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

**accomplishing a sustainable agricultural model for Europe through the reformed CAP –  
the tobacco, olive oil, cotton and sugar sectors**

**{SEC(2003) 1022}  
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## EXPLANATORY MEMORANDUM

Since 1992, the common agricultural policy (CAP) has been immersed in a fundamental reform process, aimed at moving away from a policy of price and production support to a more comprehensive policy of farmer income support. The last step in this process was the decision reached at the Luxembourg Council on 26 June 2003 regarding the 2003 CAP reform, with the introduction of the single farm payment scheme.

The Luxembourg Council also invited the Commission to submit in autumn 2003 a communication on the reform of the common market organisations for olive oil, tobacco and cotton that would be based on the principles of the June CAP reform. This Communication meets the commitment made by the Commission in Luxembourg, while legal texts of the reform proposal for the three sectors involved will follow in November.

With the Luxembourg decision, decoupling of direct producer support becomes the core element of CAP direct payments, although the possibility of coupling part of support is kept mainly as a response to member states concerns related to the risk of production abandonment in more marginal areas.

The present Communication follows the same basic approach as the June reform of the CAP. The largest part of support for the three sectors is decoupled, based on historical references for the 2000-2002 period, and is integrated into the legal framework of the single farm payment.

Thus the fundamental objectives of CAP reform are met by:

- establishing a long-term policy perspective for these sectors, in line with their present budgetary envelope, the ceiling of Heading 1 of the current financial perspectives and the new framework for agricultural expenditure agreed at the Brussels European Council in October 2002;
- promoting the objectives and the approach of the June 2003 CAP reform, namely enhanced competitiveness, stronger market-orientation, improved environmental respect, stabilised incomes and a higher regard for the situation of producers in LFA;
- giving priority to producer income and not product support through the transfer of a significant part of the current production-linked direct payments to the single farm payment scheme, **as from 1 January 2005**;
- subjecting these payments, as is the case with all CAP direct payments, to the respect of the statutory EU environmental and food safety standards, through cross-compliance, and rules of good agricultural and environmental condition, as well as to the modulation and financial discipline mechanisms.

In addition, the Communication reflects the Commission's conclusions, based on the Commission's Extended Impact Assessment of the EU tobacco sector, regarding a sustainable policy-approach for the sector, in the context of the EU strategy for sustainable development, agreed at the Göteborg European Council in June 2001.

The common main aim as regards tobacco, olive and cotton growing is to support sustainable development in the sector, achieved by reorienting the support to reward healthy, high-quality products and practices, and developing alternative sources of income and economic activity.

However, in developing its proposals, the Commission had to take account of the fact that the tobacco, olive oil and cotton sectors are characterised by a concentration of their production in regions notably lagging behind in their economic development. In addition, with all three sectors showing differences in the present market regimes and in the problems and long-term priorities they face, different solutions are also envisaged in the proposed coupled part of their support.

For tobacco, the overall aim is to allow producers to adjust to a situation where product support would be phased-out. Thus the move towards full decoupling, and the shift of part of the present support into measures that assist producers to adjust. For olive oil, where potential risks are mainly associated to the abandonment of olive-groves in marginal areas with consequent negative environmental impact, the coupled part of support is aimed to guarantee that the cost of maintenance of olive trees is covered, while the production decision is left to producers. Finally in cotton, overall orientation is towards a mix of non trade-distorting (green box) and less trade-distorting (blue box) forms of support that minimise the already marginal impact of EU cotton on world markets.

Finally, taking account of the potential impact of decoupling on these sectors, in particular the risk of production abandonment and the competitiveness of rural areas, the proposals either earmark part of the sector expenditure as an area payment and/or transfer part of it to a restructuring envelope.

The Communication also fulfils the Commission commitment to report to the Council in 2003 on the EU sugar regime and its prospects, as laid down in Article 50(2) of Council Regulation (EC) No 1260/2001. The complexity of the sector and the various challenges it faces, both domestically and internationally, as well as the potential impact of various options, are documented in the accompanying Extended Impact Assessment of the sugar sector.

The sugar sector is characterised, among others, by the fact that it has never until now been fundamentally reformed. As a result, the Council and Parliament have not been given the opportunity to conduct a political debate on the possible policy approaches available for this sector.

This Communication seeks, in a similar way to that followed in the lead up to the latest reform to the milk sector, to open a first discussion on three reform policy options identified for the EU sugar regime, before proceeding to a formal proposal, and invites the Council, the Parliament and the stakeholders to actively participate in this debate.

Notwithstanding the different implications of the various options that could be envisaged, it is nonetheless evident that any reform of the sector would have to follow the fundamental principles of the CAP reform initiated in other sectors, i.e. bridging the gap between domestic and world market prices and shifting support from product to producer. In addition such a reform would need to closely examine its effect in the international context, especially with respect to the impact it may have on developing countries in general and ACP countries benefiting from the Sugar Protocol in particular.

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

### accomplishing a sustainable agricultural model for Europe through the reformed CAP - the tobacco, olive oil, cotton and sugar sectors

#### 1. INTRODUCTION

Ever since 1992, the common agricultural policy (CAP) has been immersed in a fundamental reform process, aimed at moving away from a policy of price and production support to a more comprehensive policy of farmer income support. The last step in this process was the decision reached at the Luxembourg Council on 26 June 2003 regarding the 2003 CAP reform.

The central feature of the CAP of the future will be the single farm payment, applicable from 2005, which cuts the link between eligibility for direct payments and the production decision. This key shift in policy, which will increase the transfer efficiency of the direct payment as an income support mechanism significantly, should lead to an improvement in the income situation of farmers. In this way, the June 2003 CAP reform effectively rounds off for the major agricultural sectors the move away from product support towards producer support, begun in 1992.

In the lead up to the adoption of the June 2003 CAP reform, attention was focussed, not only in Council but also in the European Parliament, the Economic and Social Committee and the Committee of the Regions, on the *risk in specific areas of production disruption and abandonment* from decoupling. This perceived threat to the agricultural sector was the principal motive for allowing Member States some degree of production-linked payment to be kept.

On the other hand, the widespread support for the reform to be accompanied by an increase in the financial resources for the CAP's second pillar through compulsory modulation and an extension in the scope of its measures, reflected a broad consensus in the EU on the need to *improve the sustainability and competitiveness of rural economies*.

It was with these two broad *caveats* that the Council reached a political agreement on the June 2003 CAP reform, accompanied by the following declaration:

"The Council notes that the Commission will submit next autumn a *communication on the reform of the common market organisations for olive oil, tobacco and cotton*, and will follow it by legal proposals.

As in its July 2002 communication, the Commission will provide a long-term policy perspective for these sectors in line with their present budgetary envelope and the new framework for agricultural expenditure agreed at the Brussels European Council in October 2002. The reform of these sectors will be based on the objectives and the approach of the current 2003 CAP reform."

Indeed, such a declaration confirmed the Commission's view, indicated in both July 2002 and January 2003, that the more sectors included in the single farm payment, the greater the economic and administrative benefits, in terms of simplification, will

be. However, independently of the engagements made at the time of the agreement of the June 2003 CAP reform, specific circumstances prevail concerning the tobacco cotton and olive oil regimes.

Regarding the tobacco sector in particular, the future of the common market organisation was last touched upon at the Göteborg European Council in June 2001, in the context of the EU strategy for sustainable development.

Though the Council withheld from adopting any specific conclusions on tobacco, it was evident from the discussions, and the context in which they took place, that certain reservations existed about the sustainability of the EU tobacco sector.

Doubts were voiced about the social justification for production-related payments for tobacco growers, the apparent contradiction between those aids and public health concerns about tobacco consumption. The current support to tobacco growing is not consistent with public health policies, which are among the priorities of the EU sustainable development strategy. Under these conditions, the long-term viability of tobacco-growing as an economic activity was put into question. However, there was also awareness that, in order to avoid social breakdown in those rural areas with a great dependency on tobacco growing, alternative sources of income for tobacco producers and tobacco-growing regions would be necessary, in the event of any major reform.

The Commission's response at the time was to strengthen its commitment to finding a sustainable policy-approach for the tobacco regime, based on an assessment of the economic, social and environmental aspects of the sector. Thus, in May 2002, in its Legislative and Work Programme for 2003, the Commission decided to subject its policy reflections on the tobacco sector to an Extended Impact Assessment<sup>1</sup>, in accordance with its 'Sustainable and inclusive economy priority'.

As far as the olive oil sector is concerned, a clear deadline has already been set for the expiry of the current aid scheme through Article 5 of Council Regulation No 136/66/EEC. In this context, the Commission considers the present communication to meet the obligation, laid down in Article 3(2) of Council Regulation (EC) No 1638/98, to carry out the following:

"On a proposal from the Commission to be presented in 2003, the Council shall decide on the common organisation of the market in oils and fats which is to replace, as from 1 November 2004, the one established by Regulation No 136/66/EEC."

The EU cotton regime, which dates from Greek accession in 1981, was last modified in 2001, with the aim of strengthening the price reduction mechanism, in order to tighten budget discipline and limit the total area dedicated to intensive cotton production, associated with environmental problems. Member States also agreed to undertake appropriate environmental measures in relation to agricultural land dedicated to cotton production. In the meantime, the Commission has noted that, despite the adoption of these new measures, the necessary reduction in surface area has not taken place and there are signs that such a reduction will be difficult to achieve. For that reason, the Commission believes that the Council, in its concluding remarks to the CAP reform decision in Luxembourg in June this year, has provided a valuable opportunity for a re-appraisal of the current arrangements in the cotton

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<sup>1</sup> SEC(2003) 1023 presenting the Extended Impact Assessment of the Tobacco Sector.

sector, with a view to introducing a more effective and sustainable policy orientation for cotton in the EU.

The sugar sector is singular in having so far stayed out of the 1992 reform process, which has essentially consisted of increasing competitiveness by compensating institutional price cuts with direct income payments. Instead, the current sugar common market organisation has been founded on the basis of a repartition of the production capacity across the entire Community, through the maintenance of national production quotas and high internal prices. With the last step towards competitiveness now completed by the June 2003 CAP reform, the Commission believes that the role of the repartition principle in the current EU sugar regime must be carefully reconsidered, in order to follow the CAP objectives of more market orientation and economically, environmentally and socially sustainable agricultural production.

In 2001, after extending the duration of the current regime for sugar by five years until 30 June 2006, the Council also placed the following obligations on the Commission, as found in Article 50(2) of Council Regulation (EC) No 1260/2001, which reads:

"On the basis of Commission studies on the market situation, all aspects of the quota system, prices, relations within the trade and an analysis of the increase in competition resulting from the European Union's international commitments, the Commission shall submit a report at the beginning of 2003, together with any appropriate proposals."

With sugar, the Commission's method, in a similar way to tobacco, has been to subject the regime to an in-depth assessment of the economic, social and environmental factors at stake. For that reason, the Commission also undertook to carry out an Extended Impact Assessment<sup>2</sup> on the sugar sector in its Legislative and Work Programme for 2003, published in May 2002. Together with that impact assessment, the Commission considers that the present communication fulfils the engagement to report on the EU sugar regime and its prospects.

In the light of these various commitments, the remainder of this communication gives, in the first instance, a description of the overall outlook for each of the four sectors concerned, including the conclusions to be drawn from the Extended Impact Assessments carried out for the tobacco and sugar sectors, as well as from working documents made available for these sectors<sup>3</sup>. This is followed by a presentation of the Commission's proposal for reform of the tobacco, olive oil and cotton sectors, in line with the orientation given by the Council, and a closing chapter on budgetary aspects of the proposals.

For sugar, however, being aware of the fact that the Council and Parliament have not been given the opportunity to conduct a political debate on the subject, the Commission has adopted a two-phase approach. Based on the information provided in the sugar Extended Impact Assessment, which describes the available reform policy options, the Commission wishes first to open discussion on the future of the EU sugar regime, in a similar way to that followed in the lead up to the latest reform to the milk sector, before proceeding to a formal proposal.

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<sup>2</sup> SEC(2003) 1022 presenting the Extended Impact Assessment of the Sugar Sector.

<sup>3</sup> [http://europa.eu.int/comm/agriculture/capreform/com554/index\\_en.htm](http://europa.eu.int/comm/agriculture/capreform/com554/index_en.htm).

## **2. OVERALL OUTLOOK FOR THE SECTORS CONCERNED**

### **2.1. Tobacco**

Tobacco production represents only 0,4 % of the EU agricultural output. In the last decade, there has been a decreasing trend in the volumes of world and EU tobacco production. With 348 013 tonnes, corresponding to 5,4 % of world production, the EU is the fifth world producer, behind China (38 %), Brazil (9 %), India (8 %), and USA (7 %). Greece and Italy cover more than 75 % of EU raw tobacco production.

Production of tobacco in the EU shows a remarkably high geographical concentration. Seven regions concentrate about 70 % of total holdings, 63 % of the areas under tobacco and 57 % of total gross income. In some districts, tobacco production accounts for more than 50 % of regional agricultural production.

The area under tobacco in the EU has been decreasing at a rate of 2,6 % per year, while the EU average yield has risen from 2 to 2,7 tonnes per hectare in the 1990s. The total number of farms with tobacco in the EU was 79 510 in 2000, following a ten year decline of 3,6 % per year. The average area per holding has increased from 1,4 ha in 1990 to 1,6 ha in 2000.

The tobacco sector employs an important quantity of labour force, that is 126 070 annual working units (AWU), or 212 960 persons, corresponding to 2,4 % of total AWU employed in the EU agricultural sector. Labour demand for raw tobacco production is highly seasonal and the share of part-time employment is remarkably high. Family labour force is about 80 % of total labour force employed in the sector.

A key feature of tobacco holdings is that they are extremely heterogeneous across regions and farms. In particular, a noteworthy dichotomy persists between few large farms, which are more capital-intensive and concentrate production on the best varieties, and many small farms, which are typically of small size, labour-intensive and less integrated with markets.

Problems of restructuring are still particularly acute in some areas where tobacco production plays a very important economic and social role. There, pulling out workers from the sector too rapidly could perhaps cause major social imbalances and rural depopulation if adequate measures to create off-farm employment were not put in place.

Over the last decade, there has been a reorientation towards the production of high-quality varieties, an increasing specialisation per variety at farm and regional level, and prices of EU-produced raw tobacco at international and domestic level have increased. On the other side, the market price of raw tobacco is too low to cover the production costs and positive margins are currently allowed only by CAP direct payments. Yet, these account for more than 75 % of total receipts farmers obtain from this crop. Overall, tobacco activity in the EU, while exhibiting a high dependency on public support, is characterised by a structural low level of income per labour unit employed, which, however, on a per hectare basis, is very much higher compared to other agricultural sectors.

The EU has a top position in world trade of raw and processed tobacco, both on the export and import side. In particular, the EU is an importer of raw tobacco and a major exporter of cigarettes and other processed products.

The 1992 reform of tobacco common market organisation (CMO) abolished intervention and export refunds, introduced production quotas as well as stricter controls. Following later refinements of the 1992 legislation, support to producers is currently provided through a premium system, linked to quantity of production, modulated on the basis of quality criteria and subject to individual production quotas for each group of tobacco varieties. The tobacco CMO also relies on measures to convert production, through a quota buy-back programme and a Community Tobacco Fund. CAP expenditure for tobacco was € 973 million in 2001, that is, an average of about € 7 700 per tobacco AWU or € 7 800 per ha, which took a 2,3 % share of the 2001 EAGGF Guarantee budget.

## **2.2. Olive oil**

The olive sector is a key element of the EU model of agriculture. In 1998/99, the area under olive groves in the EU was approximately 5,4 million hectares, that is, about 4 % of the utilisable agricultural area, of which 44,5 % were in Spain, 26,3 % in Italy, 18,8 % in Greece, 9,7 % in Portugal and 0,7 % in France. The sector involves about 2,5 million producers, roughly one third of all EU farmers, and is an important source of employment and economic activity in the main producer areas, most of which, with the notable exception of Tuscany in Italy and Catalonia in Spain, are located in Objective 1 regions of the EU-15. Furthermore, olive production offers the advantage of providing seasonal employment in winter, complementary with other agricultural activities, and provides significant off-farm employment in the associated milling and processing industry.

The size of specialised olive holdings in the EU is relatively small but diverse, ranging from an average of 13,5 ha in Spain to 3,2 ha in Greece. Olive oil processing structures tend to reflect the mix of traditional olive groves and more intensively managed, modern plantations, found across the producing Member States. Consequently, the association that olive production has enjoyed with positive landscape features and environmental impacts in the areas where it is practised has started to be questioned. Traditional olive groves are valued for their role in combating desertification and promoting biodiversity. Abandonment of production in such holdings brings increased risks of fire and erosion. On the other hand, criticism is more frequently directed towards the negative impacts of intensive plantations, through the increased dependence on phytosanitary products, monoculture techniques and water resources for irrigation.

The EU dominates world production, with harvests that have steadily grown in the nineties, especially in Spain, to a record of 2,46 million tonnes of virgin olive oil in 2001/02. Olive production, however, is noted for its fluctuations, determined by the biological production cycle and susceptibility to weather variations. Tunisia, Turkey, Syria and Morocco are the other main olive oil producers. They account for about 20 % of total world production. While production in other regions of the world is currently negligible in comparison to that in the Mediterranean basin, some countries without an olive oil tradition appear to be willing to invest in this sector.

Historically, olive oil consumption tended to be high only in traditional producer countries. While olive oil still only represents about 3 % of total world oil consumption, since 1995/96 demand has risen at a rate of about 6 % per year, in the light of olive oil's positive image in terms of healthfulness and quality. Apart from the EU, main markets for olive oil are the United States of America, Japan, Canada, Australia and Brazil.



Thus, trade has become an important feature of the olive oil market in the EU, which has doubled its exports, in the last ten years to almost 324 000 tonnes in 2001/02, mostly in bottled form. Imports, on the other hand, mainly destined to Italy, remained relatively stable, with the exception of the poor production years in Tunisia, the main importer to the EU.

In turn, the growing production of olive oil on the EU market has given rise to a decrease in producer prices during the nineties. Several projections of production and consumption point to a fragile balance for the world olive oil market, which will face appreciable surpluses if world production increases faster than demand.

The current common market organisation for olive oil, originally created in 1966, relies on production aid, as the principal measure of support to the sector. The former intervention system was replaced by a private storage mechanism, as an instrument for crisis management, and consumption aids were abolished in 1998. Production aid, at a rate of € 1 322,5 per tonne, is granted to all producers on the basis of the quantity of olive oil actually produced and the table olive equivalent, subject to the National Guaranteed Quantity (NGQ), currently totalling 1,78 million tonnes. Mechanisms regulating the amount of aid granted to producers, in the case where Member States over- or undershoot their NGQs have been put in place.

Intervention buying-in has been replaced by a private storage aid scheme. Export refunds have been set at a zero level since 1998 without negative impact. A production refund is granted for olive oil in vegetable and fish preserves. In 2001, further emphasis was given to control and quality aspects, most notably through the 'EU Quality Strategy for Olive Oil', which established product and marketing standards for the sector.

### **2.3. Cotton**

The cotton sector, despite being of limited significance to the EU as a whole, contributing only 0,5 % to the final agricultural output, has strong regional importance. Greece, with 79,4 % of the total EU production of 1,55 million tonnes of unginned (raw) cotton, receives 9,0 % of its final agricultural output from cotton while in Spain, the other main EU producer, cotton contributes 1,5 %. Production in other Member States (only in Portugal) is less than 1 500 tonnes.

Within the main producer Member States, there are even stronger distribution effects. After reaching a maximum land area under cotton of 440 000 ha in 1995, the vast majority of today's 380 000 ha of land devoted to cotton production in Greece is located in three regions: Thessaly, Macedonia-Thrace and Sterea Ellada. In Spain, production is concentrated in Andalusia, mainly in the provinces of Seville and Cordoba. The total area under cotton cultivation in Spain, after reaching a maximum of 135 000 ha in 1988, has decreased at around 90 000 ha.

Cotton holdings in these regions are characterised by their large number (71 600 in Greece and 7 600 in Spain) and small size (Greece, 4,9 ha and Spain 12,0 ha). On the other hand, Greek cotton holdings are noted for their higher degree of specialisation, the Thessaly region having evolved towards almost exclusive dedication to cotton cropping. Indeed, despite its vital role in many local rural economies, the tendency towards monoculture in cotton production has been one of the strongest sources of criticism in recent years. Combined with the heavy dependence of cotton on irrigation and fertiliser inputs, cotton production is widely associated with low

biodiversity and soil impoverishment. Intensive use of phytosanitary products, especially insecticides, and leaf defoliants to assist with harvest, are techniques, which are pointed to as examples of the most negative environmental impacts of agriculture. For that reason, specific commitments to reduce the negative environmental impacts of cotton production have been made by Member States in 2001.

Most cotton producers in the two main producing Member States belong to producer organisations, which have a management and co-ordination role. At the processing level, a mixture of private enterprises and co-operatives assure the conversion of raw to usable cotton through the ginning process, by which the cotton fibres are separated from the cotton seed. Spain, with almost half of its 22 plants run by co-operatives, shows a certain over-capacity for ginning compared to its production level, while the ginning capacity in Greece is more in balance with production and a lower proportion of plants are running by co-operatives (20 out of a total of 75).

Trade in the sector is generally referred to in terms of ginned cotton. As a producer, the EU is a minor player on the international scene, contributing only about 2,5 % to total world production. The latter, now at 19,9 million tonnes, practically doubled in the last forty years, mostly due to yield improvements. The chief producing countries, having retained their relative importance for the last two decades, remain China (22,6 %), the USA (20,1 %), India (13,1 %) and Pakistan (9,0 %).

The EU, with 708 000 tonnes of imports and 227 000 tonnes of exported ginned cotton, is the major net importer on the world scene. China alternates between net import and export, depending on the state of its own harvest. Brazil and South-east Asia are also significant importers of cotton for their manufacturing industries, having little or no production themselves, though Brazil has appeared recently as a new producer country, of about 800 000 tonnes of cotton over the last few years.

World cotton exports are undoubtedly dominated by the USA, which currently takes about 1,8 million tonnes, that is, 30 % of world trade of 6,0 million tonnes. Uzbekistan, Africa (CFA area countries) and Australia, each with around 800 000 tonnes traded, are the only other major exporters on the world scene.

The largest consumers of cotton in the world are those with established manufacturing industries. China consumes 25,4 % of the world's cotton, followed by India, the USA and Pakistan, the latter consuming about 9,0 %. The EU's consumption of around 1,0 million tonnes of ginned cotton (5,4 % of the world level) is mostly centred in Italy, Portugal and Germany.

The fact that the EU is a marginal producer of cotton<sup>4</sup> implies that the impact of EU production on the evolution of world market prices has been negligible. This is further strengthened by the fact that the EU, for this sector, does not use export subsidies and provide for duty free access. Though policies of both other developed and developing countries have had a significant effect on cotton prices, the main factor contributing to the price decline is more a result of increased competition with synthetics in the fibre market.

The cotton common market organisation dates from the time of the accession of Greece into the European Community in 1981. The current regime is centred based

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<sup>4</sup> Press release on cotton: 15.09.2003, IP/03/1244.

on a direct aid per tonne of unginced cotton, subject to a National Guaranteed Quantity (NGQ) for each Member State. The level of the aid, granted to processors, who pay a minimal price to producers, is fixed periodically on the basis of the difference in a "guide price" and the world price. Since 1995/96, the "guide price" has been fixed at € 1 063 per tonne, with a minimal price of € 1 009,9 per tonne. The NGQ is fixed at 782 000 tonnes for Greece, 249 000 tonnes for Spain and 1 500 tonnes for other Member States. Adjustments can be made to the amount of aid paid out if production over- or undershoots the guaranteed quantities.

## 2.4. Sugar

Sugar beet covers 1,8 million hectares throughout the EU-15, accounting for 1,4 % of the Utilised Agricultural Area, and provides 1,6 to 1,8 % of the EU's agricultural output. It is grown on more than 230 000 farms along with other arable crops, such as cereals. Generally, holdings with sugar beet are larger than average, in terms of both area and economic indicators. The overall agricultural area for holdings with sugar beet (70 hectares, of which 8 are dedicated to sugar beet) is greater than the average for all farms (20 hectares). Holdings with sugar beet also achieve a better income. It is estimated that the net value added per Annual Working Unit (AWU) is 1,7 times higher for holdings with sugar beet than for all farms<sup>5</sup>.

The EU-15 sugar production oscillates between 15 and 18 million tonnes, in refined equivalents. With the ten new Member States, areas under sugar beet are likely to increase by 30 % and sugar production by 15 %. In the EU-15, there are 135 sugar processing plants and 6 refineries.

Sugar is produced in all Member States of the EU-15 with the exception of Luxembourg. However, the productivity of sugar production varies significantly across Member States. Germany and France account for more than half of the EU-15 sugar production, followed by the United Kingdom and Italy (8 % each). Among the ten new Member States, six are manufacturing sugar for a total of about 3 million tonnes, with Poland accounting for two thirds.

The EU-15 both imports and exports sugar, but in net terms it is an exporter. On average for the marketing years 1999/2000 to 2001/02, exports amounted to 5,3 million tonnes versus 1,8 million tonnes for imports. Net exports represent on average 20 % of sugar production and 2 to 3,5 % of the EU-15 exports of agri-food products, according to the Uruguay Round definition.

The EU is a key player on world sugar markets. The share of the EU-15 in world total amounts to 13 % for production, 12 % for consumption, 15 % for exports and 5 % for imports. Its share in world production, consumption and exports has declined, whereas Southern Hemisphere countries have steadily gained importance. While the EU has been the leading world producer for several decades, Brazil and India have disputed the first rank from 1996 onwards, both accounting for 15 % of world supply. India has also outpaced the EU-15 in terms of consumption.

Although leading sugar producing countries are also main users, sugar is a widely traded commodity. On average international trade, close to 40 million tonnes,

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<sup>5</sup> Based on figures from the Farm Accountancy Data Network comparing income indicators for farms with sugar beet and average for all holdings (except those with horticulture) from 1998 to 2000.

represents about 30 % of world production, which totals 120 million tonnes, in refined equivalent. Brazil now dominates exports, with a share as high as one fourth of world exports.

International prices for sugar are of significant importance and are extremely volatile, following an erratic path. After the historical peaks of 1974 and 1981, over the nineties monthly world prices for raw sugar have fluctuated between € 280 per tonne in March 1990 and € 110 per tonne in April 1999. Since 1995, prices have been on a decreasing trend. This is mainly explained by an overall excess of production over consumption, as measured by the rise in the stocks to use rate. From their low point in 1999/2000, as a result of a shortfall in production in several leading suppliers, prices improved over the marketing year 2000/01, reaching an average € 240 per tonne. By the following year they had declined again to € 180 per tonne. The average for the first quarter 2003 is even lower, down to € 170 per tonne.

There are several reasons explaining price volatility. Exchange rate fluctuations can increase or decrease the price volatility of sugar for a certain currency. The steady growth in consumption is a fundamental driving force in the sugar market, but this has not necessarily translated into sustained import demand. The increase in consumption is much sharper in developing countries than in others and sugar imports are dependent on macro-economic factors. Production is not particularly responsive to changes in world market prices due to the protected internal prices in many countries, the perennial nature of sugar cane, which represents 75 % of the total areas under sugar production, and the long time horizon for investments in sugar manufacture. By contrast, supply is particularly sensitive to weather and revisions in production estimates often cause significant adjustments in international prices. Moreover, sugar exports are concentrated in a limited number of countries that are also leading producers. Brazil, the EU-15, Australia, Thailand and Cuba achieve 70 % of world exports. Finally, both supply and demand are influenced by the various policy instruments used by governments.

Within the EU-15, the sugar sector benefits from a system that combines border protection, supply control and support prices. The intervention price for sugar is currently set at € 631,9 per tonne for refined sugar or € 523,7 per tonne for raw sugar. Compared to international reference prices for recent years the EU market price has been two to three times higher.

Volatility makes it difficult to provide a solid forecast on world sugar prices. Several analysts estimate that prices will remain on a decreasing trend over the short (2003/04 marketing year) and medium term. In its 2003 agricultural outlook, the OECD forecasts a price of € 170 per tonne for 2008/09 for raw sugar. Compared to the average for the reference period (1997/98 to 2001/02), this represents a 13 % drop. According to the OECD, this projected low level is mainly due to "increasing sugar supplies and exports from low cost producers as well as continuing high support and protection in many OECD countries". In global terms, consumption is projected to increase at a slightly quicker rate than supply, most of the growth taking place in non-OECD countries. However, the burden of stocks is expected to keep prices low over the medium term.

### 3. PROPOSED REFORMS AND THEIR LIKELY IMPACTS

#### 3.1. General considerations

In its assessment of the needs for reform in the tobacco, olive oil and cotton sectors, the Commission had recourse to the following elements of consideration:

- the clear request from Council for a reform of the sectors concerned "based on the objectives and the approach of the 2003 CAP reform";
- similarities between the sectors, in terms of certain structural and production characteristics, and their policies, which make them suitable for the June 2003 CAP reform approach;
- specific features of each sector, in particular, the risk of production disruption and abandonment of olive groves and the need to improve the sustainability and competitiveness of rural economies.

The Commission believes that a reform based on the June 2003 CAP reform objectives of enhanced competitiveness, stronger market-orientation, improved environmental respect, stabilised incomes and a higher regard for the situation of producers in LFA, should aim to achieve the following objectives:

- establishing a long-term policy perspective for these sectors, in line with their present budgetary envelope, the ceiling of Heading 1 of the current financial perspectives and the new framework for agricultural expenditure agreed at the Brussels European Council in October 2002;
- promoting the objectives and the approach of the June 2003 CAP reform, namely enhanced competitiveness, stronger market-orientation, improved environmental respect, stabilised incomes and a higher regard for the situation of producers in LFA;
- giving priority to producer income and not product support through the transfer of a significant part of the current production-linked direct payments to the single farm payment scheme, **as from 1 January 2005**;
- subjecting these payments, as is the case with all CAP direct payments, to the respect of the statutory EU environmental and food safety standards, through cross-compliance, and rules of good agricultural and environmental condition, as well as to the modulation and financial discipline mechanisms.

Producers in the tobacco and olive oil sectors already receive a payment linked to the level of production, subject to Maximum Guaranteed Quantities. In the cotton sector, the payment per tonne of unginned cotton, also subject to a Maximum Guaranteed Quantity, is calculated on the basis of the difference in the EU "guide price" and the world price and granted to the ginner, who pays a minimum price to the producer.

Bearing in mind that no price cuts are deemed necessary and that direct payments already exist in the three sectors in question, the Commission considers that translation of those payments into the single farm payment scheme would not present major difficulties.

However, all three sectors have tended to concentrate their production in regions, which are notably lagging behind in their economic development and all are input-intensive, in terms of labour or capital inputs, generating significant off-farm employment through the importance of their associated processing industries.

It is this fact, which has prompted the Commission, within the context of the June 2003 CAP reform approach, to pay attention to the potential impact of decoupling on these regionally important sectors, in particular the risk of production abandonment and the competitiveness of rural areas, in which their production is traditionally located. In accordance with the CAP reform of June 2003, Outermost regions and the Aegean Islands should benefit from a special treatment as regards production support. The direct payments in those regions will not be integrated in the single farm payment.

### **3.2. Tobacco**

The Commission's principal conclusion, from the Extended Impact Assessment for the tobacco sector, was that a step-wise decoupling of the existing tobacco premium, accompanied by a phasing out of the Tobacco Fund and the setting up, within the second pillar of the CAP, of a financial envelope for restructuring tobacco producing areas, would provide the most sustainable policy for the tobacco sector in the future. Under this schema, tobacco quotas would need to be kept as a means of fixing the envelope of that part of the tobacco premium not yet decoupled. Consequently, during the transitional period, any production taking place outside of quota would not receive the corresponding coupled premium remaining to be paid. At the end of this process, the current tobacco common market organisation would no longer be of application.

This option was found to balance adequately the need to break the link between supporting individual producer incomes and the growing of tobacco, while providing funding for a re-orientation of the sector towards alternative sources of income. Furthermore, since at present about one third of the current tobacco premium is needed to cover variable production costs, the progressive implementation of the reform was preferred, in order to avoid a disruptive effect on production and local economies and to allow the market price to adjust to the new conditions. That implementation will last three years.

The proposed reform would begin with the transfer of all or part of the current tobacco premium into entitlements for the single farm payment. While, as shown in Table 1, this transfer would be complete for a producer's first 3,5 tonnes of production, for the following tranche between 3,5 tonnes up to 10 tonnes, only 80 % of the current tobacco premium would be incorporated into the single farm payment. The remaining 20 % would feed the proposed restructuring envelope.

**Table 1 – Summary of the Tobacco Reform Proposal**

| <b>1st STEP</b>                                    | <b>Current payment</b> | <b>Transferred to single farm payment</b> | <b>Restructuring envelope</b> |
|--|------------------------|---|-------------------------------|
| <i>Level of payment, by tranche of production:</i> |                        |   |                               |
| 0 – 3,5 tonnes                                     | 0                      | completely                                | none                          |
| 3,5 – 10 tonnes                                    | 0                      | 4/5                                       | 1/5                           |
| + 10 tonnes  | 2/3                    | 1/6                                       | 1/6                           |

| <b>2nd STEP</b>                                    | <b>Current payment</b> | <b>Transferred to single farm payment</b> | <b>Restructuring envelope</b> |
|--|------------------------|---|-------------------------------|
| <i>Level of payment, by tranche of production:</i> |                        |   |                               |
| 0 – 3,5 tonnes                                     | 0                      | completely                                | none                          |
| 3.5 – 10 tonnes                                    | 0                      | 4/5                                       | 1/5                           |
| + 10 tonnes  | 1/3                    | 1/3                                       | 1/3                           |

| <b>3rd STEP</b>                                    | <b>Current payment</b> | <b>Transferred to single farm payment</b> | <b>Restructuring envelope</b> |
|--|------------------------|---|-------------------------------|
| <i>Level of payment, by tranche of production:</i> |                        |   |                               |
| 0 – 3,5 tonnes                                     | 0                      | completely                                | none                          |
| 3,5 – 10 tonnes                                    | 0                      | 4/5                                       | 1/5                           |
| + 10 tonnes  | 0                      | 1/3                                       | 2/3                           |

When implementing the reform for larger tobacco farms, the current tobacco premium, corresponding to the tranche above 10 tonnes, would be decreased by one third at each one-year step. In order to avoid any major changes in income at agricultural holding level, one third of this tranche's tobacco premium would be converted into single farm payment entitlements, the remainder being transferred to the restructuring envelope.

Equity and efficiency considerations have guided the fixing of the rates of transfer to the restructuring envelope, which would be used to speed-up the re-conversion process in tobacco-producing regions. The restructuring envelope will switch funding to the rural development measures, foreseen in the rural development regulation ((Council Regulation (EC) No 1257/1999). This could include more beneficiaries, more measures, or even an increased aid intensity of existing rural development measures.

With full implementation, this reform process would re-distribute more than 70 % of the current tobacco premium to the single farm payment and at least 20 % to the restructuring envelope. This re-distribution would correspond to an allocation, on average, of € 6 900 per family Annual Working Unit (AWU), through the single farm payment.

With a step-wise implementation, the reform would be expected to bring better market orientation and income growth for producers, in addition to the positive impact on producer income development from the increased transfer efficiency of decoupled payments, especially for small holdings, who will receive earlier a larger part of their income as a single farm payment.

During the three year phasing-out period of the current tobacco regime, the Tobacco Fund will continue to be used to support anti-smoking information campaigns. The Commission is committed to continue support for anti-smoking activities despite the diminishing subsidy during this period.

In the short-term, the cultivation of less-profitable tobacco varieties in the EU would be expected to cease. Furthermore, the transfer of the current tobacco premium into the single farm payment would undoubtedly encourage producers, who are not currently covering their variable production costs or who could shift production to crops generating higher income per hectare, to reconvert to another land use in the short-term.

It is projected that the resulting slack in EU tobacco production would be taken up by larger and more professionalised demand- and/or quality-driven tobacco holdings, at an EU price, which would align with world levels prices, according to the varieties produced.

Acting together with the gradual introduction of the single farm payment amongst tobacco growers, the restructuring envelope would promote further the shift in production to more rationally structured holdings, improving the rate of income transfer to holdings producing tobacco during the reference period and encouraging a re-conversion within the local labour market in tobacco-growing areas.

### **3.3. Olive oil**

The Commission considers that the long-term needs of the EU olive oil sector would be best served by a reform, based on the orientation given by the Council at the time of the agreement over the June 2003 CAP Reform.

It is proposed that the existing production-linked payments in the olive oil sector be converted into direct income support, through the creation of new entitlements to the single farm payment for farmers, in addition to those arising from the June 2003 CAP Reform. There are three major benefits to be obtained from including the olive oil sector in the single farm payment.

Firstly, under the single farm payment scheme, the olive oil sector may be expected to achieve better market orientation and enhanced competitiveness. While the olive oil sector already enjoys a positive trade dynamic and has made conscious efforts to keep in touch with consumer trends through its Quality Strategy, the challenges for the future, should world production levels outstrip consumption, can only be met by a sector, which is responsive to the trends in world market demands.

Secondly, adhesion to the single farm payment results in more stable income for farmers, due to the higher transfer efficiency of support, and enables low input olive oil producing regions to maintain their overall level of income support.

Lastly, the positive association already enjoyed by the olive oil sector, in terms of transparency, consumer confidence and the provision of environmental and landscape benefits to society, would be enhanced by its inclusion in an EU agriculture sector moving in the same direction. Any tendencies within the olive oil sector, which are arguably leading to an erosion of its positive image, particularly in environmental issues, would be given greater exposure under the proposed reform arrangements.

However, the Commission considers that a complete conversion of current production-linked payments in the olive sector to the single farm payment could bring problems to certain traditional producer regions of the EU and to low-output olive groves. There exists a significant risk of widespread disruption to olive tree maintenance in these cases, which could in turn lead to degradation of land cover and



landscape or negative social impacts. This problem is heightened where such areas manifest a high dependency on the olive sector in their local economies.

For these reasons, the Commission concluded that a reform proposal, which completely broke the link between support payment and olive trees, in terms of the permanence of existing olive groves in sensitive areas, could fail to respect the concerns expressed by the Council and the Parliament, concerning the risk of production abandonment and the need to provide sustainability of rural economies.

Consequently, the Commission proposes that 60 % of the production-linked payments in the olive oil sector, for the reference period, should be converted into entitlements to the single farm payment for holdings larger than 0,3 ha. For reasons of simplification in the implementation of the policy, smaller holdings would have their payments completely decoupled.

Member States would retain 40 % of the payments in the olive oil sector, for the reference period, as national envelopes, for the granting to producers of an additional olive grove payment, calculated on a per hectare or per tree basis. This payment is not linked to production but is intended for maintaining the olive trees, preserving the soil and the environment while taking into consideration the local traditions and culture. The purpose of this additional payment would be to ensure the permanence of olive trees in marginal areas or low-output olive groves by contributing significantly to the maintenance cost of olive groves in those areas. Member States will identify those zones according to objective sustainable development criteria, within a common EU framework. This should include landscape preservation, environmental, social and cultural concerns.

The calculation of the reference hectares for the single farm payment, as well as the area or number of trees for olive grove payments, would be based on IACS-compatible, geographical information system (GIS) data. Areas of olive trees planted after 1 May 1998, except those included in approved new planting schemes, will be excluded from the single farm and olive grove payment schemes.

Concerning olive oil market policy, the Commission proposes that the current private storage measures should be kept intact, as a safety net mechanism, but the refunds relating both to export and to manufacture of certain preserved food, which no longer serve a purpose, should be repealed.

Finally, in relation to the Olive Oil Quality Strategy, the Commission proposes that, to support the sector during the adaptation to the evolving market conditions, existing quality and traceability measures should be reinforced. Activities eligible for support should be broadened to include monitoring of olive oil quality in pluri-annual programmes and reinforcing activities at national, EU and international level. The extra necessary funding would come from the Member State national envelopes for the olive grove payment.

Regarding control aspects, it is proposed that the financing of the present olive oil control agencies will be suppressed beyond 1 November 2005. Control of the new area payment will be made through IACS, supported by GIS. For simplification, the olive grove payment will not be allocated below € 50 per aid claim. As far as quality measures are concerned, control over the activity programmes will be strengthened through, among others, new evaluation and control obligations.

It is proposed that, in order to enforce the single farm payment as from 1 January 2005, the reform of the olive oil sector would apply as from 1 November 2004.

### **3.4. Cotton**

The Commission has reached the conclusion that, on balance, the economic, social and environmental benefits of a reform to the EU cotton sector, based on the June 2003 Reform approach, would far outweigh the disadvantages.

For that reason, the Commission proposes to transfer the part of the EAGGF expenditure for cotton, which was destined to producer support during the reference period, into the funding of two producer income support measures, namely, the single farm payment scheme and a new production aid, granted as an area payment. With regard to the latter, the Commission considers that such a production-linked aid would also respond to the objective of the Cotton Protocols in the Acts of Accession of Greece and of Spain and Portugal to support the production of cotton in the regions concerned.

It is proposed that 60 % of that producer-support expenditure, per Member State, would be transferred to the single farm payment scheme, in the form of new entitlements. In doing so, improvements may be expected in terms of the responsiveness of the cotton producers to future market evolutions and requirements. The inclusion of the cotton sector in the single farm payment would also bring to cotton producers the benefits of more stable producer incomes.

In the context of the conflicting association between the cotton sector and environmental degradation, it is important to note that the June 2003 CAP reform approach brings coherence and transparency, with regard to the application of EU legislation covering production standards. Given the newly agreed cross-compliance arrangements for all CAP expenditure, entry into the single farm payment scheme would allow cotton producers to benefit from the same rights as other farmers, in terms of freedom to make more extensive, switch or diversify their production.

Finally, the Commission believes that, in addition to the significant decrease in trade distorting subsidies already proposed by the EU in the Doha Development Agenda, such a reform could help alleviate the rather complex problem of the level of the world market price for cotton by shifting support away from the current “deficiency payment” mechanism, towards a mix of blue and green box measures.

Nevertheless, in view of the appreciable risk of production disruption, the Commission proposes that Member States will retain 40 % of the producer-support expenditure, during the reference period, as national envelopes, for the granting to producers of the new area payment per hectare of cotton, in zones suitable for that crop.

The level of the new area payment has been fixed in order to allow cotton production to continue, on a reduced area than at present, with a gross margin similar to that of competing crops. The combined effect of subjecting both the single farm and area payment to cross-compliance criteria, will lead to more environmentally-friendly cotton production in an income-neutral manner.

The new area payment will be subject to a maximum area of 425 360 ha (340 000 ha in Greece, 85 000 ha in Spain and 360 ha in Portugal). The maximum areas are designed according to the rates of past developments in cotton areas and correspond

to 11 % less than the areas in the reference period for Greece and 5 % for Spain. The level of the area payment will be proportionately reduced in the event of payment claims exceeding the maximum area of a Member State.

The area payment would be granted on the basis of specific criteria, relating to the participation of producers in an inter-branch organisation. Each inter-branch organisation would be approved by Member States, covering an area of, where practicable, at least 20 000 ha, and be subject to controls, which could lead to the application of financial penalties or to the withdrawal of approval for all or part of the area allocated.

Half of the area payment envelope could be differentiated according to inter-branch scales, rewarding production deliveries in quality and quantity terms. The activities of each inter-branch organisation would be financed by its members and by a Community grant of € 10 per hectare. Total support should be around € 4,5 million, which will be included in Member State national envelopes.

The balance between the total market expenditure for cotton and the two producer income support measures, of around € 100 million, would be included in restructuring envelope for cotton areas. This amount would be shared between Member States according to the average area eligible for aid over the reference period. This envelope would become an additional financial instrument within the second pillar of the CAP and will fund rural development measures, foreseen in the rural development regulation (Council Regulation (EC) No 1257/1999). This could include more beneficiaries, more measures, or even an increased aid intensity of existing rural development measures.

### **3.5. Sugar**

Following the introduction of production quotas in Member States, the common market organisation for sugar has developed along essentially different lines from those other sectors that have been involved in the CAP reform process. The decision to impose sugar quotas was a political choice, made to ensure a spread of production over the entire Community, rather than to encourage economic specialisation in the most competitive regions of the EU.

This high price support in the current sugar regime permits producers located in the less competitive regions of the EU, which do not have a comparative advantage in sugar beet production, to cover at least their production costs. Internal market prices were maintained through high intervention prices, accompanied by the necessary border protection.

This policy has offered a number of advantages over the years. Firstly, a secure, stable and high quality supply of sugar has been assured on the internal market, even though that result may have been reached with other types of less distorting mechanisms and an higher transfer efficiency. From the point of view of EU producers, the regime offers stability at relatively high prices, which in turn maintains producer incomes. Furthermore, the main countries benefiting from preferential market access and currently exporting sugar into the EU, tend to express, on balance, their satisfaction with a regime that offers their own operators favourable prices for stable quantities traded. However, for a number of reasons, this policy approach has come under growing pressure and its inherent disadvantages have become increasingly apparent.

The principal criticism of the sugar regime is the assertion that it encourages the production of a substantial quantity of sugar in the EU at non-competitive prices. Subsequently, taking account of the EU's sugar import commitments, EU sugar surplus to domestic requirements must be disposed of on the international market, at the prevailing world price. Using such arguments, the external impact of the EU sugar regime has been criticised for creating distortion to free trade and hinders the growth of primary industry in some developing countries.

Within the EU, the high price has been guaranteed to EU producers at the expense of consumers and processors. Not only is the EU intervention price at a level much higher than the world market price, but the EU market price has remained above the intervention price. Further, since it is based on quotas allocated per Member State, the CMO inherently leads to low market integration and favours market partitioning. The price incentive to producers to cultivate sugar beet by means of pushing up yields, is criticised by environmental groups, which also express concerns about the lack of coherence between the sugar policy and sustainable development objectives.

A number of drivers of change to the EU sugar policy, in various stages of development, can be identified.

Firstly, there is the question of the coherence between the current sugar policy and the new orientations for EU agriculture, taken by the June 2003 reform to the CAP, which itself has been based on the objectives of the EU Sustainable Development Strategy. In this context, the importance of the repartition of the production capacity, currently built into the sugar quota regime, must be weighed up against the need to move towards a more competitive and sustainable sugar sector.

Secondly, with the EU's unilateral import concessions awarded to the Least Developed Countries through the Everything But Arms initiative (EBA), and to the Balkan countries, the EU's sugar market could face substantial imbalance, as early as 2007. This market imbalance would bring severe disruption and decline to the industry in many parts of the EU.

Lastly, on the international scene, the legal action against the EU sugar regime must be seen against the backdrop of the ongoing Doha Development Round. Even though the final outcomes of those multi-lateral negotiations are not yet known, the basic features of the new environment of the EU sugar economy are already in place and sufficiently clear for their impact to be assessed. Furthermore, independently of the option to be considered, the EU export regime will have to be brought in line with the outcome of the agreement under the ongoing DDA round in the WTO.

Taken together, these evolutions alter the conditions that prevailed when the balance between the various interests and concerns was originally struck years ago. The Commission believes that the current sugar regime must now be carefully reconsidered, in order to renew an agreement on a sustainable and long term EU sugar policy. Considering the heavy and long-term investment required in the sugar industry, the Commission also believes that any further delay in this decision would be harmful to the sector, whether in the EU or in the developing countries.

Any option leading to a reduction in the internal market price will have a significant impact on the countries benefiting from the Sugar Protocol under the EU-ACP Cotonou Convention. The Commission will evaluate the impact of the reform for the ACP countries benefiting from the Sugar Protocol and will draw therefrom the

appropriate conclusions, taking into account the difficulties that may be encountered by the countries concerned.

The Commission proposed three possible policy orientations for the EU sugar regime, which have been analysed in the Extended Impact Assessment, taking into account the effects of the internal and external constraints placed on the sector and the ongoing dispute currently before the WTO. Furthermore, these policy options will have to be considered in the light of the recently approved Community policy on bio-fuels and of the impact for ACP and other third countries.

As a reference scenario for the alternative options, the Commission has first looked at the consequences of an extension of the present regime beyond 2006. This would consist of keeping intact the current common market organisation, based on flexible quotas and price intervention. The EU market would be open to import quantities, according to the various international commitments already agreed or agreed in the future. Custom duties, internal prices and production quotas would be reduced. To put the effects of this scenario in context, though there is little difference in the final outcome, the Extended Impact Assessment also addressed the hypothetical impact of any request by the EBA countries to implement that agreement through an orderly, agreed system on deliveries.

The second scenario evaluated was that of a reduction in the EU internal price. Once the levels of imports and production have stabilised, production quotas would be phased out. In this scenario, the internal market price is allowed to adjust itself to the price of those imports. However, in view of the fact that lowering the level of the EU internal price, which was found to come to an equilibrium value of around € 450 per tonne, makes the EU market less attractive for the least competitive sugar producing countries, the impact of this policy option on the world trade patterns was given particular attention. To smoothen for the effects of the reduction in the EU sugar prices, this scenario also looked at the possibility of introducing the single farm payment into the sugar sector, in line with the June 2003 CAP reform. Finally, the impact of this scenario on the revenue from sugar for countries currently exporting sugar to the EU has been assessed.

The third option for reform represents a complete liberalisation from the current regime. This means that the domestic EU price support system would be abolished and production quotas would be abandoned. Consequently, under this option, the impact on the EU sugar market, of the complete removal of import tariffs and quantitative restrictions to imports, has been assessed. As with the price reduction scenario, the possible introduction of income support for EU producers, as well as the impacts of liberalisation on world trade and the implications for the revenue from sugar of countries currently exporting sugar to the EU, have been assessed.

**Table 2 – Summary of the Impacts of the Policy Options for the Sugar Sector**

|                                    | <b>Advantages</b>   | <b>Disadvantages</b>  |
|------------------------------------|---|---|
| <b>Extension of current regime</b> | <ul style="list-style-type: none"> <li>• Production and producer incomes are maintained in the majority of regions, though the level of both gradually decreases</li> <li>• Budget cost of the regime progressively decreases</li> <li>• Current preferences to ACP/EBA countries are maintained</li> </ul>   | <ul style="list-style-type: none"> <li>• Restructuring and improved competitiveness of the sector is delayed</li> <li>• Non-restricted quantities of imports, under preferential agreements, at non-competitive prices, are attracted to the EU market</li> <li>• Maintenance of EU production is threatened</li> <li>• Distortions in competition and inequalities between producers remain</li> <li>• The sugar CMO remains complex</li> <li>• No environmental improvement is achieved</li> <li>• Dependence from the EU market in uncompetitive developing countries is maintained therefore delaying the necessary restructuring</li> </ul>  |
| <b>Price decrease</b>              | <ul style="list-style-type: none"> <li>• Restructuring and improved in competitiveness of the sector are facilitated</li> <li>• Ensures a better balance between supply and demand in the EU market and reduces production surpluses and world market distortion</li> <li>• Distortions in competition and inequalities between producers are lessened</li> <li>• Consumer prices for sugar come down</li> <li>• Diversification in the market for sweeteners takes place</li> <li>• Budget cost of the regime is reduced</li> <li>• Competitive LDCs/ACP producers maintain preferential access</li> </ul> | <ul style="list-style-type: none"> <li>• Revenue falls for the ACP countries benefiting from the sugar protocol and the least competitive might even stop exports</li> <li>• The question of the need to introduce restructuring and/or reconversion measures is raised</li> </ul>  |
| <b>Liberalisation</b>              | <ul style="list-style-type: none"> <li>• Competitiveness of the sector is improved in the medium- to long-term</li> <li>• World market distortions are reduced</li> <li>• Export refunds are suppressed</li> <li>• Budget cost of the regime is reduced to the cost of compensation</li> <li>• The common market organisation for sugar is simplified</li> <li>• Increased market opportunities for low cost / competitive producers</li> </ul>   | <ul style="list-style-type: none"> <li>• Price stability is no longer assured</li> <li>• A large part of the EU sugar industry irreversibly disappears</li> <li>• Producer incomes fall with significant effects on certain rural communities</li> <li>• Revenue falls for the ACP countries benefiting from the sugar protocol and most will probably be uncompetitive</li> <li>• The question of the need to introduce restructuring and/or reconversion measures is raised, including for those affected ACP countries</li> <li>• Production of sweeteners is no longer competitive and disappears</li> <li>• Profitability of sugar refineries is threatened</li> <li>• There is a risk of reduced crop rotation</li> </ul> |

#### **4. BUDGET ASPECTS**

Consistent with the objectives and approach of the June 2003 CAP Reform, the overall expenditures resulting from the proposals for tobacco, olive oil and cotton will be in line with recent historic expenditures on the premia and aids under the existing regimes for these sectors.

The reform will also respect the new framework for agricultural expenditure, agreed at the Brussels European Council in October 2002. In addition, the transfer foreseen to strengthen rural development measures will take place within the overall Agriculture Heading 1 ceiling.

The proposals are therefore budgetary neutral compared to past expenditure because the reforms are based on historical reference (average 2000-2002) and avoid a redistribution of funds between Member States. The annual costs remain within the status quo expenditure scenarios for these sectors established by the Commission when, at the time of the CAP Reform proposals of January 2003, it presented expenditure forecasts for the CAP for the period to 2013.

With regard to the sugar sector, projected budgetary costs of the different options are given in the accompanying Extended Impact Assessment. While extending the current regime represents some savings, the overall costs of the other two options depends on the level of compensation granted.