply control is weaker where production or capacity limits are fixed at regional or national level, yet here too production is unable to respond fully to changes in competitive advantage due to the impossibility of transferring these production rights between member states, and often between regions within member states. In the period following the completion of the Single Market, with its much-vaunted "four freedoms" - free movement of goods, services, capital and people - the complete absence of a mechanism - market-based or otherwise - for the transfer of agricultural production rights between member states stands out as a serious anomaly that is bound over the longer term to damage the performance of EU agriculture.

It has to be stressed that these physical limits apply to volumes of *supported* products or to capacity on which *premiums* have been paid. For most CAP products, unsubsidised production is not constrained. However, since compensation payments are set in line with high pre-reform prices, the opt-out rate is negligible. Similarly, as regards external trade, those who complain that the GATT commitments will prevent the EU sharing in any expansion of world trade forget that it is only *subsidised* exports and export subsidies that are constrained by these commitments. Clearly, some EU producers could compete and survive without subsidies due to a favourable combination of agroclimatic conditions and size, and the demographic changes expected in the next 10 years should allow more farms to increase to an economic size. With the dismissal of the zero option in the early stages of the Uruguay Round, the idea of a complete withdrawal of all support to agriculture, never seriously entertained in the EU, has again been distanced from the public debate. But it has not been replaced by a discussion of what would constitute an appropriate and feasible level of agricultural support.

There is in fact no longer-term political vision in this respect. The old ambiguity remains over the intended beneficiaries of the CAP - full-time farmers, farm-based households, food processing industries, traders, consumers? Moreover, the accession negotiations of 1994 and the discussions about future enlargement to the east raise questions about the degree of detail with which the current wider, more market-oriented and integrated EU can and should impose and administer a *common* agricultural policy. Indeed, this review illustrates many of the problems of designing and implementing detailed common policies to cover a wide economic area characterised by the agroclimatic and structural diversity among just 12 member countries.

The recent independent Larsen Report (published as EC 1994b) advocates further price cuts, compensation for which (together with the compensation for the 1992 reforms) would be completely decoupled and gradually phased out of the EU budget, to be continued on an optional basis by member states within the framework of EU competition policy and possibly targeted so as to conform with national or regional objectives. Quantitative controls would be redundant and therefore abolished. This well-argued report, with its implication that a significant part of CAP financing should be renationalised, has been repudiated by the Commission. Yet it is hard to quarrel with its implicit diagnosis of the basic problems underlying EU agricultural decision-making at Council level: the heterogeneity of EU agriculture and the incentives within the system for agriculture ministers to act either individually as national representatives or collectively as lobbyists for farming and food sector interests, without the usual political and financial controls imposed by national legislatures.

Apart from nationalisation, several other options exist for the phased withdrawal of compensation payments[32] compatible with a gradual reduction in supply management and subsidy dependency. It seems inevitable that further attention will focus on the long-term future of the compensation payments and premiums introduced with the 1992 reform. Although safe from external pressures during the life of the Uruguay Round agreement, they may well cause severe budgetary strain before the end of the decade. It is acknowledged that the offer of these payments made agreement on the 1992 reform possible politically. But there is growing awareness that blanket untargeted direct payments cannot be part of a final solution.

EU policy makers are likely to have a few crisis-free years ahead during which to put in place policy measures designed to manage change towards a less subsidised agriculture, but there is little indication that they will take advantage of the opportunity. The recent changes in EU policy prolong the sector's dependency on untargeted subsidies. Moreover, they work against increasing agriculture's longer-term competitiveness by reducing both the incentive for size restructuring and the scope for a market-led relocation of production that would maximise the gains from comparative advantage.

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[32] See for example OECD, pp.34-35.

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