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**COMMUNICATION FROM THE COMMISSION TO THE COUNCIL
AND THE EUROPEAN PARLIAMENT**

Report on the situation in Portuguese agriculture

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1. INTRODUCTION

At Copenhagen in December 2002, the European Council was asked by Portugal to take action pursuant to the conclusions of the Berlin European Council in March 1999, in which the Council “taking into account the specificity of Portuguese agriculture recognised the need to improve the balance of support granted to agriculture by means of rural development measures, financed by EAGGF Guarantee”.

The Council also noted that Portugal considers that a specific problem, arising from the way the CAP currently applies to Portuguese agriculture, still exists. To this effect, the Council invited the Commission to present a report analysing the situation.

This report responds to the request made by Council to the Commission to present a report analysing the situation of Portuguese agriculture¹.

2. MAJOR TRENDS IN PORTUGUESE AGRICULTURE

2.1. Economic Output, Production and Consumption

Over the period 1986-1995, Portuguese agricultural output decreased in real terms at a rate of 3.1% per year. The rate of decline in Portuguese agricultural output slowed down in the period 1995-2001 to 1.6% per year, a somewhat lesser rate than the EU average (2.2% per year). Consequently, the share of Portuguese agriculture in the EU total agricultural output has increased slightly from 2.0% in 1995 to 2.2% in 2001. However, in a growing national economy, Portuguese agriculture reduced its share of GDP from around 5.1% in 1990 to 2.8% in 2001.

Since Accession, the key trend in Portuguese agriculture has been the major shift from arable crop to animal production, which has been reflected in a considerable increase in forage area. Over the period 1990-2001, volumes of crop products decreased by 0.3% per year, while final animal output volumes increased by 1.5% in average. Wine, fresh fruit and fresh vegetables are the three most important crop products, accounting for a little under a third of the total value of agricultural output. However, crop output has been more volatile than animal output in Portugal, due to the dependency of those most important crops, particularly wine production, on weather conditions. Within the fresh fruit and vegetable sector, however, there have been upward trends in the volumes of citrus fruit and, to a lesser extent, tomatoes.

¹ The main findings of this report are based on official data published in Eurostat and EAGGF Financial Reports. In addition, where indicated, a more detailed analysis of the Portuguese situation has been made using the FADN database.

As for cereals, production tends to decrease for many products except positive developments recorded for maize and durum wheat. For the latter, unfortunately the development in areas and production would appear to have been poorly valorised by the food industry. Other notable trends have been observed in rice and tobacco, which have increased their production significantly, and, starting from very low levels, the increase recorded for sugar beet has been the highest among the less important Portuguese arable crops.

In relation to the CAP production limits in the arable sector, in 2002/03 the areas for which aids were requested are still below the maximum level for the base area, as well as for irrigated base area. Furthermore, since no use has been made so far of the reserve of 60 000 ha created in Agenda 2000 for new irrigated areas, it must be concluded that currently these ceilings are not binding. The reverse is true in the case of durum wheat, for which, despite that the five-fold increase in eligible area in Agenda 2000, an overshoot has been recorded in claims of nearly 60%.

However, the declines in output volumes do not imply that the share of the value of crop output in that of agricultural output has been decreasing. On the contrary, since the real value of output has been decreasing more in the animal sectors, with a 3.5% drop against an average decline of 2.6% for the real value of crop output over the period 1990-2001, the share of final crop output in the value of agricultural production is higher now than it was a decade ago.

Within the animal sector, milk, pigs, poultry and cattle output are, in decreasing order of magnitude, the most important activities. Volumes of pig production have been growing strongly while poultry production is rapidly expanding following the shift away from cattle production. On the other hand, the cattle market in 2001 was still not showing significant signs of recovery after the BSE crisis, which significantly affected Portuguese production. Indeed, in spite of a certain overshoot in claims on suckler cow and special beef premium claims, the decline in cattle production has been the main reason for the subsequent decrease in the share of animal production in total agricultural production in Portugal.

It should be noted that the demand for pig meat has also continued to grow in recent years, which has pushed up real producer prices. As for poultry meat, despite long-term positive trends, the development of real prices has been less favourable with a consequent fall in the level of real output values. Over the period 1993-2001, poultry consumption increased by 37% and pork consumption by 29%.

The expansion of the pig industry has positively affected the volume of animal feed demanded. In the absence of a supply response from the Portuguese arable sector, this increase has been met by an increase in imports, which contributed to a decline in the self-sufficiency rate for cereals by 5% from the early 1990s. Furthermore, the degree of self-sufficiency for all the main kinds of meats has also deteriorated, reaching levels of less than 100% in recent years.

In the milk sector, over the last decade there has been a steady rise in milk output volumes, though the BSE crisis has led to certain disturbances in production in the last two years. While milk economic output has not grown to a significant degree, in spite of a rise in prices in recent years, milk is one of the few sectors that increased its contribution to Portuguese agricultural output.

The role of the milk sector is particularly important in the Azores, where annual production has almost doubled in the last decade and, at 500 000 t, represents about a quarter of Portuguese production. However, the accompanying high density of dairy cows has put pressure on the environment and has raised problems for other agricultural sectors. In particular, increased dairy cow numbers have created an oversupply of cow beef on the local market, which has resulted in an outlet problem. Furthermore, the fact that arable land has been converted into pasture for milk production, has caused a shortage of supplies to the local sugar industry.

2.2. Land use

In 1999, of the total land area in Portugal, about one third (3.35 million ha) was covered with woods and forests. Around 42% of the land area (3.86 million ha) makes up the Utilisable Agricultural Area (UAA), of which about 86% has been designated Less Favoured Areas. Arable land was 46% of the UAA, permanent pasture 36% and 18% permanent crops.

During the period 1990-1999, the UAA showed a net decrease of around 130 000 ha, arable land area and permanent crops having retracted by about 600 000 ha and 80 000 ha, respectively, and permanent pasture having increased by 550 000 ha. In the same period, irrigated land decreased by 85 000 ha to about 800 000 ha, or 21% of the UAA. Portuguese UAA represents just less than 3% of the total UAA of the EU.

2.3. Farm Size and Farm Size Distribution

Portuguese farm structures continue to be characterised by a strong dichotomy. Between 1990-1995, Portuguese holdings decreased at a greater rate than EU-12, falling by 5.5% per year against a rate equal to 2.7% per year for the EU-12. In the period 1995-2000, the total number of agricultural holdings in Portugal fell by a further 35 000, going down from 451 000 to 416 000, at an average of 1.6% per year, compared to a reduction in the EU-15 as a whole of 1.7% per year.

Consequently, in recent years, the percentage of Portuguese holdings in the EU-15 has remained stable (about 6.1% in 2000), while, with total UAA in Portugal remaining virtually stable, the average agricultural area of the Portuguese holdings increased from 6.7 ha to 9.3 ha.

However, the average size of Portuguese agricultural holdings is still roughly half that of the EU average (18.7 ha) and the distribution of farm size in Portugal remains very uneven. Holdings less than 2 ha in size represented 54% of all holdings in 2000 and covered only 6% of the UAA while 1.4% of holdings had more than 100 ha and covered 53% of total UAA.

2.4. Farm Labour

According to the 2000 census, 1 064 000 people were employed in Portugal in agricultural activity, which represented 476.000 Annual Working Units (AWU). Between 1995 and 2000, the total labour force in agriculture decreased by 2.4% per year in Portugal, as compared to a fall of 3.1% per year for the rest of the EU-15.

Thus, Portugal's contribution to the agricultural workforce of the EU-15 only slightly increased, staying around 8.0% of the total. Given the similar proportion (28%) to the EU of holding managers with a gainful activity outside farming, high under-employment remains a key feature of Portuguese agriculture.

In fact, part-time working of holding managers, though quite stable, is particularly prevalent in Portugal, where 83% of managers were working part-time in 2000, compared to 76% for the EU-15. This basic characteristic of the Portuguese labour force is correlated with the higher number of small-sized holdings.

In 2000, 90% of total agricultural labour force was of family origin (against 82% for the EU-15). The regularly employed non-family labour force represented only 47 000 AWU, corresponding to 9% of the total. Between 1995 and 2000, in contrast with the gradually downward trend in Europe, the share of family labour in Portugal has remained stable.

A facet of Portuguese farm labour is that only 1% of holders is declared to have received full agricultural training, against an average for the EU-15 of 5%. Another key feature is the high percentage of agricultural holdings run by older farmers. In 2000, the proportion of the Portuguese agricultural labour force over 55 was equal to 65%, significantly greater than that in EU-15 (53%).

2.5. Trade

In 1978, in the Commission opinion on the Accession of Portugal, the trade deficit in agricultural products was identified as being a key problem. Indeed, since Accession, agri-food products have slightly increased their weight in the trade deficit, rising from 17% in 1988-1990 to 18% in 2000-2002. When world prices reached their peaks from 1995 to 1998, agricultural deficit was representing even a higher share (26%) of Portuguese trade deficit. In the period 2000-2002, the total agri-food deficit (intra + extra EU-15) has stabilised at an average level of 2 800 million € per year. Though the overall trend still indicates a growing deficit in absolute terms, agricultural exports have been growing faster than agricultural imports since the mid-1990s.

Intra-EU trade is increasing as a percentage of total trade for agri-food products in Portugal, such that the share of intra-EU agri-food trade is now about 78%. While intra-EU trade is still more important for industrial products, in recent years this gap has tended to close. The importance of intra-EU agri-food trade in total agri-food trade has thus begun to match that of industrial intra-EU trade for Portugal.

It is worth remarking here that the import effect of the integration into the EU has been predominant, resulting in a rising deficit in intra-EC trade for agri-food products. While the extra-EU agri-food trade for Portugal has improved for almost all the main categories of products, with the exception of some fresh and tropical fruits and sugar, intra-EU agri-food trade has more than offset the extra-EU positive trends, resulting in a worsening overall trade position.

A product-based analysis indicates that Portugal has negative trends for the large majority of agricultural commodities, including some dynamic sectors of the Portuguese agriculture such as fresh fruits and pigmeat. Furthermore, since the early 1990s, Portugal has become a net importer of dairy products. On the other hand, the

reduction in net imports for live bovines is mainly a consequence of the BSE effects on demand. Portugal has maintained, if not strengthened, its traditional positive trade balance in the wine sector. The picture is also positive for sugar trade, where net imports are declining.

In relation to the current CAP, it should be noted that agricultural exports are mainly based on “high-quality” and processed products such as wine, fresh fruits and vegetables, while Portugal is notably an importer of products receiving high levels of price support, especially milk, bovine meat and cereals.

3. CURRENT ECONOMIC PERFORMANCE OF PORTUGUESE AGRICULTURE

3.1. Productivity

In macroeconomic terms, agricultural output per hectare in Portugal can be calculated at €1 642/ha UAA, about three-quarters of the EU level (€2 205/ha UAA).

This situation is further aggravated when productivity is expressed per labour unit. In view of the relatively high proportion of the EU agricultural workforce present in Portugal (8%), agricultural output per labour unit in Portugal averages €13 298/AWU, that is, about 28% of its EU level (€47 218/AWU).

When expressed in terms of Net Value Added at basic prices (NVA) per ha and per AWU, the Portuguese situation is slightly more positive. In 2001, NVA was €636/ha, about 71% of EU average levels, and NVA was €5 149/AWU about 27% of the EU average.

3.2. Inputs

Currently, the intermediate consumption in Portugal is about 50% of the total agricultural output. The share of Portuguese intermediate consumption in EU is almost equal to the share of Portuguese agricultural output, that is 2.3%.

Over the last decade, though the use and the share in Portuguese intermediate consumption of seeds, pesticides and fertilisers has increased, the share of these inputs has remained below the EU average. Conversely, the share of animal foodstuffs has remained above the EU average, though their share in Portuguese intermediate consumption has declined.

The real value of costs such as rents, interest payments and paid-labour costs has been decreasing. However, the share of rents in these external costs is inferior to the EU average values, the importance of interests paid being almost the same while labour costs are more important in Portuguese agriculture than for the EU as a whole. As for depreciation costs, their relative importance is low in Portugal, implying a low degree of capital investments of the agricultural sector.

3.3. Income

Eurostat’s Economic Accounts for Agriculture show that between 1986 and 1995 Portuguese agricultural incomes increased by around 30%, significantly more than the EU average of 25%. From 1995 to 2002, the income growth of 32% in Portugal has been the highest in the EU, far exceeding the EU average income growth of 8%.

However, using FADN data to calculate Net Added Value (NVA) per AWU, in real terms, over the last five years, income increased in Portugal at a rate of 5.8% and of 2.0% per year in the EU, which represents a cumulative increase of 48%.

Despite this higher rate of increase, agricultural incomes in Portugal (€4 200/AWU), based on FADN data, were still only 27% of the EU average in 2002 and there remain substantial differences in income between regions within Portugal. The average for 1999-2000 ranges from around €2 400 in the Algarve region to €10 900 in the Alentejo region.

In terms of type of farm, specialist arable producers have the highest income per head at €11 751/AWU, followed by specialists poultry and pig producers (€10 562/AWU), dairy producers (€7 879/AWU) and wine producers (€5 923/AWU).

Finally, the low productivity and average efficiency of use of inputs in Portugal, mean that income per hectare of UAA, based on Eurostat data, is amongst the lowest in the EU, at €416/ha UAA, just under half the EU average (€882/ha UAA).

4. PREVIOUS RECOGNITION OF THE SPECIFICITY OF PORTUGUESE AGRICULTURE

As long ago as 1978, as part of Portugal's application to Accession to the EU, the Commission made a report observing the major structural weaknesses of the Portuguese agriculture and the high dependence on imports of basic foodstuffs. These specificities were covered by a series of transitional arrangements, in particular for agriculture, within Portugal's pre-accession program, set up in 1981.

After Accession, EU structural policies were fully applied to Portugal. In addition, 700 million ECU was devoted to the farm sector within a special program for the development of Portuguese agriculture (PEDAP), over the 10-year transition period (1986-1995).

Specific transition measures were also introduced to take into account the sensitivity of the agricultural sector, with the bulk of Portuguese agricultural production following the path of a mixed transition, with two main stages. From 1986 to 1990, market organisations, while remaining national (including for their financing) had to be progressively adapted, according to common objectives. Customs duties had to be gradually dismantled with a view to a liberalisation of trade but special mechanisms applied for sensitive products. From 1991 to 1995, in preparing for the full CAP implementation, Portuguese prices and aids were aligned on EC levels.

In the 1992 reform of the CAP, independently of the degree of alignment of Portuguese support prices, EC prices were reduced from 1993 onwards. The price cuts were compensated by direct payments, and this switch from price to income support was relatively favourable for Portugal. Though the 1992 reform was fully applied to Portugal, it was granted some special conditions. The reference yield for cereals are higher than the historical and present yields and special conditions applied for the beef premium payments. Moreover, transitional arrangements were still applying in some sectors. A specific measure for livestock premia in the form of a reconversion programme of land used for arable crops towards extensive livestock

production within a 200 000 ha limit, was also granted at that time and has been extended until 2005.

In relation to the completion of the Single Market, some of the agreed transition measures still applying to sensitive agricultural products in Portugal appeared to be incompatible with this goal. Thus, these measures were phased out in 1993, and digressive, transitional compensation was granted in sensitive sectors, mainly for cereals, milk and beef.

Under the Agenda 2000 Reform of the CAP, Portugal benefited specifically from increases in the ceiling for durum wheat, the extended irrigated area in the cereal sector and the increased ceilings in beef premia in the livestock sector. Furthermore, in having a relatively high proportion of land in designated LFA, Portugal benefited from the switch in the funding of LFA measures to EAGGF-Guarantee.

Currently, in relation to the Azores, the Community grants specific support for the milk and beef sectors and an exemption was granted in 2001, for the period 1999-2003, from the dairy levy for 73 000 t of milk, in order to enable the Azores milk sector to continue being restructured, without interfering with the milk market.

5. BUDGET

Before 1993, Portugal's percentage contribution to the EU budget was higher than the share of total EAGGF-Guarantee expenditure granted to its agricultural sector. Since then, with some fluctuations, the opposite has been true and Portugal has received around 1.6% of total EAGGF expenditure.

The years 1994 and 1995 saw the combined effect of the 1992 Reform and of certain specific, one-off measures applying to Portugal. The "1993" package was applied in the 1994 financial year to the Portuguese agricultural sector and agri-food industry, exceptional payments were made following the droughts of 1992 and 1993 and the agri-monetary compensations were granted in 1994 and 1995.

The combined effect of these transitory measures was that EAGGF-Guarantee expenditures to Portugal in 1996 and 1997 decreased from over €700 million to an average of €650 million, a figure which better reflects the consequences of the 1992 CAP Reform. In turn, the significant increase in 2001 (up to €873 million, i.e. 2.1% of total EAGGF expenditure) was in part the result of the modifications introduced by Agenda 2000 in the financing of certain measures and, in particular LFA payments, which until then had been financed by the Guidance section.

Analysis of the evolution of the share of Heading 1a of EAGGF-Guarantee expenditure in Portugal, as a share of Gross Value Added, at market prices, showed that it increased significantly to 26% by 1994 and then stabilised at around 20%. This level situates Portugal in the lower part of the middle range of Member States, the EU average being 20%, but above Luxembourg, the Netherlands and Italy.

On the other hand, in relation to labour units (AWU), due to the low labour productivity of Portuguese agriculture, Heading 1a of EAGGF-Guarantee expenditure in Portugal is low, being only 20% of the EU average. Moreover, expenditure per hectare of agricultural land (UAA) increased to €173/ha in 1993 and

has remained at a similar level since then, but is still low at only 60% of the EU average (€293/ha).

On top of this, over the periods 1994-1999 and 2000-2006, €2 125 million and €2 279 million respectively, were allocated to Portugal, as EAGGF-Guidance expenditure, for speeding up the adjustment of agricultural structures and facilitating the development of rural areas. The 100% rate of execution of the measures within these programmes reflects the necessity and the success of the EAGGF-Guidance intervention in Portugal.

6. CONCLUDING REMARKS

While the above analysis of these economic performance indicators shows an impressive and steady growth in Portugal in real agricultural income per unit of labour, Portuguese agriculture continues to manifest several specific difficulties:

- economic output and income per labour unit, even though they are improving, are still very low;
- these low incomes arise largely from the fact that Portuguese agricultural labour is poorly equipped with land, variable and fixed capital, and from the fact that there is important, underlying underemployment in the sector.

The assessment of the Commission is that the specificity of the problems experienced by Portuguese agriculture can not just be traced to deeply rooted structural adjustment problems, but are also affected by the manner in which the CAP currently applies to Portugal.

Therefore, the critical issues for Portuguese agriculture, in the coming years, would appear to be essentially the need to:

- **re-launch and speed up structural adjustment.** Current farm structures in Portugal still do not allow an optimal use of both variable and fixed inputs, even though Portugal is making savings on inputs at a faster rate than the EU average. This situation hampers improvement in profitability and investment capacity in the Portuguese agriculture sector;
- **support the development of a sustainable and market-oriented agriculture focused on quality.** Increased value for Portuguese agricultural products would be possible, as a result of better product differentiation and further investment in order to improve quality and enhance marketing methods. This would enable Portuguese agriculture to benefit more from the opportunities open to it in the Single Market;
- **improve the sustainability and competitiveness of rural areas.** This can only be achieved through a more diversified and flexible labour market, which facilitates the creation of new job opportunities and thus a better use of surplus labour present on Portuguese farms.

6.1. Re-launching and Speeding up Structural Adjustment in Portuguese agriculture

Through EAGGF-Guidance funding, Portugal has made considerable progress in the promotion of agriculture as a modern and competitive productive activity, particularly on infra-structural investments related to the improvement of quality in some important sectors in Portugal as olive, wine and fruit, together with irrigation investments. The competitiveness of Portuguese quality products has consequently been substantially reinforced at Community level.

Since the rate of structural adjustment of Portuguese agriculture continues to be the main factor hampering economic development in the sector, the Commission recommends that the next generation of Rural Development programmes should certainly continue to support the improvements being made in this domain.

6.2. Developing a Sustainable, Market-oriented Agriculture in Portugal, focused on Quality

The presence of sector supply management tools, such as Maximum Guaranteed Areas, quotas, national and regional ceiling etc, has in general not limited Portuguese production during the last decade. The impact of such measures has therefore played a minor role in holding back the development of Portuguese agriculture, although in recent years concerns have been expressed by the Portuguese authorities that such limitations are playing a more important role than in the past.

Thus, within the framework of the common market organisations and the Commission's current proposal for their reform, the proposed implementation of a single farm payment system has elements compatible with the needs of Portuguese agriculture since it will lead to a removal of production limitations, with the notable exceptions of dairy quotas, cattle and sugar quotas, the latter not being a part of the current reform proposal.

Within the restraints of the proposed prolongation of the quota regime until 2014, the Commission sees benefits for Portuguese agriculture from the current dairy reform proposal since extra increases in Member State quotas are foreseen in 2007 and 2008. However, the Commission recognises that the particular economic importance of this sector in the Azores, and the problems linked to the development of Azores milk production, merit specific attention and that these problems need a solution with appropriate measures.

On the other hand, an important feature of Portuguese agricultural developments over the last decade has been the shift in land use from arable crop production, with very low productivity, to extensive animal rearing, based in particular on an expansion of the suckler cow herd. This movement has been supported through specific policy measures for Portugal and would appear to correspond better to the conditions in many of its Less Favoured Areas. The Commission would therefore be prepared to monitor how this positive development for Portugal may continue to be encouraged in the future.

In global terms, the Commission would therefore expect that Portuguese agriculture will profit from the new perspectives offered by the various elements of the current CAP reform proposal. In becoming more market-oriented and thereby facilitating

quality production, the CAP will be better adapted to the possibilities for growth in Portuguese agriculture.

6.3. Improving the Sustainability and Competitiveness of Portuguese rural areas

It could be argued that continued structural adjustment and the introduction of better a market-orientation into the CAP, may not solve, in the short-term, Portugal's productivity problems and may not bring about the necessary increase in incomes for Portuguese producers because of underlying rural development problems.

In this light, specific attention will need to be paid to the impact of the reform on agricultural production in Less Favoured Areas, all the more because these areas have a considerable overlap with those of high nature value. For Portugal, this concerns, in particular, extensive suckler cow and sheep farming activities.

The Commission believes that its current proposal to strengthen the Second Pillar of the CAP is consistent with these concerns and would offer new possibilities for Portugal to promote the development of its agriculturally dependent rural areas and respond fully to society's demand for environmental services.

Consequently, the Commission considers that economic measures, such as the LFA and agri-environmental programmes, may provide a crucial answer to the need to consolidate the income of Portugal's semi-subsistence holdings, while the necessary restructuring of the sector is continuing to take place.

For that reason, the Commission is prepared to look favourably into the possibility of taking up the Berlin European Council's conclusions of March 1999, on a possible strengthening of support to Portugal from Heading 1 b) of the EAGGF-Guarantee Fund (Rural Development) and the conclusions of the Brussels European Council of October 2002, that the needs of producers in the disadvantaged regions of the present EU should be safeguarded, and that multifunctional agriculture will be maintained in all areas of Europe.