COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 06.12.1996
COM(96) 636 final

REPORT FROM THE COMMISSION TO THE COUNCIL
AND THE EUROPEAN PARLIAMENT

ON THE AGRI-MONETARY SYSTEM FOR THE SINGLE MARKET

1 July 1995 to 30 June 1996

CONTENTS

Abbreviations for national currencies:

BLF:	Belgian and Luxembourg franc	HFL:	Netherlands guilder
DKR	Danish krone	IRL:	Irish pound
DM:	German mark	LIT:	Italian lira
DRA:	Greek drachma	ÖS:	Austrian schilling
ESC:	Portuguese escudo	PTA:	Spanish peseta
FF:	French franc	SKR:	Swedish krona
FMK:	Finnish markka	UKL:	Pound sterling
		$:	dollar

Other specific abbreviations:

PDB 97:	preliminary draft budget for 1997
PDSAB 96:	preliminary draft supplementary and amending budget for 1996
ACR:	agricultural conversion rate
RMR:	representative market rate

REPORT TO THE COUNCIL OF THE EUROPEAN UNION ON THE AGRI-MONETARY SYSTEM FOR THE SINGLE MARKET

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Introduction

This report by the European Commission has been drawn up pursuant to the commitment entered into at the Council meeting (Agriculture) of 19 to 22 June 1995, when the Commission undertook to draw up a report each year analysing the consequences for the common agricultural policy and the single market of monetary fluctuations and the agri-monetary system in force, accompanied by proposals for appropriate remedies to the problems that might ensue.

It also constitutes a response to the own-initiative resolutions of Parliament of 19 September 1995 on the agri-monetary system,[1] which "calls on the Commission to make a detailed assessment of all implications of the Council Decision[2] and its financial impact."

This report relates to the economic sector of agriculture over the period 1 July 1995 to 30 June 1996 (1995/96). It comprises a main report summarizing and commenting on the result of the investigations carried out, and indicates the proposed solutions to the problems identified. The main report is followed by a description of the analysis of agri-monetary events in 1995/96, and their effects.

The first and second parts of the analysis, parts A and B, describe the currency and agri-monetary developments of the period under review, including the granting of compensatory aid. As an earlier report was produced in a similar manner for the period 1 January 1993 to 30 June 1994,[3] developments in the latter half of 1994 and the first half of 1995 are referred to, so as to give an uninterrupted picture of agri-monetary developments since the single market was completed on 1 January 1993.

Part C is an approach to the economic consequences at the level of agricultural markets and farm incomes. In view of the available statistics, the most convenient approach is to compare results for twelve-month periods from July to June for the analysis of prices, by calendar year for trade and by notional year for incomes.

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1 Joint resolution under Article 40(5) of Parliament's Rules of Procedure, No PE 193.731, of 19 September 1995 on the agri-monetary system.

2 Decision of Council meeting of 19 to 22 June 1995, on the basis of which two Council Regulations were adopted, namely Regulation (EC) No 1527/95 of 29 June 1995 regulating compensation for reductions in the agricultural conversion rates of certain national currencies (OJ L 148, 30.6.1995, p. 1) and Regulation (EC) No 2611/95 of 25 October 1995 establishing the possibility of national aid being granted in compensation for losses of agricultural income caused by monetary movements in other Member States (OJ L 268, 10.11.1995, p.3).

3 COM(94)498 final.

Part D assesses the effects of the agri-monetary system on Community expenditure. The impact is estimated on the basis of the 1996 budget in the course of execution, and the preliminary draft budget for 1997 as it stood at 30 June 1996. Budget years cover twelve-month periods running from 16 October.

The basic data for this report are presented in tables and graphs appearing in a Commission staff working paper.

I. MAIN REPORT

A. Agri-monetary effects observed

1. Conversion rates

Although there were no major currency fluctuations in the period July 1995 to June 1996 (referred to as 1995/96), at least half the Community currencies did behave in remarkably atypical ways: traditionally strong currencies were devalued, and currencies that had undergone numerous depreciations were revalued.

Since the switch-over mechanism was discontinued on 1 February 1995, all agricultural conversion rates (ACRs) move up and down in line with representative market rates (RMRs). However, the mechanism for aligning ACRs on RMRs is not symmetrical. Larger monetary gaps, and longer reference periods for their observation, are needed to trigger a reduction in the ACR after a currency has appreciated[4] (i.e. after a decline in institutional prices in national currency) than to trigger an increase in the ACR following depreciation.

In general, monetary gaps remained positive for all the currencies over the period. As there was always at least one currency (either the LIT or the SKR) with a positive monetary gap in excess of 4 points, the permitted margin ("franchise") for negative gaps was very small, at less than one point, throughout the period.[5] This situation led to many minor devaluations - often very small indeed, with 82% of the adjustments amounting to less than 0.5%.

Shortly after the Council's agri-monetary decisions of June 1995, "appreciable" reductions were made to the ACRs of five currencies.[6] The "appreciable" part of the reduction was 0.496% for the DKR, and ranged from 2.193% to 2.572% for the BLF, DM, ÖS and HFL.

The other currencies that revalued were the PTA, the LIT and the SKR. The monetary gap for the PTA stabilized after a non-appreciable revaluation of 2.9% in July 1995. There were four non-appreciable reductions in the ACR for the LIT in 1995/96, making a total decline of 12.1%. There were three reductions in that for the SKR, totalling 9.9%,

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4 Under the agri-monetary arrangements, the conversion rates express the value of one ecu in national currency. A devaluation against the ecu therefore corresponds to an increase in those rates, while a revaluation is equivalent to a reduction.

5 Where the "aggregate" gap made up of the largest positive gap and the largest negative gap exceeds 5 points over a certain number of reference periods, ACRs must be adjusted to reduce the monetary gaps.

6 An "appreciable" reduction in the ACR is one leading to a reduction in institutional prices in national currency that is greater than the effects of any devaluation occurring during the three preceding years. These effects are estimated as two thirds of the increase in institutional prices due to changes in the ACR occurring between 12 and 24 months previously, and one third of the increase between 24 and 36 months previously.

including one "appreciable" reduction of 1.734%. A further appreciable reduction was made just after the end of the period, on 7 July 1996.

Only two currencies were significantly devalued: the ACR for the DRA increased by 3.1%, that for the FMK by 3.5%.

2. Ad hoc Council measures for appreciable revaluations

In view of the risk of an appreciable revaluation for the BLF, DKR, DM, HFL and ÖS, Council Regulation (EC) No 1527/95 was adopted at the end of June 1995, to lay down ad hoc measures. When the FMK and SKR were seen to be at risk at the end of December 1995, Council Regulation (EC) No 2990/95[7] provided for similar measures, later extended to 31 December 1996.

These measures suspend the application of Articles 7 and 8 of the basic agri-monetary Regulation;[8] they introduce flat-rate compensatory payments and a freeze on agricultural conversion rates. Article 7 provides, in cases of revaluation exceeding the devaluations of the two preceding years, for an increase in ecus in most direct aid to producers[9] so as to avoid any decline in its value in national currency. In view of the scale of the aid in terms of the budget (almost 60% of EAGGF Guarantee Section expenditure), this measure would cost approximately ECU 250 million a year for each percentage point revaluation. Article 8 of Regulation (EEC) No 3813/92 provides for aid to offset the loss of income occasioned by the impact on prices of reductions in ACRs. The aid may be granted only after a twelve-month reference period, on the basis of the actual reduction in farm incomes.

3. Freezing of ACRs

ACRs for the aid referred to in Article 7 of the basic agri-monetary Regulation are frozen at the rate in force on 23 June 1995, or 11 January 1996 in the case of the SKR. The freeze applies until 1 January 1999, the date planned for the introduction of the single currency. Obviously, this temporarily affects the level of Community support from one Member State to another. In view of the operative events determining the ACRs applied to the aid concerned,[10] several rates will remain frozen until 30 June 1999. As the aid was established in ecus, the balance between different agricultural sectors thus changes in national currency, particularly in Sweden.

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7 OJ No L 312, 23.12.1995, p.7. Amended by Regulation (EC) No 1451/96 (OJ L 187, 26.7.1996, p.1).

8 Regulation (EEC) No 3813/92 (OJ L 387, 31.12.1992, p.1). Last amended by Regulation (EC) No 150/95 (OJ L 22, 31.1.1995, p.1).

9 Flat-rate aid expressed in ecus per hectare or per livestock unit and aid of a structural or environmental nature.

10 The ACR as it stands on the date of the operative event is applied to the amount concerned. For aid per hectare established in the framework of the reform of the CAP, the date of the operative event is 1 July; for most of the other aid referred to in Article 7 of Regulation 3813/92, it is 1 January.

Gaps between frozen ACRs and RMRs are fairly small for the currencies that revalued in June and July 1995. However, the gap between the frozen ACR and the RMR for the SKR has become quite considerable in the case of per hectare aid: for the 1996/97 crop year, aid in Sweden will be 11% higher than the level of the current ACR.

4. Compensatory aid for appreciable declines in ACRs

The compensatory aid that can be granted under Regulations (EC) No 1527/95 and No 2990/95 is limited by a ceiling established on the basis of the effects expected to ensue from appreciable declines in ACRs and on that of the latest figures for disposable incomes. The aid comprises three twelve-month degressive tranches, 50% of which is financed by the Union irrespective of the national contribution in the form of additional financing by the Member State.

By the end of 1995/96, the six Member States concerned by Regulation (EC) No 1527/95 had notified plans for compensatory aid. The Commission raised no objections to these plans.

Sweden, which has a further six months to notify aid under Regulation (EC) No 2990/95, did not submit plans for a scheme during the period under review.

Luxembourg and Germany decided to grant the maximum possible aid, using national funds to double the compensation financed by the EAGGF. Belgium plans to provide additional aid equal to 15% of the maximum authorized, on top of the 50% supplied by the EU. Denmark, the Netherlands and Austria are not providing additional aid.

Unlike the other Member States, which allocate aid direct to farmers on the basis of past output, Denmark, Germany and the Netherlands have opted for flat-rate allocation for the third tranche, since amounts would have been less than ECU 400 per holding.

5. Compensation for effects of devaluations by other Member States

In view of the consequences of the major devaluations early in 1995, the Council adopted Regulation (EC) No 2611/95, authorizing the Member States to grant national aid in compensation for losses of agricultural income caused by devaluations by other Member States before 31 December 1995. The aid is subject to the Commission's approval, and it must be degressive over a maximum of three years. It should not encourage production of any particular product in relation to the situation that would have obtained had the devaluation not occurred.

France and Belgium notified planned aid schemes before the deadline of 30 June 1996. The schemes comprise a single annual tranche to offset the effects in the beef and veal sector of the devaluation of the LIT. The Commission raised no objections, since both national markets were directly or indirectly heavily dependent on the Italian market.

6. <u>Summary of agri-monetary compensatory aid</u>

The following table summarizes aid notified and authorized. All amounts are expressed in millions of ecus on the basis of the RMR on 1 July 1996. The second and third tranches of compensation for appreciable decline in ACRs amount respectively to two thirds and one third of the first tranche, which is shown in the table.

Member State	Appreciable decline in ACR (%)	Ceiling (ECU million)	Notified EU financing (ECU million)	Notified national financing (ECU million)
Regulation (EC) No 1527/95				
Belgium	2.193	40.2	20.5	6.1
Luxembourg	2.193	3.2	1.6	1.6
Denmark	0.496	8.0	4.0	0.0
Germany	2.229	216.7	108.3	108.3
Netherlands	2.572	101.4	50.7	0
Austria	2.264	38.7	19.4	0
Regulation (EC) No 2990/95				
Sweden	1.734	20.8	-	-
Regulation (EC) No 2611/95				
Belgium	-	-	0	3.3
France	-	-	0	17.3

7. <u>Conversion rates for import charges</u>

Commission Regulation (EC) No 1482/95 introduces transitional measures for determining the conversion rate to be applied to import charges defined in ecus. This rate is fixed once a month in cases where the annual rate provided for in the Customs Code should have applied. The Commission subsequently extended the application of the transitional monthly rate for a further year, since the Council and Parliament had not yet completed consideration of the Commission's proposal to amend the annual rate provided for in the Customs Code by 30 June 1996.

However, this transitional monthly rate is applicable only to the import charges that are not fixed by an instrument under the CAP within the meaning of Article 1 of the basic agri-monetary Regulation. In other cases, the agricultural conversion rate is applied. The use of two different conversion rates has led to certain economic inconsistencies and has greatly complicated administration, with concomitant scope for errors and legal uncertainty. In February 1996 the Commission accordingly proposed to amend the agri-monetary arrangements in such a way as to eliminate the use of the agricultural conversion rate, and to use only one rate for import charges on agricultural products. By 30 June 1996, the Council had not yet reached a decision on this proposal.

8. General remarks on economic effects

In theory, the ACR will affect only those market prices that are closely linked to an intervention mechanism (mainly in the sectors of cereals, sugar, milk and beef/veal). The development of ACRs may thus have an impact on farm incomes through the prices of those products. Moreover, problems in trade may arise when divergences appear either between ACRs and RMRs, or between market prices and intervention prices in national currency.

The prices of other products, on the other hand, are not affected by ACRs. However, trade in those products may be distorted by sudden major changes in the RMRs. This happens, in particular, when market prices in national currency do not follow currency movements.

As well as the impact of currency movements on prices, farm incomes are subject to the direct effects of the ACRs applicable to direct aid to producers.

9. Effects on market prices

As there were no major devaluations, the movements in ACRs with the greatest potential repercussions in 1995/96 were:

- substantial steady revaluation of the LIT (12.1%) and the SKR (9.9%);
- appreciable revaluation of the BLF, DKR, DM, HFL and ÖS in June and July 1995, and of the SKR in January 1996.

For products with no intervention mechanism influencing market prices, there is, as expected, no observable link between movement of those prices and movements of ACRs. For other products, observation of prices has concentrated on sectors where there are usable figures, pinpointing one representative market for each Member State concerned.

During the period under review, the market prices of cereals were substantially higher than intervention prices in national currency. At this unusual level, markets react hardly at all to small agri-monetary fluctuations. However, despite very wide variations, there is no contradiction on the whole between the general trend of market prices and that of intervention prices in national currency. The tendency is broadly similar, even if correlations are very loose and calling in question the existence of a relationship between cause and effect. Despite slight uncertainty, in the 1995/96 context of high market prices, revaluations do not seem to have been passed on in agri-monetary declines in cereal prices.

Market prices for skimmed-milk powder and for butter remained exceptionally high in the first half of the 1995/96 marketing year. No link is observable between the revaluations of the LIT and the SKR on the one hand, and market prices on the other. For those currencies whose value increased appreciably in June and July 1995, market prices clearly did not follow ACRs downwards. Had there been no appreciable revaluation, it is hardly likely that prices in the currencies in question would have increased, or have increased more than they did.

Prices for the meat of young bovine animals declined sharply early in 1995, nearing or even reaching the level for triggering intervention. Towards the end of 1995, prices recovered strongly up to the time the bovine spongiform encephalopathy crisis broke. Just before the period under review, between March and July 1995, the decline in prices in certain Member States was probably partly influenced by prices in LIT, which did not increase as fast as ACRs. After July 1995, low prices in LIT remained stable, and as they had not increased earlier, they did not follow the downward movement to keep pace with ACRs. Market prices in SKR, another currency that appreciated strongly during the 1995/96 marketing year, followed the decline in the ACR fairly closely. For the currencies that revalued appreciably early in the marketing year, the downward movement in ACRs most probably affected the development of market prices for bovines, unlike those for cereals and milk products.

10. Effects on trade

Any monetary effects on trade are masked, in the short term, by wide variations in the monthly value of exports. For the Member States trading with those whose currencies have depreciated strongly, the figures do not show significant links between total exports of any particular product group and short-term currency movements.

Among other possible short-term agri-monetary effects, deflection of trade may in theory occur for products attracting export refunds when the aggregate monetary gap widens. However, export figures do not show any development that could be attributed to monetary gaps. This does not mean that there have not been isolated instances, but even where aggregate gaps have been very wide over two months, as happened at the end of 1995, no systematically organized network was set up, since there is no certainty that the situation will last.

Over longer periods, the figures do however show certain links. From 1992 to 1995, indices of competitiveness, which reflect currency trends and the development of costs, were progressing in line with exports expressed in deflated national currencies, i.e. constant in terms of purchasing power. However, the impact of competitiveness appears only in increased profits on exports. It is not apparent in terms of quantities exported or market shares.

11. Effects on incomes

A number of assumptions and approximations were adopted in order to circumscribe an order of magnitude for the effects of ACRs in 1995/96 on twelve months of income.

According to calculations based on a theoretical model grouping all the consequences of ACRs over twelve months, it would appear that their impact on incomes was significant, and unevenly spread over the Member States.

The impact of the year-on-year change in ACRs from 1994/95 to 1995/96 was fairly limited, and did not exceed 2% for most of the Member States. However, in three Member States the positive impact was significant:

- + 7.2% in Sweden, owing to the increase in per hectare aid;
- + 4.1% in Italy and + 4.5% in the United Kingdom, owing to increases in prices and in aid, the latter accounting for two thirds of the effect in Italy and half in the UK.

Altogether, the impact on net income from farming is estimated at 1.7%, or ECU 1 559 million.

All the Member States benefited from the effect of the agri-monetary arrangements by comparison with the situation that would have obtained had the RMR been applied directly in place of the ACR in 1995/96.

The largest benefit in terms of incomes was once again recorded in Sweden (+ 8.8%). Significant benefits were also felt in Luxembourg (+ 5.6%), Germany (+ 4.6%), Belgium and Denmark (+ 3.8%). The benefit was less marked in Austria (+ 2.5%), since national aid, which constitutes a major component of incomes, was not affected.

Farm incomes in the Netherlands, Ireland, Italy and Spain were about 2% better than they would otherwise have been, and the benefit was smaller in the other Member States, at around 1% or less in Greece and Portugal. Altogether, the impact on net income from farming is estimated at 1.9%, or ECU 1 718 million.

12. The budget and the legacy of earlier periods

In the agri-monetary area, the Community budget is strongly affected by the legacy of the switch-over mechanism (or "green ecu"). This mechanism, introduced in 1984, was discontinued from 1 February 1995. It resulted in a general increase of almost 20% of prices and amounts expressed in ecus, which cancelled out the effects of bringing the conversion rates used in agriculture back to a realistic level.

The effects of the green ecu mechanism, reflected in the increase in prices in ecus, involve expenditure of ECU 6 800 million for the 1996 budget and ECU 6 920 million for the 1997 budget.

The effects of the green ecu, passed on through world market prices, are estimated to result in an additional cost of ECU 1 320 million a year.

Price reductions due to agri-monetary causes in 1990 and 1993, accounting for 1.46% of the total, brought about further savings of around ECU 340 million a year.

Altogether, the residual effects of past agri-monetary problems involve a cost of about ECU 7 800 to 7 900 million a year, almost 20% of EAGGF Guarantee section expenditure.

13. The cost of agri-monetary developments in 1995/96

The figures in the table below show an annual cost of about ECU 1 200 to 1 300 million. This cost is in addition to that of the residual effects from earlier periods.

Almost two thirds of the cost of developments in 1995/96 (ECU 800 to 900 million) is due to the effects of permitted margins. The reason margins entail a cost is basically attributable to the asymmetry of the mechanism, whereby positive monetary gaps can rise to 5 points while negative gaps are usually limited by a variable threshold determined by the maximum positive gap minus 5 points. Moreover, in situations of steady and significant appreciation for several currencies, like that obtaining in 1995/96, the duration of confirmation periods plays an important role in keeping the largest positive gaps in existence over time.

The cost of operative events, which is difficult to compress without distorting markets, is about ECU 100 million a year. Independently of any ACR, this cost is due to the monetary development between the date of the operative event (event by which the objective of the operation is reached) for the amount in question and the date of comptabilisation of the expense in the budget execution. This result is unusually high because there was no offsetting, in 1995/96, between currencies that appreciated and those that depreciated.
The cost due to freezing ACRs gradually rises, because of operative events, eventually reaching ECU 185 million. As the freeze will continue until 1 January 1999, it also affects the budget for 2000.

The cost of compensatory aids could be reduced as from 1997 in order to take into account the devaluations occurred after the appreciable revaluations which justified these aids.

(ECU million)

Cost of agri-monetary developments 1995/96	**1996**	**1997**	**1998**	**1999**
ACR freeze	111	180	185	185
Compensatory aid	201	141	70	2
Permitted margins	817	890	916	913
Operative events	107	104	-	-
Total	**1 236**	**1 315**	**1 171**	**1 100**

In 1996, the main beneficiary under the agri-monetary arrangements was Sweden, with increased expenditure in SKR of 11.2%. This is the result of the effects of the margins and operative events in a context of strong currency appreciation. In the future, even if these effects disappear, Sweden would still be a major beneficiary under the arrangements owing to the freeze on ACRs, whose effects will become significant from 1997.

The second beneficiary under the arrangements in 1996 is Italy, where Community expenditure has increased by 5.6%. This is linked to the appreciation of the LIT in the period under review, and will not necessarily be lasting.

Expenditure increased by 3.8% to 4.7% in the States where ACRs were frozen in June and July 1995, where the currency situation has moderated the effects of permitted margins; this could change.

The impact of the Council Decisions of June 1995, i.e. the freeze on ACRs and the flat-rate compensatory aid in place of Articles 7 and 8 of Regulation (EEC) No 3813/92, can be assessed by estimating the cost that would have been incurred under the agri-monetary arrangements had those Decisions not been adopted. The savings amount to almost ECU 8 900 million over four years, or on average over ECU 2 200 a year.

The enormous cost of Articles 7 and 8 of Regulation (EEC) No 3813/92 seems to be mainly due to the level of per hectare aid in SKR (which would have been 10% higher in ecus if maintained in SKR). Supposing Article 7 to have been applied only to the appreciable revaluations of June and July 1995, the extra cost, in relation to the actual situation, would still have been almost ECU 2 500 for the four years 1996 to 1999.

B. Analysis, outlook and proposals

1. General view

Observation of the agri-monetary arrangements over the period 1995/96 reveals difficulties with technical, economic and financial aspects. Some of these difficulties may become serious problems, depending on how the situation develops.

Three major developments need to be taken into account: economic and monetary union, enlargement of the European Union, and the future of the CAP. The proposals to be made depend not only on the urgency and seriousness of the agri-monetary problems to be dealt with, but also on the options and timing resulting from these three developments.

2. Financial difficulties

In the financial context there is no escaping the legacy of the past; recent events show how the agri-monetary arrangements can assume considerable importance over a very few years. The costs of the present arrangements are high, but considerably less than they would have been if the mechanisms originally planned for appreciable revaluations had been applied. This consideration fully vindicates the Council's ad hoc decisions on compensatory aid and the freezing of certain ACRs. The costs of the ad hoc measures can be seen to be fairly moderate, even though some of them could have been further compressed, since the economic necessity of certain measures is not clear: particular, flat-rate compensation for loss of income for price reductions that did not actually occur.

The costs linked to operative events are unavoidable in relation to the operation of the CAP, but the main costs, linked to permitted margins, depend on the choice of mechanisms under the agri-monetary arrangements.

However, as margins constitute a sensitive system based on fragile equilibria, it would be dangerous to tamper with single components in isolation from the whole. But the system of permitted margins as a whole is in fact the mainstay of the present agri-monetary arrangements.

3. Economic difficulties

Almost all farmers benefit economically from the agri-monetary arrangements, although the extent of their benefit varies according to the relative currency situation and, for different reasons, to the stability of the national currencies concerned. Effects on markets vary with the products concerned and, for the most sensitive, with the level of prices recorded in relation to guaranteed institutional prices. In the longer term, trade may be affected, at least in value, by the index of competitiveness which reflects currency developments, adjusted for prices.

Thus, while the economic effects of the agri-monetary arrangements are usually acceptable, they may occasionally lead to substantial distortion between Member States.

To some extent, these potential problems also result from the system of permitted margins.

When currency developments are not passed on, which happens with the freeze on certain ACRs applicable to direct aid to producers, there is a possibility of long-term structural divergence, either between Member States, or between agricultural sectors in the same Member State. Moreover, it may become increasingly difficult to envisage return to equilibrium at a common level in ecus.

When currency developments are passed on only partially and with some delay, which happens with products for which there is no intervention mechanism, divergences may emerge in the medium to long term, either between prices recorded in the different Member States or within overall trade.

When currency developments are fully passed on, through guaranteed prices, the movement in incomes and prices for the products concerned may diverge from the general development of prices and incomes.

In all cases, depending on the economic situation and circumstances, major difficulties may occur, mainly in the long term. This means that the best system is not one that is fixed for ever, but one that can be adapted to the agricultural and monetary background and to the risks most likely to materialize.

4. Technical difficulties

From the technical point of view, certain aspects of the present arrangements are somewhat incoherent and sometimes contribute to the economic and financial difficulties described above. They mainly relate to the impact of the revaluation, the conversion rate used for import charges and the timing of changes to ACRs.

Some measure of the impact of currency revaluation and decline in ACRs is required: it enables past currency developments to be taken into account when assessing the possible consequences of the present currency revaluation. However, experience has shown the present approach based on the definition of "appreciable" revaluations to be unsatisfactory and excessively complex.

Currency developments causing the same "appreciable" decline in the ACR may have quite different effects on incomes, i.e. their practical impact may be totally different. For example, two currencies which have been stable for two years are treated the same way if the level of the ACR at the end of the third year is below its initial level. However, it is perfectly conceivable that one of the currencies might have been 15% down for 11 months of the third year, and the other for only one month, prior to appreciable revaluation: the agri-monetary benefit to farmers during the third year is consequently very different.

An appreciable decline in the ACR is based on the confirmation of monetary gaps over five reference periods. It is important to set a limit on the period, given the risk of deflection of trade flows; but steps must be taken to prevent currency movements in the opposite direction just after the appreciable revaluation. Clearly, a decline in the ACR lasting, for example, two months would not have the same effects as the same decline lasting a full year. In this context, the duration of the reference periods, about 10 days, is a vital factor in the equilibrium of the system as a whole.

The use of the twofold conversion system for import charges on agricultural products is unnecessarily complicated, leading to economic inconsistency and to disputes. As this twofold system does not make any practical difference to the Community preferences, it should be abandoned, as proposed by the Commission.

The rules for changing ACRs make up the fragile system of permitted margins. For example, under one of the rules, an exceptional three-day reference period is triggered when any aggregate bilateral monetary gap exceeds six points.Where this rule is applied, it contributes to the instability of ACRs: in particular, it upsets the established calendar for changes in rates, on which operators base their expectations. This rule has been criticized for its shortcomings.

The rule was introduced by the Commission for the practical implementation of the agri-monetary arrangements in order to avoid a delay of 10 days, or safeguard measures, in cases of sudden major currency movements. Experience of long reference periods before an appreciable revaluation has called into question the economic justification for this rule. But the rule does sometimes contribute to shortening the overall confirmation period before appreciable revaluation. It would once again be economically justifiable if a sudden and very substantial devaluation occurred, creating gaps even larger than those recorded in 1995. This rule too is very closely tied in with the whole system of permitted margins, on which the present agri-monetary arrangements are based.

5. Impact of monetary and agricultural outlook

The third stage of economic and monetary union, from 1 January 1999, is quite exceptionally important for the future of the agri-monetary arrangements.

Among the Member States that adopt the euro, agri-monetary arrangements will no longer be needed, since fixed amounts will be paid direct in euros. However, the transition from the present arrangements to a system of direct payments in euros implies that monetary gaps between agricultural conversion rates and market rates will be eliminated. For prices and amounts linked to the markets, these gaps may not exceed a lower limit of -2 or an upper limit of +5, nor may the sum of the gaps for any two currencies exceed 5 points. However, in view of the freeze on certain ACRs, gaps are not limited for most of the direct aid to producers.

The extent of the effort needed will depend, at the end of 1998, on the currency situation and the market prices of the products with a guaranteed institutional price.

For the other Member States, those which do not adopt the euro on 1 January 1999, agri-monetary arrangements will still be needed, if only so that payments to settle prices and amounts fixed in euros can be made in national currencies without distortion of the markets. The arrangements will also affect relations between the Member States which have kept their national currency on the one hand, and those which have adopted the euro on the other. However, the currency situation and perhaps the agricultural situation as well may be quite different from that obtaining at present.

The agri-monetary arrangements need to be adapted to the new situation. Even if it were possible to conserve the same principles, the arrangements themselves would need to be reviewed. First, as the new arrangements must take account of the risk of variations in national currencies against the euro, they must also allow for the relations that will be established between the Member States that do and those that do not use the euro, and of the possible role of new accessions.

Secondly, the arrangements must be adaptable to possible developments of the CAP, in particular in terms of the prospects of enlargement of the European Union. The key factors here will be the level of guaranteed prices, and the level and uniformity of direct aid to producers.

6. Proposals

According to the calendar for economic and monetary union, the use of the euro by the Member States that qualify will be introduced on 1 January 1999. This date sets a time limit on revising the agri-monetary arrangements. Relevant Commission proposals must be presented by early 1998, at the latest, for a Council decision in the light of the most recent available information on the monetary and agricultural situation.

With the prospect of major and imminent revision of the agri-monetary arrangements, it is not a very good idea, at the end of 1996, to consider any significant changes other than the strictly essential, which will in any case need to be reconsidered after 1997. However, in view of the problems that will arise for the transition between national currencies and the euro, it is best not to aggravate situations and risks created by the freeze on ACRs when appreciable revaluations take place.

For cases similar to those of appreciable revaluations in 1995/96, care should be taken to ensure similar treatment, that does not create discrimination between Member States. However, agreement not to reduce the ACRs should be limited at least by the maxima reached by the SKR, i.e. 12.8% in the case of aid where the operative event occurs on 1 July, and 6.9% in other cases. To keep potential problems even smaller and to avoid reproducing the differences in support between different sectors that arose for the SKR, the ACR should never be frozen for reductions in excess of 6.9%. If this limit were to mean cutting some aid in national currency, the effects could be offset by degressive compensatory aid to cover any loss of income due to appreciable revaluations.

According to present rules, if there is no devaluation, the appreciable revaluation of the LIT will not be of the same type as those which occurred in 1995/96. If the ACR for the LIT remains unchanged, the conditions for applying compensatory aid retrospectively as laid down in Article 8 of the basic agri-monetary Regulation will be realized in May 1997. If there is a further decline in the ACR for the LIT meanwhile, even if it is not deemed to be an appreciable decline in the ACR within the meaning of Article 1 of the basic Regulation, this may lead to the application of Article 8 before May 1997, or even trigger the conditions for a general rise in most direct aid to producers, expressed in ecus, in accordance with Article 7.

In all cases, appreciable revaluations may be dealt with by means of ad hoc measures decided by the Council pursuant to Article 9 of Regulation (EEC) No 3813/92 and in the light of the actual circumstances arising. In this framework the Commission will make appropriate proposals for cases arising for the LIT, or according to the guidelines described above for similar cases of appreciable revaluations in the period 1995/96.

Altogether, the conclusions can be summarized in four points:

- no change should be made to the general way the present agri-monetary arrangements function pending their revision with a view to the third stage of economic and monetary union on 1 January 1999;

- where possible and necessary, rules should be simplified without compromising the system as a whole, which means discontinuing the use of the agricultural conversion rate for import charges, as already proposed to the Council;

- future appreciable revaluations should be dealt with, but disparities resulting from freezing ACRs should not be aggravated, for they would interfere with the changeover to the euro;

- without prejudice to the Commission's proposals, study and analysis of the present agri-monetary arrangements and possible future approaches should continue, especially among the experts of the agri-monetary management committee.

Consequently, there is no immediate call for the Commission to present a new proposal for a Council regulation to adapt the agri-monetary arrangements.

II. ANALYSIS OF AGRI-MONETARY EFFECTS IN 1995/96

A. Currency developments

1. Representative market rates

Unlike the preceding 12 months, the period July 1995 to June 1996 (1995/96) saw no dramatic currency fluctuations[1], movements remaining fairly even, except for the FMK and DRA, and relatively moderate, except for the LIT and SKR. Nevertheless, such movements are by no means typical for at least half the Community currencies. Taking the possible over-reactions to the change in the dollar in early 1995 into account, the traditionally strong currencies declined in value while those with a history of depreciation strengthened.

During the period under review, the dollar rose against the ecu to reverse the trend over the previous 18 months from early 1994. The representative market rate (RMR) for the dollar thus fell by 6.8%, after rising by 16.7%[2].

Generally speaking, this change in the trend for the dollar was reflected in similar movements for the LIT, PTA and SKR, with inverse movements for the BLF, DM, FMK, ÖS and HFL.

The RMRs for the BLF, DM, ÖS and HFL rose by nearly 2.5%, insufficient to offset their falls of around 4% over the preceding 18 months but bringing them back to their approximate levels of early 1995.

Depreciation of the FMK began late, in December 1995, but despite its scale (7%), it did not cancel out the revaluation of nearly 13% over the period January 1994 to November 1995. However, since March 1996 the RMR for the FMK has reached the level applying on Finland's accession on 1 January 1995.

The LIT and PTA have fallen back below their levels of early 1995 despite devaluations of around 14% and 5% respectively between January and April 1995. The RMRs for those currencies fell by 11.5% and 1.5% during the twelve-month period under consideration.

A 6% depreciation in the SKR over the first five months of 1995 was made good by October of that year. In June 1996, the RMR for the SKR stood 7% below the level obtaining on Sweden's accession.

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1 See Tables and Graphs A1 to A4 in Working Paper on Basic Information.

2 Under the agri-monetary arrangements, the conversion rates express the value of one ecu in national currency. A devaluation against the ecu therefore corresponds to an increase in those rates, while a revaluation is equivalent to a reduction.

During the 12 months under examination, the RMR for the DRA continued to rise fairly steadily, but there has been a reversal in this trend since March 1996. The DKR and the ESC have remained more or less stable. The previous tendency of the IRL and the UKL to depreciate switched to relative stability and even tended towards appreciation in May and June 1996. The FF has continued to show a constant, albeit very slight, tendency to appreciate against the ecu.

2. Agricultural conversion rates

Since the switch-over mechanism was discontinued on 1 February 1995, all agricultural conversion rates (ACRs) move up and down in line with representative market rates (RMRs).[3] However, the mechanism for aligning ACRs on RMRs is not symmetrical. Larger monetary gaps, and longer reference periods for their observation, are needed to trigger a reduction in the ACR after a currency has appreciated (i.e. after a decline in institutional prices in national currency) than to trigger an increase in the ACR following depreciation. In accordance with those mechanisms and movements in currencies, the ACRs for the BLF, ESC, FF and IRL remained unchanged during the period under consideration, which is also true for the DKR and the PTA following their July 1995 revaluation. Apart from those for the LIT and the SKR, which underwent a substantial revaluation, the other ACRs rose fairly slightly but sometimes rather frequently.

Generally speaking, the monetary gaps for all currencies remained positive or close to zero. Given their tendency to revalue substantially, the LIT and the SKR alternately maintained positive monetary gaps in excess of four points. The available margin for negative gaps was thus always very small at below one point[4], triggering a large number of small or very small devaluations of less than 0.5% in 82% of cases.

Shortly after the Council's agri-monetary decisions of June 1995, five currencies underwent "appreciable" falls[5] in their ACRs. In the case of the currencies in question, this terminated five months of positive monetary gaps standing constantly or intermittently at above five points.

The "appreciable" part of the reduction in the ACR for the BLF amounted to 2.193% at 24 June 1995. The figures for the DM, the ÖS and the HFL were

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3 See Tables and Graphs A4 to A5 in Working Paper on Basic Information.

4 Where the "aggregate" gap made up of the largest positive gap and the largest negative gap exceeds 5 points over a certain number of reference periods, ACRs must be adjusted to reduce the monetary gaps.

5 An "appreciable" reduction in the ACR is one leading to a reduction in institutional prices in national currency that is greater than the effects of any devaluation occurring during the preceding three years. These effects are estimated as two thirds of the increase in institutional prices due to changes in the ACR occurring between 12 and 24 months previously, and one third of the increase between 24 and 36 months previously.

2.229%, 2.264% and 2.572% respectively at 1 July 1995. Subsequently, the ACR for the DKR underwent an "appreciable" of 0.496% on 24 July 1995. In the following months the positive monetary gaps for those currencies declined, with those for the DM, HFL and ÖS even becoming negative in May and June 1996, calling for slight increases in the ACR.

Of the other currencies, those with stable or practically stable ACRs had monetary gaps of around + 1 (ESC) or around + 2 (FF). The gap for the IRL generally remained below + 2, before rising swiftly to + 4 from May to June 1996. There was a "non-appreciable" revaluation of 2.9% in the PTA at the end of July 1995. Subsequently, the monetary gap for the PTA stabilized at somewhat below four points.

The ACR for the LIT underwent four "non-appreciable" reductions, amounting to 12.1% in total, during the period concerned, though the monetary gaps remained positive and large.

The ACR for the SKR fell three times, the total reduction amounting to 9.9%. The fall of 11 January 1996 was "appreciable" in respect of 1.734%. The rather variable monetary gaps generally remained very high at above four points, while a further appreciable fall in the ACR took place on 7 July 1996.

The ACRs were devalued substantially for two currencies only, namely the DRA and the FMK. The rise was 3.1% in the case of the DRA, where the gap nonetheless became positive at the end of the period under review. After maintaining gaps of close to 5% for five to six months, the FMK finally depreciated, with a resulting increase of 3.5% in the ACR. Variations in the UKL resulted in a rise of 1.9% in the corresponding ACR for over six months, but in late June 1996 that rate eventually stood 0.8% below its original level.

B. Agri-monetary mechanisms

1. Regulatory provisions

In late June 1995 when a risk of "appreciable" revaluation arose for the BLF, DKR, DM, HFL and ÖS, Council Regulation (EC) No 1527/95 provided for specific measures covering such revaluations between 23 June 1995 and 1 January 1996. In late December 1995, when further risks of "appreciable" revaluations arose for the FMK and the SKR, Council Regulation (EC) No 2990/95[6] provided for measures similar to those laid down by Regulation (EC) No 1527/95, to apply until 30 June 1996 and subsequently until 31 December 1996.

[6] OJ No L 312, 23.12.1995, p.7. Last amended by Regulation (EC) No 1451/96 (OJ No L 187, 26.7.1996, p.1).

These measures, which were deemed necessary in particular with a view to compliance with obligations under the GATT agreement and budgetary discipline, suspend the application of Articles 7 and 8 of the basic agri-monetary Regulation[7]. Article 7 provides for an increase in ecus in most types of direct aid to producers[8] in the event of a revaluation of a greater size than the devaluations of the two preceding years, with a view to avoiding any reduction in the value of the aid in the currency in question. In view of the scale of the aid concerned in terms of the budget (over 60% of the EAGGF Guarantee Section), such a measure would cost approximately ECU 250 million a year for each percentage point revaluation. Article 8 of Regulation (EC) No 3813/92 also provides for compensatory aid for income losses due to the effects on prices of reductions in the ACRs. The aid in question can only be granted after 12 months' observation showing that there is a lasting fall in the ACR. The latter is established, where necessary, on the basis of the fall in farm incomes incurred and which can in principle be observed.

In place of the measures laid down in Articles 7 and 8 of the basic agri-monetary Regulation, Regulations (EEC) No 1527/95 and No 2990/95 introduce flat-rate compensatory aid and a freeze on the agricultural conversion rates applicable to direct aid covered by abovementioned Article 7.

(a) Compensatory aid provided for under Regulations (EEC) No 1527/95 and No 2990/95 is subject to a ceiling for the Member States at risk of "appreciable" reductions in their ACRs. These ceilings were calculated on the basis of the anticipated effects of appreciable reductions in ACRs, using the latest statistics of incomes available, regarding 1994 and expressed as a percentage appreciable fall in the ACR. The aid comprises three degressive tranches, the first of which (covering the 12 months following that of the revaluation in question) may amount to up to 100% of the ceiling. The following two annual tranches may not exceed two thirds and one third of the ceiling respectively. The European Union finances 50% of the ceiling irrespective of the national contribution which the Member State may supply in addition. In principle the aid can be granted from the month following the revaluation in question, unlike the aid provided for in Article 8 of Regulation (EEC) No 3813/92, which requires at least 12 months to elapse. The detailed rules for the application of the aid are laid down in Commission Regulation (EC) No 2921/95[9].

In accordance with the detailed rules of application, the aid must be granted to agricultural holdings in annual payments. It must vary with the size of the latter over a period in the past and must be in line with the macro-economic spread of the income loss between the various sectors of production affected. However,

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7 Council Regulation (EEC) No 3813/92 (OJ No L 387, 31.12.1992). Last amended by Regulation (EC) No 150/95 (OJ No L 22, 31.7.1995, p.1).

8 Flat-rate aid expressed in ecus per hectare or per livestock unit and aid of a structural or environmental nature.

9 OJ No L 305, 19.12.1995, p.60. Last amended by Regulation (EC) No 1481/96 (OJ No L 188, 27.6.1996, p. 21).

where annual payments per holding are less than ECU 400, the aid may be granted for measures in the collective and general interest or those for which the Community provisions authorize national aid.

The compensatory aid measures notified by the Member States are outlined in point 2 below.

(b) The freeze on the ACRs for aid provided for in Article 7 of the basic agri-monetary Regulation relates to the ACRs actually applied on 23 June 1995 (or 11 January 1996 in the case of the SKR) and valid until 1 January 1999 when the single currency comes into force. Naturally, this entails a temporary variation in the level of Community support between the various Member States. In view of the operative events[10] for the ACRs for the aid measures in question, several ACRs are frozen until 30 June 1999[11]. In national currency, in particular in Sweden, this affects the balance in aid expressed in ecus between the various sectors of agriculture.

The gaps between the frozen ACRs and the RMRs have diminished somewhat for the currencies which revalued in June and July 1995. One year after those revaluations, they stand at 5.0 for the DKR, 3.7 for the BLF, 2.4 for the HFL and 1.9 for the DM and the ÖS. However, the monetary gap for the frozen ACR for the SKR has become quite sizeable in the case of aid per hectare: for 1996/97, aid in Sweden will be 11% higher than the current ACR and 19% higher than the common level defined by the RMR. Should the SKR remain steady against the ecu, the alignment of the frozen ACR on the current ACR in July 1999 would entail a fall of around 10% in aid per hectare expressed in national currency[12]. These large gaps stem in particular from the fact that the freeze relates to the ACR applicable at the time of the appreciable revaluation and not the threshold from which the fall in the ACR becomes appreciable. This allows any reduction in the aid concerned in national currency to be avoided at the time of an appreciable revaluation. Thus the ACRs for the BLF, the DKR and especially the SKR, which plummeted before appreciating, were frozen at a particularly high level.

(c) Furthermore, in response to the significant devaluations in the first half of 1995, in October 1995 the Council adopted Regulation (EC) No 2611/95 authorizing the Member States to grant national aid to compensate for the effects on some farm incomes of devaluations occurring prior to 31 December 1995 in other Member States. The aid in question must be approved by the Commission, be degressive and be applicable for three years at most. It must not encourage any particular

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10 The ACR on the date the operative event occurs is that applied to the amount in question. The operative event for aid per hectare under the reform of the CAP occurs on 1 July. For most other aid measures referred to in Article 7 of Regulation (EEC) No 3813/92, it occurs on 1 January.

11 See Table A7 of Working Paper on Basic Information.

12 On 7 July 1996 there was a further appreciable reduction of 3.280% in the ACR.

type of production having regard to the situation which would have obtained had no devaluation occurred. France and Belgium notified draft aid schemes under Regulation (EC) No 2611/95 before the time limit (30 June 1996). Those draft aid schemes will be described in point 2.

(d) With regard to the conversion rates applicable to import charges fixed in ecus, Commission Regulation (EEC) No 1482/95[13] provides for the application, as a transitional measure, of a monthly rate where the annual rate provided for in the Customs Code[14] should have applied. The Commission subsequently extended the application of the transitional monthly rate for a further year, since the Council and the Parliament had not yet completed their consideration of the Commission's proposal to amend the annual rate provided for in the Customs Code[15] by 30 June 1996.

However, the transitional monthly rate is applicable only to import charges not fixed by an instrument under the CAP within the meaning of Article 1 of the basic agri-monetary Regulation. In other cases, the agricultural conversion rates are applied. The use of different conversion rates has resulted in certain economic inconsistencies and has very greatly complicated administration, with concomitant scope for errors and legal insecurity. In February 1996 the Commission accordingly proposed to amend the agri-monetary arrangements in such a way as to eliminate the use of the agricultural conversion rate and to use only one rate for import charges on agricultural products[16]. By 30 June 1996 the Council had still not taken a decision on this point.

(e) The concept of appreciable revaluation was introduced in February 1995 by Article 9 of Regulation (EC) No 3813/92 to describe currency appreciations which may have significant short-term consequences, in particular having regard to international commitments under the GATT agreement and budgetary discipline.

In origin, the concept was associated with that of an appreciable reduction in the ACR as defined by Article 1 of Regulation (EEC) No 3813/92. Subsequently, it appeared that other reductions in the ACR fell within the scope of appreciable revaluations, in particular those which could trigger Articles 7 and 8 of Regulation (EEC) No 3813/92. In July 1996, Article 8 of Regulation (EEC) No 1068/93[17] was amended so such cases were covered by the definition of appreciable revaluations.

2. Compensatory aid

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13 OJ No L 145, 29.6.1995, p. 43. Amended by Regulation (EC) No 1224/96 (OJ No L 161, 29.6.1996, p. 70).

14 Article 18 of Council Regulation (EEC) No 2913/92 (OJ No L 302, 19.10.1992, p. 1).

15 COM(95)335 final.

16 COM(96)40 final.

17 OJ No L 108, 1.5.1993, p. 106. Last amended by Regulation (EC) No 1482/96 (OJ No L 188, 27.7.1996).

At the end of 1995/96, the six Member States affected by appreciable reductions in their ACRs in June or July 1995 had notified draft aid schemes under Regulation (EC) No 1527/95. The Commission raised no objection to those plans.

Sweden, which has a further six months to notify aid under Regulation (EC) No 2990/95, put forward no plans for schemes during the period under review.

France and Belgium presented draft national aid schemes before the deadline of 30 June 1996 to compensate for the effects of devaluations in other Member States in accordance with Regulation (EEC) No 2611/95. The Commission raised no objections to such plans.

The following table summarizes aid authorized and notified. All amounts are expressed in millions of ecus on the basis of the RMRs at 1 July 1996. The second and third tranches of compensation for appreciable reductions in ACRs amount respectively to two thirds and one third of the first tranche, which is shown in the table.

Member State	Appreciable decline in ACR (%)	Ceiling (ECU million)	Notified EU financing (ECU million)	Notified national financing (ECU million)
Regulation (EC) No 1527/95				
Belgium	2.193	40.2	20.5	6.1
Luxembourg	2.193	3.2	1.6	1.6
Denmark	0.496	8.0	4.0	0.0
Germany	2.229	216.7	108.3	108.3
Netherlands	2.572	101.4	50.7	0.0
Austria	2.264	38.7	19.4	0.0
Regulation (EC) No 2990/95				
Sweden	1.734	20.8	-	
Regulation (EC) No 2611/95				
Belgium	-	-	0	3.3
France				17.3

(a) Compensation for appreciable reductions in ACRs (Regulation (EC) No 1527/95)

Luxembourg and Germany decided to grant the maximum possible aid, using national funds to double the compensation financed by the EAGGF. Belgium intends providing additional aid equal to 15% of the maximum authorized, on top of the 50% financed by the EU. Denmark, the Netherlands and Austria are not providing additional aid.

Unlike the other Member States, which allocated aid direct to farmers on the basis of past output, Denmark, Germany and the Netherlands have opted for flat-rate allocation for the third tranche, since amounts would have been less than ECU 400 per holding.

In order to avoid overcompensation by sector, consideration was given to ceilings on aid per product group. The ceilings were established on the basis of hypotheses for income losses used by the Council when determining the total maximum aid authorized. Accordingly, a significant loss of income was anticipated solely in sectors with institutional prices directly affecting prices received by farmers. In the light of past experience, the major sectors concerned are cereals, sugar beet, milk and beef/veal. In view of the Council's decision to grant the aid on an *ex-ante* and flat-rate basis, real losses by sector in the light of the actual change in prices after July 1995 were not taken into account with a view to adjusting the ceilings by sector or the total amount of aid.

In the case of Belgium and Austria, the aid allocated to individual sectors of production is not proportional to the ceilings though it falls below the latter in all cases. As a result the aid granted does not result in overcompensation of losses per sector in accordance with the regulations but undercompensation spread unevenly at sector level. No sector can be deemed overcompensated for the income loss as estimated by the Council.

Belgium decided to grant the following amounts in compensation in respect of the 1996 tranche. For 1997 and 1998, those amounts will be reduced by one third and two thirds respectively.

Product group	Cereals excluding maize	Sugar beet	Milk	Beef/veal
Value of production as percentage of total (4 product groups)	8.15%	10.41%	38.51%	42.93%
Maximum aid for product group (ECU million)	3.33	4.26	15.75	17.56
Total aid authorized (ECU million)	1.53	1.96	7.24	15.84
Aid authorized as percentage of ceiling	45.95%	46.01%	45.97%	90.21%
Aid authorized as percentage of total (4 product groups)	5.76%	7.38%	27.25%	59.62%
Approximate unit aid (ECU)	10.9/ha	37.6/ha	0.43/hl	54.47/LU

The aid allocation shows that almost the maximum is granted for beef/veal while the other product groups receive less.

The unit amounts of the three tranches of the aid for cereals, sugar beet and beef/veal are based on declarations by farmers in connection with compensatory payments paid under the reform of the CAP in 1994. In the case of cereals, there is provision for an adjustment on the basis of the regional yield, while in the beef/veal sector, the aid is granted on the basis of the male bovine animals and suckler cows on which the premium was paid in 1994. Quantities of milk compensated for relate to deliveries from 1 April 1994 to 31 March 1995 subject to a ceiling equal to the quota. Since the amounts granted depend on production prior to 1 July 1995, they are not deemed to constitute an incentive to increasing production.

Luxembourg apportioned all aid which may be granted in accordance with the following table relating to the 1996 tranche. The following two tranches will be reduced in accordance with the regulations. The breakdown by product group is the same as that for the production concerned. The unit amounts are allocated to farmers on the basis of quantities declared under the system of compensatory allowances for less-favoured areas (Regulation (EEC) No 2328/91).

Product group	Cereals	Sugar beet	Milk	Beef/veal
Value of production as percentage of total (4 product groups)	11.82%	pm	53.18%	35.00%
Maximum aid per product group (ECU '000)	376	0	1693	1115
Total aid authorized (ECU '000)	376	0	1693	1115
Aid authorized as percentage of ceiling	100%	100%	100%	100%
Aid authorized as percentage of total (4 product groups)	11.81%	-	53.17%	35.01%
Approximate unit aid (ECU)	13.1/ha	0	34.67/cow	10.92/LU

Since **Denmark** could not grant less than ECU 70 per holding, it decided to use the aid for measures in the collective and general interest. EAGGF finance will be allocated equally to two funds for measures not entailing production incentives, namely PMF (Promille for agriculture) and DAF (project for the development of agricultural products), which contribute towards measures involving research, advisory services, training, promotion, etc. In principle these funds are financed by compulsory contributions levied on producers. The agri-monetary compensation will be allocated to special measures and will therefore lead to new measures or a reduction in contributions allocated to measures under way.

Germany grants the maximum amount of aid, which is, however, slightly below ECU 400 per holding. Accordingly Germany opted for a simplified form of allocation to farmers, not taking account of income losses per sector.

The aid entails a subsidy on farmers' contributions to insurance against farm accidents. Since 1963, such insurance is subsidized by the State to reduce farmers' contributions. Between 1994 and 1998, these subsidies amounted to around ECU 320 million, currently accounting for 35% of the total. The farmers' share, which is around ECU 600 million, will be reduced in 1996, 1997 and 1998 by the degressive compensatory aid, amounting to ECU 216.7 million in 1996, and ECU 144.5 million and ECU 72.2 million in subsequent years.

The **Netherlands** apportion the 1996 tranche of the aid as set out in the following table. The following tranche will be two thirds of the first. The third tranche, amounting to around ECU 225 per holding, will be allocated in the form of measures in the collective and general interest.

Product group	Cereals	Sugar beet	Potatoes for starchmaking	Milk	Beef/veal
Value of production as percentage of total (5 product groups)	3.75%	6.46%	3.32%	64.13%	22.34%
Maximum aid per product group (ECU million)	3.80	6.55	3.37	65.07	22.67
Total aid authorized (ECU million)	1.90	3.28	1.68	32.54	11.23
Aid authorized as percentage of ceiling	50%	50%	50%	50%	50%
Aid authorized as percentage of total (5 product groups)	3.75%	6.46%	3.32%	64.13%	22.34%
Approximate unit aid (ECU)	10.56/ha (winter wheat)	28.17/ha	27.44/ha	19.08/cow	20.10/bovine animal 1-2 years

The apportionment of the aid among the sectors concerned follows the breakdown in production. The aid is granted to farmers on the basis of the May 1995 agricultural census data. For cereals and beef/veal, many categories were used to split up the aid on the basis of the standard gross margin by category, the amount granted differing by type of cereals and beef/veal.

The third tranche will be used for the prevention and monitoring of animal and plant diseases where the public interest is at stake and to compensate for any damage due to such diseases or the weather.

As far as compensating for damage is concerned, the aid will be used by the producer organisations to subsidize insurance premiums or contributions paid to that end by farmers.

Austria intends reducing the first tranche of aid in accordance with the regulations as set out below.

Product group	Cereals	Sugar beet	Potatoes for starchmaking	Milk	Beef/veal
Value of production as percentage of total (5 product group)	15.47%	6.27%	0.45%	44.06%	33.75%
Maximum aid per product group (ECU million)	5.99	2.43	0.17	17.07	13.08
Total aid authorized (ECU million)	0	0.94	0.17	10.34	7.91
Aid authorized as percentage of ceiling	0	38.68%	100.00%	60.57%	60.47%
Aid authorized as percentage of total (5 product groups)	0	4.85%	0.88%	53.41%	40.86%
Approximate unit aid (ECU)	0	1.08/t (A quota)	1.77/t	41.66/cow	27.18/head

Thus apportioned, the aid provides compensation equal to 100% of the ceiling for potatoes for starchmaking, approximately 60% for milk and bovines, almost 40% for sugar beet and zero for cereals.

The unit amounts for beet and potatoes are based on the quantities covered by contracts between producers and processors at 1 July and 31 May 1995 respectively. For milk and bovines, they are calculated and granted on the basis of livestock held at 1 April 1995 and declared under aid schemes to protect the environment and maintain the countryside (Regulation (EEC) No 2078/92).

(b) Compensation for the impact of devaluations in other Member States (Regulation (EC) No 2611/95)

France and Belgium granted nationally funded aid in single annual instalments to offset the effects of the devaluation of the LIT on the beef industry.

In both cases, the national markets were highly dependent, directly or indirectly, on the Italian market. In France, around 50% of exports of live bovine animals and fresh beef/veal, accounting for around 25% of production, is sent to Italy. In Belgium, 50% of exports, i.e. around 20% of production, generally goes to France and Italy. In the three Member States in question, prices fell steeply in national currency and in ecus from March 1995, coinciding with the beginning of the sharp devaluation of the LIT. To take account of seasonal changes in prices and reductions in intervention prices, the average weekly prices, minus 10%, for the last three years were calculated by way of a reference. A comparison of the weekly prices recorded in 1995 with these reference averages shows an additional fall in prices, significantly between March and August 1995. Depending on the method applied, the fall in prices attributed to the devaluation of the LIT was 3.8% on average, with a maximum of 5%, in France. In Belgium it was 1.7% on average, with a maximum of 3%.

Given the absence of other significant factors and since the period coincided with the devaluation of the LIT, these additional price falls were considered to be consequences of that devaluation. The income loss concerned was thus estimated, with a possible fluctuation margin, at around ECU 17 million in France and ECU 5.6 million in Belgium.

In accordance with the above, France calculated the flat-rate aid per category of bovine animals and per marketing week, granting the aid to farmers on the basis of animals sold during the weeks under consideration. In Belgium the aid allocated to the Wallonia region amounted to ECU 3.3 million. Given the lack of detailed, reliable information, as far as indidivual operators are concerned, on quantities marketed each week during the period in question, ECU 10.16 per LU was allocated on the basis of the premiums paid in 1994 on male bovine animals and suckler cows.

C. Economic impact

Theoretically, market prices, which are closely linked to an intervention mechanism (cereals, sugar, milk and beef/veal), may be affected by the ACRs. Through the prices for certain of the products concerned, the change in ACRs may therefore have repercussions on farmers' incomes. Furthermore, difficulties may arise in trade in the event of divergence between the ACRs and the RMRs or between market prices and intervention prices in national currency.

However, the prices of other products for which no intervention mechanism exists to provide market guidance are not affected by the ACRs. Nonetheless a sharp, sudden change in the RMRs may distort trade in such products. This is the case in particular where market prices do not follow currency fluctuations.

Lastly, in addition to the impact of monetary repercussions on prices, farm incomes are directly affected by the ACRs applicable to direct aid to producers.

1. Prices

The analysis relates mainly to monthly movements during the period 1995/96.

In the case of products with no intervention mechanism influencing market prices, as may be expected no link is observed between the movements of such prices and those of the ACRs. Even in the case of the LIT, which revalued significantly from July 1995 to June 1996, the market prices for wine, olive oil, sheepmeat and pigmeat rose or varied to an extent out of all proportion with the reductions in the ACRs.

For other products, the analysis focuses on sectors where usable data are available and covers a single representative market per Member State concerned[18].

In the absence of significant devaluations, movements in the ACRs likely to have had most repercussions in 1995/96 are:

- the continual, significant revaluations of the LIT (12.1%) and the SKR (9.9%);
- the "appreciable" revaluations of the BLF, DKR, DM, HFL and ÖS in June and July 1995 and of the SKR in January 1996.

(a) Cereals[19]

The market prices for common wheat are substantially higher than the intervention prices in national currency. During the 1995/96 marketing year from August 1995 to April 1996, the market prices in the three main producer Member States (Germany, France and the United Kingdom) stood an average 22% above the intervention price. As in the previous year (when they stood 12% above the intervention price), at this exceptional level market prices are hardly affected by small fluctuations in the intervention price in national currency.

However, despite the very wide variations in 1995/96, viewed globally the general trends in such prices are not contradictory. Thus market prices (like intervention prices, to which monthly increases apply) in most Member States tend to rise during the marketing year. In the case of the two Member States whose ACRs fell significantly in 1995/96 (Italy and Sweden), market prices as well as intervention prices almost remained on the same level in terms of national currency, whereas the market prices rather fell down in LIT and remained steady in SKR.

As regards appreciable revaluations covered by compensatory aid, reductions in market prices, where they exist, are difficult to highlight since reductions in the

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18 See Graphs B 2 to B 15 in Working Paper on Basic Information.

19 See Graph B 1 a in Working Paper on Basic Information.

ACRs for the BLF, DM, HFL and ÖS occur at the same time as the reduction in the intervention prices in ecus at the beginning of the marketing year. Between June and July 1995, that reduction was around 15% taking monthly increases into account.

Between March-April and August-September 1995 (before and after the disturbance accompanying changes from one marketing year to the next), national prices fell in the currencies in question, though prices in FF and UKL were practically unchanged between the two periods in question. However, where reductions in prices are linked with falls in the ACRs, other factors have played a part since these falls are not proportional: appreciable reductions in the ACRs were around 3%, the smallest being for the DM and the ÖS, while reductions in prices were around 4% to 5% for the BLF and the HFL, 7% to 8% for the DKR and the DM, and 11% for the ÖS.

Among the factors affecting these differences in price movements between the Member States, the impact of national harvests is clearly decisive. French output in 1995/96 was close to the average for the previous three years and explains the firmer prices in FF than in the Member States which revalued, where output rose by nearly 10%. The case of the United Kingdom, where prices remained more or less stable despite an increase in production, can be explained to some extent by the difference in the varieties of wheat covered.

There were appreciable reductions in the ACRs for the DKR and the SKR in late July 1995 and January 1996 respectively. They were accompanied by significant price stability over the period in question and thereafter. At the end of June 1995, a price reduction, applied in anticipation and subsequently wiped out in the turmoil at the beginning of the marketing year, was in theory possible for the DKR, but not for the SKR, since the latter was revalued much later.

Lastly, despite some uncertainty and the need for caution due to the many factors coming into play but not covered here (such as differences between the various types of cereals), agri-monetary reductions in prices due to revaluations probably did not take place given the context of high market prices in 1995/96.

(b) Milk products[20]

During the first half of the 1995/96 marketing year, the market price for skimmed-milk powder (SMP) and butter remained exceptionally high (approximately 10% and 5% up) compared with the intervention prices.

As the intervention prices in ecus did not change between 1994/95 and 1995/96, variations in the latter in terms of national currency are due to changes in the ACRs, which makes it easier to highlight any effects.

20 See Graphs B 1 b and B 1 c in Working Paper on Basic Information.

However, no link can be detected between the revaluations of the LIT and the SKR and movements in market prices. In Italy, butter prices soared in line with the EU market despite the fall in the ACRs in the latter half of 1995; subsequently, they plummeted like everywhere else. In Sweden, prices for SMP and butter remained high, despite large fluctuations, resisting the downward pull of the reduction in intervention prices in SKR.

Market prices in the currencies which underwent an appreciable revaluation in June and July 1995 clearly did not follow the downward movement in the ACRs. In the absence of an appreciable revaluation, it is very unlikely that prices in the currencies in question would have increased or, if so, have risen further. Changes in the latter generally follow trends over several months, which differ only slightly from those recorded in FF and UKL, the ACRs for which did not fall at the beginning of the marketing year.

(c) Beef/veal[21]

Prices for meat of young bovine animals fell sharply in early 1995, approaching or even attaining the conditions which trigger intervention. Subsequently, in late 1995 and until the bovine spongiform encephalopathy crisis broke, prices were much firmer.

In some Member States, the fall in prices between March and July 1995 was probably partly influenced by prices in LIT, which did not rise in pace with the ACRs. Such relatively low prices affected the French market, which is heavily dependent on trade with Italy, and subsequently other Member States.

After July 1995, the low prices in LIT remained stable; since they had not risen beforehand, they did not follow the downward slide in the ACRs. Market prices in SKR, another currency which appreciated significantly during the 1995/96 marketing year, followed the downward movement in the ACRs fairly closely.

In the case of the currencies which underwent an appreciable revaluation at the beginning of the marketing year, the downward movement of market prices seems to be linked with that of the ACRs. Thus despite a smaller fall in June and July 1995 than that recorded for the FF (which was relatively strongly affected by the Italian market), the price recovery of the second half of 1995 was not as firm in the Member States which revalued as it was in France and the United Kingdom. Furthermore, the change in market prices in BLF, DKR, DM, HFL and ÖS tended to follow on the heels of the movement in intervention prices in national currency between the beginning of 1995 and the beginning of the 1995/96 marketing year.

21 See Graph B 1 d of Working Paper on Basic Information.

2. Trade

Monthly variations from 1992 to 1995 in exports with the other Member States and non-member countries are analysed. On average, the period is marked in particular by the devaluations in the LIT, the PTA and the DRA.

(a) In the short term, in almost all cases the scale of the monthly variations in the value of exports masks the effects of any currency variations[22].

In the case of certain substantial devaluations like that in the LIT in spring 1995 or the UKL in late 1992, the months concerned show a brief surge in exports. Nonetheless, the sharp devaluations in the LIT in late 1992 and in the PTA in early summer 1993 were not accompanied by any rise in exports. Furthermore, the very substantial rises in exports of products like sugar and milk products in Spain in 1994 and 1995 clearly have no link with currency movements. Conversely, the appreciation of the LIT at the end of 1995 had no significant impact on general trends in Italian exports of the various agricultural product groups.

Statistics of Member States' trade with those whose currencies devalued sharply did not indicate significant links between the total exports of any product group and short-term currency movements.

Among other possible short-term agri-monetary effects, deflection of trade may in theory occur for products attracting export refunds when the aggregate monetary gap widens[23]. The scale of such aggregate gaps depends in particular on transport costs from one Member State to another, and therefore on their geographical remoteness and the type of products concerned.

In this respect, the main risks incurred in 1995/96 were due to positive gaps for the LIT and SKR, which exceeded five points during the confirmation periods. For the LIT, aggregate gaps in excess of five points arose with the DRA, DM and ÖS and recurred often in excess of four points with the DRA and ÖS. Aggregate gaps for the SKR, which exceeded six points against the IRL, UKL and in particular FMK, or five points with the DM and HFL, and up to four points with the DKR, afforded opportunities for deflection of trade flows. Such risks were high prior to January 1996 when large aggregate gaps persisted.

Nevertheless, export statistics show no movement which can be put down to such agri-monetary gaps. Any cases of deflection of trade due to differences between

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22 See Graphs C3 to C1 of Working Paper on Basic Information.

23 See Graph A 6 of Working Paper on Basic Information.

export refunds in national currency occur only sporadically. Even where the aggregate gaps over two months are significant, as was the case at the end of 1995, no systematically organized network is set up on account of uncertainty about the time the situation will last. Naturally, this does not rule out the possibility that isolated cases of financial significance to the individual operator may arise.

(b) Over longer periods, an analysis of the impact of currency fluctuations on the single market[24] shows that, generally speaking, exports can be influenced by competition. However, that impact vies with internal demand, exporters' attitude vis-à-vis their profit margins and structural causes affecting some product groups more than others. The interplay of these factors is such that distinguishing the effects of any particular one is very tricky.

Competitiveness can be gauged by the actual exchange rate, which takes account of the currency developments in each Member State, depending on the relative importance of its economic partners, and the movement of production costs. According to that indicator, from 1992 to 1995 the trend in Member States' competitiveness was:

- fairly negative in Germany, Belgium, Greece and the Netherlands;
- moderately negative in France, Denmark and Portugal and moderately positive in Ireland;
- fairly positive in Spain and the United Kingdom and very positive in Italy.

Other indicators of competitiveness provide approximately the same grading for the period in question.

A statistical examination[25] shows an overall link between an increase in competitiveness and a rise in value in national currency. That overall link is still apparent when exports are expressed in national currency deflated using the consumer price index.

However, it is not apparent when exports are considered in terms of value in ecus or in quantity in tonnes.

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24 Report of the Directorate-General for Economic and Financial Affairs published in "European Economy", Reports and Studies No 4-1995.

25 See Tables and Graphs C1 and C2 of Working Paper on Basic Information.

In general, the development of competitiveness was therefore followed by that of profits on exports but not by shifts in market shares. Thus while quantities exported increased overall by around 5% per year in both Italy and Germany, unit prices rose in the former case and fell in the latter in terms of constant purchasing power.

The main characteristics highlighted by the overall analysis are found in the group of products not affected by major intervention mechanisms. They remain present, to a lesser degree, in the case of other products (cereals, sugar, milk and beef/veal). The impact of currency movements on these products subject to intervention should not have occurred where the differences in price in national currency had simply reflected the agri-monetary gaps. Some explanation for their existence lies in the disparities outlined in point C.1 between the movements in market prices and in intervention prices in national currency. The disparities are even larger than those described (e.g. in the case of common wheat) where the products in question are derived from others directly affected by intervention. A more refined and highly specific analysis by product group provides different, confused results, which are strongly affected by factors peculiar to the markets in question.

Compared with the general trend, the situation in certain Member States is highly specific. Thus the improvement in competitiveness in Spain is only half that in Italy, while the rise in Spain's exports is almost as great in terms of value and much greater in terms of quantity. Accordingly, results for Spain essentially reflect the consequences of the reorganization of production and marketing in the sugar and dairy industries within the European Union.

Other examples of note are Belgium, whose performance outstripped expectations having regard to the index of competitiveness adopted, in particular in fruit and vegetables, and the United Kingdom, whose performance was poor, mainly owing to the decline in quantities of cereals exported.

3. Incomes

The latest statistics of farm incomes relate to 1995. In detail, the effects of the agri-monetary arrangements on incomes in 1995 are very difficult to gauge since they depend in particular on the actual impact of the agricultural conversion rates on market prices, on the operative events for ACRs, and on the terms of payment for purchases, sales and aid to farmers. As a result some effects visible in 1995 are due to movements in ACRs in 1994, whereas the consequences of certain changes in the ACRs for 1995 will only be felt in 1996 or even later.

To assess the effects of the ACRs in the period 1995/96 on income over 12 months, certain approximations and assumptions were nonetheless needed:

- prices received by farmers in 1995/96 are deemed to be the same as those recorded in 1995 and to mirror the change in the ACRs for producers of sugar beet and beef/veal. In other production sectors, the impact of the ACRs is considered nil, in accordance with results set out in point C.1 and the relatively negligible overall income affected by the minimum prices (potato starch, processed fruit and vegetables, etc.);

- agri-monetary compensatory aid notified or provided for by the Member States is assumed to have been paid in 1995/96 in order to balance out the effects of appreciable revaluations on prices. In the case of Sweden, where an appreciable revaluation occurred in January 1996, only half the maximum aid payable was taken into account;

- amounts of direct aid to producers, expressed per hectare cultivated, and aid per tonne of seed produced are those for the 1995/96 marketing year, to which the ACR for 1 July 1955 is applied[26];

- the ACR for 1 January 1996 is applied to the 1995 sheep premium; to group the whole impact of the ACR for 1 January 1996 on incomes in 1995, the balance of the 1994 premiums, which was actually paid in 1995, is replaced by the balance of the 1995 premiums, which is actually paid in 1996;

- the ACRs for early 1995, or even early 1994 in the case of olive oil, actually apply to beef premiums, structural aid, the tobacco premium and aid to olive-oil producers, which is paid in 1995. In order to assess the full impact on 12 months of the ACRs for 1995/96, it has been assumed that those premiums and aid are determined by the ACRs valid at the beginning of 1996. Aid to major olive-oil producers is deemed to have been affected by the average ACRs from November 1995 to February 1996 and the other amounts by the ACR for 1 January 1996.

Using this theoretical model, which groups the full impact of the 1995/96 ACRs over 12 months, the following were assessed:

- the effect of the annual movement of the ACRs between 1994/95 and 1995/96, by multiplying the income components affected by the agri-monetary arrangements by the gap between the ACRs applied during those two periods;
- the annual effect of the agri-monetary arrangements in 1995/96, by multiplying those components by the gap between the ACRs applied and the corresponding RMRs.

26 For the sake of simplification, the small number of cases where the operative event takes place on 1 August have been dealt with in the same way as the majority of cases where the operative event for the ACR takes place on 1 July.

Despite its abstract nature, this model does reveal a significant impact of the ACRs on incomes and variation in that impact depending on the Member States[27].

The effect of the movement in ACRs compared with the preceding year turns out to be fairly small, generally below 2% in most Member States, and is:

- fairly positive in Luxembourg, Germany, Greece, Finland, Ireland and Spain,
- fairly negative in Belgium and Denmark,
- fairly neutral in Portugal, France, the Netherlands and Austria.

These slight differences in movement are mainly the result of a balance, or lack thereof, between the effects of the ACRs on prices and the effects of compensatory aid in the Member States concerned; they are due to the effects of devaluations on aid in the case of Greece, Ireland and Spain.

The impact of the year-on-year change is particularly positive in three Member States, namely:

- Sweden (+ 7.2%), owing to the increase in aid per hectare,
- Italy and the United Kingdom (+ 4.1% and + 4.5% respectively), owing to increases in prices and aid, the latter accounting for two thirds of the effect in Italy and half in the United Kingdom.

The overall impact on net income from farming is 1.7% or ECU 1 559 million. Of that amount, 71% can be put down to the impact on aid while of the remainder, 21% of the total is due to compensatory aid and only 8% to the impact on prices.

The annual impact of the agri-monetary arrangements, by comparison with the situation that would have obtained had the RMR been applied directly in place of the ACR in 1995/96, is beneficial for all the Member States.

The major benefit in terms of incomes occurred in Sweden (+ 8.8%).

The other Member States where incomes rose substantially are Luxembourg (+ 5.6%), Germany (+ 4.6%), Belgium and Denmark (+ 3.8%). The rise was smaller in Austria (+ 2.5%) as the large proportion of income accounted for by national aid is not affected.

Farmers in the Netherlands, Ireland, Italy and Spain saw their incomes rise by around 2%. The other Member States saw smaller rises of around 1% or even less in the case of Greece and Portugal.

27 See Tables D 1, D 2 and D 3 of Working Paper on Basic Information.

In total, the effect on net income from farming is 1.9% or ECU 1 718 million, the proportion due to aid being lower in this case, at only 45%. Compensatory aid accounts for 19% and prices for 36% of the total impact on income.

D. Financial impact

1. Methodological aspects

(a) Classification of agri-monetary effects

In the agri-monetary area, the legacy of the switch-over (or green ecu) mechanism weighs heavy on the Community budget. Introduced in 1984, the mechanism was discontinued from 1 February 1995. It resulted in a general increase of around 20% in prices and amounts expressed in ecus, which cancelled out the effects of bringing the conversion rates used in agriculture back to a realistic level. Previously, from 1990 to 1993 it also brought about a fall totalling 1.46% in most prices and amounts under the CAP.

It would be wrong to ascribe the costs in question to the green ecu mechanism itself. It is unlikely that, had it not existed, prices and amounts in ecus would have developed as they did. However, in one way or another, those costs represent the financial legacy of the agri-monetary problems existing before the abolition of the green ecu.

This legacy of past costs does not stem from the present agri-monetary mechanisms but rather from the final value of the switch-over coefficient, i.e. 1.207509, and the structure of annual expenditure in ecus.

Firstly, they include the effects of the general rise in prices and amounts in ecus in early February 1995. Those effects can be determined on the basis of the difference between total EAGGF Guarantee Section expenditure minus the agri-monetary effects relating to the events of 1995/96 and the same total so reduced, divided by 1.207509.

Calculated as above, the financial impact of this rise in prices has to be corrected as far as the expenses connected to the world market price are concerned, i.e. certain export refunds and certain aids[28]. For the amounts concerned, the method indicated in the above paragraphe affects the difference between the level of the prices of the European Union and the world market level, whereas only common prices are modified.

Moreover, the agri-monetary reduction in prices in ecus was 0.17% in 1990, or 11% of the total fall, but was applied to more than 90% of the EAGGF Guarantee

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28 These effects are illustrated in Table E 1 of the Working Paper on Basic Information

Section. The 1993 reduction amounted to 1.29% but it was not applied to compensatory payments under the reform. On average, an agri-monetary reduction of 1% in prices results in a 0.7% reduction in EAGGF expenditure[29].

Furthermore, the financial impact of developments in 1995/96 stem from four mechanisms or measures, namely thresholds, operative events, the freezing of ACRs and compensatory aid.

The cost of agri-monetary compensatory aid is identified in the 1996 budget and the 1997 preliminary draft budget. The fact that these costs are degressive is laid down in the regulations and the granting of the last tranches of aid decided in 1995/96 should affect the budget for 1998 and, to a very slight extent, that for 1999.

The freezing of ACRs results in a cost equal, in national currency, to the difference between the frozen ACR and that known on the date of the operative event concerned, multiplied by the amount in ecus of the aid to which it applies. As the ACRs are frozen until 1 January 1999, this will affect the 1999 budget as regards all the aid measures concerned and that for the year 2000 as regards beef premiums only.

The financial effects of the thresholds and operative events stem from the difference between:

- the agricultural conversion rate on the date of the operative event for the amount concerned,

and

- the rate applicable for the booking of expenditure in ecus (accounting rate), i.e. the rate for the 10th day of the month of entry in the accounts of the expenditure in national currency; this is generally the month following that of payment to the recipient by the Member State.

The effect of the thresholds is due to the difference between the agricultural conversion rate and the accounting rate on the date of the operative event. The effect of the operative events relates to the difference between the accounting rate on the date of the operative event and the same rate on the date of the booking of the expenditure in ecus. Irrespective of the system of ACR selected (and therefore of no use in comparing such systems), this effect was omitted in the previous agri-monetary report relating to 1993 and 1994.

29 The percentage 0.7% comes from annual Commission reports in 1994, 1995 and 1996 on the impact on EAGGF Guarantee Section expenditure of:
- movements in the dollar/ecu parity,
- rises in the correcting factor as a result of monetary realignment within the EMS.

(b) Method for estimating the costs of developments in 1995/96

Agri-monetary events and decisions in 1995/96 mainly affect the budgets for 1996 to 1999.

When estimating the agri-monetary effects on the 1996 budget, account was taken of the preliminary draft supplementary and amending budget for 1996 (PDSAB 96) as at 30 June 1996, drawn up on the basis of conversion rates available on 6 May 1996.

For the effects from 1997 to 1999, calculations are based on the 1997 preliminary draft budget (PDB 97) as at 30 June 1996, drawn up using the conversion rates available on 21 March 1996.

The bases (PDSAB 96 and PDB 97) were corrected by replacing the ACRs used to draw them up by the ACRs available on 1 July 1996[30]. The accounting rate used was not adjusted as it is of minor significance among the agri-monetary effects due to variations in the ACRs.

- The PDSAB 96 and PDB 97 as corrected on 1 July 1996 show the situation as provided by the latest ACRs available at the end of 1995/96. Expenditure is broken down on the one hand on the basis of the various operative events for the ACRs affecting them and on the other hand on the basis of past expenditure between the various currencies of the Member States.

- An estimate of Community expenditure irrespective of any agri-monetary arrangements is arrived at by replacing the ACRs used in the PDSAB 96 and the PDB 97 by the RMRs applying at the beginning of the month of booking of such expenditure and deducting agri-monetary compensation paid.

  Note that the estimate for the month of booking of each type of expenditure is a fairly shaky approximation, subject to a wide variations[31]. The RMRs for 1 July 1996 are used for all dates of entry in the accounts thereafter.

- The overall effect of freezing the ACRs is calculated by replacing the ACRs actually used for the aid in question in the PDSAB 96 and the PDB 97 by the current ACRs applying on the date of the operative events for such aid.

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30 See Tables E 3 to E 6 of the Working Paper on Basic Information.

31 See Table E 3 of Working Paper on Basic Information.

- The effect of the operative events is assessed on the basis of the difference between the results of the calculation outlined in the second indent and the outcome of a similar simulation using the RMRs applying on the date of the operative events for the ACRs actually applied. Given reservations regarding the identification of the month of entry in the accounts, that assessment is rather imprecise and it becomes impossible after 1997 as all the conversion rates applicable after 1 July 1996 are replaced by those available and applicable on 1 July 1996.

- The impact of the margins is gauged on the basis of the difference between the results of the situation with the current (non-frozen) ACRs as described in the third indent, and the outcome of the simulation using the RMRs valid on the date of the operative events, as outlined in the fourth indent.

The ACRs for 1995/96 affect 75% of expenditure in the PDSAB 96. The conversion rates valid on 1 July 1996 are applied to 3% of the expenditure actually stemming from an operative event on that date but also to the 10% covered by operative events occurring subsequently, from 2 July to 15 October 1996. The conversion rates valid on the dates of operative events prior to 1 July 1995, but not prior to November 1994, are applied to almost all other expenditure in the 1996 budget. Overall, barely 1% of the expenditure is deemed to be unaffected by the ACRs.

Only 2% of expenditure in the PDB 97 is affected by the ACRs with operative events occurring prior to the period under review. 11% of the expenditure is affected by the ACRs for early 1996 and 37% by those for 1 July 1996. Accordingly, almost 50% of the PDB 97 hinges on the conversion rate applicable from 2 July 1996 to 15 October 1997. Those rates, which were not available when this report was drafted, are replaced by the conversion rates for 1 July 1996.

As regards figures in the 1998 and 1999 budgets carried over from the PDB 97, almost all the relevant operative events will take place after 1 July 1996 and the ACRs are replaced by those for 1 July 1996.

Overall, the agri-monetary situation at 1 July 1996 is of great importance in estimates for 1997, 1998 and 1999. Highly short-term in scope, this situation shows a very large monetary gap for the SKR (+ 6.779), which, in accordance with the agri-monetary rules, cannot be maintained for long. The LIT (+ 4.986) and the IRL (+ 4.603) also have large monetary gaps, while the gaps for the DM, the HFL and the ÖS are close to zero.

The gaps will no doubt evolve, which will have a big effect on the results calculated here. However, it should be noted that the average weighted gap according to the breakdown by currency in the 1996 budget is 2.2% at 1 July 1996 while the average for 1995/96 is 2.1%.

2. Results of estimates

(a) The legacy of the past

In the light of estimates for costs relating to developments in 1995/96 (see point (b) below), the effects of the green ecu mechanism highlighted by the rise in prices in ecus entail expenditure of ECU 6 800 million for the 1996 budget and ECU 6 920 million for 1997.

The effects of the green ecu, passed on through world market prices, are estimated to result in an extra cost of ECU 1 320 million per year[32].

Agri-monetary reductions in prices, which amount to 1.46% in total, result in savings of around ECU 340 million per year.

Altogether, the residual effects of past agri-monetary problems involve a cost of around ECU 7 800 to 7 900 million each year.

(b) Developments in 1995/96

The results set out in the table below show an annual cost of around ECU 1 200 to 1 300 million per year.

Around two thirds of that cost is due to the effects of the margins. However, the cost of the margins depends on future currency movement, in entirety as regards 1998 and 1999 and half thereof in 1997.

The reason margins entail a cost is basically attributable to the asymmetry of the mechanisms, whereby positive monetary gaps can rise to 5 points while negative gaps are usually limited by a variable threshold determined by the maximum positive gap minus 5 points. Moreover, in situations of steady and significant appreciation for several currencies, as in 1995/96, the duration of confirmation periods plays an important role in keeping the largest positive gaps in existence over time.

The cost of operative events, which is difficult to compress without distorting markets, is around ECU 100 million per year. This result is unusually high because there was no offsetting in 1995/96 between currencies that appreciated and those that depreciated. It cannot be estimated at present for 1998 or 1999.

The cost due to freezing ACRs gradually rises, because of operative events, eventually reaching ECU 185 million. As the freeze will continue until 1 January 1999, it also affects the budget for the year 2000.

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32 See Table E 2 of Working Paper on Basic Information.

The cost of compensatory aids could be reduced as from 1997 in order to take into account the devaluation occurred after the appreciable revaluations which justified these aids. The incidence of these devaluations on the amount of the tranches of the aids which have not yet been granted has to be examined by the Commission following the management committee procedure.

(ECU million)

Costs of agri-monetary events in 1995/96	**1996**	**1997**	**1998**	**1999**
A - Mechanisms actually applied				
ACR freeze	111	180	185	185
Compensatory aid	201	141	70	2
Permitted margins	817	890	916	913
Operative events	107	104	-	-
TOTAL	**1 236**	**1 315**	**1 171**	**1 100**
B - Hypothetical application of Articles 7 and 8 of Regulation (EEC) No 3813/92				
Increase in aid (Article 7)	653	2 812	2 932	2 932
Compensatory aid (Article 8)	0	201	138	70
Permitted margins	823	953	983	979
Operative events	117	104	-	-
TOTAL	**1 593**	**4 070**	**4 053**	**3 981**

As compared with the allocations per Member State in the PDSAB 96, the main beneficiary under the agri-monetary arrangements is Sweden with an increase of 11.2% in expenditure in SKR. This is the result of the effects of the margins and the operative events in a climate of high currency appreciation. In the future, even if those effects disappear, Sweden will continue to be a major beneficiary under the arrangements thanks to the freeze on the ACRs, the effects of which will be felt from 1997.

The second beneficiary under the arrangements in 1996 is Italy with a 5.6% increase in the Community expenditure concerned. This result, which is linked with the appreciation of the LIT during the period under review, could be called into question in the future.

Thereafter, with increases of 4.7% to 3.8% in the Community expenditure involved are the Member States with ACRs frozen in June and July 1995. The currency situation affecting those Member States has tempered the impact of the margins but this could change in the future.

The impact of the Council Decisions of June 1995, i.e. the freeze on ACRs and the flat-rate compensatory aid introduced in place of Articles 7 and 8 of Regulation (EEC) No 3813/92, can be assessed by estimating the cost that would have been incurred under the agri-monetary arrangements had those Decisions not been adopted. Savings turn out to be close to ECU 360 million in 1996, ECU 2 750 million in 1997 and almost ECU 8 900 million over four years.

The enormous cost of Articles 7 and 8 of Regulation (EEC) No 3813/92 seems to be mainly due to the level of per hectare aid in SKR (which would have been 10% higher in ecus if maintained in SKR). Supposing Article 7 to have been applied only to the appreciable revaluations of June and July 1995, costs would have been the same in 1996 as they actually were, but nearly ECU 700 million higher in 1997 and almost ECU 2 500 million higher over four years (1996 to 1999).

ISSN 0254-1475

COM(96) 636 final

DOCUMENTS

EN

01 09 03

Catalogue number : CB-CO-96-633-EN-C

ISBN 92-78-12921-6

Office for Official Publications of the European Communities

L-2985 Luxembourg