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MINUTES OF EVIDENCE

TAKEN BEFORE

ENVIRONMENT, FOOD AND RURAL AFFAIRS COMMITTEE

Agriculture and EU Enlargement

Wednesday 3 March 2004

PROFESSOR SECONDO TARDITI, PROFESSOR EMIL ERJAVEC

and PROFESSOR STEFAN TANGERMANN

Evidence heard in Public Questions 1 - 17

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Oral Evidence

Taken before the Environment, Food and Rural Affairs Committee

on Wednesday 3 March 2004

Members present

Mr Michael Jack, in the Chair

Mr Colin Breed

Mr David Drew

Mr Mark Lazarowicz

Diana Organ

Joan Ruddock

Alan Simpson

Paddy Tipping

Mr Bill Wiggin

Memoranda submitted by Professor Tarditi, Professor Erjavec

and Professor Tangermann

Examination of Witnesses

Witnesses: **Professor Secondo Tarditi**, University of Sienna, Director of Siena Interdepartmental Centre for Agri-food-environmental Policy, **Professor Emil Erjavec**, University of Ljubljana and **Professor Stefan Tangermann**, Director for Food, Agriculture and Fisheries at the Organisation for Economic Co-operation and Development, examined.

Q1 Chairman: Gentlemen, first may I thank you all most sincerely for coming a long way to come and talk to us about this particular inquiry. May I apologise at the outset for the slight delay in starting our evidence session. You may be aware that the Committee last week visited both Poland and Hungary to get a flavour for the subjects you are going to make your respective presentations on. We found that an interesting experience but clearly we did not cover the full range of countries who will soon be full Members of the European Union and so your comments in that context will be especially valuable. So I am not going to take up any more time other than to say I gather the plan is that you gentlemen will make your presentations and then we will have the opportunity to ask you some questions about what you have said and perhaps some other items which are of interest, but again on behalf of the Committee may I thank you most sincerely for coming. Professor Tarditi, you are going to start. There are three of us here who have a considerable enthusiasm for Italy and Siena and who, if given a free choice, would rather go to Siena to have the presentation. Nonetheless, we are delighted you are here so I wonder if you would be kind enough to start our proceedings this afternoon.

Professor Tarditi: Thank you, Chairman. I also have to thank you for inviting me on such an interesting topic. I will try to spend twenty minutes by having an overview of the problem as I see it. First, we have to show that the reform of the CAP was done largely under the pressure of the enlargement because many of the experts and some of us always thought that it could not be possible to extend the traditional CAP to the new countries, it would be catastrophic. So it is interesting to see how in 2003/4 Commissioner Fischler said it was the beginning of a new era in the Common Agriculture Policy. It is really such a beginning of a new era and if the impact on the new Member Countries -

Q2 Chairman: Professor, would you forgive me for interrupting. We have a slight problem with the sound in this room. It is not very good and the difficulty is that your computer is exactly in front of the microphone and I wonder if perhaps you could re-arrange it.

Professor Tarditi: I understand, yes.

Q3 Chairman: That is better. We do not want to miss a word.

Professor Tarditi: I feel better now as well. I will try to analyse first the data, some figures on the cost of the Common Agricultural Policy because we must know what we are talking about and we will see that it is not so easy and straightforward to agree on what we are talking about. Second, I will try to appraise the impact of the CAP on the new countries under the three main and generally accepted criteria of economic policy, which are the better allocation of resources, an increase in the wealth and the income of everybody and the society, then the income redistribution aspect in terms of equity among the different people and then the strict economic aspects such as sustainability and environment. Then I will conclude with some recommendations. This is the most banal slide upon the budget of the European Union and we all know that the CAP is now taking slightly less than 50% of the total budget. Actually part of the structural operation is also spent in agriculture under the orientation section of the FEOGA Fund. This is what is usually accepted as the cost of the CAP. We have to take into account that they are much larger because strangely enough although some very important institutions such as OECD (Professor Tangermann is here as a director of the agricultural section) are computing things like the cost to consumers of the Common Agricultural Policy, of the price policy or price import policy. Strangely enough, if you check the documents that the Commission is providing, even the Members of the Council when they decide for the next year price fixing and support there is no mention of the cost to consumers, not even mention of the average market prices, which should be of course the terms of comparison with the prices we have. So this part, which is rather large, more than 50%, is larger than the budgetary cost of the CAP. This is the cost the consumers pay due to the fact that agricultural policy is manipulating market prices and so it is a direct transfer from consumers to producers and it is rarely mentioned and rarely taken into account. We are really sad that the cost of the CAP has doubled if we include the market transfers. But rarely again, because there is not even good work in collecting evidence and data, the national expenditures are not known and the national transfers to the agricultural sector as a consequence of national, regional and local agricultural policies is not known. It is not consolidated at European level. I have data for Italy and for Italy you can see that the cost of the budget

plus the cost of market support is only half of the total cost that society is bearing for the entire Common Agricultural Policy. The other half is roughly one part in direct payments and direct subsidies from regional, local and national budget, the Italian budget, and a part (at least in Italy) is due to the rebates in social contribution and taxes to the agricultural sector. So we see how it has exploded the cost of what we are talking about, the Common Agricultural Policy in our countries. We have to say that there is some other extra cost which we have not mentioned, for example the administrative cost is not included. We will mention it later. But I did some research with my students in almost ten provinces in Italy and it comes out at roughly between 5 and 10% of the value added in agricultural, the cost of administration, just administration costs. This is terribly high and they are exploding with the kind of agricultural policy we are doing. Another cost which is almost never mentioned is the fact that if we shift support from market to budgetary support, which is under many other points of view very good, you have to raise taxes and there is a cost of raising taxes as well. Another point and I will finish on the first picture. This is again the amount of cost in Italy. The point is that all this transfer to the agricultural sector is on current terms and it is not targeted to investments on capital accounts. In the other sector, manufacturing and so on, state aid is mostly and always definitely constrained to capital improvement, structural changes and so on. This is absolutely not so in agriculture. At the economic level only a very small share, we will see it later, of the second Pillar of rural development policy is spent in investment, farm levelling, and altogether it is less than 1% of the total cost. But people think that the national policies are more intervening on structural change and in Italy we see that of all the national and local transfers only 4% of the total transfers are targeted to structural policy, which is the way for improving production, reducing cost and really reforming the policy. Now, this is the picture. How did it devolve? At first sight, if we think that we had in 1992 a reform of the CAP, very important. Then we had in 1994 the agricultural agreement in Marrakech. Then we had January 2000 and in all cases commissioners were saying almost what Fischler said, "It's the beginning of a new era. We will have a new agricultural policy, consumer-friendly, more trade-friendly and so on." So you would think that the support to agriculture has been dramatically decreasing. It did not, and here we have the cost of agriculture going up to the border price. Then the yellow part is the market price support. The reddish part is the direct payments and finally general services. So nothing changes in the structure on a whole but if we go on transfer per farmer, which could be a very good index of the level of transfer, if we are really reforming or not this policy especially according to dismantling all red box policies, which is our commitment at WTO and so on, we see that things are not changing at all. Notwithstanding the drop in the price of cereals the transfer market price transfers are steady, payments to producers are increasing and altogether the per farm transfers are increasing. So this is how the support is for different commodities. All data is mainly based on OECD work. We know that now the reform, Fischler's reform, will reduce all these disparities with the decoupling approach. Now we have this support, which was always sad in theory with WTO and so on, that it was being reduced and in practice it even worsened and it distorted the transfers because most of those transfers are, as we will see in a minute, commodity specific so are trade distorting and will be. Now the reform. Is it really improving things, the Fischler reform? We will see after some years if it happens as in the past or if it actually was different, but surely we can see from the beginning that decoupling will probably be a

very good thing in reducing inter-commodity distortion within the sector. But modulation is absolutely ridiculous, 5%, up to 5%. It does not change really the amount of money that is transferred to farmers still on the basis of the old price support. These transfers before were invisible, related to market - I am talking of a serial transfer - then they were called compensatory payments because they should have been reduced. They were not reduced. They were called farm aids and now they are called justified in terms of environment protection in any case. So this is the situation in the EEC15. What will happen if we just apply the present CAP to the new Member Countries? Support will more than double. This is the support in 2001 in the eight Central European countries of the new Member Countries and this is how it will be if the agricultural policy is just applied (as it was in 1991) to the Central and Eastern European countries.

Q4 Chairman: Could I just ask one point of definition. Where you have got the term "market support" does that include both intervention and export restitution?

Professor Tarditi: Well, yes, of course export restitution is a part of the market support because the whole policy tools of the market support, which are border protection and then limiting of supplies, land set aside or a production quota in order to keep higher prices in the domestic market, have as a result an increase in domestic prices as compared to border prices. Market price support is just the difference between domestic and border prices multiplied by the quantity produced. It is the burden borne mainly by consumers and export restitution and then there are direct payments and so on. According to our statements in our official documents and to our commitment to WTO we should reduce our level of support, this is the level of financial assistance, towards the level of the Central and Eastern European countries and we are in fact doing exactly the opposite because we are transferring to these countries our CAP. This is just the direct payments, how they were big in the past and how they will plan - they have already decided they will explode in the next years. Now, there is a point. We will be transferring, we will see later, more than 33 billion per year to farmers in these countries, just in these eight countries, without any economic reason except the fact that they will become part of a club which is the European Union. This is in a situation where we are already paying 1,700 million every year for our farmers not to produce and to keep idle 10% of the arable land. It does not make any sense, any economic sense. I think every child could understand this. If we have already an excessive supply of those resources in the sector why are you flooding all these people? We will see later on a slide from the Commission because these are all my slides and you could say, "Well, we don't believe you," but we will talk about the Commission after Professor Tangermann, which was computing the increase in agricultural income in this country into more than doubling. Why should we double all this? So let us very clearly see the impact. Of course this price support, red box policies, has a number of aspects that we all know of and that I am not dealing with. Before there was a regression showing how they are paid more by poor consumers and this slide shows how they go much more towards big farms and better producers. So they are having a distribution which is exactly the opposite of what we would imagine and hope. This is a new work I am just finishing now in Italy, the computation of how the present price support policy is redistributing income between mountain areas, hilly areas and the plain. Obviously in the plain we have much higher yields and the productivity of labour is much higher and so

on. So the transfers that go in proportion to the quantity produced are much higher in the plain. This is the transfer per unit of labour for time equivalent in the European Union. This is the amount in the hilly areas and this is in the plain areas. This is the traditional average, so a much less amount. This again does not have any meaning because we are in the surplus of production so why should we praise more favour those who produce more? In any case, if in the mountain areas we had a transfer at least equal to the national average we would have a huge amount of transfers into the poorest areas of our country, Italy specifically, which are much bigger than what the national government is doing now. If you ask anybody in Italy, "Is the mountain favoured or not?" they say, "Oh, yes. We have this policy for the mountains and this and this." Actually what we do is very little in agriculture in the mountains, slightly more in economic development, and even if all transfers done through the policy for mountains were computed it would be always lower than the imbalance that this policy is creating between mountain areas. This is the cost per household in the Central and Eastern European countries. We have three scenarios. One is the present situation. The second is all this increase in prices without expansion in supply. This is totally odd.

Q5 Mr Lazarowicz: That is per year, is it?

Professor Tarditi: Yes. It is an odd hypothesis because if you double the price of products people will produce more. But many people in the Commission said, "No, no, it will be minimum." Okay, not to be blamed, to be impartial, let us do only the increase in prices. The same quantity produced will generate so much cost for households and this is if we accept a small elasticity of supply. That is a third scenario. This is how much farmers per hectare or per agricultural unit will increase their income and this is how much on the whole consumers, citizens in the Central and Eastern European countries as consumers and as taxpayers will transfer to the agricultural sector, either farmers or general services in the sector. This is the slide I was mentioning to you before computed by the Commission and this is the present level of income. This is how much it will be increased thanks to market support and direct payments in the different countries after the alignment. Slovenia is increasing because we have already much support in the European Council, of course. We know that part of the cost would be borne by the EU15 people for two reasons. First, because there are invisible transfers due to the fact that this enlargement will create a trade diversion and we will have to import, instead of importing from outside at low prices, some basic staple goods from these countries and so there is a transfer from our consumers to them. But specifically these people are very poor, as we all know, relative to the EU15 and part of the budgetary cost will be borne by European citizens. This is the situation in the Eastern countries, how it could be roughly measured. A point again which I was mentioning before is that even in the green box policies, which do not have any of the drawbacks which we were mentioning for box policies and only account for less than 10% of the new budget, only 4% is going to investments like that. This means that the structure of farms is not improved as a consequence of the policy. It is understandable because if you have distorted prices and you tried, as we did in 1972, to incentivate investment, investment goes in the wrong direction because the market is underlying what is the real social benefit. So for this reason we never did a structural policy, but a structural policy is the only complimentary policy to the market price support dismantling if we wanted to

reform anything, otherwise if we are doing as we did, giving compensatory payments and maintaining the same producer price, part of the market price reduced but increased direct payments, then the producer will not change because their revenue will not change and the structural production will not change. Okay, this is clearly shown in this analysis of how with the increase in farm size the productivity of labour is increasing. This is the EU15 altogether. This is just the Netherlands, which is slightly more productive than the average of the 15, we know for many reasons, special agriculture and so on. The point is that the distribution of labour is extremely different in the Netherlands. We have most farms and the highest percentage of labour in efficient farms with high productivity, while in the whole of the EU15 30% of farms, for example, are very small and the concentration of labour is in very small farms. As a consequence the productivity of the whole agricultural sector is lower, largely due to the lack of scale economies and this is the factor of the present policies. I did this computation assuming the same input/output or productivity per class of size of farm but assuming that the distribution of farms would be the same as in the Netherlands in all other European countries. Just for the change in the size of the farms the productivity would increase much more and the income of farmers would increase much more in this proportion, that is where there is more green it means that the present situation (like in Italy and so on) is very small farms, very deficient, very high cost. This is, in my opinion, extremely interesting because it tells us how we should really reduce cost because the transfers of money from consumers to producers, at least in the Netherlands, goes into the pockets of producers and we are all happy for that! But if they (like in Southern Italy) they go just to pay for higher production cost that is stupid. That is a deadweight loss, as we will see in a moment and there is no explanation, in my opinion for that. There is no justification. I have no time, unfortunately, to explain this macroeconomic effect of the CAP, well, of price support. This is a model applied by DG2, finance and economics, when DG6 asked them to simulate the reduction in prices in 1994 and it shows that if you increase prices there will be less income, less investment or higher wages and nominal wages in real terms, higher profit, less investment in any case and lower development. Okay. We are almost at the end. I tried to compute all the costs of the Common Agricultural Policy. This is the transfer from households and if we also take into account the long-term loss in efficiency, resource and location, due to the structure, then 50% of the transfers go to inefficiency, either long-term, which is the higher part, or of course normal inefficiency like deadweight losses, for example the money we spend on land set aside and so on and some extra cost, altogether roughly 50% of these transfers goes towards it. Okay, I will stop because some points of the WTO will be better explained by Professor Tangermann. Gentlemen, one point, by extending the CAP to these countries, if we do not take into account the whole support but only the trade distorted, the red box support, then we can see that the CC8, the eight Central European countries we are talking about, at present are not distorted. If after they will apply our policy, as it was in 1991, then they will become the third block after the USA in importance in distorting subsidies to the agriculture. So this is terrible. This the index showing the ratio between the support, green support and total support. We can see that the Union is having almost all red box support, not green box support, and among all the countries in the world it is one of the worst places. Just to say that some ministers of agriculture, like they wrote last September, say that the CAP is not distorting worldwide the prices, these things do not exist. So we must first of all be sure of what we are talking

about because if we go on saying totally different things we will never come to an end. Sorry for taking some minutes more.

Q6 Chairman: Fascinating. I think there is a lifetime's knowledge there you have delivered in about twenty-five minutes. There is plenty for us to digest. Thank you very much for starting our proceedings. Professor Erjavec, are you taking over?

Professor Erjavec: Mr Chairman, ladies and gentlemen, it is a great honour for me and my institution to be invited here to the Committee and to present our work and I focus the presentation on three main elements in the field of agriculture. This is what was before, the pre-accession status, then accession mechanism, what will change, and then some short-term accession effects. This represents according to discussion of several focused questions. The first is what has happened with the producer prices, then a very interesting discussion I will follow where my colleague started about the policy objectives and measures and then about the production and trade and the changes related to this issue, then about the producers' incomes and farm structures, in CEEC of course, and somehow I will finish my presentation with more speculation than analysing what will happen in the CEEC and the long-term perspectives. So before I start this discussion allow me to make two remarks. The first remark is that there are several studies about transition, very good work by distinguished international bodies like OECD, European Commission and World Bank and they show us that there are very significant differences in agricultural structures, in historical development, in economical potentials in structures within CEEC and in comparison with the EU. Last week both scientists and politicians made a lot of mistakes to make very simplified horizontal estimations and analyses about this issue. It has happened in the accession negotiations where somehow EU15 negotiated with one partner but this partner was divided by ten countries. The second remark before I start is that there are less studies on accession effects and it is very difficult to predict anything, what will happen in two months. Why? Because these are not only agricultural issues, these are very broad and economically and politically sensitive relations which can change and have an impact on accession effects. We have to deal also with a lot of public fears on both sides and also stereotypes and somehow I will try to make remarks on this. So shall we start with a discussion about the first issue. This is what is going on with the producer prices and first the pre-accession status. First of all, in all cases there is the price transmission effect. The agriculture price, the producer price is mainly related also to the consumer price and also to the retaining price. So it is very difficult to give attention only to the agriculture producer price; we have to see what happens also with the consumer price and with the food processing price. Before the accession the market import regimes, which have an important influence on the price levels in the CEEC were only partially liberalised and those on the regional levels. So we have more or less free trade between the Baltic countries, we have free trade between Czechoslovakia but we do not have free trade between Poland and Hungary or Hungary and Slovenia. So the competition, which is the key element of how the prices are established and so on, is increasing, especially in the last three or four years through trade liberalisation but mainly through a very globalised retail sector, which is at the moment in all CEEC countries more or less in the hands of foreign direct investment. This means it is more or less much more in the national hands, which means that of course all these global forces bring also important forces to the price levels. So if we

compare the producer prices with the EU we can say that they are generally lower but increasing all the time after the transition. So the producer prices slowly increase but we have still important differences between the producer prices in the CEEC and in the EU15 and mainly in those sectors which are in the EU15 under the CAP more protected. This is mainly in the animal sector, milk, beef and of course also under the sugar regime. Also now before the accession these prices are in the key CEEC countries still significantly lower than in the EU, but it is very difficult to speak about the general CEEC level or the new Member States level. We can see huge differences between, for example, Baltic countries with a very low level and Slovenia, which in many cases has higher prices than EU. So what happens with the accession? First of all, the import regime will be abolished and we now have protections for both sides importantly after the accession. Then we have, and this is important for CEEC, a new trade regime to the third countries, which means mostly that the protection at this level will increase. The import protection will be higher than before. But it is important for many, many CEEC countries that the trade regime with Russia and with Western Balkan countries will worsen. This means that the conditions before the accession are better than after the accession. Somehow in negotiation both sides, the CEEC countries and the EU Commission, forget that these countries have very good trade agreements, especially some countries in Russia and some Western Balkan countries and somehow this is an additional problem for some CEEC countries. Then of course the last change is the introduction of market interventions where we can expect important influence, especially on the side of export subsidies. So what will happen after the accession? Competition will increase, especially the retailing sector. We can expect also important structural change in the food industry, for example one reason is there are hundreds and hundreds of small plants in the food processing industry which somehow will be forced to close not only, for example, through the economic forces but also through the hygiene requirements. For example, there is some estimation in Poland they will close 300 plants only through the hygiene requirements. So what will happen then with the prices? Those prices which are higher than in the EU, and there are not so many, they will immediately go down. We can expect such things through competition, which forces prices to go down. But the prices which are below the EU15 level, a significant level, they will not increase immediately. So there are no reasonable fears, I would say, that the prices will increase immediately and that we will have consumer problems, problems with the producers, suppliers, and so on. We can expect that these prices will be gradually adjusted in some years. The next point is the policy objectives. What is important to know is that agriculture is not as important a public priority in the CEEC countries as it is in the EU15. It is interesting. A higher share on GDT, higher share on employment, but there is no tradition to give agriculture such values and such importance that it is in the EU15. We have policy which is not so strategically orientated, it is more pragmatic, less conceptual and only partial elements of the CAP exist. We have also low level, if they exist, of direct payments and we have only few rural development measures which are totally, I would say, different how to settle. But what is important is these countries have different needs and problems than is the case with the EU15 and the rural development policy in the EU15 is settled for the EU15 with their concerns about the structure, about the environment, public and so on. So we have in some regions real policy issues, excess labour, scarcity of capital, which I would say is totally a different story than in the EU15, not enough in rural development, a problem also for the first year after the accession. We have a lack in the institutional set-

up. The administration has a lot of deficiencies, also I would say in old countries, not for example the countries which developed after the independency in the last ten years, for example the Baltic states or Slovenia. Maybe these new countries have much more favourable position because they took younger stuff and so on and are not so concentrated. But we have really a human capital deficiency to take over such an administrative and centralised policy like the CAP. So what will happen after the accession? An adoption of something like European model of agriculture with all these words like multifunctionality, environment, public concerns and then the gradual introduction of single flat rate area payments, which is a totally different policy which is already in the EU and which is quite different also after the reform comes in because you have the single area payments, which means that it will be the same level of amount per hectare for our farmers, which is of course totally different. Here in Britain some intensive beef producers get €1,000, €1,200, €1,300 per hectare. CEEC producers will never get more, also at the end of the period, more than €350 per hectare. But what is interesting is that the Commission and the EU15 are engaged in the negotiations, a very large and broad manoeuvre for the rural development programmes, but it is good because related to the money there is really money available for the rural development programme but nobody is talking about it. Why? First, the problems of the institutional set-up and of course a lot of these programmes are not related to the real problems of the CEEC, environmental support, which is so important to the EU15. Ironically, sometimes it is really a problem to speak, I would say, with the people in the rural regions, how they have to go to the environmental polices and they have social problems, lack of capital, lack of knowledge and so on. But what is important is a significant increase in budgetary support. We have seen the numbers from Professor Tarditi. So what will happen after the accession? We will have really confusion in the values. I think the policy makers, the farmers and also the universities, the academical world will need a lot of years to understand why the agriculture is so supported in this way with such objective as it is done in the EU15. Then we will have a different direct payments scheme, which means different competitiveness issues, and we will have only partially appropriate rural development. We have to say that CAP is made for another economic and policy environment, not for the policy environment which is now extended to the enlarged Union. The next issue is production and trade. It is well known that there was a transitional shock after the beginning of transition and we have now a recovery in crop production but less in livestock, but there is a different situation from country to country and what is important is only this limited agro-food trade within CEEC but limited agro-food trade also with the EU15 and we have one winning side. There is only one side winner in the trade between EU15 and the new Member States and the significant importance of trade with Russia and Western Balkan. So what has happened? We thought that of course through the higher level of support and change of trade regimes we expect further development of the crop production, especially cereals and oil seeds and partial improvements in the livestock centre. Why only partial improvement and only in some regions and in some sectors specifically? There are several obstacles why livestock will not improve to such levels like the crop production. Firstly, there are the quotas. Dairy production is limited and at a very low level of production, which is less understandable for the CEEC producers. Then we have direct aid, which is different and which is not for beef production like in the EU15 but for, I would say, extensive crop production, and we have a lack of capital, labour and knowledge, which is much more important for the development of more intensive livestock production. So

we also can see lots of huge developments in the food processing products but we will see, which is very important, trade creation and trade diversion. We can expect further export penetration from EU15 with the process of food products from EU15 to the CEEC and an opposite increase in raw materials exported from the CEEC to the European Union. But we can also see that I think the trade with Russia and Western Balkan will diminish for these countries. The next issue, in pre-accession status some people think that agriculture is an interesting, economic and viable production activity in the CEEC. It is not. It is totally the opposite. Agricultural production is in general a sign of poverty, the less developed activities of unemployment or over-employment. So only in some regions in some particular farm structures, in some particular production activities we can really see economic, viable, professional and competitive production. The next important issue we have is dual farm structure. On one side, large, quality farms, some of them very professional now after 13 years of transition, also very competitive. On the other side, thousands and thousands, we cannot speak about millions but hundreds of thousands of small, over-aged subsistence farms in rural households with only a few market occupations. The people do not know what to do. They have a lot of fears about the accession and so on. So what do we expect after the accession? First, of course, through the additional money, especially from the price adjustment and budgetary support, but also I think an important element of the income improvement for the CEEC countries is also the rural development programme through the LFA support, through environmental support and support for subsistence farms. So we can expect improvement in the income situation. It is not so difficult to predict. But who will gain? Again, going back to Professor Tarditi's case, of course professional farms, larger farms who can organise the production according to the levels, who will fulfil all the requirements and so on. We will still have a subsistence structure and we will still have a rural poverty issue. It is not solved with this huge amount of money which is on the table after the accession. Additionally, we will have a problem with the collapse of traditional, non-market economy, for example non-paid activities between the farmers, which was the case in the past, or neighbour assistance, these things which we are now slowly losing with the accession. What is interesting is that after the accession we can expect in some regions, in the CEEC, real difficulties, not only because of agriculture but because of places out of the agriculture because in the region where the steel industry is and the textile industry is agriculture is somehow important as a social buffer. We will really have huge problems and I think the effort has to be much more in this direction. Allow me to finish my presentation with some long-term speculation, I would say. What will happen with the markets? Yes, we will have increased prices but lower prices will still remain. We will have difficult price levels between East and West. There are several reasons. The important reason is purchasing power. What can we expect? Maybe - and this is speculation - we will have division in production between East and West, more crops in the East, less crops in the West, more livestock production additionally in the West, less in the East.

Q7 Chairman: If you would like to just draw your remarks to a conclusion. We have to go and vote and then in about ten or twelve minutes we will return. So if you would like to just finish off.

Professor Erjavec: I think what is interesting to say is that out of the macroeconomic important changes, which can have an important influence also on the agriculture, especially with the introduction of the euro. Previous

enlargements brought something to CAP. The rural development issue. What about this time? My speculation is that there is such a big difference between East and West in the understanding of the CAP that it is difficult to bring the newcomers under this umbrella, so I think re-nationalisation is already under way. So the CAP has changed already. The reform changed a lot and also if we see how different policy measures are settled for the EU15 Members and we see also for the CEEC countries we can make the conclusion that the CAP as the common policy is more or less dead.

Chairman: A marvellous way to end your presentation. We shall be back as quickly as we can, gentlemen. Thank you.

The Committee suspended from 4.11pm to 4.26 pm for a division in the House

Q8 Chairman: I am sorry about the vagaries of the House of Commons but votes occur sometimes at any time and it tends to break up occasions like this, so my apologies. Nonetheless, Professor Tangermann, I wonder if we might proceed with your presentation, if you would be so kind.

Professor Tangermann: Yes, certainly. Chairman, I very much appreciate the opportunity to put my evidence to this Committee. We talk all the time to the executive branches of Government and we are extremely happy whenever we get the opportunity to talk to parliamentarians because after all it is you and your colleagues in the other 29 OECD Member Countries who finally create the basis on which all these policies are being pursued. . . . I would like in dealing with these matters regarding the EU enlargement and agriculture to make a few comments on what the size of the production volume is in agriculture in these accession countries. I would like to also provide you with a bit of information on the level of support given to farmers in the European Union and the accession countries and will particularly emphasise the composition of support for different types of policies which have different types of effects on markets and are efficient in terms of reaching their objectives in different degrees. Based on that, I would then want to proceed to briefly outline the strategy for agricultural policy reform that all the Member Countries of OECD had agreed should be put in place, except that they do not yet all really do it in practice for a number of reasons that I also will be mentioning. Then of course I will want to draw some conclusions. When we talk about Eastern enlargement and look at it from an agricultural perspective we sometimes get the impression there is a huge amount of agriculture coming to accede to the European Union. That is right in a sense because quite obviously for many of the accession countries agriculture is much more important in their national economy than it is the average Member Country of the current EU15. On the other hand, we really look at the total size of production in agriculture in the current EU15 and in the accession countries measured to the value of production and taking away for a moment all the benefits that governments provide to farmers to increase the value of production then it is not really like a very big additional amount of agricultural production will join the European Union. The total cake obviously is the total of the agricultural production that we will have in an enlarged European Union and this is the share that EU15 has and you will see it is relatively close to 90%. Then of course Poland has the largest volume of agricultural production among the accession countries so that is a very significant addition to the production volume in the European Union. Hungary also is a big agricultural producer. All the other countries are important

countries in many regards but so far as their agricultural production volume is concerned they are not really that big. Czech and Slovak Republic taken together do not produce a lot. I apologise for having aggregated Slovenia with the Baltics here and I am very well aware of the fact that geographically that is not really very appropriate. It adds just another little bit to this. So is it an important event in agriculture? Yes and no. Not too important if you just look at the total size of the agricultural production that will join the European Union. We must not, though, forget the fact that agricultural production volumes in the countries in Central Europe at the current point in time are quite a bit above the levels of production that many of these countries have attained already before the principal measuring process began. My colleague from Slovenia has referred to that already. If you just take the volume of production that everybody was producing in 1990 then you can see that countries like Latvia, for example, that is the green line at the bottom there, now do not produce more than 40% of what they used to produce at one time. The big country, of course, in agriculture, Poland, still is not quite back in the agricultural production to where they were when the transition started but you can see the light blue line, roughly at 90% of their production volume. Everybody else is somewhere between that except for Slovenia. That indeed has managed to expand its volume of agricultural production during at least the later part of the transition period. What I really want to say with this slide is that yes, the size of production that will join is not huge compared with the production volume the European Union has already but it also is probably quite a bit below the potential volume of production in these countries and that of course is something that we will have to keep in mind when we talk about the future policy pursued and the effects that all this could have on markets and international trade. Now let me move from there to producer support in agriculture and this obviously is one of the things that we are engaged in, in the OECD. We measure the levels of support that the governments of our Member Countries give to farmers. We express that as the famous (some would argue infamous) producer support estimate (PSE) and I would like to express that in particular as a percentage of total producer revenue. In the OECD overall, just to give you that as a baseline, this now stands at 31%. So the average farmer in the 30 Member Countries of the OECD, Europe, North America, Japan and Korea, the average farmer in these countries, out of \$1 of revenue 31 cents come just through government policies and the remaining 69 cents come from the market. This is the type of numbers that I will now talk about and I will do this by looking at different categories of policies. These are the percentages of farm revenue in the EU15 and in the 8 Central European countries that will join the European Union that come through support to prices. You were asking about the definition of that, Chairman, earlier. There is one gap between domestic and international prices but I have also added to that payments which are directly based on output volumes and on input volumes. Why? Because all these measures taken together have a significant effect on production incentives for farmers and therefore has the tendency of distorting markets and trade and adds to surplus production. If you look at that picture you can see that currently the accession countries, with the exception of Slovenia, have significantly less in the form of direct production-encouraging support. Hungary comes close to the European Union but most of the others have significantly less. Now, add to that payments which are based on area or livestock numbers like the European Union has at this moment still before the new forms of payments that will result from the reform that has been decided in June 2003 and that will become reality and you can see that the gaps between the level of support that EU

farmers receive and farmers in the accession countries get even bigger. If you also add to that the payments which are based on historical entitlements like the ones that will now be introduced, the ones which are called decoupling in the jargon of the Common Agricultural Policy, it does not change the picture a lot because there are not many of these payments so far. If you add to this any other payments then it does not change the picture fundamentally. The story is that there is a huge difference in the level of support between what farmers in the current EU15 get and what farmers get in the accession countries, but of course when they join the European Union then they will begin to gradually get more and more support (except in the case of Slovenia) so that their support levels will finally be aligned with those in the European Union. It will start really with the alignment of prices gradually so all the amber bars will line up with the amber bar in the European Union and that has production incentive effects, potentially rather strong ones. Then over time they will get the direct payments that farmers now get in the European Union, which since the reform has now been enacted will have less of an effect and so on. This provides a bit of an impression of what the incentives might be for extending production in the countries and Central Europe, then for them to get closer back again to the levels of production they had when the transitional period started because, as I said earlier, they are below their production potential in a technical sense. On the other hand, we must not forget that for quite a number of commodities in the European Union there is no longer much price support. That is particularly the case for cereals and oil seeds, of course, and those commodities where price support still is very significant, particularly milk and sugar, there were quotas and of course these quotas have also been negotiated with the accession countries and therefore act as a brake on any expansion of production that they would otherwise certainly be very happy to engage in. That is something which tells us there is a suppressed supply potential in these countries, suppressed by the quotas that they will all have to adopt as agreed in the accession negotiations. Having talked about the different types of support and showed you the picture of how the support is composed of the different types of policies, let me go to the historical development of this in the European Union and I will now show you the shares and total support that comes with these different categories of measures. This is again price support, input and output payments, the production incentive providing measures, and you can see that has come down quite a bit over time. So that is good in the sense of not distorting markets quite as much as used to be the case in the past but still you can see it is something like two-thirds of all support that is provided in that way. That is the share of the total support that is given to farmers. This is the share which is given through the old payments and I have just added to this a rough estimate of how the situation would have looked in 2002 had the most recent CAP reform been in place in that year already, that is the 2002 with two stars against it, and of course because of this decoupling that share goes down and the share of payments based on historical entitlements (the so-called decoupled payments) goes up. Other payments - and I will come back to that in a minute - have a tiny little share in total support and that is an unfortunate state of affairs for reasons I will come back to. What does this change over time in the composition of policies in the European Union look like compared with what other countries in the OECD have done over time? This shows how the level of support is measured on the horizontal axis against our percentage, PSE percentage, of farm revenues had changed and how the share of the most trade and market distorting elements in the PSE, again market price support, input/output payments, has changed over time and that is

measured along the vertical axis. Obviously from the point of view of the reform principles in OECD we would like countries to reduce their levels of support over time so as to not get too much in the way of markets and in particular to also reduce the level of the most trade-distorting elements in it. So we want these countries to the west to reduce the level and south to reduce the trade-distorting elements in it. Overall, on aggregate the OECD have gone in this direction. It is not a very long arrow but still something has happened. The United States has always been a little further to the south-west but they have not made much progress in that corner (if I can put it like that). But there are countries, such as Canada, who indeed have made a lot of progress in this sense. There are countries like Japan in the upper right corner who appear to have lost their compass and are just marching in the wrong direction and the European Union has a pretty long arrow showing that yes, there has been quite a bit of policy change over time. But of course there is still some way to go until they really go completely to the south-west corner to reduce the level of support and make it less trade-distorting. Why is it that we emphasise this composition of support so much? It has a lot to do with the effectiveness of policies in reaching their objectives and this is a topic we have taken up in the OECD in a nice little brochure, which if you like you can download from our website, which describes an agenda for reform. We want to not only criticise all policies but want to help our Member Countries moving in the right direction and have finally achieved everybody's consensus decision on this document which, as the EU must know, is a consensus organisation. We cannot publish anything before each individual of the 30 Member Countries has nodded yes to. So this is a document which even Japan and Norway have agreed to. What it really says is the first priority should be to reduce price support and rather pursue the domestic objectives with effective domestic policies. That should be in the form of decoupled payments, targeted payments and would also allow one to reduce support overall. If one does all this, such reform brings benefits domestically and internationally and I would want to, Chairman, briefly take you through the argument of why this is something that is important and it has a bearing on EU enlargement because, as I will later explain, the bigger the EU gets the more important it is that it engages in the right types of policies. Why is it that a reduction of price support is a first priority? It is because price support is not really necessary for the two major objectives that countries pursue with their agricultural policies, farm income support and non-trade concerns. But then you still find that something like 63% of all OECD support comes in the form of market price support and, as I have shown you before, the European Union is not much different from this average of the OECD countries. Now let me take you through the argument in the context of the income support objectives and why it is that price support is not really adequate in that sense. It is because it is not really necessary. It is not like there is the general income from agriculture in OECD countries. It is also inefficient because if you throw one extra dollar to farmers in the form of price support no more than 25 cents end up in the farm operator's pocket and it is inequitable because the wrong farms get the support. Briefly I would want to explain the two latter points to you. Why is this inefficient in the sense of not much ending up in the farmer's pocket? Let us look at what happens when we increase market price support to agriculture and where it goes. Yes, one part of it goes to remunerate the land that the farm operator cultivates. Some of it indeed goes to remunerate the labour that the farmer and his family invest in the business. But that is it and this is just 25% of the extra dollar spent on price support. Where does the rest go? The rest goes first to the non-farm

land owners as more price support means farmers want to produce more. For that they need more land. They go on the land market and drive up the price there and it ends up outside the area of farm operators. Of course, for the same reason farmers like then to use more influence and it ends up in the hands of the fertilizer and tractor companies and what have you. The last bit of it is simply lost through inefficient resource use as farmers receive encouragement to produce at costs that are above the level of international cost. So the story is no more than 25 cents really end up in the farmer's pocket. A pretty inefficient policy. Can one do better? Yes, one can by decoupling support from production, for example introducing payments such as those that the European Union will now be introducing as a result of the June 2003 reform. Then something like nearly 50% of the extra money transferred to agriculture really ends up in the farmer's pocket but still a large amount goes to non-farm land owners as long as these payments are directly related to land because then of course farmers still want to have more land and it forwards the support to land owners. But still from 25 cents in the dollar to something like 50 cents in the dollar is a huge improvement in terms of the efficiency of farm income support. So far for the argument that market price support is inefficient for farm incomes. It is inequitable also and this is another variation on a theme that my two colleagues have already referred to. It has to do with the unequal size of farms. If you look at what the share is of the 25% largest farms in gross receipts of agriculture in their respective country and you see that in a country like the European Union the quarter largest farms get something like 70% of all the revenues and if support comes directly aligned to production then of course it is distributed in agriculture very much like revenues are distributed and therefore it cannot surprise us to find that 25% of the largest farms get something like 70% of support. What is wrong with that? I have no quarrel with a big farmer getting a lot of money except if the argument is that we need as governments to support agriculture because there are people who are simply too poor then it is not the biggest ones in agriculture that really are the target audience of this policy but that is where the money ends up. Now, for the second area of objectives, non-trade concerns or what often is referred to as multifunctionality, there is no doubt about all sorts of worthy objectives that governments pursue in that area having to do with environment and so on, except that price support is rarely an optimal policy there because it does not really reward farmers for making contributions to the specific objectives. It rewards farmers for producing more wheat, milk, sugar beet, whatever, and hence targeted payments that really have directly to do with the contribution that a farmer makes to improving the environment, to safeguarding biodiversity and what have you are much more efficient.. What is the conclusion from all that? Decoupling and targeting are really the way forward in agricultural policies. Support should be decoupled from production. Objectives should be defined carefully and then measures should directly target these objectives. If all that is done, the policy becomes so much more efficient that the support levels can be reduced and still the same level of the objective payments can be guaranteed. That means that countries should move in that direction, except unfortunately they are not yet there. The conclusions in the context of EU enlargement and agriculture based on this really say that the reform that the Common Agricultural Policy will now undergo as a result of the decisions taken in June 2003 was certainly a step in the right direction because it did add a significant degree of decoupling to the policy and the shift towards the second Pillar at least opens up the possibility to engage in more targeted policies. Whether that really is the case, so much will depend on how the

measures in the second Pillar are defined precisely. EU enlargement makes such a reform even more important for at least two reasons. First, the size of EU agriculture grows and therefore any inefficiency becomes the more relevant and any market distortions become the more relevant, in particular for the rest of the world and therefore the bigger a unit is the more rational should the policies be that that unit pursues. Also, and this very much is in line with the comment that my colleague from Slovenia has made already, diversity of course increases across countries in the enlarged European Union and if you consider what I have said about the inefficiency of old policies in reaching their targets then it must logically follow that the more variation there is in conditions the more important it becomes to be able to target policies directly to the problems one is faced with and therefore the more diversity one has the more important it is to move in the direction of the decoupled and targeted policies. Obviously, after having said all that, I must conclude with one last statement. Yes, it is a good step forward, this policy reform that the Common Agricultural Policy will undergo now when it is going to be implemented but there is still a lot of scope for further reforms in the future, not only in terms of including those policies that have not yet been included in the reform but also in continuing to move towards more decoupled and in particular more targeted policies in the future. Thank you very much.

Q9 Chairman: Gentlemen, I think you have provided us with not only a very interesting series of perspectives on the matters which relate to the enlargement of the European Union from the agricultural standpoint but also some very challenging commentaries about the reform package which is now being implemented in various ways in the existing 25 Member Countries. If there is one theme which runs through all of what you are saying it is a big question mark against the way in which support is actually being used. I think the impression we had from both Poland and Hungary, which we visited, is that the big may well survive the process of change but many of the smaller farming units, and Poland is typical of that, may struggle against the background of rising competition and the pressure which could come from the supply side from big, efficient units. I think I might throw the question out to you to perhaps say a word about the structural impact of these changes because if the accession countries' agriculture is to play catch-up with the efficient farming members of the existing community not all of them are going to survive and one of the things we did not touch on was the impact on rural life, the rural fabric of what could be a big structural change. Do you think that there will be a big change, what will be the impact on farm employment and given the scarcity of resources, how should the accession countries deal with that kind of issue?

Professor Tangermann: Chairman, this obviously is a very, very important and politically extremely relevant question. I do, though, believe that we must not make the mistake of assuming that the structures that some of the current EU Member Countries have in place already and those components of their agriculture that we consider to be competitive would also be the proper benchmark for structure developments in the countries in Central Europe for the simple reason that the appropriate structure in agriculture (if there is anything such as that) very much depends on the ratio between labour costs and capital costs. Given the fact that labour costs in the accession countries still are significantly below those in the existing EU while the costs of capital are at least as high, if not higher, because of all sorts of imperfections in the capital market and difficulties for farmers of getting

access to credit and all the rest of it, we would indeed not necessarily want to see agriculture emerging there which is structurally fully in line with what we consider to be the most competitive types of agriculture in the Western part of Europe. So it is not the same target that they are moving towards, at least in the medium term. Secondly, with the pretty significant injection of higher levels of support into agriculture in the accession countries, not least in the form of the direct payments (even though they will be phased in only gradually), there is the prospect of a very significant improvement in the income position of rural people, or more precisely of agricultural people in these new Member Countries *vis-à-vis* the income situation of non-agricultural people. In particular in rural areas that might cause social stress because if I am a non-agricultural rural inhabitant working in a small enterprise there and do not see anything happening to my income while my neighbour, being a farmer, suddenly gets quite a significant amount of money thrown at him through all the benefits that the Common Agricultural Policy brings with it, that will cause me some thinking at least. So the Common Agricultural Policy will provide benefits to farmers and therefore reduce the stress that they are under in terms of needs for structural development but at the same time it can cause a new type of stress in social relations and the rural fabric may not necessarily always benefit from that.

Professor Tarditi: Could I come in. I think this is really a central point of the restructuring, as I tried to mention before. First of all, we have to make it clear that it is not true that small farms are environmentally better than large farms. The amount of pollution either in terms of more fertilizer or whatever is most of the time higher where a certain area is cultivated by a very large number of farms than the other. So environmental standards can be targeted with special aid and of course if this aid is sufficient to maintain small farms, even if they are inefficient that is okay because society at least is taking back the environmental benefit. But going deeper into the philosophy of the issue, I do not believe we should support income farmers *per se* because this would be sort of discrimination among the people. If I am a farmer my income should not be guaranteed. So in the long term all externalities like the environmental effects and so on should be paid by society but in the long term direct income support should not be given, in my opinion. In the transition period, of course, you can do whatever you like in order to come to a better structure for production. The point is that at present the price support beyond all the drawbacks that were mentioned by everybody is maintaining a structure which is largely inefficient. As I was mentioning before, in the Netherlands larger farmers - not large farmers of the American size, 200 acres, no, they are physically not very large but they are intensive in capital and these farms, which are family farms with maybe one or two workers, they are granting on average for such households almost twice the income that non-farmers get in the Netherlands. That means that they are much more efficient. If in the whole of the EU15, and in Poland for example, we have 30, 40% of farmers who have a farm too small, 5, 6, 10 hectares of usual commodities - not of course flowers because you just need a hectare of flowers to be a rich farmer if you properly use it but in terms of the European dimension in terms of output - then they will always have a low income and they will always be in need of public support. So unless they produce some externality, whatever it is, and they can be paid that way through targeted policies there is no reason why we should keep those kinds of farmers inefficient and transfer money to the sector to pay for inefficient

production and high cost production. So the structural policy should be really the main objective of the Common Agricultural Policy but it is not. It used to be the case but nobody is speaking any more of the structural policy, but if we do not reduce the level of inefficiency in our farms we will always be in need of transferring in one way or the other non-targeted aid to all farmers and this will, for small inefficient farms, pay inefficiency. For large farms we will create rents because if a farm is large and very efficient, if you have higher prices or a transfer which is not targeted they will create rents and this is not so bad as inefficiency but it is not so good in terms of the distribution of money because why should society create rents somewhere? The economic statement was that it would commence with tax rents because they are unearned income, not create them, and the CAP has always created rent by a price support rather than by production quotas, even the crazy things of paying people for not utilising land and the set-aside. So I think this is fundamental but we should not have the problem of how to keep people in land if they are not useful for society. We should pay for mobilising the workforce and have a much better allocation of labour in a different economic activity. If all the money spent in the last 40 years for supporting farmers was spent in structural adjustment and labour mobility and resource mobility like it was, for example, the Mansholt reform in 1968/69 and 1970s then we would be now in a position where support would not be necessary at such a high level and all society will be much better off.

Chairman: Mark, you have a follow up question on this.

Q10 Mr Lazarowicz: It is a question which arises from Professor Tarditi's paper but I think it also relates to what our other witnesses have told us as well. Professor Tarditi, in your paper you look at the change in payments between producers, consumers and tax payers in the accession countries but if we look at the effects of accession also on the existing 15, if we look at producers, consumers and taxpayers in the accession countries and producers, consumers and taxpayers in the existing EU15 and take all those together who are, in your view, going to be the biggest winners and the biggest losers in terms of resources and payments? Then perhaps you could talk about both in the immediate term and in the longer term.

Professor Tarditi: Okay. This is the point I had written but I did not say directly. In my opinion, this report - we are referring to the report of the CAP - is having a moderate positive impact on the EU15. We have seen it being repeated. It is very good in the right direction as a theoretical frame but in terms of shifting resources from red box policies towards green box policies (or even out of agriculture because agriculture is actually in excess of resources) we have not cultivated 10% of our arable land. This we should every day repeat to ourselves this sentence because it is plain stupidity and a waste of resources, inefficiency. So a slight improvement in the EU15 but if you have a tremendous reduction in social affairs and in the structural production a worsening - not in Slovenia, but in all the other countries, newcomers - on the whole, in my opinion, it will be a huge reduction in social affairs but I think in history we never had such a disastrous decision, economic policy, as this in agriculture because transferring, as I said, roughly 30 or more billion euros every year to farmers in a situation where they live happily, they do not really need it, they are not starving or whatever in these countries, in a situation where we already have a tremendous excess of resources all over Europe is just wasting money in the most plain

and direct way. So good reform as a framework to improve the situation, slight because in practice at the end of the story the change is not so much because 5% in a shifting modulation is really nothing, it should be 25, 30 or 40 and we would never dismantle the present structure of transfers if we are going in that direction. On the whole, not only in the EU15 but also at world level because, as was said also by Professor Tangermann, we will be a bigger economic unit and our impact on the world trade will be more negative, as I showed in the last slide, the increase in price support in these countries will become really important. Resource location in EU25 and at global level will surely be worsened as well as the income distribution because there is no reason why poorer, non-agricultural people will pay a much higher share, as we know, in consumption prices of their food, and favour larger (especially in some countries) farmers, especially if we take into account that in the Central and Eastern European countries a larger share of land is owned by non-farming people because it was given back after the transition from the Soviet regime. So this worsens the whole thing because these transfers do not even go, as was shown by some slides, to farmers but go to land owners who do all other sorts of jobs and it is rent. It is unearned income. So this is an income distribution totally perverse and also in terms of externalities probably these higher prices will increase higher import of fertilizers and so on and worsen on the whole the environmental sustainability of European agriculture.

Q11 Mr Lazarowicz: Will the biggest winners from accession be the producers in the existing 15 countries?

Professor Tarditi: No. Well, in principle in the 15 countries nothing changes. We are just extending our CAP to the newcomers. There are some transfers generated by this because part of the support paid by the Union to those farmers will not be supported by their taxpayers but part will be supported by us and this will be a cost for our taxpayers as well as in terms of invisible transfers due to price support. Part of our consumers' cost will flow to those countries. But the enlargement will depend on the market. Probably the competition of these countries will be bigger more or less than ours. We will be forced either to lower the price support if we have such circumstances or to introduce further and further higher levels in terms of production quotas for land set aside. In this case of course everybody will pay the cost if they will produce more than was foreseen and then we will be compelled to reduce our share of total production. But overall there will be a total loss of efficiency in the system, especially loss at macroeconomic level, especially in those countries, and this will be paid by society as a whole.

Q12 Chairman: I think Professor Erjavec and Professor Tangermann also wanted to contribute on that point.

Professor Erjavec: Very shortly on the income distribution story, who will gain and who will lose, the first winners, I think, to emerge from the whole enlargement story are the biggest food producers, the multinational firms in the West. They already have capacity in the East. They already shift the production from West to the East.

Q13 Mr Lazarowicz: By the West you mean the EU15?

Professor Erjavec: The EU15, yes. They gain with the trade, they gain with the

cheaper labour in the East, they gain with the cheaper raw materials from the East and with the pressure on the raw material production in the EU15. This is the general. This is the real winner of the story. The second winners are the biggest land owners in the East with the huge amount of land and with the simplified scheme and as a single flat area hectorage payment, which really again is the rent, it is nothing to do with the production, and of course they will organise the production. We will see how this develops in Hungary, Slovakia and other countries with good economic possibilities for crop production. Others are losers or somehow stay on the level, maybe some big livestock producer in the EU15 which can extend the capacity of the production, especially in beef, especially in pork. It depends if this industrial type of livestock production will be organised also in the CEEC. At the moment it is in a very bad shape. The second point I would like to make is the social stress. So we will put a lot of money into rural areas and agriculture workers are in a better position to other rural people. In fact we have a different type of people in the rural areas so it will look very simple, again in two years it is €100 per hectare more or less. It will be more in Slovenia but in other countries €100 per hectare direct payments. So who will get it? If you have a small farm, 10 hectares, what does this mean, €800? Okay. What is the wage? The wage in such agricultural areas in the CEEC is between €100 and €500 per hectare. So if you are close to the €500 it is not so important again but more important if you have a small farmer who has also occupation outside agriculture. So we increase with the agricultural payment social welfare somehow, but who will really gain in this case? As Professor Tangermann told us, it is family farms organised on a professional basis, which are now developed everywhere in the CEEC, with 3, 4, 500 hectares, I would say a British type of farm. Only in the EU15 you can find this in Great Britain. These are of course the winners of the story. What happens with the large collective farms, collectively organised? In fact I think they are in such bad shape because of lack of capital and a low level of labour, so it depends if the owner - and who is the owner? Sometimes it is a private person, sometimes it is collectively owned. If it is collectively owned this means it increases the wages, the direct payments directly to the wages of the labour forces, then I think it is not so bad. If they put this in the capital investment it is necessary. But if it is the third case, that the money is going to the owners, which is the case at the moment, then it is a pretty story. We have in Slovenia at the moment such stories. At the beginning of the transition nobody liked agricultural enterprises. It was not economical production and everybody said, "Okay, in ten years we are out." Now with the introduction of harmonised direct payments system big money is coming from the banking sector, from everywhere, because they know that you get, I do not know, a 300, 400, €500,000 cheque and you are also competitive. I think this is the problem and also the decoupled story does not solve the problem because the decoupled story with regional payments for the new Member States it is more or less rent for the owners and this is the problem. So I think it is a step in the right direction for the Common Agricultural Policy but I am not sure it is the right policy with the CEEC.

Q14 Chairman: Did you want to just add a brief comment?

Professor Tangermann: Very briefly. In broad terms winners and losers, just inside agriculture, forgetting about the food industry for the moment, the winners are farmers in the accession countries because they get higher levels of support. Where does the money come from and therefore who are the losers?

Two groups: (a) consumers in the accession countries because they are being faced with higher food prices; (b) the taxpayer in the EU15 Member Countries because the payments that will go from Brussels to the new Member Countries in agriculture will be considerably larger than the contributions that these countries will make to financing the agricultural expenditure out of Brussels. So farmers in Central Europe gain and the losers are the consumers there and the taxpayers here. For our farmers, probably not very much will change.

Chairman: I am going to draw our proceedings to a conclusion at about 5.30 but before I do that I would like to ask Alan Simpson and Diana Organ if they would also like to raise their points.

Alan Simpson: I am less worried about the cost that we pick up as European consumers in this because it seems to me that there is a wonderful example about what cohesion means that was to be found in Germany unification, where those in the West made a conscious choice to levy solidarity taxes on themselves to pay for the development of infrastructure in the East and provide stability and not this tidal mobility of labour, which would have risked the implosion of the infrastructure in the East and the overloading of the infrastructure in the West. So I am not too worried about Professor Tangermann's point. What I am worried about is your final point, Professor Tangermann, when you said there is scope for reforms in the future. Is not the reality that we are faced with somewhat different? The previous system of CAP may have had the logic to start out with but it just became a mechanism which was very good at feeding rich farmers and the new proposals will be very good at feeding rich land owners. But, as Professor Erjavec said, those land owners will also be corporate owners of production, some of which we saw in Poland, who bring with them the prospect of colossal downsides in other environmental costs. We are particularly concerned about pig meat production in Poland and the role that the American corporation Smithfield has had where a single one of their pig factories produces more pig waste, pig manure, than the whole population of Warsaw. That is quite a different set of environmental consequences which just cannot any longer be absorbed in the infrastructure of more localised family farmers. So is not the problem that we have to grab hold of, almost to break free from the sort of free market economic presumptions that all of the externalities that determine the viability of community life and environmental continuity, access to sustainable water, ought we not now to be saying at a time when there are European surpluses that we focus on food security and employment stability and continuity? Is not that the direction of future reform and would a step in that direction be to put a ceiling on the land-based payments to be made in transfers so that we were no longer making sure that the big money went to the big holders? If we put a ceiling on it so that the smaller family farmers were the principal beneficiaries would not the community as a whole get more out of it?

Q15 Chairman: Professor Tangermann, would you like to have a crack at this?

Professor Tangermann: Yes, I would certainly be very happy to try and respond. Let me start by saying that what I earlier said about who are the winners and losers was just stating facts. I would not argue that it is wrong for the existing EU15 to make financial and economic transfers to the countries that will accede because, as you rightly say, cohesion as such is a very important element in European policy and that the richer countries give to the less well-off countries is an absolutely accepted principle. One would, though, want of

course - and that brings me to the second part of your statement - to see that the monies are being then used in a way which not only creates additional incomes for the recipients but also is an efficient way of doing this and avoids any additional problems that might arise out of such transfers and that indeed is something which is not necessarily guaranteed. These transfers are made along with the volume of agricultural production that affects these payments because indeed that might well have negative environmental implications. There is no particular reason to believe that any support that one provides to farmers in a broad sense, be it through prices or payments per hectare, has any benefit to the environment; on the contrary, it is probably not helping the environment and it would be a much better environment policy to indeed use these monies and pay for active contributions that people can make towards improving the environment. As far as the ceiling is concerned on individual people's payments out of the current regime, I think it is extremely important to come up with a good explanation for why these payments are being made at all and the only proper explanation I believe one can think of is that these payments, having followed from price support that was provided in the past, should help people with the adjustments they have to undergo when prices are being reduced. It now turns out that some of the investments they have made in the past are not really any longer very profitable. But there is nothing like a long running justification for such payments and therefore the proper strategy in my mind would be over time to reduce these payments anyhow. If that happens then of course the issue of ceilings on individual people's payments no longer is very relevant because these payments disappear after 15 years anyhow. Then that is not so much an issue and what should happen, rather than continuing to make these payments on a very long running basis is to use these monies, or rather only a fraction of it because not all of it would be used for it, to pay people for making contributions to all those benefits that society wants agriculture to provide, having to do with the environment, biodiversity, food safety, animal welfare and all the rest of it. I think that is the proper strategy, to phase out over time payments that have originated from the history of price support and turn them into targeted payments which are made to farmers for the benefits that they provide to society.

Chairman: Thank you very much.

Q16 Diana Organ: I want to ask you a bit to do with actually the cost of food to the consumer. You said earlier that the losers in all of this may be the consumer. I wonder if you would comment about the predicted price rises affecting the rural poor, which may be the very same rural farmers to whom we are giving some kind of support but this may be all swept away because an important bit of their budget, which is their weekly food bill, may be seen to be escalating beyond control. Coupled with that, when we were in Poland and Hungary and we went to a supermarket we were told there that people already are extremely price-sensitive in the way they do their shopping. The impact that that might have on accession states and you were saying earlier about how you might be in a rural area and the farmer next to you is getting some money and you are not. The sort of social divisions that they may cause. "This farmer is getting money but my food has suddenly cost a lot more," and there are real social problems about that. The second part is that you have shown us about the productivity of agriculture, except for Slovenia, had dipped in the last decade or so but probably with the accession into the EU there are possibly going to be increases in agricultural production because there is

great opportunity. Do you see the increase of production going to meet rising consumer demand in the ten States, possibly because of increased incomes through other sectors or do you see the farmers looking at the opportunities across the EU and saying, "Let's all get really market orientated and we will all export it to Germany, or wherever." I am sorry, there are about three questions in there. The first one is about the impact of food prices and the second is what is going to happen to where the food is. Is it going to be increased consumer demand or is it going to go for export?

Professor Tarditi: The impact on food prices will surely be a share of the increase of farm prices because at consumer level of course the increases of farm prices will be reflected in much lower percentage increases although in absolute terms it could be the same according to the competition in the market channel. The point you are making about the poor in poorer areas and so on in my opinion should be tacked in the same approach. If there is a local problem for whatever, poor farmers, that society wants to keep in their region for any possible objective then a proper policy should be targeted at local level, not that in order to keep some bovine production in the hilly areas we increase the price all over Europe. This is the big mistake that we always make. I want to come back to a point on the previous intervention of Professor Tangermann. Of course if we intend to maximise the social welfare of society as a whole, which is usually the main objective of economic policy, we must take into account all possible uses of resources we have. So let us just think of how many things could be done, not only in agriculture by shifting from the price of water to green box policies, rural development and so on. But why not? We rarely talk about using this money in all other economic activities, investing in whatever in these Central and Eastern European countries and not using it flowing to land rents and so on. This is a basic issue that clearly tells how such policies are sectorally driven and inefficient. The last point you made was should we increase our production in order to feed the demand due to increased income and so on. When we started introducing supply management and controlling supply with administrative devices all the economic approach is reversed because producing more is damaging because we have to get rid of it. So everything is false. If we do not reduce the price support and do not come into a much more liberal economy we cannot even reason in terms of increasing supply is a good thing. It is not at present because we are paying 10%. We are paying farmers not to produce 10% of our land. So it is very disturbing.

Q17 Chairman: Professor Erjavec, would you like to have the final word on this?

Professor Erjavec: Yes, only about the food prices. I will say in the short term, and I think you will be surprised, my evaluation is that the prices will not increase significantly because the food prices are driven by demand, by purchasing power, much more than we expect. I think the competition is so strong that they will really compete with each other and also through the direct payments, which compensate the farmers. We have some power to manoeuvre. The raw materials prices, especially for the livestock, will still stay at the lowest levels. But in the long term, I agree there is a price adjustment and also this affects the consumer with the increase in the consumer prices. So I think there is the tendency to go with high wages or food prices. I think we expect too much on the consumer side. Secondly, I would say that we have all on the West and on the East side a little bit too much illusion on the rural development policy. I do not see so much a possibility to solve all the problems in the CEEC only with the structural

policy measures. We have a big farm now in Poland which produces 300,000 pigs. We know it has to be closed. It is against animal welfare, it is against the environment, against anything, but what do we need? Shall we build 100, 300 or 500 family farms? There is no programme. Rural development policies are so bureaucratic, so settled by the rules, which are somehow I will say in the EU15 bureaucrats' imagination that I do not believe that with the rural development policy as it is now it is possible to solve all these problems of poverty, of environment, of cohesion. What the CEEC really needs are the new industrial working places in the agricultural areas. This is the key point. Then we solve the agriculture subsistence farming problems and so on and to build, like the Germans, new working places. I do not see the policy here. There is not enough money and it is too bureaucratic. The EC Commission makes policies like, you know, not to increase - we need very primitive measures. Build new factories. This is the key point for the rural areas in the CEEC.

Chairman: Gentlemen, thank you all very much indeed for three well put together, stimulating and indeed challenging presentations. You have provided us in a relatively short space of time with an enormous amount of data for us to think about and I think provided us with a very important perspective to the visits that we made last week because you have given us both a practical as well as a theoretical analysis with which to review the experiences that we had. We are most grateful. If there is one thing that I have concluded from all of this it is that it is a lot more complicated than I think we all thought. So thank you very much indeed for coming. We really appreciate the time and trouble you have taken and we are very grateful to your contribution to this inquiry.