EUROPEAN COMMUNITY AGRICULTURAL SUBSIDIES TO BEEF AND DAIRY PRODUCTS

PREPARED FOR

DAIRY FARMERS OF CANADA

by

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Introduction

Dairy Farmers of Canada asked Grey, Clark, Shih and Associates, Limited (GCS) to prepare an analytical study of support to agriculture provided by the European Communities and its Member Governments under the 2003 CAP Reform with particular emphasis on the dairy and beef sectors. Because significant volumes of E.U. beef come for culled dairy cows, the E.U. dairy herd sector is highly integrated with the beef and veal sectors. Therefore, to have a proper appreciation of dairy support, it is important to understand support granted or planned in each sector.

The E.U. Common Agricultural Policy (CAP) has undergone several significant reforms since the early 1990s by, first, reducing reliance on market price support and a shift toward support through direct payments (e.g., the 1992 and 1999 reforms). The most far reaching in 2003 set the E.U. on the track of converting some coupled direct subsidies into decoupled direct payments beginning in 2005. The focus of this study is on effects of CAP Reform in Doha Round (the Doha Development Agenda or DDA negotiations) for the period 2005-2012.

Reforms of the CAP have important implications for Canada's and for other participants in the WTO because:

- the E.U. is the world's largest importer of agri-food products,
- the E.U. is the second largest exporter of agri-food products that compete with Canada's exports in the world market,
- the E.U. will play a pivotal role in determining the outcome of the current World Trade Organization (WTO) negotiations on agriculture;[1]
- France and other CAP beneficiaries have defined the 2003 Reforms as the limit of adjustments they are prepared to accept in the Doha Round negotiations.

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[1] The E.U. CAP Reform, Context and Implications, Policy Secretariat, Alberta Agriculture, Food and Rural Development, October 2003

The focus of our analysis must be on publicly available information. Because of the wide range of languages in the E.U., and the limited availability of translations, analysis, particularly of budget information at the level of Member States, was limited. In addition, from 2005 E.U. and Member state support is increasingly tied to single farm payments (SFP), i.e., support which is purportedly decoupled,[2] that is, not tied to production of particular products – making it difficult, indeed impossible, within the scope of this study, to provide more detailed product or sector specific analysis than we have.

Our objective was to determine:

- the total value of subsidies/support available or projected under CAP;
- the total amount of subsidies and support directly related to dairy and beef production, indirectly related to dairy and beef production, and related to dairy production through infrastructure or other general benefits; and
- the impacts of this support on Doha Round negotiations on market access,[3] domestic support and export competition.

Our review and discussion of the CAP from an historical perspective is limited. While it may be interesting to review the evolution of the CAP from an historical perspective, it is the most recent reforms which will shape negotiating results and competition on world markets. The 2003 CAP Reforms establish and will establish the system and programs which will determine future E.U. presence on world markets as well as prospects for improved access to European markets. We also focus on the present and future implications of CAP reform for real and meaningful improvements in the E.U.'s domestic support regime and for improving market access to the large and expanding EU-25 market.

Analysis of the WTO consistency (or inconsistency) of the programs and policies in the new CAP is limited. We were not asked to address the consistency of E.U. programs. Indeed, because the scope of both Green box and Blue box support is the subject of ongoing, if stalled WTO negotiations, any such analysis would be highly speculative and conjectural. However, we

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[2] It is clear that decoupling in the E.U. Reform package is not complete decoupling and that it varies from one Member State to another in degree and timing.

[3] The relationship between internal subsidies and support and import tariffs.

do address the implications of CAP reform for achieving meaningful progress in the Doha Round negotiations, precisely because the E.U. Commission has linked the limits of its negotiating position to the reforms envisaged in the 2003 package. We have gone beyond the positions in the three pillars of the WTO negotiations on agriculture to focus on the interlinkages between negotiations about disciplining domestic support and improving market access.

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October 31, 2005

OVERVIEW AND CONCLUSIONS

The European Union (E.U.) has been singled out by many commentators as the largest subsidizer of Agricultural production. Since the European Communities Common Agricultural Policy (CAP) was first funded in 1962, it has insulated European farmers from international competition and stimulated overproduction of many commodities. These often massive surpluses described at various times as wine lakes, or beef and butter mountains, were disposed of on world markets at distress prices. In the view of Oxfam and many farm groups in recipient markets these surplus commodities are often dumped at less than cost of production, either as commercial trade or food aid.[4]

Many WTO Members have been very critical of subsidies provided through the CAP. These subsidies are a principal target for reform in negotiations under the Doha Development Agenda (Doha Round). European export subsidies and border measures which strictly regulate imports have been the subject of international concern for decades. U.S. farm groups and legislators claim that their own very generous subsidy programs were needed to address the effects on world markets of European over-production (which turned Europe from a major net importer of food and agricultural products into a major exporter).

The E.U. Common Agricultural Policy (CAP) has undergone significant reforms since the early 1990s, first by reducing its reliance on market price support and shifting toward support through direct payments (i.e., the 1992 and 1999 CAP reforms), and most recently (June 2003) by a major restructuring and refocusing of support by shifting much of the production linked or coupled subsidies into decoupled direct payments beginning in 2005.

The 2003 CAP reform was to increase the market orientation of European agriculture, and to have important implications for Canada and other agricultural exporters because:

- the E.U. is the largest importer of agri-food products,

[4] See Oxfam Briefing Paper 71, “Food Aid or Hidden Dumping”, March 2005

- the E.U. is the second largest exporter of agri-food products that compete with Canada's exports in the world market,
- the E.U. will play a predominant role in deciding the outcome of the current World Trade Organization (WTO) negotiations on agriculture,[5] and
- France and other E.U. member states have insisted that 2003 CAP reforms will set the limits of the E.U. negotiating position in the Doha Round.

We have not reviewed the historical evolution of the CAP is not reviewed in detail. This report focuses on the 2003 CAP Reform. The 2003 Reform establishes and will establish the support systems and programs which will influence and determine E.U. presence on world markets and access to European markets, as well as circumscribe their participation in the Doha Round negotiations of the WTO Agreement on Agriculture (AoA).

2003 CAP Reform and the WTO Doha Negotiations[6]

Agricultural trade is of considerable importance for the E.U., as it is the world's biggest importer as well as the world's second biggest exporter of agricultural products. There can be no meaningful multilateral negotiations on agriculture without the full participation of the E.U.

In the current and ongoing impasse on WTO negotiation about fair trade rule and market access, the E.U. is under great pressure to make further concessions. The E.U. considers that CAP Reforms have already made a very significant contribution to progress and that they will not accept any additional reforms.

In October 1999, the E.U. Agricultural Ministers agreed on their common position for what they wanted to be the "Millennium Round" of WTO negotiations. While the Seattle Ministerial failed to launch negotiations, the E.U.'s objectives did not change.

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[5] The E.U. CAP Reform, Context and Implications, Policy Secretariat, Alberta Agriculture, Food and Rural Development, October 2003

[6] EUROPA, Common agricultural policy: beginnings to the present day http://europa.eu.int/scadplus/leg/en/lvb/l04000.htm

The E.U.'s objectives and interests in the negotiations which were eventually launched at Doha in November 2001 were:

- that the non-trade aspects of agriculture should be addressed: agriculture has a multi-functional role to the extent that, apart from food production, it is involved in preserving the countryside, environmental protection, food safety and quality, and protecting animal welfare. The objective is to create a balance between trade-related and non-trade issues of agriculture;
- providing special and differentiated treatment for developing countries, taking account of great importance of food and agriculture in these countries;
- the improvement of access to market opportunities: the E.U., being a major food exporter, wants to increase opportunities for its exporters and to reduce unjustified customs barriers. The E.U. fully expects to share in the expansion of world trade in agricultural products.

The E.U.'s approach to the agricultural negotiations is based on its Agenda 2000 package, as modified by the June, 2003 reform measures. E.U. positioning on Doha AoA is:

- the negotiators must advise parallel progress in phasing out all types of export support;
- no flexibility on green box;
- crucial role for "green" and "blue" box;
- because of the extent of CAP Reform, the E.U. will be defensive on market access and will seek special treatment for sensitive products.[7]

The E.U. proposals made on October 28, 2005, included some apparently very ambitious concessions. Nonetheless, these have been criticized by the USA, Canada, New Zealand and others as inadequate, unambitious and unhelpful. Commissioner Mandelson on the other hand signaled that there was a need for reciprocity from others, and that the discussions needed to become more realistic.

[7] Moehler, Rolf, "The Doha Development Agenda, Taking Stock, A European Perspective"

While this positioning may be a function of the starting points, a review of the reductions envisaged for dairy products from pure application of the tariff cutting formula appears to be very far reaching.

Impact of E.U. market access proposal on tariffs for selected E.U. dairy products/product types

Product type	Product description	CN code	AVE (%)	Tariff reduction	Current tariff	New tariff
Milk & cream	Less than 1% fat, in packaging of less than 2 litres	040110	14.66		€138/t	
Milk & cream	1-6% fat, in packaging of less than 2 litres	040120	43.25	45%	€188/t	€103.40/t
Milk & cream	More than 6% fat	040130	53.36	45%	€575/t	€316.25/t
Butter	-	040510	101.33	60%	€1896/t	€758.40/t
Dairy spreads,	39-60% fat	040520	80.04	50%	€1194/t	€597.00/t
Fresh cheese	Fat content less than 40%	040610	77.73	50%	€1852/t	€926.00/t
Processed cheese	-	040630	44.36	45%	€1449/t	€796.95/t
Blue-veined cheese	Roquefort	040640	20.47	35%	€1409/t	€915.85/t
Blue-veined cheese	Gorgonzola	040640	46.95	45%	€1409/t	€774.95/t
Selected other cheeses	Emmental	04069013	72.77	50%	€1717/t	€858.50/t
	Cheddar	04069021	52.73	45%	€1671/t	€919.05/t
	Edam	04069023	60.26	50%	€1510/t	€755.00/t

Note: AVE = ad valorem equivalent. Calculations assume products in question are not nominated as "sensitive products".
Source: Dairy Markets calculations based on European Commission figures

No doubt some of these tariff lines will be declared “sensitive”. Butter will likely be in this category – which will mean a larger TRQ – but the increase in the size of the TRQ would be expressed in terms of percentage of current imports.

Tariff cut and TRQ options for butter (as sensitive product)

Standard tariff cut: 60%			
Options for tariff cut deviation	Implied actual tariff cut	New TRQ requirement (as % of current imports)	Size of new TRQ, in tonnes*
20% points	40%	5 - 8%	4 500 - 7 200
30% points	30%	7 - 12%	6 300 - 10 800
40% points	20%	9 - 16%	8 100 - 14 400

Note: * Assumes current butter imports = 90,000t.
Source: Dairy Markets calculations based on European Commission figures

The E.U. in the Doha Round (The Doha Development Agenda)

The ambitious negotiations launched in Doha in November, 2001 reached an impasse in Cancun in 2003. On August 1, 2004, the 147 members of the WTO finally reached an agreement of sorts, on a framework for negotiations. The Framework was expected to liberalize free trade and to extend existing trade legislation to new areas, while also expanding the trade capacity of developing countries.

The 2004 Framework agreement, as it relates to agriculture, rested on four points:

- A reduction in agricultural aid that distorts trade; for example, a substantial reduction in domestic support;.
- The suppression of export subsidies and export distorting practices. (The E.U.'s demand for equal treatment for all practices of this type is yet to be resolved.)
- Opening up agriculture markets or "market access". This would involve a general reduction in customs duties and liberalizing barriers such as TRQs, with exceptions for those products considered "sensitive".
- Special and differentiated treatment for developing countries.
- The E.U. also argued that the least developed countries should enjoy tariff- and quota-free access. Those parties that are in a position to do so should agree to such liberalization (Canada has).

This “framework” has been the subject of extensive consultations and several mini-ministerials, and high level officials meetings, but there has been little progress in adding precision nor in moving towards the stated goals. The negotiations on Agriculture are stalled, and while the mood in Geneva shifts from exuberance to pessimism from week to week, there is little evidence of movement. The USA, the G-20 and Cairns Group members continue to press for more; the E.U. and WTO Director General Pascal Lamy urge realism. And at some point it will be recognized it is better to harvest what is ripe and to end the dialogue of the deaf.

At the bottom line, the 2003 CAP Reform:

- does not decouple in either a clear nor a complete way;
- permits farmers to continue to take subsidies from the SFP and revenues from the market;
- through reduced reference prices encourages consolidated into larger, more economic units, which will be much more competitive; and
- through a variety of devices, insulates E.U. markets from increased imports what over market accesses may be negotiated.

The latest E.U. offer of October 28 will continue to insulate many E.U. markets, including beef and important dairy products from market forces. The re-introduction of the highly criticized pivot approach will reduce the claimed benefits of tariff cutting.

Mme Fischer Boel admits that beef is among the likely sensitive products, along with fruits, vegetables and poultry.[8]

While applying the tariff cutting proposal to dairy products without any “sensitive” products cover, would result in serious tariff reductions, this will not likely improve access. It is unthinkable that butter would not be a sensitive product.

[8] “E.U. tables last ditch offer to save WTO talks from disarray”, Agra Europe, October 28, 2005

There is a global farm income crisis. Farmers around the world understand that the way out of this crisis is to increase prices in the market place. Continued reliance in the U.S. and E.U. on subsidies which insulate their farmers from market forces will continue to frustrate efforts to increase prices for many agricultural commodities.

How realistic is the U.S. demand that the highest tariffs be reduced by 90%? E.U. farmers are not prepared to buy this when the U.S. Senate is not prepared to commit to real reductions in domestic support – or to eliminate counter-cyclical payments.

Agra Europe reported that the E.U. nearly filled its butter and cheese export quotas – and fill rates for SMP and other products were over 80%. The E.U. will be unable to expand its exports to take advantage of a growing world dairy market without further major policy reform. Export subsidy reductions will be difficult for the E.U.[9]

The E.U. has tried its reduction in export support to other participants coming clean on food aid, export credits or cross subsidization of the type used by New Zealand's Fonterra (reducing the reference price on butter also reduces Fonterra's premium revenue due to its preferential access).

A commitment by the E.U. to reduce export subsidies is merely likely to consolidate changes that will already have taken place. [10]

Expansion of the scope for geographic indicators protection to dairy and other products is also important to the E.U. – as a competitive device.

Arguably the E.U. does not need all of the tariff and quota protection it now has. Pork is one example. Five cheeses are another. But it is the baseline for the reductions which will be made.

There are benefits from being in the middle of a market of 400 million where freshness and quality are becoming increasingly important. The environmental and animal welfare

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9 "E.U. Struggles to stay within dairy export limits", Dairy Markets, July 22, 2005
10 "Import access is major WTO issue for dairy industry", Dairy Markets, July 28, 2005

requirements of the SFP are aimed at providing consumers with the quality and reliability assurances they need after the BSE crisis – and growing concern about avian flu.

The Foreign Policy Centre (FPC) notes:

> "It is much easier and reassuring to source perishable food from "local" sources. Whilst New Zealand farmers can supply long-life butter, they cannot ship fresh milk the Europe to satisfy the needs of yoghurt and soft cheese markets."[11]

The outlook for some European farmers is good. FPC notes:

> "Because of favourable climate, good soil and competitive farm structures, large numbers of European farms will prosper in an open world market. The dairy cows of Normandy and Cork can compete with anyone, as can the grain producers of Schleswig-Holstein, the Paris basin and Eastern England. Nobody can produce pigs like the Danes and potatoes like the Poles".[12]

CAP Reform is positioning European farmers to compete in world markets. But reform is always a gradual process. Change is not easy to manage or to accept and the history of the CAP does not inspire confidence in its architects.

The current reforms have been imposed on often reluctant European farmers. These farmers are skeptical – dubious about the advertised benefits. The reforms underway are too much for many of them.

To seek more adjustment is unacceptable – and one must wonder how farmers on the USA with complete insulation from risk, can demand more. The 2003 CAP reform and their location close to the market and consumer preferences will also insulate European farmers from the impact of improved market access offers. It is the European farmer's lack of faith in the reforms – and in the Eurocrats which has caused the resistance to further concessions in Market Access.

Ambition is essential to all parts of the Doha Agenda in order to ensure a meaningful result. But at some stage the ambition must run headlong into and clash with reality – and that reality will

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[11] CAP Reform: No more stalling., The Foreign Policy Centre (downloaded September 24, 2005)
[12] Ibid.

define the results – and the results will be cautious – a building block – the alternative is a loud non! and continuation of the status quo.

Farmers around the world want prices to increase. European farmers share this objective. The agricultural support policies of the E.U. and USA as currently designed have frustrated unless radically modified and will continue to frustrate the desired price recovery. Domestic support, whether or not decoupled, is still a stumbling block to negotiations. Clearly, the E.U. and others do not want to open up markets to U.S. production which is insulated with market forces, with safety nets which have shed any pretence of being emergency measures.

The 2003 CAP Reform is an important change for Europe and the world. It is an important first step. Combined with protection for sensitive products – and incomplete decoupling it will result in moderate and paced improvements in market access. Hopefully, particularly if the E.U. achieves what it wants in terms of broad disciplines on export distorting practices, it will improve world prices.

Pushing too hard – particularly in the absence of disciplines on equally distorting domestic support, is a very dangerous and unenlightened game. Negotiations, like politics, must reflect the art of the possible.

Negotiations are about give and take. To date, too much has been focused on trying to force the E.U. to give more and more – with little of interest to Brussels offered in return.

Elements of the CAP 2003 Reform Package

Budgets

The 2003 CAP Reform addresses four key issues:

1) Control of market-support budget expenditures through financial discipline;
2) Preparation for multilateral agricultural negotiations;

3) Management of budget and support problems resulting from enlargement to the East; and
4) Consumer and environmental concerns in agricultural policy.

2003 CAP Reform reflects a significant change in the E.U. approach to agricultural policy which also responds pressure from environmentalists and E.U. consumer groups. The move away from price support toward income support through decoupled payments, while gradual and incomplete, allows E.U. farmers to have more choices in their planting decisions because of decoupled payments.[13]

2003 CAP Reform established two pillars in the budget:

Pillar I for market and price support policies,

Pillar II for rural development policies.

The principal means to accomplish the various goals of the 2003 CAP Reform were to move from commodity support to support of farmers through direct payments based on average historical commodity-based payments from 2000-02. Decoupled payments are supposed to allow E.U. farmers to be more responsive to domestic market signals than to policy interventions, that is to cope with lower, unsupported prices.

Member states, however, can opt to retain coupled payments equal to 25% of the area for arable crops, 50% of the sheep and goat premiums, 40% of supplemental durum wheat aid, and from 40% to 100% of various beef premiums. Canada is directly impacted by E.U. incentives on durum wheat.

In order to qualify for the SFP, farmers must comply with food safety, animal welfare, and environmental standards. Unlike previous reforms, E.U. farmers are not required to produce any crop, unless member states opt for partially decoupled payments. Most E.U. member states are planning to take advantage of the latitude allowed them regarding the timing of implementation

[13] European Union: Policy , Common Agricultural Policy, USDA Economic Research Service, Briefing Room, p. 3 (www.ers.usda.gov/Briefing/EuropeanUnion/Policy/Common.htm)

(2005, 2006, or 2007) and the degree of coupling of payments to production. To qualify for the SFP, farmers also must maintain the land in good agricultural condition if it is not planted. In addition, pasture land may not be planted to arable crops, and land may not be diverted to nonagricultural uses.

The U.K. House of Lords was told that CAP budgets will be strained (exceeded) as member states top-up entitlements from Brussels– and of the weak U.S. dollar/Euro relationship continues for a number of years. This will increase the amount of export required subsidies and exacerbate budget pressures.[14]

Access to E.U. beef markets and subsidized European competition in third markets has long been a concern for Canadian beef exporters. There does not appear to be any imminent relief, nor will market access improve.

The CAP Reform does not provide either complete or clean decoupling. CAP 2003 promises more of the same for Canadian wheat, pork and beef producers. Nor does the most recent Doha Round offer promise improvements.

Dairy farmers need not produce milk to obtain the SFP – but surveys in the U.K. show that significant numbers of them will "use the single payment as if it is a bonus per litre on top of the milk price and it will not be purely decoupled".[15] That is, dairy farmers will have the SFP to supplement their market income – and may in fact do better at lower unregulated prices.

Entitlements to SFP can be traded with other farmers. Entitlements can be sold with or without land – only to farmers with land with no entitlements. There is scope for leases but within equivalent number of hectares.

[14] U.K. Parliament House of Lords – Memorandum by the Biscuit, Cake, Chocolate and Confectionery Association, January 17, 2005

[15] CAFRE, University of Manchester, "U.K. Mill Production following the 2003 Reform of the CAP", December 2004, p. 4

It is possible for a dairy farmer to sell his cattle, sell his quota, and still receive entitlements as long as he maintains his land in a state that it could be re-activated – and if he complies with 38 E.U. regulations covering public health, occupational environmental and animal welfare.

The British House of Lords recommended

> "the continued use of the single farm payment only for the 2007-2013 period a transitional tool to:
> i) provide stability and
> ii) prepare farmers for the more market oriented aid environmentally focused future of European Agriculture."[16]

The E.U.'s own impact analysis projections assume static world demand for dairy products. However, others suggest rising global consumption trends.[17] The Foreign Policy Centre notes,

> "the population of the world is expected to rise by 50% over the next thirty years, and thus will require a comparable increase in food production."[18]

While the new reforms have introduced new policy tools and reduced some prices, intervention at guaranteed prices for major commodities, generally above world prices, will remain an important component of the CAP. The reforms do not address market access issues as the E.U. still has high tariffs. E.U. market projections do not contemplate increased imports.

If E.U. proposals for market access in the Doha Round are accepted, there should be some increase in imports. But these will be minimized by:

- more competitive farming units, which benefit from the SFP;
- "sensitive" items protection;
- consumer preferences for fresh local production, subject to animal welfare controls which are an important element of the SFP regime.

Export subsidies will still be available for surplus commodities (within WTO limits), although some reduction in intervention prices should result in lower per-unit subsidies for those commodities in the future, depending on the strength of the euro. A strong euro has recently

16 House of Lords, European Union, Second Report
17 The Impact on Developing Countries of the European Commission is Recent Proposals for Reform to the Dairy Regime", Oxford Policy Management, January 2003, p. 8.
18 Foreign Policy Centre, CAP Reform: No More Stalling

made E.U. exports more expensive, which has pushed some subsidized exports close to WTO quantity ceilings. [19]

E.U. proposals for reductions in export subsidies are conditional on concessions by the U.S. and others related to food aid, export credits and STEs, which are being resisted. But absent movement towards Brussels on these issues, we can expect to see reduction in the Market Access offer.

Implementation of 2003 CAP Reform

The 2003 CAP reform is implemented through three Commission Regulations:

- Regulation 1 covers the provisions concerning cross-compliance, controls and modulation.[20] The provisions with regard to cross compliance are one of the key elements in the CAP reform, which make the Single Farm Payment (SFP) dependant on the farmers respecting public health, animal health, environmental and animal welfare, E.U. norms and good agricultural practice.
- Regulation 2 introduces a Single Farm Payment, which is no longer linked to production (decoupling), guaranteeing a revenue base while purportedly allowing production to become more market oriented. Full payments of the SFP is conditional on cross compliance. The E.U. considers this takes support out of the Amber Box and puts into the Blue Box.
- Regulation 3 covers those areas of support which are too sensitive to be fully decoupled. It would appear that the E.U. Reform is built on the premise "Decoupling if necessary but not necessarily decoupling."

It is not surprising that the 2003 Reforms are not working as advertised, Oxfam claims – most E.U. Member States are keeping some production subsidies. There is also evidence that even "decoupled" payments are very likely to affect production levels and trade.[21]

[19] CAP Reform of 2003-04, USDA, August 2004
[20] This situation is not unique to Europe. Dairy Farmers of Canada report that about 5% of dairy farmers leave the business every year. In the USA consolidation into larger units appears to be even greater.
[21] Oxfam Briefing Paper 75, "Making Trade Work for Development in 2005", p. 5

Will 2003 CAP Reform Really Impact Production?

While the E.U. has taken important steps to reform the CAP, the impact on production, exports and market access are far from clear. Even with decoupling, production of some important commodities will increase. USTR Rob Portman told the Senate Finance committee that the E.U. was ahead of the USA in dealing with domestic support.[22] This is true, but it underlines the importance of qualitative as well as quantitative analysis. E.U. decoupling is partial and incomplete. It varies from one Member State to another, both in degree and in timing.

The 2003 reforms will not have major impact on overall imports. E.U. farmers will continue to receive SFP revenues sufficient to insulate them from the vagaries of the market place to supplement their market income. While lower reference prices will reduce market based income, this will be replaced by direct payments, notably the SFP.

The OECD found that contrary to the expectation that if prices were reduced, production would fall – production would, in fact, increase due to the relatively high level of efficiency in the dairy industry.[23]

"Decoupled" support is often not really decoupled because as the WTO Panel found in *U.S.-Upland Cotton*, the limits on crops which can be substituted negate decoupling. The Appellate Body stated:

> "We agree with the Panel that a partial exclusion of some crops from payments has the potential to channel production toward the production of crops that remain eligible for payments."[24]

This means that payments such as the SFP must be decoupled from all production. But they are not. Either partial coupling is permitted – or the farmer may not plant "permanent" crops.

The AB also noted:

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22 "Johanns signals U.S. subsidies must change in new Farm Bill", Inside U.S. Trade, September 23, 2005
23 Reform of the E.U. Dairy Regime, Agra Informa Ltd., 2005, p. 101
24 WT/DS/267/AB/R, para 329

> "The fact that farmers may continue to receive payments if they produce nothing at all does not detract from this assessment, because according to the Panel this is not the option preferred by the 'overwhelming majority' of farmers who continue to produce some type of permitted crop." [25]

The E.U. SFP program requires that the land be kept in good order for agricultural use. It can be argued that this will encourage its continued use for farming. And no payments are available in the E.U. for production of permanent crops such as wine, fruit, vegetables, and potatoes, other than those intended for potato starch. This is, in effect, a decoupling which will continue to focus production on cereals, oilseeds and existing livestock and dairy sectors.

As noted above, in some Member States the decoupling is "partial", i.e., in France. This means that in effect there is no decoupling. The subsidies clearly are not green – they are at best blue.

In analyzing the evolution of E.U. farm support, it is important to recognize that for many farmers that money is fungible and that decoupling will not likely reduce production.

- Why, if dairy support is to be decoupled and replaced with SFP (income support), will it be necessary to maintain milk production quotas until 2014? Could it be because absent the quotas and overproduction penalties, surplus production would increase?
- A University of Tennessee study[26] suggests that absent subsidies, farmers will continue to farm. If their revenues continue to be supported, will there be any incentive not to farm?
- Why would farmers, particularly those with capital investment in particular products like dairy, beef and swine, switch into other product areas? Why would they learn new skills if they have a safety net?

Farmers will still receive SFP even if they continue to farm; indeed, they cannot be prevented from farming, or producing what they always did. No change is required.

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[25] WT/DS/267/AB/R, para 329

[26] Rethinking U.S. .Agricultural Policy: Changing Course to Secure Farmer Livelihoods Worldwide; Agricultural Policy Analysis Centre, University of Tennessee, September 2003

These measures will likely encourage rationalization and restructuring of the E.U. dairy industry. They will make it stronger and more competitive building on the SFP base. The production units will become bigger and more cost-competitive even at lower price support levels. Milk production will not likely fall between now and 2014 because the quota will stay in place. In the aggregate the end result will be perpetuation of the status quo. [27]

The 2003 E.U. reforms will not solve the current farm income crisis because they will not contribute in a meaningful way to stability on international markets nor will they increase prices. The decoupling efforts are partial and qualified and are not likely to be more successful at reducing production than so-called U.S. "Green Box" programs which have been condemned by the WTO.

The U.S. Congress understands that their own decoupling initiatives did not liberalize trade, wants to see the E.U. do more market opening – they want real Market Access commitments. So does the G-20.[28] Developing countries are concerned about E.U. shifting their support from the Blue Box to the Green Box and the E.U. wants to keep the Blue Box.

An enlargement of the Blue Box could be used by the E.U. to cumulate old blue box payments and the new "decoupled" payments of the 2003 CAP Reform. Oxfam calls this a major loophole.[29]

While the 2003 CAP Reform was seen as the first step towards real reform of European agriculture, our analysis suggests that the reform will not significantly reduce E.U. production and will not materially improve market access, and may have minimal effects on export markets. What the 2003 Reforms do is repackage and re-orient European agriculture, increase the average size of farming operations in the E.U., make them more efficient, and permit currently suppressed productivity gains which will permit these larger, more efficient units to compete profitably at lower reference prices.

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[27] FAPRI – University of Missouri, "Analysis of the 2003 CAP Reform Agreement, FAPRI Staff Report, 2-03, September 2003, p. 11

[28] Critics say E.U. market access proposal falls short of Uruguay Round, Inside U.S. Trade, October 14, 2005

[29] Oxfam Briefing Paper 65, "One Minute to Midnight", July 2004, p. 4

We have the following observations with respect to 2003 CAP Reform:

- It will allow market prices to fall, reducing the need for export subsidies to meet competition in world markets. But the move to safety net subsidies will shift E.U. farmers into a situation similar to their U.S. counterparts. While European farmers will take less from the market – they will be insulated from price impacts by government support.
- Reductions in market prices and tariffs will not improve access to E.U. markets, if the single farm payment (SFP) and other direct payments combined with market based farming activities, maintain farm incomes and insulate European farmers from market forces.
- The E.U. mechanisms will permit some internal prices to decline closer to world levels. This means that while E.U. internal prices will fall, market revenue lost will be made up by direct payments from Brussels, topped up by Member State contributions.
- The E.U. has introduced these reforms to minimize the budgetary implications of enlargement to 10 new countries with smaller farming units, and because the farmer who will leave the farm will in many cases be older operators, who will be replaced by younger farmers, who have access to incentives to encourage in the consolidation which the new CAP encourages. This is a reform and revitalization of agriculture in the E.U.
- While the SFP may not help less efficient, small scale producers to cope with lower prices,[30] the reforms will force consolidation (which some consider is long overdue) into larger, more economic and more profitable farming units.[31] This trend is illustrated by the Spanish experience where 5,000 small dairy farmers have been replaced by 500 larger farmers[32] – no doubt operating at 10 times the scale. Spain has also introduced policies to facilitate the retirement of older farmers and their replacement by younger ones.[33]

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[30] However, member states can "top-up" these payments by 10% cushioning the impact for many marginal farms.
[31] See Agra Europe
[32] Ibid
[33] Ibid

- In France, quota transfer rules will give priority to young farmers who started in business before 2000/01 and where quota is below the regional average. [34]
- Tariff reductions proposed by the E.U. appear to envisage are diluted by:
    - the inclusion of pivots in E.U. formula which permit the ratcheting down of tariff reductions;
    - The insistence on a large number of tariff lines which can be designated as sensitive products.
- Market access concessions by the E.U. will be difficult to exploit – as potential exporters will be unable to compete with more efficient, larger scale E.U. farms supported by SFP base income.
- The E.U. support is being moved, not entirely, but substantially from the Blue Box,[35] and the Amber Box to the Green Box.
- Decoupling when combined with the SFP will not guarantee reduced production. Indeed, it will create income security which will insulate E.U. producers from market signals. "Partial" decoupling is even more likely to encourage increased production.
- E.U. farm units will through the 2003 reform package become larger, more efficient and lower cost. The elimination over time of production controls will result in increased production which will find its home first on the domestic market (keeping out imports) and then on world markets where a reduced differential between domestic and export prices will reduce E.U. expenditures on export refunds and restitutions.
- Support to dairy in the aggregate will not decline, and is likely to increase.
- E.U. Support to the dairy industry was estimated by OECD to be € 16 billion, in December 2002.[36] This was equated to $2 per cow per day. At today's exchange rates this is now $3 per cow per day. While the majority of this amount was attributed to price supports and consumption incentives, reductions in these payments

[34] "New milk quota rules for France", Dairy Markets, July 25, 2005
[35] The special concessions in the Uruguay Round with respect to non-inclusion of Blue Box support in AMS reduction was a special gift to the E.U. which the E.U. wishes to continue and the U.S. now wants to redefine in order that it better fits the evolution of U.S. support.
[36] Oxfam Briefing Paper 34, "Milking the CAP", December 2002, p. 1

have been offset by direct payments.[37] Nor do the OECD calculations take account of subsidies to dairy producers through benefits received from their involvement in the beef and veal sector.

- The dairy industry in some member states may be better off with SFPs. The U.K. has traditionally experienced milk prices well below the target price (14-16% below between 1998-2000). The price in the U.K. was 40% of the average price in Italy.[38]
- Market access to the E.U. for milk and milk products access will not improve between now and 2014/15, based on E.U. market projections and expected proposals for "sensitive products".
- Market access for beef and veal products access will continue to be less than 2% of consumption. Beef will be a "sensitive" product.
- If the E.U. were to grant 5% clear market access for cheese imports would increase by nearly 300,000 tonnes annually.
- If the E.U. were to grant the equivalent of these Canadian TRQ access in the Uruguay Round for cheese, imports would increase by over 500,000 tonnes annually.

Dairy Products

The Single Farm Payment will increase from € 30,146 billion in 2005 to € 35,687.4 billion in 2013 – an increase of 19%. This increase is due in large part to the integration of the milk premium into the SFP after 2007.

The Dairy Premium will increase to offset milk price reductions as follows:

	Dairy Premium	National Top-Up
2004	€ 8.15/t	€ 3.66/t
2005	€ 16.31/t	€ 7.34/t
2006	€ 24.49/t	€ 11.01/t
2007	€ 24.49/t	€ 11.01/t

37 Oxfam Briefing Paper 34, p. 2
38 Oxfam Briefing Paper 34, p. 16

The reference price for milk will be eliminated and there will be further reductions support for butter and skim milk powder. It appears that the € 1,390,000,000 included in the budget in 2005 for the dairy premium and additional payments for milk producers will have gone a long way to compensate. We are likely to see a transformation to an industry characterized by fewer larger herds with increased productivity. Indeed, when the milk quotas are finally removed, it is likely production will increase because many herds are producing at less than optimum efficiency.

Because milk quotas will remain in place for the foreseeable future, i.e., until at least 2014/5, E.U. milk production will remain relatively stable between 2005 and 2012 (about 1% increase). Yields will increase from 6,187 KT to 6,183 KT (11%) and the number of dairy cows will decline from 23 million to 21.2 million (7%).

A recent analysis of E.U. Dairy Reform concluded that:

> "Support of the dairy sector will remain firmly hitched to market intervention, export subsidization and compensatory payments which are likely to be decoupled in name only. Thus while the E.U.'s arable farming sector may be in sight of eventual and effective decoupling, the politically most important sector, dairying, which employs more than 30% of the farm population of north western Europe, will remain firmly set in the traditional CAP mould until at least 2014."[39]

Cheese

E.U. cheese production is expected to increase from 8,568 KT to 9,237 KT or by 8%.

The 2003 CAP reform will not improve access to the E.U. market for cheese. Imports of cheese will remain relatively low at 114 KT increasing to 131 KT – representing 1.44% of consumption in 2005 and 1.53% in 2012. Clean 5% access for cheese to the E.U. would result in very substantial additional imports – some 300,000 tonnes in 2012:

[39] Reform of the E.U. Dairy Regime, Agra Informa Ltd., 2005, p. 103

	Imports	5%	Difference
2005	114 KT	396 KT	282 KT
2012	131 KT	429 KT	298 KT

If the E.U. granted 8% of current consumption minimum access – closely paralleling Canada's Uruguay Round commitment – the calculations would be:

	Present Estimate	8% Access	Difference
2005	114 KT	634 KT	520 KT
2012	131 KT	686 KT	555 K5

The E.U. access to the USA on cheese is based on non-application of export restrictions to such exports to the USA.[40] That such restrictions do apply on exports to Canada is a form of discrimination which is arguably inconsistent with the E.U.'s Most-Favoured Nation (MFN) obligations under GATT (1994).

Butter

Butter production in the E.U. is expected to decline by 10% (**2,125** KT to **1,910** KT). The support price will be reduced by 25% - which is 10% more than in the Agenda 2000 reform package. However, the price reduction for butter means that there will be reduced E.U. export subsidies. And the reduced overhand of E.U. stocks will improve the competitive situation. It is not clear that it will improve prices.

Lower E.U. reference prices coupled with high tariffs on imports will discourage increased imports. Imports will be stable between 2005 and 2012 – while exports will decline by 44% (350 KT to 193 KT). Intervention stocks will decline rapidly after 2005 becoming negligible in 2010.

40 www.USDA.gov

This may have some beneficial impacts on world markets because there will be less E.U. dairy product exports over time and their intervention stocks will be virtually eliminated. OECD expects E.U. prices for butter will decline steadily between 2004-2008, as will exports. This is expected to contribute to increased global butter prices.[41]

SMP

Skimmed milk powder (SMP) production over the period to 2012 will decline by 17% (1,098 KT to 903 KT). Imports between 2005 are estimated at 10 KT annually each year. This is more than 80% below 2003 imports. Exports will decline by 53% (250 KT to 117 KT). E.U. projects no intervention stocks of SMP after 2004.

While the E.U. is no doubt an efficient producer of SMP, the projected imports for the period reflect only 1/10 of 1% of consumption. If indeed the E.U. is such an efficient producer of SMP, the reference price was reduced by 15%, why does it require TRQ protection?

The E.U. does not impact **whole milk powder**.

Beef

Support in the beef and veal sector is likely to decline at least in part because of reductions in the dairy herd due to a steady increase in productivity and a corresponding reduction in herd size. The linkage between the dairy herd and beef production is very important. The OECD determined that the E.U. would not have a beef surplus problem if it were not for the continuation of the dairy quotas.[42]

E.U. production of beef and veal will decline from 7,938 KT in 2005 to 7,716 KT in 2012 (2%). Live cattle imports will continue to be negligible and live exports will increase by 18%. Imports

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[41] OECD Analysis of the 2003 CAP Reform, 2004, pp. 33/34
[42] Reform of the E.U. Dairy Regime, Agra Informa Ltd., 2005, p. 102

of beef will increase by 15% from 549 KT to 628 KT. Exports will decline 62% from 266 KT to 101 KT. This is more than proportional to the decline in the dairy herd – which is one of the principal sources of E.U. beef. There will be a slight decline in per capita consumption of beef from 17.9 kg to 17.5 kg, concentrated in the EU-15. Per capita consumption in the EU-N10 – will be stable at about one-third the level of the EU-15 level. The beef sector will continue to be an outlet for culled cows from the dairy sector.

While the beef sector will be less sheltered than the dairy sector, its continuing heavy reliance on culled cows from the dairy herd mean that it will continue to require some protection. Oxfam concluded that the E.U. exports beef at 47% of its cost of production[43] and argues that the E.U. could, in the Doha Round, expand such trade distorting support by a massive €28.8 billion from current levels, without running afoul of it s anticipated obligations.[44]

Beef support is likely to decline at least in part because of reductions in the dairy herd due to a steady increase in productivity and a corresponding reduction in herd size.

Other Products

Cereals markets in the EU-25 are expected to increase slightly – between 2005 and 2012. Imports are expected to increase less than 2%, while exports will grow by about 10%. Imports will represent less than 5% of consumption. Within the category imports of wheat, barley and corn will be stagnant while there will be an increase of about 35% in coarse grains.

Oilseed production between 2005-2012 will increase by slightly more than 5%. Imports will increase by about 6% and exports will decline by up to a third and then recover to some 25% above 2004. Exports of oilseeds, however, are less than 2% of consumption while imports represent nearly 50% of consumption.

[43] Oxfam Briefing Paper 76, "A Round for Free", June 2005, p. 3
[44] Ibid at p. 4

Pork (Pigmeat) production will increase by 4% from 21,207,000 MT in 2005 to 22,015,000 MT in 2012. Imports over the period will increase more than 250% from 14,000 MT to 37,000 in 2012, but this represents a very small (0.2%) share of E.U. consumption. A slight (3%) increase in exports from 1,309,000 MT to 1,343,000 MT is expected over the period.

Poultry production will increase 5% from 11,119,000 MT to 11,681,000 MT in 2012. Imports will increase from 587,000 MT in 2005 to 723,000 MT in 2012 – or by 24%. Imports will represent 0.6% of consumption in 2005 and 0.7% in 2012. Exports over the period will decline by less than one per cent.

Sheepmeat production will be essentially stable from 2005 to 2012, as will imports and exports.

E.U. **egg** production will increase from 6.3 million tonnes in 2005 to 6.6 million tonnes in 2012. While consumption will increase from 6.2 million to 6.4 million. The E.U. does not anticipate ***any*** egg imports – and the increased production will be disposed of on export markets. Exports are expected to increase 50% from 200,000 MT to 300,000 MT.

EVOLUTION OF THE EUROPEAN COMMON AGRICULTURAL POLICY

The Common Agricultural Policy (CAP) was created in 1957 by Article 33(1) of the Treaty of Rome which stipulated the following objectives:

a) to increase agricultural productivity by promoting technical progress and by ensuring the rational development of agricultural production and the optimum utilization of factors of production, in particular labour;
b) thus to ensure a fair standard of living for the agricultural community, in particular by increasing the individual earnings of persons engaged in agriculture;
c) to stabilize markets;
d) to ensure the availability of supplies;
e) to ensure supplies reach consumers at reasonable prices.

European Community CAP budgets were first funded in 1962 through establishment of the European Agricultural Guidance and Guarantee Fund (EAGGF).

The principal elements of the CAP were:

- Price Support
- Direct Payments
- Supply Control
- Border Measures
- Export Restrictions and Refunds

USDA has identified the following as primary objectives of the CAP:

- increasing agricultural productivity;
- ensuring a fair standard of living for farmers;
- stabilizing markets;

- guaranteeing regular food suppliers; and
- ensuring reasonable prices to consumers.[45]

Arguably the CAP was very successful in achieving increased production and security of supply and attractive returns for European farmers. However, in recent years, many European farmers have become increasingly dissatisfied with prices and incomes, particularly after a series of CAP reforms. European consumers consider they pay more for food than consumers in other countries, particularly those who receive subsidized imports of a wide range of agricultural commodities from Europe.

The CAP has been widely criticized by other agricultural exporting countries for:

- changing the E.U. from being a significant importer of farm products to a major exporter;
- for disrupting world markets for agricultural commodities and depressing prices;
- for damaging developing country producers by "dumping" surplus production at substantially less than cost of production;
- for delaying the integration of agricultural, food and beverage products into the GATT/WTO rules-based international trading system.

The problems which the CAP created were not foreseen when it was introduced. Europeans had experienced food shortages and had a political imperative to achieve greater self-sufficiency. This philosophy encouraged production without proper attention to balancing supply and demand.

Domestic Price Support

Domestic price support is the historical backbone of the CAP's income support pillar. For major commodities, such as grains, oilseeds, dairy products, beef and veal, and sugar. The E.U. supported internal prices through price intervention and high external tariffs.

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45 European Union: Policy , Common Agricultural Policy, USDA Economic Research Service, Briefing Room, p. 1 (www.ers.usda.gov/Briefing/EuropeanUnion/Policy/Common.htm)

The E.U. continuously purchases surplus production when prices threatened to fall below agreed minimum prices, known as the intervention price.[46] USDA explains the process as follows:

> "Farmers are guaranteed intervention prices for unlimited quantities of eligible agricultural products. This means that E.U. authorities will purchase, at the intervention price, unlimited excess products meeting minimum quality requirements that cannot be sold on the market. The surplus commodities are then put into E.U. storage facilities or exported with subsidy. While less important from a budget perspective, exports of processed products that contain a portion of a CAP-supported commodity also receive an export subsidy, based on the proportion of that commodity in the product and the difference between the intervention price and the world price."[47]

E.U. tariffs are set at levels that require imports of most price-supported commodities to be sold in the E.U. at or above the internal market price set by E.U. authorities.[48]

Other measures that support domestic prices included: surplus storage (for intervention or buffer stocks) and consumer subsidies paid to encourage domestic consumption of products like butter and skim milk powder (SMP). The 2003 CAP reforms reduced storage subsidies by 50% and provide for lower reference prices for butter and skim milk powder (SMP).[49]

In addition, some fruits and vegetables are withdrawn from the market in limited quantities by authorized producer organizations when market prices decline to specified levels.

Direct Payments

Payments made directly to E.U. producers provide substantial income support and will become increasingly important under the 2003 CAP Reforms. Direct payments began in 1994 as compensation for reductions in reference prices pursuant to the 1992 CAP Reform. These direct payments were increased to offset the price cuts resulting from the Agenda 2000 CAP reform.

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[46] European Union: Policy , Common Agricultural Policy, USDA Economic Research Service, Briefing Room, p. 1 (www.ers.usda.gov/Briefing/EuropeanUnion/Policy/Common.htm)

[47] European Union: Policy , Common Agricultural Policy, USDA Economic Research Service, Briefing Room, p. 1 (www.ers.usda.gov/Briefing/EuropeanUnion/Policy/Common.htm)

[48] European Union: Policy , Common Agricultural Policy, USDA Economic Research Service, Briefing Room, p. 1 (www.ers.usda.gov/Briefing/EuropeanUnion/Policy/Common.htm)

[49] European Union: Policy , Common Agricultural Policy, USDA Economic Research Service, Briefing Room, p. 3 (www.ers.usda.gov/Briefing/EuropeanUnion/Policy/Common.htm)

Some such payments are being integrated into the decoupled Single Farm Payment (SFP) introduced as the central element of the 2003 CAP Reform. Others will continue.

Compensation payments were established on a historical-yield basis for arable crops by farm. Farmers had to plant to receive the payment. By comparison, the SFP specified in the 2003 reform will be made to farmers based on the average level of payments made during 2000 – 2002 and no production is required to receive the SFP.

In the beef and sheep sectors, per head payments (payments per animal) will be made based on 2000 – 2002 average payments with no production required. Other special payments are made, but they are less important than the SFP.

> "Direct payments currently account for approximately 35% of E.U. producer receipts and for an even higher percent of net farmer income (once input costs are subtracted from receipts)."[50]

Supply Control: Better Late than Never?

Supply-control production quotas have been in effect for the **dairy** and sugar sectors for nearly 20 years.[51] The dairy quotas are reinforced by levies on producers for excess production. The super levy was 115% of the reference price. The existence of these controls suggests that absent the controls, productivity gains would significantly increase production.

The 1992 CAP reform introduced supply control for a number of products through a mandatory paid set-aside program to limit production. This was an important move in preparing E.U. agriculture for Uruguay Round liberalization. Attempts to control supply have been maintained through subsequent reforms.

In order to be eligible for direct payments, producers of grains, oilseed, or protein crops were required to remove a specified percentage of their area from production. The set-aside rate under

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[50] European Union: Policy , Common Agricultural Policy, USDA Economic Research Service, Briefing Room, p. 3 (www.ers.usda.gov/Briefing/EuropeanUnion/Policy/Common.htm)
[51] European Union: Policy , Common Agricultural Policy, USDA Economic Research Service, Briefing Room, p. 3 (www.ers.usda.gov/Briefing/EuropeanUnion/Policy/Common.htm)

Agenda 2000 for arable crops was 10%. This rate was reduced to 5% for 2003 – 2004 because of drought-reduced crops in 2002 – 2003. Small producers (<92 mt of grain) are exempt from the set-aside requirement.[52]

Border Measures

The E.U. maintains high tariffs to ensure that imported products cannot be sold at prices below the internal market prices reference set by the CAP.[53] For certain sensitive products there are also tariff rate quotas – which have for some sensitive products been set well below a 5% of consumption minimum access level.

Export Restrictions and Export Refunds

Over production and high domestic prices mean the E.U. has had to pay very high export subsidies to dispose of surplus production. It has been estimated that E.U. accounts for approximately 90% of global agricultural export subsidies.[54] This assessment depends on what is reported to the WTO as export support – and ignoring the real export impacts of domestic support, export credits and "commercial" food aid which is really designed for surplus disposal. The E.U. is not wrong in trying to ensure that all forms of export support are disciplined.

As discussed in our report on U.S. subsidies, "U.S. Federal and State Agricultural Support", in fact, much domestic support – particularly that which encourages excess production which must be exported at very low prices – is "de facto" export subsidization. But only the WTO Dispute Settlement system can adjudicate these issues, and the Doha Round negotiations have been bogged down in debates over semantics, but semantics with very real commercial implications.

[52] European Union: Policy , Common Agricultural Policy, USDA Economic Research Service, Briefing Room, p. 3 (www.ers.usda.gov/Briefing/EuropeanUnion/Policy/Common.htm)
[53] European Union: Policy , Common Agricultural Policy, USDA Economic Research Service, Briefing Room, p. 3 (www.ers.usda.gov/Briefing/EuropeanUnion/Policy/Common.htm)
[54] European Union: Policy , Common Agricultural Policy, USDA Economic Research Service, Briefing Room, p. 3 (www.ers.usda.gov/Briefing/EuropeanUnion/Policy/Common.htm)

Oxfam refers to these domestic subsidies as “hidden” export subsidies which stimulate dumping on world markets. They note:

> “A 2001 key study the Australian government showed that if the volume of subsidized E.U. and U.S. dairy exports was halved, world dairy prices would be between 17% and 35% higher.”[55]

It is not clear how accurate this assessment is; there is no incentive for Cairns market opening advocates to engage in conservative analysis, but as dairy demand has increased, prices too have increased. If one is guided by the Uruguay Round experience, however, there is little confidence that prices will increase as a result of market opening.

The same Oxfam report indicates that over 20 years, 10,000 farmers in the Dominican Republic were forced out of business by subsidized imports of milk products from the E.U.[56]

The E.U. cap on export subsidies is approximately € 7.5 billion a year. In 2001-2 only about a third of this limit was used – and between 1990 and 1999, the share of export refunds in the CAP budget declined by more than half – from 31% to 14%. However, during the same period CAP spending increased with the shift away from reference prices to direct payments.

Oxfam reports that the E.U. massively understates the real levels of its export subsidies, i.e., “the E.U. pays out the equivalent of € 4.1 billion in hidden export support – four times the amount which it reports to the WTO”.[57]

Current proposals in the Doha Round do not suggest that there will be meaningful reductions in domestic support. The problems are a combination of too much “water” in the current obligation levels to make reductions meaningful and an over-categorization of support as “Green”.

Brussels and Washington appear to consider that the each others’ domestic support programs are the root cause of farm income problems. Neither wants to alienate its farmers. Both want to maintain their flexibility to deliver support to their farmers.

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[55] Oxfam Briefing Paper 76, p. 12
[56] Oxfam Briefing Paper 76, p. 12
[57] Oxfam Briefing Paper 76 “A Round for Free”, June 2005, p. 3

The MacSharry Reforms

The 1992 reforms helped to set the stage for E.U. participation in the Uruguay Round Agreement on Agriculture (WTO AoA). Those reforms substantially reduced guaranteed (intervention) prices and compensated farmers for the lower prices with direct payments.[58] These direct payments were linked to a mandatory 10% land "set aside". The payments were coupled to production through a requirement to plant on land not set aside. Crop farmers producing less than 92 metric tons were not required to set aside land. Premiums were also established for reduced or low stocking rates in cattle farming.

Before the 1992 reforms, high intervention prices, often set far above world prices, were paid to E.U. farmers for any production not sold on the market. As a result, the E.U. built up large surpluses of agricultural commodities including wheat, barley, beef, butter, dry milk powder, and wine. These excess stocks had to be exported onto world markets. Surplus wine production was converted to alcohol for fuel or industrial use. The 1992 reform reduced beef intervention prices by 15% and cereal intervention prices by 30%. E.U. farmers were compensated for the price cuts, as long as farmers continued to produce, with direct payments based on historical yields and herd size.

Agenda 2000 Reform

Agenda 2000 was principally designed to prepare the E.U. for enlargement to its present 25 members. The guaranteed beef price was reduced by a further 20% and guaranteed cereal prices were reduced by another 15%. However, direct payments were increased by only 50% of the reduction. European farmers began to share the burden of adjustment.

Agenda 2000 laid the groundwork for future dairy reform by mandating phased-in price reductions for butter and dry milk powder beginning in 2005. Direct payments would compensate dairy farmers.

[58] For cereals, oilseeds, protein crops and beef

Direct payments were conditioned on the use of sound environmental practices including avoiding water pollution.

These reforms – focusing on the function and role of agricultural policy – paved the way for more sweeping reforms to come in 2003 – which were driven too by the Doha Round negotiations on Agriculture.

There had been a quantum shift in the focus of CAP support mechanisms. Farmers are now receiving direct payments to meet raised public awareness and demand for preventative sanitary and animal welfare practices and lower prices, while complying with set-aside and environmental practices. E.U. taxpayers were more keenly aware of the CAP's costs because direct payments were funded by their taxes. Animal-health issues, such as "mad cow" disease and environmental problems (nitrate pollution) in agriculture production also demanded attention and have become another important focus of agricultural policy in Europe.

External Pressures on European CAP

The CAP was far too successful in stimulating production and ensuring stable, healthy farm incomes.

The result was very disruptive and burdensome over-production. Oxfam International has frequently complained about the impact of European subsidies on developing country producers. In 2002, Oxfam reported:

> "Farmers in the poorest nations are competing not just against farmers in the industrialized work, but against the financial power of the world's richest countries. U.S. negotiators in particular like to stress their commitment to a 'level playing field' in agriculture. However, for producers in the developing world, competition is an uphill struggle: millions of smallholder farmers have to survive on less than $400 a year in total income. They are competing against American and European farmers who receive respectively an average of $21,000 and $16,000 a year in subsidies."[59]

[59] Rigged Rules and Double Standards: Trade, Globalization, and the Fight Against Poverty, Oxfam, 2002, p. 112.

Although Oxfam is clearly concerned with unfair competition between producers in developing and developed countries, it is evident that producers in other developed countries are also forced to compete with the E.U. treasury. E.U. producers benefiting from average subsidies of $16,000 per year have a distinct advantage over producers in all other countries expect the United States.

And the averages hide many distortions. Many E.U. farmers receive less than € 5,000 and some receive hundreds of thousands of Euros. It is these larger holdings which contribute most to the overproduction.

Oxfam has exposed numerous examples of "export dumping", which it defines as the practice of dumping surplus agricultural products onto the world market at less than cost of production. Oxfam notes that these practices deprive developing country producers of foreign-exchange earnings and market share. Furthermore, Oxfam notes that this practice undermines local production of agricultural products.

Oxfam has come to the following conclusions about E.U. export dumping:

- E.U. wheat exports are priced at approximately 34% below cost of production (the E.U. and USA account for approximately one half of total world wheat exports);
- The E.U. is the world's largest exporter of skimmed milk powder, which is exported at prices representing approximately one-half of the cost of production; and
- The E.U. is the world's largest exporter of white sugar, which is exported at prices that are approximately one-quarter of production costs.[60]

The practice of selling at below cost of production affects all participants in world agricultural products markets, including producers in developed countries. Oxfam concluded that,

> "The dominance of the E.U. and the USA in world markets means that these dumping margins effectively set world market prices. This is because rival exporters have to follow the export price levels set by E.U. and the USA, or lose market share. For practical purposes, the world agricultural market is a dumping market in which prices are unrelated to cost of production."[61]

[60] Rigged Rules and Double Standards: Trade, Globalization, and the Fight Against Poverty, Oxfam, 2002, p. 115.
[61] Rigged Rules and Double Standards: Trade, Globalization, and the Fight Against Poverty, Oxfam, 2002, p. 115.

2003 CAP Reform

Brussels has probably more influence over agricultural policy than any other policy area. It has passed more legislation on agriculture than in any other single policy area, and agriculture dominates the E.U. Budget.[62]

The influences both internal and external influences which drove Agenda 2000 reform intensified as the May 2004 expansion date approached. These 10 new members[63] would increase the number of farmers in the E.U. to 11 million and land in agricultural production by 30%.[64]

The increased budgetary implications and external pressures on the E.U. to liberalize its farm trade policies in the Doha Round negotiations also influenced the pace and direction of reform.

Further CAP reform was agreed upon, on January 23, 2003, followed by a reform of Mediterranean commodities in April, 2004. In July 2004 E.U. Farm Commissioner Franz Fischler proposed a reform of the organization's sugar regime in response to the WTO dispute settlement decision in *E.U. - Sugar*.

The 2003 reforms represented a very important shift. Franz Fischler, then E.U. Farm Commissioner said the 2003 CAP reform:

> "… marks the beginning of a new era. Our farm policy will fundamentally change. Today, Europe has given itself a new and effective farm policy. The bulk of our direct payments will no longer be linked to production. To our farmers, it offers a policy which will stabilize their incomes and enable them to produce what the consumers want. Our consumers and taxpayers will get more transparency and better value for money. This reform also sends a strong message to the world. Our new policy is trade friendly. We are saying goodbye to the old subsidy system which significantly distorts international trade and harms developing countries. Today's decision will give Europe a strong hand in the negotiations on the Doha Development Agenda. The EU has done its homework, now it's up to others to move to make the WTO trade talks a success. But let there be no mistake.

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62 EUROPA, Common agricultural policy: beginnings to the present day, http://europa.eu.int/scadplus/leg/en/lvb/l04000.htm

63 Czech Republic, Slovakia, Estonia, Malta, Lithuania, Hungary, Poland, Cyprus, Slovenia, Latvia

64 EUROPA, Common agricultural policy: beginnings to the present day, http://europa.eu.int/scadplus/leg/en/lvb/l04000.htm

> At the Cancún Ministerial Meeting, the EU will be ready to use its increased negotiating capital only if we get something in exchange. Unilateral disarmament is not on. The ball is now in the camp of other countries, such as the USA, whose agricultural policies continue to be highly trade-distorting and have even become increasingly so."[65]

Herr Fischler's statement was made before the Cancun ministerial. It is interesting to note the similarities today as the negotiators preparing for Hong Kong, despite numerous mini-ministerials and last ditch efforts to rescue and mobilize agricultural negotiations are very much deeply entrenched in their differences.

The EU-USA developed a very self-serving framework after the July 2003 Montreal mini-ministerial. This was rejected at Cancun, and was spared a public thrashing only by the rather unique management of the Cancun meeting – which allowed it to crash and burn over the so-called Singapore issues without even getting to agriculture. And heading to Hong Kong, E.U. negotiators have once again stressed the linkages of their Agriculture offer to other areas of the negotiations and that there will be no unilateral disarmament.

The 2003 CAP Reform principally addresses four issues:

1) Control of market-support budget expenditures through financial discipline;
2) Preparation for multilateral agricultural negotiations;
3) Budget and support problems resulting from enlargement to the East; and
4) Consumer and environmental issues in agricultural policy.

2003 CAP Reform reflected a significant change in the E.U. approach to agricultural policy which reflected pressure from environmentalists and E.U. consumer groups. The move away from price support toward income support through decoupled payments allows E.U. farmers to have more choices in their planting decisions because of decoupled payments.[66]

[65] Seedquest News Releases, http://www.seedquest.com/News/releases/2003/june/6090.htm
[66] European Union: Policy , Common Agricultural Policy, USDA Economic Research Service, Briefing Room, p. 3 (www.ers.usda.gov/Briefing/EuropeanUnion/Policy/Common.htm)

2003 CAP Reform established two pillars in the budget:

Pillar I for market and price support policies,

Pillar II for rural development policies.

The principal means to accomplish the various goals of the 2003 CAP Reform were to move from commodity support to support of farmers through direct payments based on average historical commodity-based payments from 2000-02. Decoupled payments are supposed to allow E.U. farmers to be more responsive to domestic market signals than to policy interventions, that is to cope with lower, unsupported prices.

Member states, however, can opt to retain coupled payments equal to 25% of the area for arable crops, 50% of the sheep and goat premiums, 40% of supplemental durum wheat aid, and from 40% to 100% of various beef premiums. Canada is directly impacted by E.U. incentives on durum wheat.

In order to qualify for the SFP, farmers must comply with food safety, animal welfare, and environmental standards. Unlike previous reforms, E.U. farmers are not required to produce any crop, unless member states opt for partially decoupled payments. Most E.U. member states are planning to take advantage of the latitude allowed them regarding the timing of implementation (2005, 2006, or 2007) and the degree of coupling of payments to production. To qualify for the SFP, farmers also must maintain the land in good agricultural condition if it is not planted. In addition, pasture land may not be planted to arable crops, and land may not be diverted to nonagricultural uses.

The U.K. House of Lords was told that CAP budgets will be strained (exceeded) as member states top-up entitlements from Brussels– and of the weak U.S. dollar/Euro relationship continues for a number of years. This will increase the amount of export required subsidies and exacerbate budget pressures.[67]

[67] U.K. Parliament House of Lords – Memorandum by the Biscuit, Cake, Chocolate and Confectionery Association, January 17, 2005

Access to E.U. beef markets and subsidized European competition in third markets has long been a concern for Canadian beef exporters. There does not appear to be any imminent relief, nor will market access improve.

While the new reforms have introduced new policy tools and reduced some prices, intervention at guaranteed prices for major commodities, generally above world prices, will remain an important component of the CAP. The reforms do not address market access issues as the E.U. still has high tariffs. E.U. market projections do not contemplate increased imports.

Export subsidies will still be available for surplus commodities (within WTO limits), although some reduction in intervention prices should result in lower per-unit subsidies for those commodities in the future, depending on the strength of the euro. A strong euro has recently made E.U. exports more expensive, which has pushed some subsidized exports close to WTO quantity ceilings. [68]

Implementation of 2003 CAP Reform

The Commission has chosen to implement 2003 CAP reform through three Commission Regulations.

- Regulation 1 covers the provisions concerning cross-compliance, controls and modulation.[69] The provisions with regard to cross compliance are one of the key elements in the CAP reform, which make the Single Farm Payment (SFP) dependant on the farmers respecting public health, animal health, environmental and animal welfare, E.U. norms and good agricultural practice.
- Regulation 2 introduces a Single Farm Payment, which is no longer linked to production (decoupling), guaranteeing a revenue base while purportedly allowing production to become more market oriented. Full payments of the SFP is conditional on cross compliance. The E.U. considers this takes support out of the Amber Box and puts into the Blue Box.

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[68] CAP Reform of 2003-04, USDA, August 2004

[69] This situation is not unique to Europe. Dairy Farmers of Canada report that about 5% of dairy farmers leave the business every year. In the USA consolidation into larger units appears to be even greater.

- Regulation 3 covers those areas of support which are too sensitive to be fully decoupled. It would appear that the E.U. Reform is built on the premise "Decoupling if necessary but not necessarily decoupling."

The Reforms also imposed a ceiling on Pillar I spending while Pillar II spending appears to be open-ended. The intended budget for rural development is intended to double over the next ten years while the budget for market and price support policies may only increase by 1% per year from 2006 to 2013.

The main changes to the 2003 CAP Reform to be implemented throughout 2012 include:

- direct payments as a SFP, rather than a range of different payments for different commodities;
- payments 'decoupled' from production, and based on historical payment levels that will gradually reduce over time; and
- such payments are conditional on farmers meeting environmental requirements in managing their land.[70]

As part of the 2003 CAP reform, the majority of EU-15 countries decided to begin implementing the SFP scheme in 2005, with the rest (Finland, France, Greece, the Netherlands and Spain) commencing in 2006. Germany, Ireland, Italy, Luxembourg and the United Kingdom chose to maximize, while France chose to minimize, the use of the decoupling provision of the single payment scheme. The majority will base the single payment on farm level historical entitlements, with Denmark, Finland, Germany, Luxembourg, Sweden and the United Kingdom using a mix of both farm level historical and regionalized payments.

2003 CAP Reform also introduced the concept of "modulation", which reduces single farm payments greater than € 5,000 by 5% without penalizing farmers who receive single farm payments that are less than € 5,000. The intention is that at least 80% of the funds generated

[70] Media Release, Australian Farm Institute, June 5, 2005

through modulation will remain in the country where the single farm payment is made and will be used for rural development.[71]

The CAP started to apply in new member states on the date of accession in May, 2004. The implementation of the 2003 CAP reform began in 2004, and the SFP will replace most of the previous area and livestock headage payments as of 2005 to 2007, depending on the country. The hop, tobacco and olive oil sectors were reformed in 2004, all by incorporating previous payment mechanisms into the SFP.

As a result of pre-accession treaties, trade flows between the EU-25 countries had already increased by 2003. For these new E.U. Member States, the accession process resulted in a progressive increase in the level of support for both producers and general services to agriculture. However, the level of producer support in the new member states remains lower than in the EU-15. Enlargement is estimated to have reduced the level of producer support in the E.U. by one percentage point.[72]

With the exception of Malta and Slovenia new member states implemented single area payment schemes (SAPS) in 2004, providing a flat rate (averaging € 48 per hectare across the eight) for all agricultural land, with all ten providing "top-up" payments. These payments contributed to increases in agricultural income in all new member states except Cyprus, Malta and Slovenia. After the transitional SAPS phase, the new member states will implement the single payment scheme on the basis of the regional model.

Single Farm Payment[73]

The 2003 reform of the CAP introduced the SFP system (income support) and cut the link between support and production (decoupling). The majority of common organizations of markets (COMs) have become or will become subject to this system in 2005 or 2006 (with the exception

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[71] European Union: Policy , Common Agricultural Policy, USDA Economic Research Service, Briefing Room, p. 4 (www.ers.usda.gov/Briefing/EuropeanUnion/Policy/Common.htm)
[72] Agricultural Policies in OECD Countries: Monitoring and Evaluation 2005 Highlights.
[73] EUROPA, http://europa.eu.int/scadplus/leg/en/lvb/l11089.htm

of the new Member States). Existing direct aids may be continued until 2012, subject to certain conditions (cross-compliance), but they will be gradually reduced (modulation). Certain crops are eligible for additional support to compensate for the loss of income resulting from modulation and the transition to the SFP.

The implementation of the SFP is neither uniform nor universal. Member States may choose among different options, which will influence the degree of "decoupling" of the payments. Present indicators are that in 2012 approximately 90% of the budgetary transfers in the form of direct payments (including national envelopes and top-ups) for the arable crops, milk, beef and sheep sectors will be part of the SFP for the EU-25 as a whole. The rate would be higher for the milk (100%) and arable crops (93%) sectors than for beef and sheep sectors (78% and 73% respectively).[74]

Products Covered

All farmers may apply for direct payments, which are independent of production and supplementary to their market income. That is, the SFP is a payment in addition to any revenue which a farmer may choose to generate from farming. Specific support schemes have nevertheless been introduced for durum wheat, protein crops, rice, nuts, energy crops, starch potatoes, milk products, seeds, arable crops, sheepmeat and goatmeat, beef and veal, grain legumes, cotton, tobacco, hops, as well as for farmers maintaining olive groves.

The single payment is an annual income payment to farmers that is based on their entitlement over the 2000-02 reference period (with the exception of the new Member States). The object of the SFP is to ensure greater income stability (a safety net) for farmers. Farmers are free to decide what they want to produce in response to demand without losing their entitlement to support.

[74] Prospects for Agricultural Markets and Income (2005-2012), European Commission Directorate-General for Agriculture, July 2005

Single Farm Payment Expenditures

The table below outlines the trend of expenditures for the SFP. It is interesting to note the SFP expenditures increase significantly in 2007, when dairy direct payments are integrated.

	Million €	% Change
2005	30,145.7	N/A
2006	30,390.8	0.8%
2007	35,094.9	15.5%
2008	35,693.6	1.7%
2009	36,292.5	1.7%
2010	36,891.1	1.6%
2011	37,489.8	1.6%
2012	38,088.6	1.6%
2013	38,687.4	1.6%

Source: European Commission budgetary documents

Granting of SFP Direct Payments

Conditionality

SFP recipients must maintain their land in good agricultural condition and comply with prescribed standards on public health, animal and plant health, the environment and animal welfare (cross-compliance).

If a farmer fails to comply with those rules through negligence, direct payments may be reduced by between 5% and 15%. In the event of deliberate non-compliance, payments will be reduced by at least 20% and the producer may be denied SFP aid. Unexpended funds will be paid back into the European Agricultural Guidance and Guarantee Fund (EAGGF) subject to 25% retention by Member States. The Commission is to present a report on the application of the conditionality system by January 1, 2008.

Degressivity, modulation and financial discipline

Between 2005 and 2012, direct payments - other than those to farmers in the outermost regions (French overseas departments, the Azores, Madeira, the Canary Islands) and the Aegean Islands – will be reduced by 3% in 2005, 4% in 2006 and then by 5% annually (degressivity). The resulting saving will be divided among the Member States and allocated to rural development measures (modulation). Each Member State is to receive at least 80% of the sums generated. It may even receive up to 90% of the amount in order to alleviate the effects of abolishing the intervention mechanism for rye.

In order not to penalize small farms, farmers may receive an additional amount of aid. That amount, subject to adjustment by the Member States, is to correspond to the loss resulting from modulation for the first € 5,000 tranche of direct payments.

There are budgetary checks and balances to prevent over-spending. Should these mechanisms work it will be a major change in CAP administration.

Farm advisory system

By January 1, 2007 Member States are to establish systems for advising farmers on land and farm management. The farm advisory work will relate to compliance with regulatory requirements and to good agricultural and environmental conditions. Member States are to give priority to farmers receiving more than € 15,000 in direct payments annually. By January 1, 2011 the Commission is to present a report on the application of the farm advisory system accompanied, if necessary, by proposals for making it compulsory.

Integrated administration and control system (IACS)

Each Member State must establish an integrated administration and control system comprising:

- a computerized data base;
- an identification system for agricultural parcels;
- a system for the identification and registration of payment entitlements;
- aid applications;

- an integrated control system;
- a single system to record the identity of each farmer who submits an aid application.

In the past there have been highly publicized instances of fraud, manipulation and misappropriation of CAP payments. IACS will enable farmers' payment applications to be reviewed and verified. In the event of non-compliance with the rules, the aid granted may be reduced or cancelled. The Commission will be kept informed of, and monitor, the application of IACS.

Payment

Payments will be made once a year between December 1 and 30 June of the year following the application. The additional amount of aid is to be paid at the latest by September 30 of the year following the calendar year concerned. The Commission may also extend the period of payment in the oils and fats sector and authorize advances.

Farmers who have artificially created the conditions required for obtaining payments will not receive them.

Allocation and calculation of the single payment

Farmers will receive a payment entitlement which is generally based on benefits during the reference period (2000-02) and the number of hectares which conferred entitlement to those payments. Total direct payments in each Member State are subject to a ceiling. From 2007, producers of milk products will receive an amount supplementary to the SFP.

National reserve

In order to create a national reserve of payment entitlements to assist new farmers, Member States may reduce the amounts of direct payments by a maximum of 3%.

National ceilings (millions of Euros) EU-15

Member State	2005-2007	2008	2009	2010 and subsequent years
Belgium	411	413	530	530
Denmark	838	838	996	996
Germany	4,489	4,503	5,492	5,496
Greece	837	1,700	1,722	1,760
Spain	3,244	4,043	4,241	4,253
France	7,199	7,231	8,091	8,099
Ireland	1,136	1,136	1,322	1,322
Italy	2,539	3,112	3,464	3,497
Luxembourg	27	27	37	37
Netherlands	386	386	779	779
Austria	613	614	712	712
Portugal	452	493	559	561
Finland	467	467	552	552
Sweden	612	612	729	729
Total	23,250	25,575	29,226	29,323

Source: European Commission, *(Annexes VIII and VIIIA of Regulation (EC) No 864/2004)*

These member state data should be useful in showing the importance of dairy production in individual Member States, but, at least in the case of France, suggest other factors may be in play.

National ceilings - NMS-10

Member State	2005	2006	2007	2008	2009	2010	2011	2012	+ 2012
Czech Republic	228.8	226.7	343.6	429.2	514.9	600.5	686.2	771.8	857.5
Estonia	23.4	27.3	40.4	50.5	60.5	70.6	80.7	90.8	100.9
Cyprus	8.9	12.5	16.3	20.4	24.5	28.6	32.7	36.8	40.9
Latvia	33.9	39.6	55.6	69.5	83.4	97.3	111.2	125.1	139
Lithuania	92	107.3	146.9	183.6	220.3	257	293.7	330.4	367.1
Hungary	350.8	420.2	508.3	634.9	761.6	882.2	1,014.9	1,141.5	1,268.2
Malta	0.67	0.83	1.64	2.05	2.46	2.87	3.28	3.69	4.10
Poland	724.6	881.7	1,140.8	1,425.9	1,711.0	1,996.1	2,281.1	2,566.2	2,851.3
Slovenia	35.8	41.9	56.1	70.1	84.1	98.1	112.1	126.1	140.2
Slovakia	97.7	115.4	146.6	183.2	219.7	256.2	292.8	329.3	365.9

Source: European Commission

Use of payment entitlements

Payments depend on the area of the holding. A farmer who has eligible hectares is to receive payment of the amount fixed by the payment entitlement. As a general rule, payment entitlements may be transferred only between farmers in the same Member State. Other than in exceptional circumstances, any payment entitlement which has not been used for three years will be transferred to the national reserve.

Land use

Land conferring payment entitlement is to be used for agricultural activity. However, permanent crops such as wine, the production of fruit and vegetables, and potatoes other than those intended for the manufacture of potato starch are not eligible activities. These limitations clearly limit choice and the scope for truly decoupled production.

Set aside

To qualify for SFP, farmers must set aside part of their land, except that used for organic production or for production not intended for human or animal consumption. The land set aside must be maintained in good agricultural and environmental condition and may be subject to rotation. It is anticipated that there will be increased use of oilseeds and biomass crops in energy and fuel production. Member States may pay up to 50% of the costs of establishing multi-annual crops.

Regional implementation

As of August 1, 2004, Member States could decide to allocate payments at the regional level. Regional ceilings are to be established and divided among the farmers in the region.

Where regionalization is implemented, farmers may use the parcels covered by a payment entitlement to produce fruit and vegetables or non-starch potatoes. Member States may also set the value of entitlements for grassland and include the dairy premium and additional payments in the SFP. Transfers of payment entitlements within a region or between regions may take place only if the entitlements are identical.

Partial implementation

Member States may opt for its partial implementation of the SFP in order to prevent the abandonment of land. Aid will be paid to farmers partly as a single payment and partly as an additional payment.

Member States may allocate per-hectare payments up to 25% of the total amount for arable crops or up to 40% if they decide to retain the additional premium for durum wheat.

For beef and veal, the suckler cow premium (SCP) may be retained in its entirety as well as up to 40% of the slaughter premium. If the SCP is not retained, it is also possible to retain 100% of the slaughter premium and 75% of the special male premium.

Sheepmeat and goatmeat premiums may remain linked to production up to 50%.

Member States may pay additional aid representing 10% of SFP to farmers for developing specific types of farming which are important for the environment or for the quality and marketing of agricultural products.

The Commission is to submit to the Council no later than December 31, 2009, a report on the implementation of the general or partial SFP system.

Optional exclusion

Member States may exercise their option to exclude some aid from the single payment scheme, such as that for growing cereals in the Nordic countries, the dairy premium and certain types of aid for producers in the outermost regions.

Transition

In order to facilitate implementation of the SFP system, Member States may decide whether or not to opt for a transitional period ending on either December 31, 2005 or December 31, 2006. During that period, Member States are to apply a direct payment system in compliance with the E.U.'s competition rules and international obligations.

Transitional measures

A simplified scheme for small farmers will apply until 2005. While participating in that scheme, farmers are not entitled to direct payments.

Additional Benefits

Durum wheat

For durum wheat, payment for improving quality is to be € 40 per-hectare subject to national limits. If the area applied for exceeds the limit, then the amount will be reduced proportionately.

Where the single payment scheme is partially implemented, an area payment supplement of € 291 per hectare for 2005/06 and € 285 from 2006/07 onwards will be paid, subject to national limits. If the area in respect of which the payment is applied for exceeds the limit, then the aid is to be reduced proportionately.

For well-established areas of durum wheat production, special aid of € 46 per hectare is to be allocated during the 2005/06 marketing year.

Protein crops

For peas, field beans and sweet lupins, the amount of aid is € 55.57 per hectare for a maximum guaranteed area of 1.4 million hectares for the E.U. If the area is exceeded, the aid is to be reduced proportionately.

Rice

In order to preserve certain traditional production areas, producers will receive aid for rice production established on the basis of the yield for a maximum guaranteed area in each Member State. That area will vary depending on whether or not the Member State opts for the transitional period. If the area is exceeded, the aid will be reduced proportionately.

Nuts

In order to preserve certain traditional production areas, aid of € 120.75 per hectare for the production of hazelnuts, walnuts, filberts, pistachios and almonds may be paid to producers. The guaranteed area is 80,000 hectares for the EU-25. If the area is exceeded, the amount of aid will be reduced proportionately. Community aid is conditional upon farmers complying with a minimum tree density and plot size. In addition, Member States may grant national aid up to an annual maximum of € 120.75.

Energy crops

Aid of € 45 per hectare is to be available for producers of energy crops (crops intended for the production of biofuels or electric and thermal energy). Production must be covered by a contract with the processing plant, subject to a maximum guaranteed area of 1.5 million hectares for the E.U. If the area is exceeded, the aid will be reduced proportionately. The Commission is to report by January1, 2007 on the implementation of the scheme, accompanied, where appropriate, by proposals taking into account the E.U. biofuels initiative.

Starch potatoes

Producers of potatoes intended for the manufacture of starch are allocated aid of € 110.54 for the transitional period or € 66.32 from the 2005/06 marketing year per tonne of starch. Aid is granted only if a contract has been concluded between the producer and the starch manufacturer.

Specific regional aid for arable crops

In the event of exclusion from the SFP, in Finland and Sweden north of the 62nd Parallel, farmers producing cereals, oilseeds, linseed, flax and hemp may receive aid of € 24 per tonne, subject to the limits set by the Commission.

Seeds

If seeds are excluded from the SFP, the amount of aid is to be granted subject to the limits set by the Commission.

Area payments for arable crops

Payments are to be made if the SFP is partially implemented in the arable crops sector. The marketing year will run from July 1 to June 30. The area payment is to be regionally differentiated. If the base areas are exceeded, the payment is to be reduced proportionately for all farmers. The area payment will be calculated by multiplying the basic amount of € 63 per tonne by the average cereal yield determined in the regionalization plan. For flax and hemp, the area payment will be made if processing is guaranteed.

During the transitional period, farmers wishing to receive the area payment must set aside at least 10% of the area of their holding. Member States may require a higher percentage in order to take account of special circumstances.

The land set aside may be used for products not intended for human or animal consumption and for organic production. Member States may grant national aid up to 50% of the costs associated with establishing multi-annual crops intended for bio-mass production on set-aside land.

In order to qualify for the area payment a farmer must have sown the seed no later than May 31 preceding the relevant harvest and have applied for the payment by May 15.

Sheep and goats

The premium for maintaining ewes is to be € 21 per head or € 16.8 if the farmer markets sheep's milk.

Provided that she-goats are intended for meat production and that they are reared using techniques similar to those for he-goats, the premium is € 16.8 per head.

The minimum number of animals to which the premium application relates, as determined by the Member State, must not be less than 10 or greater than 50. The premium is subject to national limits.

A supplementary premium of € 7 per head will be paid to farmers rearing sheep and goats in less-favoured areas or in geographical areas where transhumance[75] is a traditional practice.

Farmers may transfer their premium rights after sale of the holding. If the rights are transferred without transfer of the holding, a maximum of 15% of those rights is to be surrendered to the national reserve. Member States may take measures to avoid premium rights being moved away from regions where sheep production is especially important for the local economy.

Member States are to allocate premium rights from the national reserve to newcomers, young farmers or other priority farmers. During the transitional period, the Member States will make additional payments to support farmers engaged in quality agriculture or the restructuring of holdings. A global amount is to be allocated to each Member State.

Main features of reform of the E.U. Dairy Regime

The main elements of the CAP reform package relating to the dairy sector are:

- the target price for milk was abolished as of 2004;
- a 15% price support cut for skimmed milk powder phased in over 3 years from 2004;
- a 25% price support cut for butter phased in over four years from 2004;
- butter intervention limited to the period between March 1 and August 31 each year and an annual volume limit introduced after which automatic intervention is suspended or replaced by intervention by tender (both these elements already exist for skimmed milk powder intervention);
- the introduction of direct payments for milk producers, (the Dairy Premium and Additional Payment), phased in over 3 years from 2004;
- dairy direct payments are to be incorporated into the decoupled SPF from 2007, but Member States have the option to bring this forward to 2005 in certain circumstances;
- an overall 1.5% increase in milk quotas in between 2006 and 2008.

[75] Seasonal movement of livestock between upland and lowland pastures.

- However, Member States have discretion in:
  - determining the date of decoupling of the dairy payments and their incorporation into the single payment scheme;
  - establishing objective criteria to use for making the Additional Payment element of the coupled payments;
  - allocating to individual producers the additional quota awarded between 2006 and 2008.[76]

The European Dairy market has been undergoing continuous rationalization. During the 1990s, the number of E.U. dairy farmers declined by 50%,[77] (from 1.5 million in 1990 to 642,000 in 2000 to approximately 1,600,000 (EU-25) in 2005[78]) and the average herd size increased by 55%,[79] from 18 to 28 cows. Rising yield per cow has reduced the number of cows required to meet the quota.[80]

Grain legumes aid

During the transitional period, lentils, chickpeas and vetches may be eligible for production aid by marketing year. The marketing year is from July 1 to June 30, during which the amount of aid is € 181 per hectare, subject to the ceiling set by the Commission.

Mediterranean products

In 2004, cotton, tobacco, olive oil and hops were incorporated into the SFP. These COMs will also be eligible for coupled aids on the same conditions as the other COMs mentioned above. A common feature of Mediterranean products is that they are grown in less favoured areas, often in monoculture. These aids are designed to help preserve rural areas and, in particular, conventional farms.

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76 Reform of the E.U. Dairy Regime, Agra Informa Ltd., 2005
77 Oxfam Briefing Paper 34, p. 2
78 European Dairy Association
79 Oxfam Briefing Paper 34, p. 2
80 Oxfam Briefing Paper 34, p. 5

Cotton

Cotton is subject to the new aid decoupling scheme (decoupled SFP) while retaining 35% of support per hectare. In this connection, it is important to read what the Appellate Body said in *USA – Upland Cotton*,

> "We agree with the Panel that a partial exclusion of some crops from payments has the potential to channel production toward the production of crops that remain eligible for payments."[81]

Tobacco

Tobacco will be subject to the decoupled SFP after a four-year transition period starting in 2006. From 2010, half the tobacco aid will be used to finance programs for restructuring production areas in the context of rural development.

Hops

Hops are subject to SFP decoupling starting January 1, 2005. Member States may choose to allocate a maximum of 25% of hop production aid as aid to farmers or producer organizations.

Aid for olive oil

The olive oil and table olives COM has also been adapted to the new system of single farm payments. At least 60% of all production aid paid during the 2000-02 reference period (100% for holdings of less than 0.3 hectares) will be transferred to the SFP. The amounts will be calculated over the 2000-03 reference period.

Access to the single payment will be limited to olive-growing areas corresponding to olive trees that existed prior to May 1, 1998 and to new plantings provided for under the programs approved by the Commission. The cut-off date for Cyprus and Malta is December 31, 2001.

Up to 40% of all former direct production aids may be used for additional payments to olive groves of environmental or social interest. Holdings of less than 0.3 ha also qualify for this aid.

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[81] WT/DS/267/AB/R, para 329

During the 2004-05 marketing year, current production aid in the amount of € 1,322.50 per tonne will be maintained until November 1, 2005.

Due to their approved programs for new plantings, Portugal and France will receive additional amounts of € 18 million and € 2.1 million respectively.

The SFP and aid to olive groves of environmental or social interest will be applicable from January 1, 2006.

That decoupling is not trade distorting is a myth

The U.S. experience certainly demonstrates, particularly in the case of feed grains that decoupling does not reduce production.

"Decoupled" support is not really decoupled because as the WTO Panel found in *U.S.-Upland Cotton*, the limits on crops which can be substituted for the formerly coupled crop negate decoupling. The Appellate Body stated:

> "We agree with the Panel that a partial exclusion of some crops from payments has the potential to channel production toward the production of crops that remain eligible for payments."[82]

This conclusion means that payments such as the SFP must be decoupled from all production.

The AB also noted:

> "The fact that farmers may continue to receive payments if they produce nothing at all does not detract from this assessment, because according to the Panel this is not the option preferred by the 'overwhelming majority' of farmers who continue to produce some type of permitted crop." [83]

The OECD considers that decoupling will not work – inter alia, because decoupled payments will be concentrated on those who traditionally received them.[84]

[82] WT/DS/267/AB/R, para 329
[83] WT/DS/267/AB/R, para 329
[84] A Round for Free: How rich countries are getting a free ride on agricultural subsidies at the WTO, Oxfam Briefing Paper 76

The World Bank concluded that the co-existence of coupled and decoupled programs means that incentives to overproduce remain. [85]

Under CAP 2003 decoupling there is no requirement not to produce (except that E.U. farmers may not shift into wine, potatoes and certain fruits and vegetables).

- The SFP and other payments will keep farmers in business with a guaranteed income base.
- Decoupled income flows will enable larger units to consolidate by purchasing smaller units.
- Reducing risk will not discourage planting or inhibit production decisions, including those related to productivity enhancement.
- Farmers will anticipate that (as has occurred in the USA) payment basis may be updated. This creates an incentive to maintain production – or indeed to increase it. In this connection, because European farmers are required to maintain the land in good agricultural condition, and not to reduce pasture land, there are disincentives to reducing production.
- Decoupling does not preclude farmers continuing to produce what they have always produced.

It is low world prices – which are creating a farm income crisis because "implicit export subsidies created by domestic support are increasing, lending unfair advantage to producers in industrial countries".[86] Professor Daryll E. Ray of the University of Tennessee told the 2005 WTO Public Symposium on the Global Farm Income Crisis,[87] that farmers continue to farm even without subsidies. Our analysis suggests too that farmers will continue to focus their efforts on:

- what they have always produced;
- products for which they have made capital investments – and this is particularly true of livestock-related production, such as dairy, beef and swine.

[85] World Bank, as reported in , A Round for Free: How rich countries are getting a free ride on agricultural subsidies at the WTO, Oxfam Briefing Paper 76

[86] A Round for Free: How rich countries are getting a free ride on agricultural subsidies at the WTO, Oxfam Briefing Paper 76

[87] Geneva, April 21, 2005

Commodity Regimes

Dairy

Evolution of the Dairy Regime

The dairy policy regime has been one of the main structures of the CAP since the creation of the European Community in 1963 by its six founding member states. The policy embodied the classic protectionist features of the CAP in the form of external tariffs on imports of dairy products, and internal support in the form of intervention in member states to purchase butter and SMP at preannounced floor prices. The nominal levels of protection given to dairy products in the Community was high throughout the 1960 and 70s, and caused a strong growth in milk supply.[88]

From 1973, when the U.K., Ireland and Denmark joined the Community to 1984, cows milk production increased from 91.3 to 110 million tonnes. Between 1974 and 1976 intervention stocks of butter and especially SMP rose very rapidly. Costs of the milk regime exceeded 40% of total Guarantee section expenditure. Stocks were reduced between 1977 and 1981/2 but began to rise again sharply in 1983, with milk regime costs remaining at over 30% of the CAP market support budget. This persistent high cost for the dairy sector became politically unsupportable, and milk marketing quotas were imposed upon the 11 individual member states in the 1984/5 marketing year.

Quota was initially set at each country's 1981 level of deliveries, and was then subject to phased reductions. The quota was made effective by the imposition of heavy fines (super levies) on deliveries of milk above each national quota, which were more or less successful in limiting output to quota levels.

[88] European Union: Policy , Common Agricultural Policy, USDA Economic Research Service, Briefing Room, p. 4 - 5 (www.ers.usda.gov/Briefing/EuropeanUnion/Policy/Common.htm)

Supply control kept E.U. internal prices high. Milk products required the continued use of high levels of export refunds, and of subsidies to various forms of disposal (ice cream making, confectionery, and animal feed) in the internal E.U. market.

The 1992 Reform

The E.U. agreed to certain very modest reforms of its milk regime in 1992. They were largely confined to a 5% reduction in the butter intervention price in two steps to be completed in 1994/5. At the same time the quota regime was extended once more for a further eight years to 2000.

ABARE reported that:

> "Until 1994, restrictions on imports were primarily through variable levies that prevented entry to all but permitted quantities, predominantly a quota on New Zealand butter and quotas on specified cheeses from a number of countries. As a result of the WTO Agreement on Agriculture, the variable levies were converted to tariffs and imports of butter and cheese were made subject to tariff-quotas. The import tariff-quota for butter was set at 76,700 tonnes a year. For cheese, tariff-quotas were set at 15,300 tonnes in 1995 rising to 83,400 tonnes in 2000. Although this increase was large in percentage terms, overall access is still small relative to E.U. consumption of some 5.2 million tonnes a year and world trade (excluding intra-E.U. trade) of around 1 million tonnes a year (Roberts et al. 1999)." [89]

Oxfam also attributes the problems of small farmers to subsidies being focused on the dairy processing and exporting industry.[90]

The 2000 Reform

The E.U. dairy system continues to be dominated by a quota system established at the national level. Dairy production above the quota continues to be subject to super levies that operate as fines to discipline production. Dairy production is protected through tariffs on dairy product imports and is supported by export subsidies and surplus intervention purchases of dairy

[89] Impacts of Liberalizing World Trade in Dairy Products, By Ian Shaw and Graham Love, ABARE Research Report 01.4, 2001, Canberra
[90] Oxfam Briefing Paper 34, p. 7

products. Products covered by the CAP dairy regime include: fresh, concentrated and powdered milk; cream; butter; cheese; and curd.

Changes to the dairy regime in Agenda 2000 were again modest and slow. The key changes were:

- It was agreed reductions in dairy product support prices of 15% would be phased over three years starting in 2005.
- Direct compensation to producers for the support price cuts increasing to €17.24 per tonne of quota available on each holding by 2008.
- In addition, national funding envelopes can be used to top up basic payments or to introduce area payments.
- The life of milk quota was extended until the 31st March 2008, and national quotas would be increased by 1.5% in three installments starting in 2005. Specific quota increases for Italy, Spain, Greece, the Republic of Ireland, and Northern Ireland were granted for 2000/1 and 2001/2.[91]

The 2003 Reform[92]

The reform of the CAP, agreed in June 2003, addressed the E.U. dairy regime with respect to milk quotas and market support, in addition to extending the concept of direct aids to dairy farmers in line with the CAP as applied in other agricultural sectors. The package of CAP reforms was to fundamentally change the way the CAP operated, the central element of the reform being the introduction of the SFP – the decoupled aid payment that incorporates and replaces many of the former direct aids to farmers.

The main elements of the 2003 CAP Reform relating to the dairy sector are:[93]

- the target price for milk was abolished as of 2004;
- a 15% price support cut for skimmed milk powder phased in over 3 years from 2004;
- a 25% price support cut for butter phased in over four years from 2004;

[91] Phasing Out Milk Quotas in the E.U., DEFRA, April 2002
[92] EUROPA, europa.eu.int/comm/agriculture/ capreform/infosheets/milk_en.pdf
[93] Defra, U.K. Farming, http://www.defra.gov.uk/foodrin/milk/capreform.htm

- butter intervention limited to the period between 1 March and 31 August each year and an annual volume limit introduced after which automatic intervention is suspended or replaced by intervention by tender (both these elements already exist for skimmed milk powder intervention);
- the introduction of direct payments for milk producers, (the Dairy Premium and Additional Payment), phased in over 3 years from 2004;
- dairy direct payments to be incorporated into the decoupled Single Payment Scheme from 2007, but Member States have the option to bring this forward to 2005 in certain circumstances;
- an overall 1.5% increase in milk quotas phased in between 2006 and 2008.

The areas in which Member States have discretion are:

- The date of decoupling of the dairy payments and their incorporation into the single payment scheme;
- Possible objective criteria to use for making the Additional Payment element of the coupled payments;
- How to allocate to individual producers the additional quota awarded between 2006 and 2008.
- From 2004 to 2007, and subsequently if the dairy premium is excluded from the single payment scheme, each holding's milk reference quantity (quota) expressed in tonnes is to be multiplied by € 8.15 for the 2004 calendar year, € 16.31 for 2005 and € 24.49 for 2006 and subsequent years.
- From 2004 to 2007, and subsequently if dairy production is excluded from the SFP, additional payments are to be made to each farmer. A global amount is established for each Member State.

Shortly after the CAP 2003 announcement, Chris Phillips of Dairy Australia offered the following observations,[94]

> "The E.U. recently announced a major change in its domestic support structure for dairy. This involves a shift away from supporting farm incomes through product price supports

[94] Implications of Common Agricultural Policy Reform for the Australian Dairy Industry, Chris Phillips, Dairy Australia

> and the management of market outcomes to a system of direct income payments for farmers. Two key issues for Australian producers concerning these recent Common Agricultural Policy reforms are: how the expected impacts on E.U. production and prices will flow through to world markets and prices and therefore Australian farm gate returns, and whether the changes will affect Australian businesses' future access opportunities into the E.U. At this stage the outcome of both issues is still unclear. While the E.U. reforms will encourage a more dynamic and market oriented dairy industry, there is an expectation that further reforms will be necessary in future years."

E.U. Dairy Programs

The common organization of the market in milk and milk products permits prices to be stabilized and farmers guaranteed a fair standard of living through the implementation of systems of intervention, marketing and trade with third countries. In implementing the Regulation, the E.U. Commission is assisted by a Management Committee for Milk and Milk Products, comprising representatives of the Member States and chaired by a representative of the Commission. The products covered under the common organization of the market in milk and milk products are: concentrated milk and cream, buttermilk, yoghurt, lactose, butter and butteroil, milk powder, cheese and other milk preparations. The E.U. milk and milk products marketing year runs annually from 1 July to 30 June. Intervention prices have been set by the Council of Ministers.[95]

Intervention and Private Storage System

Intervention and Private Storage System for Butter: Where the market prices for butter are at a level lower than 92% of the intervention price for a representative period, the intervention agencies of each Member State may buy in butter at 90% of the intervention price between 1 March and 31 July each year. The Commission may suspend intervention if the quantities offered exceed 70,000 tonnes in 2004, 60,000 tonnes in 2005, 50,000 tonnes in 2006, 40,000 tonnes in 2007 and 30,000 tonnes in 2008. The butter bought in must have certain characteristics and meet certain requirements. Private storage aid may be granted for cream and salted or unsalted butter produced from cream or milk. The aid amount is determined in the light of storage costs and the likely trend in prices for fresh butter and butter from stocks. Butter bought

[95] EUROPA, http://europa.eu.int/scadplus/leg/en/lvb/l11092.htm

in by the intervention agencies is to be disposed of in such a way as to avoid disturbing the balance on the market.

Intervention and Private Storage System for SMP: The intervention agencies of the Member States buy in skimmed milk powder at the intervention price between 1 March and 31 August. That milk must comply with certain composition characteristics, particularly as regards minimum protein content, which must be between 31.4% and 35.6%; the intervention price is adjusted accordingly. The Commission may suspend intervention if the quantities offered exceed 109,000 tonnes. Private storage aid is also available. Where the market situation so requires, the Commission may decide to remarket some or all of the skimmed milk powder covered by private storage contracts.

Intervention and Private Storage System for Cheese: Private storage aid is granted for certain cheeses, such as Grana Padano, Parmigiano Reggiano, Provolone, sheep's and goat's milk cheese, as well as long-keeping cheeses. The aid amount is determined in the light of storage costs and the likely trend in prices. Where the market situation so requires, the Commission may decide to remarket the various cheeses stored.

Cheese market projections for the EU-25, 2003 – 2012 ('000 tonnes) [96]

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Total production (1)	8,272	8,419	8,568	8,717	8,825	8,879	8,988	9,081	9,152	9,237
EU 15	7,289	7,385	7,522	7,654	7,745	7,763	7,846	7,910	7,956	8,014
EU N10	983	1,034	1 047	1 062	1 080	1 116	1 142	1 170	1 196	1 223
Imports	139	111	114	116	118	120	123	125	128	131
Exports	574	572	586	590	598	605	610	613	613	614
Human consumption (2)	7,660	7,788	7,927	8,072	8,174	8,225	8,331	8,422	8,498	8,584
Per capita consumption (	16.8	17.0	17.3	17.5	17.7	17.8	18.0	18.1	18.3	18.4
EU 15	17.8	18.0	18.2	18.5	18.6	18.6	18.7	18.8	18.8	18.8
EU N10	11.6	11.9	12.2	12.4	12.7	13.3	13.9	14.7	15.4	16.2

(1) Including cheese used for processed cheese. Excluding farm cheese

(2) Excluding processed cheese and farm cheese.

[96] Prospects for Agricultural Markets and Income (2005-2012), European Commission Directorate-General for Agriculture, July 2005, p 69

Price Setting

The intervention prices for 100 kg of **butter** are:

€ 328.20 from 1 July 2000 to 30 June 2004,

€ 305.23 from 1 July 2004 to 30 June 2005,

€ 282.44 from 1 July 2005 to 30 June 2006,

€ 259.52 from 1 July 2006 to 30 June 2007,

€ 246.39 as from 1 July 2007.

It is noteworthy that as the internal butter price declines, so does the value of preferential TRQ access held by New Zealand. This reduces the premium revenue available to Fonterra to assist it in competing in more price sensitive markets.

The intervention prices for 100 kg of **skimmed milk powder** are:

€ 205.52 from 1 July 2000 to 30 June 2004,

€ 195.24 from 1 July 2004 to 30 June 2005,

€ 184.97 from 1 July 2005 to 30 June 2006,

€ 174.69 as from 1 July 2006.

Special Marketing Aid

Aid is available for:

- producers of skimmed milk and skimmed milk powder (including buttermilk and buttermilk powder) used for animals. (These products must meet certain conditions).
- skimmed milk processed into casein and caseinates;[97]
- the purchase of cream, butter and concentrated butter by non-profit organizations, institutions and bodies;
- the sale of certain milk products to the armed forces;
- manufacturers of pastry products and ice-cream in order to dispose of butter surpluses.

[97] Canadian dairy producers have expressed concern about increased imports of subsidized casein from the E.U.

School Milk Aid

The school milk scheme was introduced in 1977 by the E.U. to encourage the consumption of milk by school children.

The School Milk Scheme requires Member States to make available subsidized milk to primary and nursery schools wishing to participate. But participation is entirely a matter for the school or Local Education Authority. The subsidy is available on a number of milk and milk products but the mandatory elements are whole and semi-skimmed milk (plain and flavoured) and whole and semi-skimmed milk plain yoghurts.

In July 2000 Agriculture Ministers agreed to cut the level of aid from 95% of the target price of milk to 75% from 1 January 2001. The European Commission had originally wanted to abolish the subsidy because studies it had commissioned had concluded that the scheme was not providing value for money. To compensate for the cut in E.U. funding, E.U. legislation allows Member States to top-up the subsidy by charging a levy to the industry or from government funds.

As a result of 2003 CAP reform, the target price has been abolished and the Community subsidy rates has been reduced from 2004 onwards.

To encourage children to drink milk, aid for the supply of 0.25 l of milk equivalent per pupil and per day is paid to educational establishments. Member States may grant additional aid. For whole milk, Community aid for 100 kg is:

€ 23.24 until 30 June 2004,

€ 21.69 from 1 July 2004 to 30 June 2005,

€ 20.16 from 1 July 2005 to 30 June 2006,

€ 18.61 from 1 July 2006 to 30 June 2007,

€ 18.15 as from 1 July 2007.

In the U.K. in the 2003/2004 academic year, 34.9 million litres were subsidized, at a cost of around £7m and benefiting approximately 1 million school children.[98]

Trade with Non-E.U. Countries

The trade arrangements under the CMO have the following characteristics:

- *Issue of import and export licenses:* Imports are subject to presentation of an import license. Exports may be subject to issue of an export license.
- *Common Customs Tariff:* The rates of duty in the Common Customs Tariff apply to milk and milk products.
- *Additional duty:* If imports threaten to destabilize the Community market, additional duty may be charged in accordance with WTO rules.
- *Trade barriers:* Taxes having equivalent effect to customs duty and the application of quantitative restrictions or measures of equivalent effect are prohibited in trade with third countries.
- *Tariff quotas:* These may be awarded using the first come/first served principle, the simultaneous examination method, the traditional importers/new arrivals method, or other non-discriminatory methods.
- *Refunds:* The difference between prices on the world market and Community prices may be covered by export refunds.
- *Export charges and import duties:* Where the free-at-frontier price significantly exceeds the Community price and threatens to cause long-term disruption to the proper functioning of the Community market, the Community may fully or partially suspend import duties and even collect export levies.
- *Safeguard measures:* These may be taken if the Community market is threatened with serious disturbance by reason of imports or exports.
- *Processing:* Recourse to inward processing arrangements may be prohibited.

[98] Defra, http://www.defra.gov.uk/foodrin/milk/schoolmilk.htm

Other provisions

Combating animal diseases: Market support measures may be adopted to combat the spread of certain diseases.

- *State aid:* Save as otherwise provided in the Regulation, the Treaty rules on state aid apply to the milk products sector.
- *Measures to expand milk markets and improve quality:* A Member State may impose a levy on its producers in respect of marketed quantities of milk in order to finance these measures.

Milk quotas: continued stability in the dairy sector

The milk quota regime brought stability to the E.U.'s dairy sector since its introduction in 1984. The regime has been extended to March 31, 2015. There will be three annual increases of 0.5% of quota volumes for 11 of the EU-15 Member States beginning in 2006 (Greece, Spain, Italy, Ireland and North Ireland are the exceptions as they benefited from quota increases agreed earlier), and a special quota increase of 120,000 tonnes for Greece was implemented in 2005. The Azores (Portuguese territory) were granted a derogation from superlevy (the tax paid by farmers on over-quota production) of 73,000 tonnes in 2003/04 and 63,500 tonnes in 2004/05. The normal quota for the Azores from 2005/06 will be 50,000 tonnes.

E.U. Milk Quotas are projected as follows:

	MT
2004/5	137,340,929
2005/6	137,390,928
2006/7	137,871,575
2007/8	138,352,222
2008/9 – 2014/5	138,832,859

Source: European Commission

So there will be no reduction in milk production as a result of the 2003 Reform. In order to tighten control of the milk quota system, financial discipline has been reinforced by obliging Member States to pay superlevy even before they have collected all contributions from individual farmers.

Market support: ‘safety-net’ intervention

Dairy market support will be oriented more towards a ‘safety-net’ approach in the future, with public intervention (buying into storage) for butter and SMP becoming measures of last resort.

Intervention agencies may buy in butter during the March 1 to August 31 period of any year. When the quantities of butter offered for intervention exceed the prescribed thresholds (even during the period March 1 – August 31) the Commission may suspend conventional intervention buying and continue buying in using a tendering procedure. The threshold is 70,000 tonnes in 2004, 60,000 tonnes in 2005, 50,000 tonnes in 2006, 40,000 tonnes in 2007 and 30,000 tonnes in 2008 and subsequent years.

The butter intervention price will be reduced by 25% over a four-year period, which began on July 1 2004, the four reductions being three times 7% plus a final cut of 4% in 2007. The resulting price levels will be:

- € 328.20/100 kg in 2003/2004;
- € 305.23/100 kg in 2004/2005;
- € 282.44/100 kg in 2005/2006;
- € 259.52/100 kg in 2006/2007;
- € 246.39/100 kg from 1 July 2007.

Butter market projections for the EU-25, 2003 – 2012 ('000 tonnes)[99]

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Total production	2,156	2,104	2,125	2,093	2,041	2,013	1,986	1,964	1,935	1,910
EU 15	1,875	1,797	1,810	1,788	1,750	1,734	1,717	1,697	1,670	1,648
EU N10*	281	307	315	305	291	279	269	267	265	263
Imports Exports	93 322	90 352	84 350	85 300	85 279	85 239	85 222	85 213	85 200	85 193
Total consumption	1,901	1,904	1,900	1,900	1,896	1,874	1,865	1,845	1,822	1,803
per capita consumption (	4.16	4.16	4.14	4.13	4.11	4.05	4.02	3.97	3.92	3.87
EU 15	4.33	4.30	4.28	4.27	4.23	4.15	4.12	4.06	3.99	3.94
EU N10*	3.34	3.43	3.38	3.39	3.45	3.51	3.50	3.50	3.49	3.53
Intervention Stocks										
Ending stocks	223	161	120	97	48	33	17	8	6	5
Stock changes	31	-62	-41	-22	-49	-15	-16	-9	-2	-1

Note: The figures on imports and exports are referring to total trade, i.e. including inward processing. EU N10: ten new member states

The skim milk powder (SMP) intervention price will be reduced by 15% over a three-year period, with reductions of 5% in each of 2004, 2005 and 2006. The resulting price levels will be:

- € 205.52/100 kg in 2003/04;
- € 195.24/100 kg in 2004/05;
- € 184.97/100 kg in 2005/06;
- € 174.69/100 kg from 1 July 2006.

Skimmed Milk Powder market projections for the EU-25, 2003 – 2012 ('000 tonnes)[100]

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Total production	1,286	1,097	1,098	1,060	1,025	997	970	944	921	903
EU 15	1,063	872	884	854	820	789	768	750	741	732
EU N10*	223	225	214	206	205	208	202	194	180	171
Imports	58	25	10	10	10	10	10	10	10	10
Exports	341	280	250	180	164	148	143	131	121	117
Total consumption	948	949	923	890	872	860	838	823	810	796
EU 15	885	868	854	827	809	797	776	766	753	742
EU N10*	63	81	69	63	63	63	61	58	57	54
Stock changes	55	- 107	- 65	0	0	0	0	0	0	0
Intervention Stocks										
Ending stocks	194	65	0	0	0	0	0	0	0	0
Stock changes	53	-129	-65	0	0	0	0	0	0	0

Note: The figures on imports and exports are referring to total trade, i.e. including inward processing.

* EU N10: ten new Member States

99 Prospects for Agricultural Markets and Income (2005-2012), European Commission Directorate-General for Agriculture, July 2005, p 69

100 Prospects for Agricultural Markets and Income (2005-2012), European Commission Directorate-General for Agriculture, July 2005, p 69

SMP intervention was already limited to the March-August period for a maximum quantity of 109,000 tonnes. Beyond this quantity intervention may be suspended and may be replaced by a tender procedure.

The Target Price

The Target Price for milk was originally introduced as a benchmark against which farmers could gauge their performance by comparing their milk price to the target price. Intervention prices were originally calculated from the Target Price to guarantee that milk prices for farmers would be maintained at a reasonable level. The Target Price had become largely academic and was abolished on 1 July 2004 as part of the reform.

Abolition of the Target Price meant that the super levy which had been expressed as 115% of the target price had to be amended. First, the superlevy used to be expressed as 115% of the target price. The new dairy regulation states the following specific values of the superlevy as:

- € 33.27/100 kg for 2004/05;
- € 30.91/100 kg for 2005/06;
- € 28.54/100 kg for 2006/07;
- € 27.83/100 kg for 2007/08 and subsequent periods.

Secondly, the school milk subsidy, to promote the consumption of milk and dairy products by schoolchildren, was also expressed as a percentage of the target price. The new dairy regulation establishes the specific value of the subsidy as:

- € 23.24/100 kg for 2003/04;
- € 21.69/100 kg for 2004/05;
- € 20.16/100 kg for 2005/06;
- € 18.61/100 kg for 2006/07;
- € 18.15/100 kg from 1 July 2007.

The dairy premium

In order to compensate dairy farmers for reductions in intervention prices, producers qualify for support payments paid directly to producers from 2004 to 2007 milk. These will be paid per calendar year, per holding. The payments consist initially of two elements: dairy premiums paid equally to all milk producers, and additional payments paid to milk producers according to Member State criteria. The total amounts available for direct dairy premiums in a given year are based on quota held at the end of the preceding quota year and are as follows:

- € 8.15/tonne of quota for calendar year 2004;
- € 16.31/tonne of quota for calendar year 2005;
- € 24.49/tonne of quota for calendar year 2006/2007.

Moving from the dairy premium to the SFP

Member states may introduce the SFP in 2005, 2006 or 2007. Dairy payments may be included in the SFP beginning in any one of these years. The SFP, including for the dairy sector, must be implemented by 2007. There is no option to continue with a combination of SFP and partially coupled payments from 2007 for dairy as there is on some other sectors.

A maximum amount of money – a ‘national ceiling’ – has been calculated for each Member State, which total SFP payments in all agricultural sectors must respect. A Member State may retain up to 10% of the component of the national ceiling contributed by a certain sector (e.g. the dairy component) for redistribution to the same sector under certain conditions.

A ‘reference amount’ is attributed to each farmer under the SFP, which is calculated by taking the average annual direct aid he received in 2000, 2001 and 2002. The reference amount for dairy farmers will be their reference quantity (quota) held on March 31 of the calendar year the SPS is introduced multiplied by the dairy premium.

Market Stability

The E.U. dairy industry will, where necessary, continue to benefit from market stabilization measures. The principal measures are: support for the storage of butter and cheese at certain times of the year (Private Storage Aid); subsidies for butter and cream used by the food industry, for SMP for incorporation into animal feed, and for skimmed milk for casein manufacture;[101] and, subsidies for exports of dairy products to non-E.U. countries.

Production and Projections of Milk and Milk Products (2003-2012)

Milk production, deliveries and dairy herd in the EU-25, 2003 – 2012[102]

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Total production (million tonnes)	143.5	142.3	143.4	144.5	144.9	145.2	145.1	145.0	145.0	145.0
EU 15	121.8	120.4	121.4	122.4	122.8	123.2	123.1	123.1	123.1	123.1
EU N10*	21.7	22.0	22.0	22.1	22.1	22.0	22.0	22.0	22.0	22.0
Deliveries (million tonnes)	130.9	130.6	132.0	133.6	134.2	134.9	135.4	135.7	136.0	136.0
Delivery ratio (in %)	91.3	91.8	91.5	92.4	92.6	92.9	93.3	93.6	93.8	93.8
Fat content (in %)	4.05	4.07	4.06	4.06	4.06	4.07	4.07	4.07	4.07	4.08
Protein content (in %)	3.32	3.32	3.33	3.33	3.33	3.33	3.33	3.34	3.34	3.34
Milk yield (kg/dairy cow)	5931	6018	6187	6340	6457	6555	6615	6677	6739	6813
EU 15	6275	6323	6508	6677	6801	6891	6936	6979	7022	7077
EU N10*	4536	4739	4866	4956	5042	5154	5256	5371	5497	5634
Dairy cows (million heads)	23.9	23.4	23.0	22.6	22.3	22.0	21.8	21.6	21.4	21.2
EU 15	19.3	18.8	18.5	18.2	17.9	17.8	17.7	17.6	17.5	17.3
EU N10*	4.7	4.6	4.5	4.4	4.3	4.2	4.1	4.0	3.9	3.8

Note: Dairy cow numbers refer to the end of the year (historical figures from the December cattle survey)

Likely Impact on Dairy Production by Member States

Germany

The current demographics of German dairy sector are likely to force consolidation into fewer, larger sized herds. Currently some 60% of German herds are less than 20 cows.

[101] Canadian dairy farmers have been concerned about increased imports of subsidized casein from the E.U.
[102] Prospects for Agricultural Markets and Income (2005-2012), European Commission Directorate-General for Agriculture, July 2005, p 69

France

The dairy industry in France is not expected to undergo major structural change because about 60% of its herds are in the most resilient medium-sized 30-100 cow range.

United Kingdom

The herd sizes in the U.K. are larger than average for the E.U. with 60% of heads at over 50 cows and 25% over 100 cows. Many farms with less than 50 cows will experience negative margins – which will lead to even greater concentrations of activity in larger herds. This concentration will be mitigated by the relatively greater dependence in the U.K. on fluid milk.

E.U. Dairy farmers and processors are not well placed to take advantage of expected world market growth. Domestic prices continued to be too high compared to world prices and the quota is too large in relation to unsubsidized domestic and foreign demand.[103]

Denmark

More than 60% of dairy herds in Denmark have more than 50 cows – and average yield is 18% above the E.U. average. CAP reform will not require major changes in structure.[104]

Ireland

Ireland has good herd size but underwhelming yields, well below the E.U. average. There is scope for considerable productivity improvement to get to average yields.[105] The Irish Agriculture Minister has expressed concern about the E.U. offer.

Austria and **Finland** have a heavy concentration of herds with small operators with heavy concentrations of herds in the under 30 and under 10 cows categories. Social policies at the Member State level will prevent rationalization, in Austria. Yields are much better in Finland. The industry is expected to remain profitable.[106]

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[103] Reform of the E.U. Dairy Regime, Agra Informa Ltd., 2005, p. 81
[104] Ibid, p. 84
[105] Ibid, p. 82
[106] Ibid, p. 84/85

Sweden

No major changes in structure are expected. The yields are well above E.U. average. [107]

The E.U. Dairy sector has not been decoupled from production. Support of the dairy sector will remain firmly attached to market intervention, export subsidies and compensatory payments – which are decoupled in name only. [108]

Failure to eliminate the milk during quota will prevent reforms experienced in the grains sector. [109] Subsidized production is maintained at a level 15 million tonnes greater than unsubsidized consumption. [110] In conclusion, the 2003 CAP reform of the dairy sector hinders rather than promotes rationalization and liberalization. Further market access will exacerbate costs to the European taxpayer.

Beef and Veal[111]

The organization of the market in beef and veal throughout the E.U. is based on regulations dating back to 1968. The four major elements of the system were:

- price support through a system of intervention buying, triggered when E.U. market prices fell below 80% of the 'intervention price';
- high levels of tariff protection around the E.U. market for beef;
- a system of export refunds to promote beef exports and, more recently, increased volumes of live cattle exports;
- direct payments in the form of per head premia for male bovine animals and suckler cows.

Because two-thirds of E.U. beef production comes from the dairy herd, the common organization of the market for dairy products also has a major bearing on E.U. beef production. The basic

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107 Ibid, p. 86
108 Ibid, p. 103
109 Ibid
110 Ibid
111 European Union: Policy , Common Agricultural Policy, USDA Economic Research Service, Briefing Room, p. 5 (www.ers.usda.gov/Briefing/EuropeanUnion/Policy/Common.htm)

E.U. beef regime has in the past sustained beef prices in the E.U. substantially above price levels on the world market.[112]

Beef and veal is supported through price support, export subsidies and high tariffs that are used to keep E.U. prices above world market prices. Price support payments are generally based on historical numbers of male bovines, suckler cows (cows with calves), a special slaughter payment for heifers and "extensification" of livestock production, whereby producers must observe maximum stocking rates (livestock units per hectare) to qualify for payments.

For the E.U. as a whole, some two thirds of the beef produced is derived directly or indirectly from dairy herds. These close links with the beef sector mean that meat from dairy herds increases are overall agricultural output by some 10%. Developments in the market-organization regime for dairy products are therefore of particular importance for the beef sector. [113]

Agenda 2000 Reform[114]

The Agenda 2000 reform package contained a range of measures designed to stabilize markets within the E.U., to ensure a fair standard of living for farmers, to restore levels of beef consumption in the E.U., and to make beef products more competitive on world markets. The main reform measures targeted were direct payments to producers, payments for private storage and the public storage regime.

Market management

Reform gradually reduced market support by 20%. Farmers were compensated for this by a general package of direct payments. Starting in July 2002, the intervention price was replaced by a basic price of €2,224 per tonne. Payments for private storage could be made when the average price on the Community market fell below 103% of this basic price.

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112 Agritrade Beef and Veal, Executive Brief, December 2003
113 EUROPA, http://europa.eu.int/comm/agriculture/markets/beef/index_en.htm
114 EUROPA, http://europa.eu.int/comm/agriculture/markets/beef/index_en.htm

The reform also provided for public intervention (the "safety net") when the average market price of juvenile cattle or steers fell below €1,560 per tonne.

Following the BSE and foot and mouth crises, new emergency measures were adopted for the beef sector to reduce surpluses and reassure consumers that about tighter food-safety standards for beef produced in the E.U. These measures helped to stabilize the Community market in 2001, with both production and consumption showing a net recovery.

Direct Payments to Producers

The Agenda 2000 reforms provided various types of direct aid for farmers, designed to:

- compensate for the reduced intervention price (special premium for male cattle and slaughter premium);
- maintain the income of specialist beef producers (premium for maintaining suckler cow herds);
- encourage producers to adopt extensive grazing methods (extensification payment);
- help producers in disadvantaged areas or Member States in which the beef sector is particularly important (additional suckler cow premium);
- guarantee market balance throughout the year (deseasonalization premium);
- enable Member States to provide support for specific production systems (additional payments).

The Agenda 2000 support payments for beef by 20% between 2000 and 2003. The reduced payments were partially offset by higher direct payments. But it did not achieve the desired results.

2003 CAP Reform: Partial decoupling

The new reform of the CAP in 2003 introduced the decoupling of headage payments and their replacement with a single income payment per farm based on historical entitlements.

2003 CAP Reform

If the SFP system is partially implemented for beef and veal, farmers may apply for various premia:

- The special premium for bulls (uncastrated male bovine animals) or steers (castrated male bovine animals);
- The deseasonalisation premium, within the limit of the budgetary resources available where the Member State opts for the transitional period, if the number of bovine animals slaughtered during the year is more than the average annual slaughterings of male bovine animals;
- The suckler cow premium (€ 200) for farmers supplying little or no milk or producing organic milk. An additional premium of € 50 may be provided by the Member State.
- Suckler cow premium rights may be transferred. If the rights are transferred without the holding, the Member State may return up to 15% of the rights to the national reserve. Member States may prevent premium rights from being transferred outside regions where beef and veal production is particularly important for the local economy. Premium rights from the national reserve are to be allocated to newcomers, young farmers and other priority farmers. For Member States where more than 60% of heifers and suckler cows are kept in mountain areas, the granting of premiums for heifers and suckler cows may be managed separately;
- The slaughter premium, subject to ceilings to be determined, is to be € 80 for cows, bulls and heifers and € 50 for calves;
- The extensification premium, if the farmer is already receiving the special premium and/or the suckler cow premium during the transitional period;
- Additional payments during the transitional period are to be made according to area and/or headage.

2003 CAP Reform gives Member States a range of alternatives for supporting beef and veal which did not involve price decoupling: a 100% coupled payment for the number of suckler-cows, up to 40% coupled payment for slaughter of heifers, a 100% coupled payment for slaughter of heifers, and/or a 75% coupled payment for special male bovines.

According to McCallum and Murphy of Meat and Livestock Australia and EM Consultants,[115]

> "The European Union (EU) beef and veal production systems have been functioning under a favourable operating environment with internal support systems and protection measures such as tariffs and quotas. Recent reforms of the EU's Common Agricultural Policy (CAP) aimed to encourage EU beef and veal production systems to become more market orientated. A centrepiece of the reform involved the introduction of a Single Farm Payment (SFP) Scheme, which is farm based rather than production based and hence, is designed to remove the incentive for EU producers to overproduce. The scheme aims to rebalance the market place and as a consequence producer's incomes should be maintained and improved. However, the final CAP reform package has been implemented in a variable manner, with some Members States opting for partial decoupling with no commitment to adopt full decoupling in the future. These recent CAP reforms are welcome, even though the new scheme still offers strong support via government assistance to EU beef producers. The EU also still imposes a beef import quota on the Australian beef industry limiting high quality beef imports to 7,000 tonnes. Until such time as Australia's country specific high quality beef quota expands or the above quota tariffs are removed, there will be no significant increase in Australia's beef trade with the EU."

E.U. Beef and Veal Market Projections

Beef/veal market projections for the EU-25, 2003 – 2012 ('000 tonnes cwe*)[116]

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Gross Indigenous Production	8,069	8,132	8,020	8,153	8,101	8,033	7,942	7,843	7,763	7,716
Live Imports	7	9	3	3	3	3	3	3	3	3
Live Exports	93	106	95	112	112	112	112	112	112	112
Net Production	7,983	8,035	7,928	8,044	7,992	7,924	7,833	7,734	7,654	7,607
EU 15	7,359	7,440	7,414	7,473	7,429	7,352	7,260	7,158	7,075	7,027
EU N10*	625	595	514	571	563	572	574	576	578	581
Import	440	509	549	560	566	577	588	600	614	628
Exports	390	333	266	337	298	264	226	169	116	101
Stocks changes	-204	0	0	0	0	0	0	0	0	0
Consumption	8,265	8,244	8,210	8,267	8,260	8,238	8,195	8,165	8,151	8,134
Per Capita Consumption	18.1	18.0	17.9	17.9	17.9	17.8	17.7	17.6	17.5	17.5
EU 15	20.1	20.1	20.0	20.1	20.0	19.9	19.7	19.6	19.5	19.5
EU N10*	7.7	7.1	6.7	6.7	6.7	6.7	6.7	6.7	6.7	6.7
Ending stocks (Intervention)	34	0	0	0	0	0	0	0	0	0

* cwe = carcass-weight equivalent

Because decoupling under the beef and veal regime is only partial – and direct payments continue – we have reviewed below the principal direct payment programs.

115 E.U. Common Agricultural Policy Reform: Implications for Beef Imports
116 Prospects for Agricultural Markets and Income (2005-2012), European Commission Directorate-General for Agriculture, July 2005, p 67

Special Premiums

Under the Beef Special Premium Scheme (BSP), steers and young bulls are eligible for BSP but heifers do not qualify. BSP can be claimed twice on steers, but only one claim can be made on bulls. The first payment is made on steers between 9 and 22 months of age, and the second payment is made on animals at 22 months of age and over. Bulls are eligible for payment from 9 months of age. Animals claimed must be retained for 2 months from the day after the premium application was submitted. The age of the animal at the end of the retention period determines eligibility; therefore applications can be made for steers between 7 and 20 months for the first payment, and at least 20 months of age for the second payment.

Payment rates under the 2003 BSP scheme were € 150 for steers and € 210 for bulls, before modulation of 3.5%. Advance payments are made from mid-October of the scheme year, with the balance paid from the following April.

Each E.U. member state is subject to a regional ceiling on the number of claims which can be made; for 2003 the U.K. reference herd was 1,461,978 head, which included a temporary additional 100,000 head due to the ban on calf exports. If the total number of first premium and bull claims exceeds the regional reference herd, claims are scaled back proportionately.

The animals are covered by animal passports or equivalent administrative documents containing the relevant information on their premium status. The premium, which is subject to regional ceilings is granted in respect of an annual maximum of 90 animals per age bracket per holding.[117]

Suckler-cow Premiums

The Suckler Cow Premium Scheme (SCP) was introduced in 1980 to increase the returns of beef producers. Eligible cows must be of a meat breed or cross, and used for rearing calves for meat. Claimed animals must be retained for 6 months from the date of application. Small milk producers may claim SCP on their beef cows provided they hold less than 174,780 litres of milk quota. In 2003, there was a requirement that heifers should comprise a minimum of 5% up to a

[117] On the basis of objective criteria, the Member States can modify the herd size limit of 90 animals.

maximum of 40% of the SCP claim, unless the total animals in the claim was for less than 14 animals.

Payment rates for the 2003 scheme year consisted of € 200 in premium and an additional maximum of € 50 from national funds (Beef National Envelope). Advance payments of 80% are paid in the autumn followed by the balance the following spring.

The number of SCP claims which can be made is limited by the amount of quota available and national ceilings. SCP rights can be transferred, (purchased or sold) with or without land. When transferring without land, up to 15% of the quota must be surrendered to the national reserve. Likewise, producers not using 90% of their rights must transfer the unused portion to the national reserve. These rights are re-distributed to new entrants, young farmers and other priority producers. Quota can also be traded between producers, temporarily, by lease for whole calendar years only. In these cases no transfer of land is required.

Stocking Density

Suckler Cow Premium and Beef Special Premium schemes are subject to a maximum stocking density applied to all producers with over 15 livestock units (LU). For the 2003 scheme year, the limit was set at 1.8 LU per forage hectare. Male cattle, suckler cows and heifers for which SCP has been claimed and sheep for which Sheep Annual Premium (SAP) has been claimed are taken into account, as well as milk quota held.

Suckler cows and other cattle over 24 months of age, and the notional number of dairy cows required to produce milk up to the quota (attributed to holding on the March 31 in the scheme year), represent 1 LU, male cattle and heifers between 6-24 months old 0.6 LU and sheep 0.15 LU.

Slaughter Premiums

The Slaughter Premium was introduced in 2000. Bulls, steers, cows and heifers over 8 months old are eligible, as are calves between 1 month and 7 months of age and over 160kg carcass weight. Animals must have been held by the producer for at least 2 months ending less than 1 month before slaughter. Adult cattle qualify for € 80/head and calves € 50/head. Slaughter Premium claims are subject to a national ceiling.

Additional Payments

Member States may grant additional headage and/or area payments. Additional headage payments may be granted for male bovine animals, suckler cows, dairy cows and heifers. A ceiling per Member State applies to such payments. Area payments are granted per hectare of permanent pasture under certain conditions.

Payments

Payments are made once the inspections are carried out but not earlier than October 16 of the calendar year of application and not later than June 30 of the year following the calendar year of application.

Investigation

Where an inspection shows that producers have illegally used authorized substances or illegal substances in rearing animals or where they obstruct the inspection, they are excluded from receiving direct payments for the calendar year concerned. In the event of a repeated infringement, they may be excluded for five years. This is an essential element of the animal welfare protection of 2003 CAP Reform.

Storage

From July 1, 2002, private storage aid was available where the average Community market price fell to less than 103% of the basic price, set at € 2,224 per tonne for male bovine animals. This basic price may be adjusted by the E.U. Council.

Public intervention is triggered from the same date where the average market price in a Member State or region of a Member State falls below € 1,560 per tonne for two consecutive weeks. In that event, the buying-in price and the quantities involved are determined by invitation to tender.

Arable Crops

E.U. crop markets will be influenced by a series of key factors that influence the medium-term (today to 2012) prospects for E.U. arable crop markets. The most important are:[118]

- *The im*plementation of the 2003 CAP reform: the introduction of the SFP and the reduction in the level of support in the cereal sector are expected to lead to a slight decline in cereal area (mainly affecting rye and durum wheat) and to a rise in voluntary set-aside as land with low profitability would move out of production;
- The mandatory set-aside: after a record 2004 harvest characterized by favourable weather conditions and a reduction from 10% to 5% in the mandatory rate of set-aside, the return to a mandatory set-aside level equivalent to the regulatory level of 10% over the medium term is projected to significantly reduce the E.U. production potential and improve the cereal market balance, notably in the second half of the projection period;
- Lower prospects for yield growth: the significant slowdown in cereal yield growth observed in the E.U. over the last few years is expected to persist over the projection period;
- Modest growth in feed use: The period to 2012 is expected to be in the production growth of the pig meat, poultry meat and egg sectors. This should lead to a more moderate expansion of feed use of cereals;
- Supportive world markets: world market conditions for cereals and oilseeds are forecast by most international organizations to be moderately favourable, with notably an expanding world (import) demand (South East Asia);
- The US$/€ exchange rate: the transmission of these favourable world market conditions to E.U. markets under the current policy conditions does depends on the value of the Euro relative to the US$. The E.U. appears to be relying on a decline in the value of the Euro to $1.15 by 2012.

[118] Prospects for Agricultural Markets and Income (2005-2012), European Commission Directorate-General for Agriculture, July 2005

The impact of E.U. enlargement:

- *Importance of the new Member States*: In 2004, the new Member States accounted for 29% of the total E.U. cereal and oilseed production. The new Member States have improved production potential for arable crops;
- *Integration of the new Member States into the single market*: By competitiveness of a number of southern landlocked new Member States has been hampered by high transport costs and the lack of important storing facilities. This will require additional infrastructure investigations. These investments will take time to effectively influence production and trade patterns. This will delay expected benefits to those countries.
- *Currency appreciation in the new Member States*: the strengthening against the Euro of several currencies (in nominal and real terms) of the new Member States is expected to persist over the medium term as the new Member States grow at a much faster pace than the Eurozone economies. This strengthens, will be supported by inflows of foreign direct investments at significant levels of GDP as well as the transfer of E.U.

The biofuel policy: The energy crisis will create additional demand for crops to be used in the production of biofuels. Current projections suggest that there will be limited shifting to biofuel supply. But exemption from set aside will create additional income incentives to service these markets.

Area Allocation[119]

After an initial sharp drop in 2005 to 50.9 million hectares, cereal area is expected to remain relatively stable and reach 50 million hectares in 2012 (i.e., a further 0.9 million hectares fall). Oilseed area would remain stable at 6.8 million hectares in 2005 and then slightly increase by 0.4 million hectares to 7.2 million hectares in 2012 (including the non-food (energy) oilseed production on set-aside area). Nonfood oilseed production on set-aside land increased from 0.5

[119] Prospects for Agricultural Markets and Income (2005-2012), European Commission Directorate-General for Agriculture, July 2005

million hectares in 2004 to 0.9 million hectares in 2005 in line with the increase in mandatory set-aside. Protein crop area in the EU-25 is projected to stabilize at around 1.4 million hectares, of which 0.2 million hectares would come from the new Member States.

Area under arable crops and set-aside in the E.U., 2003-2012 (million hectares) [120]

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Cereals	**51.3**	**52.4**	**50.9**	**50.7**	**50.6**	**50.5**	**50.0**	**50.0**	**49.9**	**50.0**
of which EU-15	36.3	36.9	35.7	35.6	35.5	35.5	35.4	35.4	35.3	35.2
EU-N10	15.0	15.5	15.2	15.2	15.1	15.0	14.6	14.6	14.7	14.7
Soft wheat	18.3	19.3	19.5	19.0	19.0	18.9	18.8	18.8	18.9	18.9
Durum wheat	3.8	3.9	3.3	3.6	3.6	3.6	3.6	3.6	3.6	3.6
Barley	13.4	12.9	12.8	12.8	12.7	12.7	12.5	12.4	12.3	12.2
Maize	6.2	6.5	6.1	6.0	6.0	6.0	5.9	6.0	6.0	6.1
Rye	2.6	2.7	2.6	2.8	2.8	2.8	2.7	2.7	2.7	2.7
Other cereals	7.1	7.0	6.7	6.5	6.5	6.5	6.4	6.4	6.4	6.4
Oilseeds (1)	**5.9**	**6.3**	**5.9**	**6.3**	**6.3**	**6.3**	**6.3**	**6.3**	**6.4**	**6.4**
of which EU-15	4.2	4.5	4.3	4.6	4.6	4.6	4.6	4.7	4.7	4.7
EU-N10	1.7	1.8	1.6	1.7	1.7	1.7	1.6	1.7	1.7	1.7
Rapeseed	3.5	3.9	3.6	3.9	3.9	3.9	3.9	3.9	3.9	4.0
Sunflower seed	2.2	2.1	2.0	2.1	2.1	2.1	2.1	2.1	2.1	2.1
Soybean	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Protein crops	**1.6**	**1.5**	**1.4**	**1.4**	**1.4**	**1.4**	**1.4**	**1.4**	**1.4**	**1.4**
Flax and Hemp	**0.2**	**0.2**	**0.2**	**0.2**	**0.2**	**0.2**	**0.2**	**0.2**	**0.2**	**0.2**
Silage (2)	**4.6**	**4.4**	**4.1**	**3.9**	**3.9**	**3.9**	**3.9**	**3.9**	**3.9**	**3.9**
Total arable crops	**63.7**	**64.8**	**62.5**	**62.5**	**62.4**	**62.3**	**61.8**	**61.8**	**61.8**	**61.8**
Compulsatory set-aside	4.0	1.9	4.0	4.0	4.0	4.0	5.0	5.0	5.0	5.0
of which EU-15	4.0	1.9	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0
EU-N10	0.0	0.0	0.0	0.0	0.0	0.0	1.0	1.0	1.0	1.0
of which non-food oilseeds	0.9	0.5	0.9	0.8	0.8	0.8	0.8	0.8	0.8	0.8
Voluntary set-aside	2.3	3.3	3.0	3.2	3.2	3.2	3.3	3.2	3.2	3.2
Total set aside	**6.3**	**5.3**	**7.0**	**7.2**	**7.3**	**7.3**	**8.3**	**8.2**	**8.2**	**8.3**
Total COP	**70.0**	**70.0**	**69.5**	**69.7**	**69.6**	**69.6**	**70.0**	**70.0**	**70.0**	**70.1**

(1) major oilseeds on non set-aside land;

(2) excluding grass silage;

EU-N10: Ten new Member States

(a) Grains and Cereals

2003 CAP Reform abolished intervention support for rye and required a decoupled SFP payment of at least 75% for arable crops. As the decoupled payment is not tied to production, farmers are free to plant any crop, or to not plant at all. Durum wheat was allowed a 40% coupled payment in traditional areas. Support for durum wheat in non-traditional areas was abolished. In addition, storage payments for grains were cut by 50%.

[120] Prospects for Agricultural Markets and Income (2005-2012), European Commission Directorate-General for Agriculture, July 2005, p 66

Despite these amendments, USDA considers that E.U. grain prices will likely remain above world prices most of the time, requiring that export subsidies be used so that E.U. grain exports will remain competitive.[121]

According to James Molan of the Australian Wheat Board,[122]

> "The E.U. is important to the Australian grains industry as both a market for wheat, lupins and canola and as a competitor in wheat and barley. While the 2003 Common Agricultural (CAP) reforms represent a further decoupling of production from government support, the European Commission's principal objective continues to be to use production subsidies, price support and border protection to prop up its agricultural sector and achieve food production autonomy. The European Commission's latest reforms are more about restructuring the way producer subsidies are paid rather than reducing payment levels or exposing E.U. farmers to competitive pressure from the international market. Therefore, the 2003 CAP reforms are unlikely to result in a decrease in E.U. surpluses of soft wheat and barley, especially given the recent expansion of the E.U. into Eastern Europe. Exports and stocks of E.U. soft wheat and barley are predicted to increase, although durum wheat production is expected to fall, potentially creating some new export opportunities for Australia. A major problem for the European Commission is that, increasingly, E.U. wheat exports will struggle to compete in traditional markets in North Africa and the Middle East with low-priced wheat originating from the former Soviet Union States. As a result, the E.U. is expected to continue to rely on export subsidies at least until they are phased out through the World Trade Organization Doha Round."

The medium-term projections depict an outlook for the E.U. cereal markets that would appear moderately positive for most E.U. cereals, with the noticeable exception of barley which would only gain competitiveness on domestic markets towards the end of the decade. However, the functioning of cereal markets in some producing regions could remain constrained by marketing inefficiencies. The latter could affect in particular the marketing of soft wheat and maize from southern central European countries. It is assumed that the market integration of these regions into the single market would gradually increase until 2008 alongside with improvements in infrastructure.

The medium-term prospects for yield growth in the E.U. would show a more modest pattern than earlier projections suggested, with an average annual growth estimated at approximately 0.8%

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[121] European Union: Policy , Common Agricultural Policy, USDA Economic Research Service, Briefing Room, p. 4 (www.ers.usda.gov/Briefing/EuropeanUnion/Policy/Common.htm)

[122] Agricultural Policy Reform in E.U.: An Australian Grains Industry Perspective, James Molan, AWB Limited

between 2005 and 2012. In the past years, yield growth slowed down considerably and future increases in the intensive cereal production basins of the old Member States now appear more limited. However, corn (maize) yields should continue to increase substantially throughout the E.U. Some scope for further yield increase are also expected in the new Member States, which are on average at roughly half of the yield levels of the old Member States.

The projected rise in cereal yields would more than offset the decline in cereal area and entail a gradual expansion in cereal production over the medium term. After a pronounced short-term fall in 2005 at 261 million tonnes due to the increase in mandatory set-aside and lower levels of yield, EU-25 cereal production would resume expanding to reach 271 million tonnes in 2012.

Domestic consumption of cereals would exhibit an 11 million tonnes increase over the projection horizon to stand at 256 million tonnes in 2012. Cereal feed demand would continue to expand from 153 million tonnes in 2005 to 161 million tonnes in 2012. However, compared to the previous decade when feed use expanded by more than 20 million tonnes, the coming years would only exhibit a moderate growth. Industrial and human consumption would demonstrate a slight increase by 4.2 million tonnes until 2012.

Several factors would contribute to this moderate growth in cereal feed use. First, the increase in feeding efficiency will continue, in particular in the new Member States, resulting in lower feed use per ton of meat and livestock products than seen in the past. The overall increase in white meat and egg production in the E.U. is also projected to be lower than in the last decade. Feed cereals gained competitiveness in the 1992 and 1999 reforms and largely replaced cereal substitutes. Future additional gains in cereal consumption in this respect appear more limited.

Changing price relations over the medium term would result in a significant change in the composition of cereal feed use in the medium term. In the first half of the period soft wheat and regionally also maize would become more attractive in feed use, while barley would gain competitiveness in the second half of the period.

In the short term most of the public stocks would consist of soft wheat, rye and maize. Rye public stocks would disappear by 2007. Soft wheat and maize stocks would be gradually reduced and disappear in 2008 and 2009 respectively. Barley would suffer from significant loss of competitiveness during that time and public stocks of barley would tend to accumulate. The competitiveness of barley would then improve, leading to a reduction in public stocks from 2009 onwards.

In summary, the medium-term prospects for cereal markets for the EU-25 should remain moderately positive thanks to the impact of the CAP reform and the return to a higher set-aside level which, combined with more favourable conditions on world markets, should contribute to the improvement of the balance of cereal markets after the record harvest of 2004. The assumed return to a slightly weaker euro over the medium term should also help to restore a moderate level of competitiveness for cereals.

Total cereals market projections for the European Union, 2003-2012 (million tonnes) [123]

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Usable production	**229.8**	**284.8**	**261.1**	**260.3**	**261.3**	**262.9**	**263.0**	**265.8**	**267.8**	**270.9**
of which EU-15	185.2	221.6	206.2	206.1	206.9	208.1	209.1	211.2	212.3	214.2
EU-N10	44.6	63.3	54.9	54.2	54.4	54.7	53.9	54.6	55.6	56.7
Consumption	**239.1**	**243.3**	**244.9**	**244.5**	**246.5**	**248.8**	**249.0**	**251.2**	**252.6**	**256.0**
of which bioenergy	0.0	0.7	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5
of which EU-15	189.9	197.4	198.1	197.5	199.5	201.9	202.1	204.3	205.8	209.1
EU-N10	49.2	46.0	46.7	47.0	47.0	46.9	46.9	46.9	46.8	46.9
Imports	14.1	10.1	9.9	9.6	10.2	10.9	11.2	11.1	11.2	11.3
Exports	20.2	22.8	27.8	27.9	27.6	27.5	25.0	27.1	29.0	30.5
Beginning stocks	48.0	32.7	61.1	58.8	55.8	52.7	49.2	48.2	45.7	41.9
Ending stocks	32.7	61.1	58.8	55.8	52.7	49.2	48.2	45.7	41.9	36.4
of which intervention	3.5	15.7	12.3	13.4	13.1	10.5	11.0	9.8	7.4	3.0

EU-N10: Ten new Member States

[123] Prospects for Agricultural Markets and Income (2005-2012), European Commission Directorate-General for Agriculture, July 2005, p 65

Total wheat market projections for the European Union, 2003-2012 (million tonnes) [124]

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Usable production	**106.6**	**136.3**	**127.9**	**125.0**	**125.8**	**126.4**	**126.7**	**128.2**	**129.9**	**131.5**
of which EU-15	90.3	111.3	106.5	105.1	105.8	106.4	107.2	108.4	109.6	110.8
EU-N10	16.3	25.0	21.4	19.9	19.9	19.9	19.5	19.8	20.2	20.7
Consumption	**108.9**	**115.9**	**118.2**	**117.5**	**119.2**	**120.1**	**119.4**	**118.3**	**118.1**	**118.3**
of which EU-15	91.8	96.5	98.8	98.0	99.7	100.6	100.0	99.2	99.0	99.3
EU-N10	17.1	19.4	19.4	19.5	19.5	19.5	19.3	19.1	19.0	18.9
Imports	6.0	6.7	6.5	6.2	6.2	6.6	6.7	6.7	6.7	6.7
Exports	10.3	13.3	16.5	16.4	16.4	16.4	14.0	16.0	17.9	19.3
Beginning stocks	19.4	13.0	26.7	26.4	23.7	20.0	16.0	15.5	15.5	15.5
Ending stocks	13.0	26.7	26.4	23.7	20.0	16.0	15.5	15.5	15.5	15.5
of which intervention	0.2	9.7	7.7	5.9	4.0	0.0	0.0	0.0	0.0	0.0

EU-N10: Ten new Member States

Total coarse grain projections for the European Union, 2003-2012 (million tonnes) [125]

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Usable production	**123.2**	**148.6**	**133.1**	**135.3**	**135.5**	**136.5**	**136.3**	**137.6**	**138.0**	**139.4**
of which EU-15	95.0	110.3	99.6	101.0	101.1	101.7	101.9	102.7	102.6	103.3
EU-N10	28.2	38.3	33.5	34.3	34.5	34.8	34.4	34.8	35.4	36.0
Consumption	**130.2**	**127.9**	**127.2**	**127.5**	**127.7**	**129.2**	**130.2**	**133.4**	**135.1**	**138.3**
of which EU-15	98.1	100.8	99.3	99.5	99.7	101.2	102.1	105.1	106.8	109.8
EU-N10	32.1	26.6	27.4	27.5	27.5	27.5	27.6	27.7	27.8	28.0
Imports	8.1	3.4	3.4	3.3	4.0	4.2	4.5	4.4	4.4	4.5
Exports	9.9	9.5	11.3	11.5	11.2	11.0	11.1	11.1	11.1	11.1
Beginning stocks	28.5	19.8	34.4	32.4	32.1	32.7	33.1	32.6	30.1	26.3
Ending stocks	19.8	34.4	32.4	32.1	32.7	33.1	32.6	30.1	26.3	20.8
of which intervention	3.3	3.9	3.6	6.5	8.3	10.3	11.0	9.8	7.4	3.0

EU-N10: Ten new Member States

Soft wheat market projections for the European Union, 2003-2012 (million tonnes) [126]

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Usable production	**97.8**	**124.6**	**119.3**	**115.4**	**116.0**	**116.6**	**116.8**	**118.2**	**119.7**	**121.2**
of which EU-15	81.5	99.6	97.9	95.5	96.2	96.7	97.4	98.5	99.6	100.6
EU-N10	16.3	24.9	21.3	19.9	19.9	19.9	19.4	19.7	20.1	20.6
Consumption	**98.4**	**105.0**	**107.8**	**107.1**	**108.7**	**109.5**	**108.7**	**107.6**	**107.2**	**107.3**
of which EU-15	81.9	86.1	88.5	88.0	89.7	90.5	89.8	88.9	88.6	88.8
EU-N10	16.5	19.0	19.2	19.1	19.1	19.0	18.9	18.7	18.6	18.5
Imports	3.8	5.2	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Exports	9.4	12.0	16.0	16.0	16.0	16.0	13.6	15.6	17.5	18.9
Beginning stocks	18.7	12.5	25.2	25.7	23.0	19.3	15.3	14.8	14.8	14.8
Ending stocks	12.5	25.2	25.7	23.0	19.3	15.3	14.8	14.8	14.8	14.8
of which intervention	0.2	9.7	7.7	5.9	4.0	0.0	0.0	0.0	0.0	0.0

EU-N10: Ten new Member States

[124] Prospects for Agricultural Markets and Income (2005-2012), European Commission Directorate-General for Agriculture, July 2005, p 65
[125] Prospects for Agricultural Markets and Income (2005-2012), European Commission Directorate-General for Agriculture, July 2005, p 65
[126] Prospects for Agricultural Markets and Income (2005-2012), European Commission Directorate-General for Agriculture, July 2005, p 65

Barley market projections for the European Union, 2003-2012 (million tonnes) [127]

2003	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Usable production	**54.1**	**60.9**	**55.5**	**55.5**	**55.6**	**55.6**	**55.4**	**55.1**	**55.0**	**54.7**
of which EU-15	46.2	51.2	46.9	46.9	46.9	46.9	46.8	46.5	46.2	45.9
EU-N10	8.0	9.7	8.5	8.6	8.6	8.7	8.6	8.6	8.7	8.8
Consumption	**51.9**	**46.1**	**46.5**	**46.3**	**46.3**	**46.9**	**47.7**	**49.2**	**50.3**	**51.7**
of which EU-15	43.5	38.9	38.3	38.1	38.1	38.7	39.3	40.7	41.7	43.1
EU-N10	8.4	7.2	8.2	8.2	8.2	8.2	8.4	8.5	8.6	8.7
Imports	0.7	0.5	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Exports	6.5	6.0	7.8	7.9	7.9	7.9	7.9	7.9	8.0	8.0
Beginning stocks	6.9	3.4	12.7	14.3	16.0	17.8	19.0	19.2	17.5	14.6
Ending stocks	3.4	12.7	14.3	16.0	17.8	19.0	19.2	17.5	14.6	10.0
of which intervention	0.0	1.5	2.6	6.3	8.3	10.3	11.0	9.8	7.4	3.0

EU-N10: Ten new Member States

Maize market projections for the European Union, 2003-2012 (million tonnes) [128]

2003	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Usable production	**41.4**	**53.1**	**47.6**	**49.6**	**49.6**	**50.3**	**50.5**	**51.7**	**52.0**	**53.3**
of which EU-15	33.8	41.0	36.8	38.3	38.3	38.9	39.0	40.1	40.1	41.0
EU-N10	7.7	12.2	10.8	11.2	11.3	11.4	11.4	11.6	11.9	12.3
Consumption	**43.6**	**50.8**	**49.3**	**50.2**	**50.2**	**51.0**	**51.3**	**52.5**	**53.0**	**54.4**
of which EU-15	35.7	44.3	42.9	43.5	43.6	44.3	44.7	45.8	46.3	47.6
EU-N10	7.9	6.6	6.5	6.7	6.6	6.6	6.6	6.7	6.6	6.7
Imports	5.6	2.4	2.5	2.5	2.5	2.6	2.6	2.5	2.6	2.6
Exports	2.0	2.4	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
Beginning stocks	9.9	11.4	13.6	11.9	11.4	10.7	10.1	9.4	8.6	7.7
Ending stocks	11.4	13.6	11.9	11.4	10.7	10.1	9.4	8.6	7.7	6.8
of which intervention	0.0	2.1	1.0	1.0	0.8	0.2	0.0	0.0	0.0	0.0

EU-N10: Ten new Member States

(b) Rice

Under the 2003 CAP Reform the intervention price for rice will be reduced by 50% to €150/tonne, and 88% compensation will be offered through higher payments. As a result, existing payments will increase from € 52/tonne to € 177/tonne. Of this, € 102/tonne will become part of the single payment per farm and be paid on the basis of historical rights limited by the current maximum guaranteed areas (MGA). The MGA will be set at the 1999-2001 average or the current MGA, whichever is lower. The remaining € 75/tonne will remain crop specific. Intervention will be limited to 75,000 tonnes per year. [129]

[127] Prospects for Agricultural Markets and Income (2005-2012), European Commission Directorate-General for Agriculture, July 2005, p 66

[128] Prospects for Agricultural Markets and Income (2005-2012), European Commission Directorate-General for Agriculture, July 2005, p 66

[129] Analysis of the 2003 CAP Reform, OECD

(c) Oilseeds

The E.U. oilseed sector has a relatively low level of self-sufficiency, largely due to adverse climate and soil conditions in Europe. There is a zero tariff on soybeans and soy meal and a low or nominal tariff on vegetable oil other than olive oil because of a 1956 agreement within the General Agreement of Tariffs and Trade (GATT). Compensatory payments are made to growers of rapeseed, sunflower seed, and soybeans for prices that had been supported through payments to oilseed crushers. The area of subsidized oilseed production is limited by the terms of the 1994 U.S.-E.U. "Blair House" Agreement, and oilseed producers (unless they are small producers) are required to set aside land at the same rate as for all arable crops. Agenda 2000 set compensatory payments for oilseeds at the same level as those for grains. While the 2003 reforms do not directly affect oilseeds, producers will have more freedom to make planting decisions, which could affect oilseed production through a reallocation of area and resources.

These projections do not suggest important improvements in market access, but oilseeds have one of the better import rates for the E.U.

Total oilseed market projections for the European Union, 2003-2012 (million tonnes) [130]

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Usable production	**16.1**	**19.2**	**18.9**	**18.4**	**18.8**	**19.2**	**19.5**	**19.1**	**19.5**	**19.9**
of which EU-15	12.7	14.9	15.5	14.9	15.2	15.5	15.8	16.2	16.5	16.9
EU-N10	3.4	4.3	3.5	3.6	3.6	3.7	3.6	3.0	3.0	3.0
of which non-food	2.3	1.8	2.2	2.2	2.3	2.3	2.3	2.4	2.4	2.4
Consumption	**32.8**	**33.3**	**35.7**	**36.4**	**36.9**	**37.3**	**37.6**	**37.4**	**37.6**	**37.8**
of which bioenergy	3.6	4.6	5.6	5.6	5.6	5.6	5.6	5.6	5.6	5.6
of which EU-15	30.9	30.9	33.2	33.8	34.3	34.7	35.0	35.3	35.5	35.7
EU-N10	1.9	2.4	2.5	2.5	2.6	2.6	2.6	2.1	2.0	2.1
Imports	21.1	17.9	17.1	18.4	18.3	18.5	18.4	18.6	18.5	18.4
Exports	1.0	4.6	0.4	0.5	0.3	0.3	0.3	0.3	0.4	0.5
Beginning stocks	7.6	9.8	4.1	4.4	4.5	4.6	4.6	4.6	4.6	4.6
Ending stocks	9.8	4.1	4.4	4.5	4.6	4.6	4.6	4.6	4.6	4.7

EU-N10: Ten new Member States

[130] Prospects for Agricultural Markets and Income (2005-2012), European Commission Directorate-General for Agriculture, July 2005, p 67

(d) Fruits and vegetables

The fruit and vegetable regime includes all fruits and vegetables grown in the E.U., with the exception of potatoes, peas and beans for fodder, wine grapes, olives, sweet corn, and bananas, for which separate arrangements operate. Market prices are supported by a system of compensation for limited withdrawals of produce from the market needed to maintain prices at desired levels. Due to product perishability, the price support system is not designed to achieve a guaranteed price over periods of excess and shortage as it is with some other commodities subject to intervention. Rather, it acts as a safety net for producers in times of oversupply. Seasonal tariffs and tariff-rate quotas in over 100 preferential trade agreements are the principal means of import protection. Processors of some products also receive processing subsidies to help defray the high costs of buying E.U. raw materials.

(e) Mediterranean products and hops

In April 2004, cotton, olive oil, tobacco, and hops were reformed along the lines of the 2003 reforms. Decoupled payments of varying amounts will be incorporated into the SFP. A brief summary follows:

Cotton

A decoupled payment of at least 65% of the 2000-02 historical payment will be made beginning in 2006. Coupled payment of up to 35% will be allowed as an area-based subsidy with a maximum base of 455,360 hectares, split between Greece, Portugal, and Spain. In 2006, 22 million Euros will be transferred from market support to a transitional restructuring fund.

Tobacco

A decoupled payment of at least 40% of the 2000-02 historical payment will be made from 2006-09, increasing to 100% from 2010 onward. Fifty per cent of the payment will go into the SFP with the remainder transferred to a restructuring fund. During 2006-09, 60% of the payment can be coupled, with any remainder going to improve quality.

Olive Oil

A decoupled payment of at least 60% will be made beginning in 2006. Countries can choose 2 years from 2000-03 for the historic period. Payment will be made only for areas planted before May 1, 1998. Member states may use up to 10% of their national olive oil envelopes (total national payment level) to improve oil quality.

Hops

A decoupled payment of at least 75% of the 2000-02 historical payment will be made beginning in 2005. Up to 25% of the payment may be coupled and paid directly to farmers or through producer groups.

Other Meat Markets

Meat per capita consumption projections in the EU, 2003 – 2012 (kg/head) [131]

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
EU-25										
Beef and Veal	18.1	18.0	17.9	17.9	17.9	17.8	17.7	17.6	17.5	17.5
Pork	44.1	43.5	43.3	43.4	43.5	43.6	43.7	43.9	44.1	44.4
Poultry	23.0	23.0	23.3	23.4	23.5	23.7	24.0	24.2	24.3	24.5
Sheep Goat	2.9	2.8	2.8	2.8	2.8	2.8	2.8	2.8	2.8	2.8
Total EU-25	88.1	87.4	87.3	87.6	87.7	88.0	88.1	88.4	88.8	89.1
of which EU-15										
Beef and Veal	20.1	20.1	20.0	20.1	20.0	19.9	19.7	19.6	19.5	19.5
Pork	43.7	43.2	43.5	43.7	43.5	43.6	43.6	43.8	44.1	44.3
Poultry	23.1	22.7	22.9	23.1	23.2	23.4	23.6	23.7	23.9	24.0
Sheep Goat	3.3	3.4	3.3	3.3	3.3	3.3	3.2	3.2	3.2	3.2
Total EU-15	90.3	89.4	89.7	90.2	90.0	90.1	90.2	90.4	90.7	90.9
of which EU-N10*										
Beef and Veal	7.7	7.1	6.7	6.7	6.7	6.7	6.7	6.7	6.7	6.7
Pork	46.3	45.0	42.5	42.0	43.5	43.8	43.9	44.1	44.3	45.0
Poultry	22.6	24.4	25.0	25.0	25.5	25.8	26.3	26.6	26.9	27.2
Sheep Goat	0.3	0.2	0.3	0.3	0.4	0.4	0.4	0.4	0.4	0.4
Total EU-N10*	77.0	76.8	74.6	74.1	76.0	76.7	77.3	77.7	78.3	79.3

The forecasts for the overall E.U. meat consumption have been established without imposing any overall constraints and reflect the projected evolution for the individual types of meat as presented above. According to these projections by individual sectors, total meat consumption in the EU-25 is set to increase from 87.4 kg/head in 2004 to around 89 kg by the year 2012.

[131] Prospects for Agricultural Markets and Income (2005-2012), European Commission Directorate-General for Agriculture, July 2005, p 68

Pig meat is by far the most preferred meat by E.U. consumers with a share of about 50%, followed by poultry, with a share of around 26%, which has overtaken beef and veal since 1996. The projections up to the year 2012 imply a further consolidation of poultry consumption with a corresponding decline in the shares of other types of meat.

(f) Poultry Meat

Prospects for poultry meat:[132] Poultry production gradually recovered after the outbreak of avian flu in the Netherlands during spring 2003, which reduced E.U. production in 2003 by more than 2%. Production in 2004 reached 11 million tonnes, slightly less than pre-2003 levels.

The medium-term outlook for poultry production remains relatively positive as competitive prices with respect to other meats, strong consumer preference and increased use in food preparations should continue to play in favour of poultry. Per capita consumption is projected to increase from around 23 kg/year in 2004 to about 24.5 kg/year by 2012, with a steeper growth in the new Member States, where it benefits from a growing consumer preference.

Poultry meat market projections for the EU-25, 2003 – 2012 ('000 tonnes cwe**) [133]

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Gross Indigenous Production	**10,847**	**11,036**	**11,119**	**11,160**	**11,209**	**11,317**	**11,444**	**11,527**	**11,612**	**11,681**
Live Imports	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Live Exports	**5**	**4**	**4**	**4**	**4**	**4**	**4**	**4**	**4**	**4**
Net Production	**10,842**	**11,032**	**11,115**	**11,156**	**11,205**	**11,313**	**11,440**	**11,523**	**11,608**	**11,677**
EU 15	9,027	9,144	9,170	9,157	9,181	9,220	9,315	9,382	9,445	9,471
EU N10*	1,815	1,888	1,945	1,999	2,024	2,093	2,126	2,141	2,164	2,206
Import	**641**	**532**	**587**	**639**	**657**	**671**	**686**	**701**	**713**	**723**
Exports	**969**	**1,029**	**1,018**	**1,015**	**1,000**	**1,000**	**1,000**	**1,000**	**1,000**	**1,000**
Consumption	**10,514**	**10,535**	**10,684**	**10,780**	**10,862**	**10,984**	**11,126**	**11,225**	**11,321**	**11,400**
Per Capita Consumption	**23.0**	**23.0**	**23.3**	**23.4**	**23.5**	**23.7**	**24.0**	**24.2**	**24.3**	**24.5**
EU 15	23.1	22.7	22.9	23.1	23.2	23.4	23.6	23.7	23.9	24.0
EU N10*	22.6	24.4	25.0	25.0	25.5	25.8	26.3	26.6	26.9	27.2

** cwe = carcass-weight equivalent

[132] Prospects for Agricultural Markets and Income (2005-2012), European Commission Directorate-General for Agriculture, July 2005

[133] Prospects for Agricultural Markets and Income (2005-2012), European Commission Directorate-General for Agriculture, July 2005, p 68

(g) Pig Meat

Prospects for pig meat:[134] EU-25 pig meat production decreased slightly in 2004 due to the strong contraction of the pig herd in the new Member States which more than compensated the increase in the EU-15. Over the medium term pig meat production, which is assumed to be driven mostly by demand (internal and external), is expected to increase but at a slower rate than in the nineties, due to the competition of poultry meat which is foreseen to capture most of the increase in overall meat consumption. EU-25 pig meat production is projected to reach around 22 million tonnes by 2012.

The medium and long-term outlook for pig meat consumption is in general positive since pig meat is likely to continue to be favoured by consumers, although clearly less than poultry. After the slight decrease observed in 2004, per capita pork consumption is projected to increase from 43.5 kg/year in 2004 to 44.4 kg/year by 2012, with a marked increase in the new Member States (supported by sustained economic growth and purchasing power).

The new Member States have a greater role in the E.U. pig sector, representing around 15% of EU-25 pig meat production and consumption. Since the enlargement producer prices have been steadily growing in the new Member States and are currently above the EU-25 average.

The strong increase in extra-EU-25 pig meat exports of 2004 is expected to be followed by a return to more normal exports levels in 2005. Over the medium term there is a scope for a slight increase in extra-EU-25 exports, while the intra community trade is projected to show stronger developments.

[134] Prospects for Agricultural Markets and Income (2005-2012), European Commission Directorate-General for Agriculture, July 2005

Pig meat market projections for the EU-25, 2003 – 2012 ('000 tonnes cwe**) [135]

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Gross Indigenous Production	**21,324**	**21,276**	**21,207**	**21,314**	**21,405**	**21,515**	**21,544**	**21,665**	**21,837**	**22,015**
Live Imports	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Live Exports	**17**	**17**	**17**	**17**	**17**	**17**	**17**	**17**	**17**	**17**
Net Production	**21,307**	**21,259**	**21,190**	**21,297**	**21,388**	**21,498**	**21,527**	**21,648**	**21,820**	**21,998**
EU 15	17,793	17,996	18,101	18,224	18,248	18,243	18,247	18,352	18,512	18,664
EU N10*	3,514	3,263	3,089	3,073	3,140	3,254	3,281	3,296	3,309	3,334
Import	**25**	**15**	**14**	**18**	**23**	**27**	**30**	**33**	**36**	**37**
Exports	**1,330**	**1,445**	**1,309**	**1,310**	**1,320**	**1,327**	**1,312**	**1,311**	**1,329**	**1,343**
Stocks changes	**- 135**	**- 90**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Consumption	**20,137**	**19,919**	**19,895**	**20,005**	**20,091**	**20,197**	**20,246**	**20,371**	**20,527**	**20,692**
Per Capita Consumption	**44.1**	**43.5**	**43.3**	**43.4**	**43.5**	**43.6**	**43.7**	**43.9**	**44.1**	**44.4**
EU 15	43.7	43.2	43.5	43.7	43.5	43.6	43.6	43.8	44.1	44.3
EU N10*	46.3	45.0	42.5	42.0	43.5	43.8	43.9	44.1	44.3	45.0

* EU N10: Ten new Member States
** cwe = carcass-weight equivalent

While imports are projected to double between now and 2012, this access is still less than 1%.

(h) Eggs

Prospects for egg consumption:[136] The prospects for the E.U. egg production appear moderately positive. Like poultry, egg production recovered from the avian flu in the Netherlands in 2003. Production of eggs reached 6.3 million tonnes in 2004 and is expected to further increase to 6.6 million tonnes in 2012 benefiting from increasing demand as well as lower feed costs particularly in the first half of the projection period. Consumption would expand from 6.2 million tonnes in 2004 to 6.4 million tonnes in 2012. Per capita consumption would increase from 13.51 kg/capita in 2004 to 13.64 kg/capita in 2012. Exports would develop between 0.2 and 0.3 million tonnes over the medium term.

135 Prospects for Agricultural Markets and Income (2005-2012), European Commission Directorate-General for Agriculture, July 2005, p 67

136 Prospects for Agricultural Markets and Income (2005-2012), European Commission Directorate-General for Agriculture, July 2005

Consumption egg market projections for the EU-25, 2003 – 2012 (million tonnes) [137]

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Usable production	**6.2**	**6.3**	**6.3**	**6.4**	**6.4**	**6.5**	**6.5**	**6.6**	**6.6**	**6.6**
of which EU-15	5.3	5.3	5.3	5.4	5.4	5.5	5.5	5.6	5.6	5.6
EU-N10	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Consumption	**6.1**	**6.2**	**6.2**	**6.2**	**6.2**	**6.3**	**6.3**	**6.3**	**6.3**	**6.4**
of which EU-15	5.1	5.2	5.3	5.3	5.3	5.3	5.3	5.3	5.4	5.4
EU-N10	0.9	0.9	0.9	0.9	0.9	0.9	1.0	1.0	1.0	1.0
Imports	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Exports	0.1	0.3	0.2	0.2	0.2	0.2	0.3	0.3	0.3	0.3
Per capita consumption	**13.3**	**13.5**	**13.5**	**13.5**	**13.5**	**13.5**	**13.5**	**13.6**	**13.6**	**13.6**
EU-15	13.5	13.7	13.7	13.7	13.7	13.7	13.7	13.7	13.7	13.8
EU-N10	12.3	12.6	12.6	12.6	12.7	12.7	12.8	12.8	12.9	12.9

* EU N10: Ten new Member States

[137] Prospects for Agricultural Markets and Income (2005-2012), European Commission Directorate-General for Agriculture, July 2005, p 68