INTERPLAY BETWEEN THE EUROPEAN COMMISSION AND THE MEMBER STATES – REVIEW OF SUBSIDY WITHDRAWALS BY THE NEW MEMBER STATES

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SUMMARY

The administration of the relevant part of EAGGF Guarantee expenditure, which accounts for more than 50% of the budget of the European Communities follows shared management arrangements. Shared management means that member states pay and control the expenditure for agricultural and rural development subsidies and the Commission is responsible for the administration of payments and for auditing the control system of member states.

The communication on the expenditure effected by accredited paying agencies takes place via a comprehensive financial reporting system and monthly EAGGF Committee meetings. These meetings provide scope for the reconciliation of any disagreement concerning the monthly advances reimbursed by the Commission to member states and also give an overview on actual budget implementation.

The new member states which joined the European Union on 1 May 2004 have started to apply the comprehensive financial reporting system following an intensive co-operation period in the form of training seminars provided to them by the Commission for setting up the reporting systems of paying agencies. The first expenditure from the EAGGF Guarantee Section was executed in July 2004 and reported to the Commission during the following month. The pioneer new member states were the Czech Republic, Slovakia and Poland, followed by Hungary, Estonia and Slovenia a month later. Until the end of August approximately 6 million Euros have been withdrawn from the Fund, used in a fifty-fifty percent split for export restitutions for milk and milk products, beef and veal, live animals and eggs to countries outside the European Union and for other market intervention measures, such as supply of food from intervention stocks for distribution to the most deprived persons in the Community, production refunds on sugar used in the chemical industry, aid for skimmed milk processed into casein and school milk. By the end of the 2004 financial year (15 October 2004) some other new member states, Lithuania, Latvia and Cyprus also intend to start paying agricultural subsidies to their beneficiaries.

The total estimated value of expenditure to be withdrawn from EAGGF Guarantee by the new member states in the 2004 financial year and charged therefore to the 2004 budget is circa an additional 14 million Euros. Therefore, the aggregated amount of the subsidy withdrawn by the EU-10 countries charged to the 2004 budget will be ca. 20 million Euros, which is a minor amount compared to the budget appropriations included in the 2004 budget for EAGGF Guarantee as a whole.

A speeding up of subsidy withdrawals is necessary for new member states to make the best use of benefit from CAP. It is possible to achieve this goal by the withdrawal of subsidies for direct aids. Direct aids can be paid to farmers in the framework of the Single Area Payment Scheme from the first day of the 2005 financial year (16 October 2004) in case of new member states (except Malta and Slovenia). The advances to member states will be reimbursed in January 2005 and charged therefore to the 2005 budget.

As it was the case for earlier enlargements of the European Union, the first months of subsidy withdrawals are being used mainly to get acquainted with the administration and to test the operation of the paying agency systems. However, this period should be considered strictly as an interim phase and significant effort should be made by the national agricultural administrations to widen the "penetrability" of the subsidy handling, that is to increase the amount of subsidy withdrawn from the EU by the paying agency systems already operating in the new member states to benefit from the Common Agricultural Policy of the European Union.

INTRODUCTION

The operation of the Common Agricultural Policy comes into practice on the one hand through the interlink of the European institutions and the delegates of the member states to these institutions and on the other hand through the activity of CAP implementing institutions in the member states. The relationship is worked out in different committees operating according to strict rules at the level of the European Union, where it is decided also how to operate CAP in everyday practice. Subsidies from the common agricultural budget of the EU are channelled to farmers, processors, traders and other beneficiaries via the paying agencies of member states based on a comprehensive reporting system between the European Commission and the member states. Most new member states of the EU have started to pay subsidies to their beneficiaries. Although some problems have arisen (such as the accreditation of paying institutions only after the accession, no payments to any new member state in the first two months or a rather limited amount of subsidy withdrawn) a rough picture on subsidy withdrawal can already be outlined.

Financing of the Common Agricultural Policy

The formation of CAP has lead to the establishment of the European Agricultural Guidance and Guarantee Fund (EAGGF, the Fund), which is the fund for financing the control measures of the EU agricultural policy. The Fund was created in 1962, in parallel to the establishment of the first market organisations. The EAGGF has been set up and replenished continuously from the budget funds of the Community, such as Value Added Tax, credits of the member states in proportion to their Gross National Income on the one hand and from its own resources, such as import levies on agricultural products or sugar and isoglucose levies on the other hand. Throughout the years, the ratio of the different contributions has varied a lot. As to their origin the most important contributors are Germany, France, the United Kingdom and Italy.

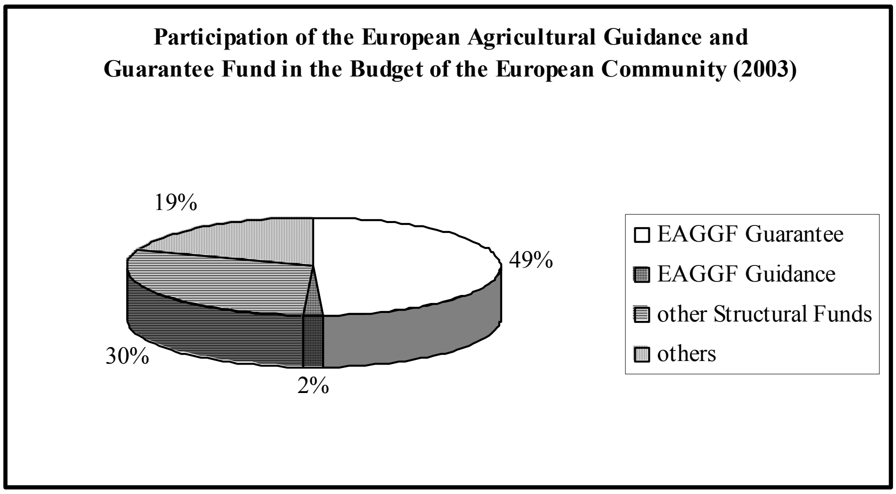
The EAGGF forms part of the general budget of the European Communities and from the point of view of financial objectives it comprises two sections. The Guidance Section finances expenditure on the improvement of production structure (i.e. structural modifications required for the proper working of the single market). The Guarantee Section subsidises the control measures of the market policy. The administrative institution of the EAGGF operates at the European Commission, more precisely in the Directorate-General for Agriculture, which takes care of the tasks of agriculture and rural development management.

The EAGGF accounts for approximately half of the European Union budget. In 2003, out of the 89.5 billion Euros total budget, 44.4 billion Euros covered the expenditure of EAGGF Guarantee. Out of the 27.5 billion Euros spent on the different Structural Funds, 2.3 billion Euros covered the expenditure of EAGGF Guidance. Due to its relevance and the high amount of subsidies involved, the communication of the European Commission and member states will be presented in the paper relating to the agricultural and rural development subsidies financed from the Guarantee Section of the Fund. Fig. 1 indicates the participation of the European Agricultural Guidance and Guarantee Fund in the Budget of the European Community in 2003.

According to Council Regulation 1258/99 the Guarantee Section shall finance:

- ✓ refunds on export to third countries;
- ✓ interventions (including direct payments) intended to stabilise the agricultural market concerning agricultural and fishery products;
- ✓ rural development measures outside the development and structural adjustment of regions whose development is lagging behind (Objective 1 regions);
- ✓ the Community's financial contribution towards certain veterinary measures and plant health measures (executed at the Health and Consumer Protection Directorate-General of the Commission);
- ✓ measures intended to provide information on the common agricultural policy and evaluation action of measures.

Figure 1



The budget procedure requires inter-institutional collaboration between the European Parliament, the European Council and the Commission. The

Commission presents each year a preliminary draft budget (PDB) of year "n+1", which is adopted by the Commission at the end of April of year "n". The first reading of the Council takes place in late July of year "n" and it adopts the Draft Budget (DB). Mid-October of year "n" the European Parliament comes to the first reading of the DB. Late October of year "n" the Commission presents an Amending letter to the PDB, which is followed by a second reading by the Council at mid-November of year "n". The conciliation procedure between the Council and the Parliament takes place at mid-December of year "n". After a second reading by the European Parliament the budget for the year "n+1" is adopted.

COMMUNICATION BETWEEN THE EUROPEAN COMMISSION AND THE MEMBER STATES

The Commission is responsible for the administration of payments financed by the EAGGF Guarantee Section and it co-operates closely with member states. This co-operation takes form within the framework of monthly EAGGF Committee meetings.

The Member states work through their accredited paying agencies (PA), which are in charge of administering and controlling the payments. The Member state appoints and accredits the paying agencies, which assure that the admissibility of claims and compliance with Community rules are checked before payment is authorised, the effected payments are correctly and fully recorded in the accounts and that relevant documentation is submitted within deadlines and in the way it is stipulated in Community rules. At the Commission the General-Directorate for Agriculture is responsible for the EAGGF budget management, for the financial management of the Fund and for the audit of agricultural expenditure (i.e. for the verification of the controls executed by the paying agencies).

Every month the Member states forward several reports of the paying agencies' expenditure to the Commission. The administration of EAGGF Guarantee expenditure follows an advance payment system. This means that following the authorisation and controls by the paying agencies the subsidy is paid to the beneficiaries. The PA sends the monthly statements of expenditure to the Commission, which is reimbursed – after the financial corrections, e.g. reduction of advances for non-respecting payment deadlines or non-recovery of milk levy from the producers - in the form of advances paid two months later to the Member states. These reimbursements are considered as pre-payments (advances), since they become real expenditure only after the yearly clearance of accounts procedure has been executed. The accounting clearance procedure is closed by the 30th of April following the financial year. The Member states have to pay back the advances, which were not eligible to the EAGGF.

In order to facilitate the new member states to overcome financial difficulties after accession arising from pre-financing the advances reimbursed later by the Commission, transitional rules were laid down in the Act of accession, which provide a monthly special lump-sum cash-flow facility for the period 2004-2006.

The EAGGF financial year is not equal to the calendar year; it runs from 16 October of the year "n" to 15 October of the following year, "n+1", e.g. the financial year 2005 comprise the expenditure from 16 October 2004 to 15 October 2005. The reason for this curious timing of the financial year is that in the 80's the budget planned until the end of the year was overspent and the next financial year had to be brought forward in order to ensure the financing of the CAP.

Due to the implementing powers conferred on the Commission by the Council, the EAGGF Committee has an important role in the regulation implementation. The procedure to be followed in the Committee is strictly laid down by rules of procedure. Within the framework of this monthly meeting of the representatives of the Commission and the Member states, the monthly advances to be paid and the possible reduction of these advances is communicated. Furthermore, the monthly situation of the budget implementation is demonstrated at the level of the budget items (representing different measure types for the sectors) and the regulations and decisions of the Commission of a horizontal nature (e.g. promotion-, rural development-, veterinary, food safety measures) are voted.

In certain cases, the Commission administers the payments to the beneficiaries directly (direct Commission expenditure) and not via the paying agencies. This type of financial management is used in the case of veterinary, food safety and phytosanitary measures, for enforcing access to the market for olive-oil and textile products, for promoting agricultural products, for funding the research for tobacco, etc.

CATEGORISATION OF EAGGF GUARANTEE EXPENDITURE AND WITHDRAWAL OF SUBSIDIES

The EAGGF Guarantee expenditure can be divided into five main measure types based on the economic nature of the measures concerned.

The export restitutions support the placement of the agricultural goods on markets outside the European Union. In 2003, the expenditure for export refunds was 3.729.6 million Euros, which corresponds to 8% of the total EAGGF Guarantee expenditure.

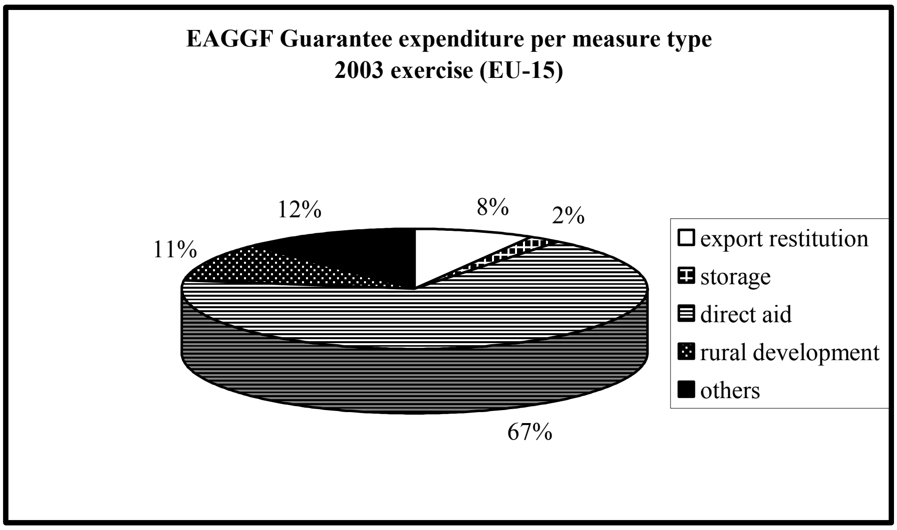
The direct aids intended to compensate the income-loss of farmers due to the decrease of market prices. Herein belong for example the area aid for cereals, oil-seeds, proteins, flax and hemp, the tobacco premium, sucker cow premium, slaughter premium, sheep and goat premium. In the 2003 exercise, the direct aids covered 67% of the EAGGF Guarantee expenditure amounting to 29.692.4 million Euros.

The storage measures contribute to stabilise the market by buying-up of products at a fixed support price. The measures belonging here are the purchase and the selling of stocks and the subsidising of private storage. In the 2003 exercise, 2% of the total EAGGF Guarantee expenditure (928.1 million Euros) was spent for this purpose.

With the Agenda 2000 reform, certain rural development measures are financed from EAGGF Guarantee since 2000. These measures are intended to improve the production structure and figure out at 11% with 4706 million Euros.

Furthermore, under “other measures” some other market interventions are to be found, such as aid for producer organisations of the fruit and vegetables sector, production aid for dried fodder, aid for cotton, aid for use of must, aid for disposal of skimmed milk, etc. In the 2003 exercise these other measures amounted to 5 405.1 million Euros and represented 12% of the EAGGF Guarantee expenditure. The percentage distribution of expenditure between the different categories shows the same picture also in the preceding period 2000-2002. Fig. 2 indicates the distribution of the EAGGF Guarantee expenditure between the different measure types.

Figure 2

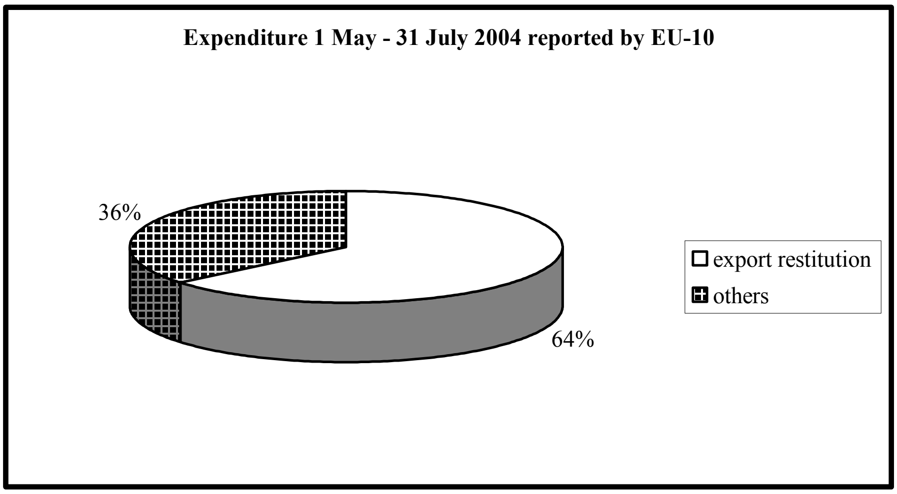


According to Art. 4(4) of Council Regulation 1258/1999 only expenditure effected by accredited paying agencies may be the subject of Community financing. The rules of granting accreditation to the paying agencies are laid down in Commission Regulation 1663/1995 and in the guidelines annexed to that regulation.

Nine out of the ten new member states (EU-10) – Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovenia and Slovakia – have decided to set up only one paying agency. Poland has chosen to operate separate agencies for handling market measures and rural development measures. In this case, an additional coordinating body has to be established to facilitate the communication with the Commission by coordinating the reporting activities of both paying agencies. Accreditation may be provisionally granted to the paying agencies with indication of the required changes to the administrative and accounting arrangements to achieve complete accreditation. The Czech Republic has granted complete accreditation to the Czech paying agency and Poland has granted complete accreditation to its paying agency handling market measures before the accession on 1 May 2004. The agency of Poland administering the rural development subsidies and the other countries' paying agencies have received a provisional accreditation with the intention of granting the complete accreditation in the last quarter of the year 2004 – first half of the year 2005. In the accreditation criteria is clearly laid down with fixed deadlines for fulfilment of criteria and these are followed in order to gain the complete accreditation in the near future, the withdrawal of subsidies is not affected by provisional accreditation. The way to accreditation of the paying agency system of Hungary and Slovenia has been demonstrated in another publication by the author.

Following the accession of EU-10, the new member states have reported for the first time expenditure to the Commission in August 2004, paid by their paying agencies to the beneficiaries in the month of July 2004. The total expenditure of this month reached approximately the level of 1.7 million Euros and was executed by the Czech Republic, Slovakia and Poland. The bigger part of the total expenditure reported belongs to the export restitution and covers expenditure on export refunds for milk and milk products (butter, skimmed milk-powder, cheese, milk powder with a fat content exceeding 1.5%) and export refunds for beef and veal (fresh beef and veal quarters). The remaining expenditure concerns other market interventions, such as production refunds on sugar used in the chemical industry and aid for skimmed milk processed into casein. The expenditure concerning the period in question was reimbursed as an advance to the member states in September 2004. Figure 3 shows the categorisation of the expenditure reported for the period 1 May - 31 July 2004 by the new member states.

Figure 3

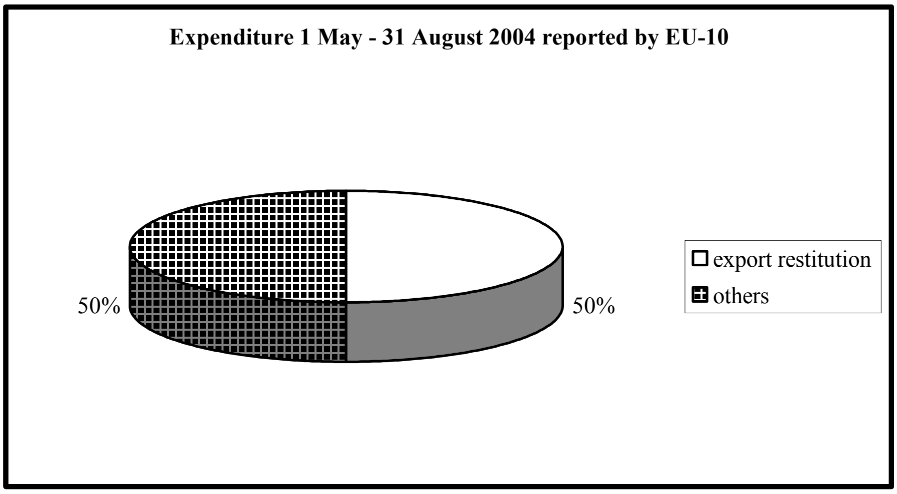


In the month of September 2004, some additional new member states, namely Hungary, Estonia and Slovenia started to report expenditure paid in August to their beneficiaries. The expenditure from the accession until the end of August amounted to 5.8 million Euros. The reported expenditure concerned export restitutions (ca. 50%) and covers export refunds for milk and milk products (butter, butter oil, skimmed milk-powder, cheese, milk powder with a fat content exceeding 1.5%), for beef and veal (fresh beef and veal quarters, boneless frozen beef and veal), for live animals and refunds on eggs for hatching.

The other half of the expenditure concerns other market interventions, such as supply of food from intervention stocks to designated organisations for distribution to the most deprived persons in the Community, production refunds on sugar used in the chemical industry, aid for skimmed milk processed into casein and school milk. The part of the expenditure concerning the month of August was reimbursed to the member states as an advance in October 2004.

Fig. 4 indicates the distribution of expenditure by market measure type, reported by the new member states for the period 1 May - 31 August 2004.

Figure 4



The split of expenditure between measure types shows that the implementation of other market intervention measures started to increase compared to the largest group in the first month of expenditure withdrawal, namely export restitutions. However, the forecasting data for the period 1 September 2004 until the end of the financial year 2004 (15 October 2004) pre-indicates an additional expenditure of ca. 14 million Euros, out of which 58% is related to export restitution and 42% to other market interventions. This forecasting is including also the intention of additional new member states (Lithuania, Cyprus and Latvia) to start paying subsidies to their beneficiaries.

The EAGGF Guarantee financial year 2005 starts on 16 October 2004. With the new financial year a re-arrangement of the expenditure distribution between measure types (export restitutions, direct aids, storage measures, rural development measures and other market interventions) is expected. The reason for this is that on the 16 October 2004, member states start to pay the direct aids to their beneficiaries, which are expected to be a crucial amount. Also storage declarations will come in the last quarter of the calendar year. Payments of advances for rural development measures will start as well in the last months of 2004.

The budget appropriations for 2006 show clearly an intention for re-arrangement of expenditure per measure type. In 2006 68% of the expenditure is likely to be attributed to direct aids, 11% to rural development measure and only 21% to export restitution, storage and other market interventions altogether. These data indicate the increasing importance of financing the activity of farmers in a way, which is decoupled from the quantities of production and to support structural modifications required for the proper working of the single market through the rural development measures.

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