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Tobacco regime

Extended Impact Assessment

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1. INTRODUCTION

In 1998, when the Council agreed substantial modifications to the existing framework of support for Community tobacco production, it instructed the Commission to submit a report¹ in 2002 on the operation of the regime accompanied.

The question of the tobacco regime's future was also touched upon during the Göteborg European Council in May 2001, in the context of the EU's strategy for sustainable development.

Although the Council held back from adopting any specific conclusions on tobacco it was evident from the discussions, and the context in which they took place, that reservations exist about the sustainability of the EU tobacco sector.

Doubts were voiced over the social justification for product-related subsidies to tobacco growers, and in particular the apparent contradiction between those aids and society's concerns about smoking. The long-term viability of tobacco production as an economic activity was itself called into question. There was also an awareness, however, that in the event of any major reform alternative sources of income for tobacco producers would be necessary, in order to avoid economic and social breakdown in rural areas that are very dependent on tobacco growing.

The Commission's response was to strengthen its commitment to finding a sustainable policy approach for the tobacco regime, based on an assessment of the economic, social and environmental aspects of the sector. Thus, in May 2002, in its Legislative and Work Programme for 2003, the Commission decided to subject its policy reflections on the tobacco sector to an Extended Impact Assessment², in accordance with its "Sustainable and inclusive economy priority".

In addition, an evaluation of the common market organisation (CMO) for tobacco was launched in 2002 and completed in 2003.

As the reform of the tobacco regime has implications for other EU policies, the Commission decided to entrust this analysis to an Interservice Steering Group (ISG), inviting representatives from twelve directorates-general and services to take part⁴. The analysis of the economic, social and environmental aspects of the tobacco regime and the impact different reform options could have on stakeholders in the Union and in third countries, benefited from the Group's diversity of knowledge and background.

Over a six-month period the work of the ISG followed the steps set out for the conduct of impact analyses. The different parts of this report correspond to each of these steps. An introductory section (chapter 2) sets out the main characteristics of the tobacco economy and the tobacco CMO.

Chapter 3 deals with the changes and tensions now facing the CMO, at which certain criticisms have been levelled, while others have underlined the serious constraints any reform must take into account. The aims of the CMO are reconsidered in the light of new engagements by the Union, the European strategy for sustainable development and the general direction of the reformed Common Agricultural Policy.

¹ Council Regulation (EC) No 1636/98 of 20 July 1998, Article 26.

In chapter 4, three types of option are outlined which reflect different approaches to the reform of the tobacco regime. The "Prolongation" option keeps the high level of production subsidy and uses fixed production quotas to regulate the market. The "Decoupling" and "Phasing out" options seek to achieve a balance between prices and costs. Their likely impact on production levels and location, on prices, farm incomes, industry, employment, the environment and trade flows from third countries where tobacco is produced, has been either qualitatively or quantitatively assessed with the help of various simulations modelled on the FADN sample.

The final part of the report (chapter 5) provides a summary of the advantages and drawbacks to the different options, which are rated according to how they respond to the challenges identified, to what extent they meet the different objectives and according to the effect they would have on stakeholders.

In March 2003 the options agreed by the ISG and a draft of the impact assessment were presented to the "Standing Tobacco Group" of the Consultative Committee on Specialised Crops. They were also presented in June to a Consultative Forum comprising representatives from the world of health, consumer groups, downstream industries, environmental and development associations as well as local authority representatives from the main EU producing countries. The different parties were invited to present their positions and comments, which would inform the choice to be made by the political authorities.

The organisations consulted and the contributions received are presented in Annexes 3 and 4. The substance of the positions expressed in these contributions, on various aspects of the CMO and on the reform options are taken into account in the corresponding parts of the report. Further annexes set out the mandate and composition of the ISG (Annexes 1 and 2), as well as certain working notes.

Main features of tobacco production

	Year	Value	Trend
<u>Raw tobacco production</u>			
World production	Average 2000-2002	6 400 000 t	↕
EU-15 production	Average 2000-2002	348 013 t	↕
<i>of which:</i>			
Italy	Average 2000-2002	130 274 t	↕
Greece	Average 2000-2002	132 261 t	→
<u>Raw tobacco EU-15 internal consumption</u>			
<i>Net imports/domestic use</i>	2001	587 000 t 43%	cyclical
<u>Raw tobacco trade</u>			
Imports	Average 1999-2001	530 000 t 36%	↗
<i>Share in world imports</i>			
Exports	Average 1999-2001	182 000 t 11%	↕
<i>Share in world exports</i>			
<u>Prices</u>			
Import Unit value	2001	from € 5 to 7,44/kg	↗
Export Unit value	2001	from € 2,9 to 4,25/kg	↗ ↘
<u>Tobacco EU-15 area</u>			
<i>Share of total agricultural area</i>	2000	125 420 ha 0,1%	↕
<u>EU-15 farms with tobacco</u>			
<i>Share of total EU-15 farms</i>	2000	79 510 1,3%	↕
<u>Average tobacco farm size</u>			
<i>of which tobacco</i>		9,4 ha 1,6 ha *	↗
<u>Budget expenditure</u>			
	2002	€ 963 mio	→
<u>Average premium</u>			
		€ 2 900/t 7 800 € /ha	→ ↗
<u>Employment on tobacco holdings</u>			
(Annual Work Units)	2000	126 070	↕
<u>First processing employment</u>			
(full time equivalent)	1999	13 372	→

* varies from 0,8 ha in Anatoloki Makedonia and Puglia to 12,1 ha in Umbria.

2. ECONOMY OF THE SECTOR AND CURRENT CMO

- Tobacco is grown in eight Member States, in two of which, Greece and Italy, 75% of EU production is concentrated.
- In the Member States producing tobacco, there is a high geographic concentration: 12 regions contain more than 72% of the tobacco area.

- The number of holdings is small (1,3% of all EU agricultural holdings) and their size is very small, on average 1,6 ha of tobacco and 9,4 ha of Utilised Agricultural Area (UAA).
- Tobacco-growing is highly labour intensive and even if based mainly on family labour (100 000 Annual Work Units, 80% of the total) is also of crucial importance to the economy of tobacco areas, where more than 25 000 AWU of non-family labour is employed.
- Trade is important: of the 350 000 t of raw tobacco produced in the EU, 55% is exported. The EU imports more than 500 000 t, the equivalent of 160% of its production.
- Unlike most European agricultural products, domestic prices are generally between one third and half of world prices (except for Greek oriental tobaccos).
- On average, and particularly due to the very small size of the farms, tobacco producers' incomes compare badly with other producers'; they are highly dependant on production premiums, which represent on average 76% of their income from tobacco-growing.
- In 2002 overall EAGGF expenditure on the tobacco CMO was € 963 mio, or around € 7 600 per Annual Work Unit in the tobacco sector.

2.1. Economy of the sector

2.1.1. Tobacco production and output

2.1.1.1. Overall production and output

World production of raw tobacco was 6,4 million t per year in the period 2000-2002. With 348 013 t, corresponding to 5,4% of world production, the EU is the world's fifth producer, behind China 38%, Brazil 9%, India 8%, and the US 7%. The last decade has seen a downward **trend in volumes produced in the EU** and all the other major producing countries except Brazil. In 2000-2002 EU production was down 20% on 1990-1992.

Raw tobacco is produced in eight Member States: Belgium, Germany, Greece, Spain, France, Italy, Austria and Portugal. **By far the most important of these are Greece and Italy** with, respectively, 132 261 t and 130 274 t in 2000-2002, together representing 75% of EU production. Although remaining at a relatively high level, 37,4% in 2000-2002, Italy's share of EU tobacco production has fallen over the last decade, while Greece's share, at 38% of the total, has remained more stable or slightly increased.

The share of raw tobacco in EU agricultural output is very small and has remained stable over the last decade. It currently represents only 0,4% of the EU's agricultural output at basic prices², although in Greece it is more important, accounting for almost 4,5% of national agricultural output at basic prices. In the other producing Member States it fails to reach the 1% threshold.

² Basic prices are the sum of producer prices and net subsidies on production.

Geographically, tobacco production is highly concentrated and is especially important to some regions (NUTS 3) of Greece and Italy, where it accounts for more than 50% of regional agricultural production.

In 2000, 0,1% (125 420 ha) of the EU's Utilised Agricultural Area (96 455 390 ha) was cultivated with tobacco. **In 2001 the area under tobacco was only 73,2% of the 1993 level.** The reduction, of nearly 45 000 ha, was concentrated primarily on the main producing Member States (Greece -17 740 ha, Italy -20 199 ha and Spain -4 935 ha).

From 1993 to 2000 **tobacco yields improved in all Member States**, especially Italy (from 2,2 t/ha to 3,3 t/ha) and Portugal (from 1 t/ha to 2,8 t/ha). The average EU yield rose from 2 to 2,7 t per ha over the same period.

2.1.1.2. Production by group of variety

EU tobacco production is characterised by a number of different varieties which attract different prices and are destined to different uses. Four broad groups of varieties can be distinguished:

- **High quality group of varieties** (e.g. "Flue Cured", "Light Air Cured") are mainly used for "American blend" cigarettes, which are currently the most popular type of cigarette on the market. These high-quality varieties together made up more than half the EU's tobacco production in 2001, with a remarkable upward trend recorded particularly for "Flue Cured" (40% share of EU tobacco production).
- **Low quality and declining group of varieties**, including the "Dark Air Cured" and, to a greater extent, the "Sun Cured" groups, have traditionally been used for cigarettes sold on local markets and the production of dark cigarettes. These varieties have become less and less important in the EU, with a 10% share for "Dark Air Cured" and a 4,1% share for "Sun Cured" in the 2001 tobacco production figures.
- **Oriental group of varieties**, produced only in Greece and used mainly to enrich the aroma and taste of "American blend" cigarettes. Their share of EU production has remained quite stable over the years, though some variations can be observed within the group. "Basmás" varieties have increased their weight, with a 8,1% share of EU production in 2001, "Katerini" has a settled 7,1% share, while "Kaba Kulak" varieties have seen a slight decrease to a 4,0% share.
- **Fire Cured** group of varieties, used mainly for the **production of cigars** and Toscani. Its share in EU tobacco production was only 1,9% in 2001.

Following recent market developments and policy changes (in particular, the introduction **in 1998** of the modulation of premiums to producer organisations on the basis of quality standards), **there has been a marked reorientation towards the production of high-quality varieties and, to a lesser extent, some of the oriental varieties.** This shift particularly shaped Italian production, with the most sought after varieties (Virginia and Bright, belonging to "Flue Cured", and Burley falling in the "Light Air Cured" group) now representing about 77% of national production. Over the last few years Greece has started to produce similar varieties, but still specialises strongly in oriental tobaccos.

The restructuring process has also resulted in **increasing varietal specialisation at farm and regional level**, with high quality varieties becoming more and more concentrated on a growing number of producers in a few regions. But big differences can still be seen between farms and regions in Greece and Italy: **a dichotomy persists between a few "industrial" farms**, which are more capital-intensive and concentrate on producing the best varieties, **and a large number of small farms**, which are typically labour-intensive and less integrated with the market.

2.1.1.3. European acceding countries and candidate countries

Of the 10 acceding countries only four produce tobacco: Poland, Hungary, Slovakia and Cyprus. Their annual production (2000-2002 average) is: Poland 24 617 t, Hungary 9 805 t, Slovakia 1 959 t and Cyprus 362 t³. Over the same period Bulgaria and Romania produced respectively 43 915 t and 10 662 t. **In all the candidate and acceding countries except Cyprus raw tobacco production is declining.**

Poland specialises in the production of Fire Cured varieties, while in Bulgaria and Romania oriental tobaccos are more widely grown.

2.1.2. Structures

2.1.2.1. EU-15 structures

In 2000 there was a total of 79 510 farms with tobacco in the EU, representing only 1,3% of all EU farms. These holdings were mainly concentrated in Greece (64% of all EU tobacco holdings), followed by Italy with a share of 21%⁴.

Over the 1990s the rate of decline in tobacco holdings, at 3,6% per year, was higher than the average rate of decrease of agricultural holdings in the EU (2% per year). On the other hand, over the same period, tobacco hectares declined by 2,6% per year against a fall of 3,2% in the EU's UAA. This means that there was **a poor increase in tobacco hectares per holding** from 1,4 ha in 1990 to 1,6 ha in 2000.

A moderate restructuring process set off the decline in tobacco holdings and areas and a partial shift from tobacco to other crops, particularly in Italy where favourable climatic conditions have made this possible.

Tobacco holdings are typically small. Almost 60% of holdings growing tobacco, in fact, are under 5 hectares, while more than 18% range from 5 to 10 ha. This inevitably limits the possibility for farmers to diversify. Even though the average size has increased slightly since 1990, there is still a myriad of tobacco holdings characterised by their very small size across the European Union, particularly in Greece, Spain, Portugal and Italy.

The tobacco sector employs a large amount of labour, 126 070 AWU (212 960 people), corresponding to a 2,4% share of the total AWU employed in the EU agricultural sector. However, most raw tobacco labour is seasonal and **the share of part-time employment is remarkably high**. Greece is the biggest employer, with 79 230 units (AWU), followed by Italy with 23 120 units. Together these two

³ All acceding countries have obtained the possibility from the EU to pay tobacco support in a simplified manner (aid per ha) as from accession but only Poland and Cyprus have decided to opt for this system of payment.

⁴ See map in Annex 9.

Member States represent 81% of the total labour force employed in tobacco production.

Family labour strongly prevails with about 80% of the total labour force employed in the sector. The equivalent figure for EU holdings not producing tobacco is 73%.

Tobacco production is typically a highly labour-intensity activity. Technical reasons limit the extent to which tobacco growing can be mechanised. On average, the AWUs per farm and hectare of tobacco holdings are higher than the equivalent indicators for "all holdings".

53% of tobacco farmers are over 55 years old. In Greece, Portugal, Italy and Spain more than 90% of managers have only practical experience, while the highest percentage of holders with full agricultural training is recorded for France. On average, only 25% of holders are women.

2.1.2.2. Regional analysis

Concerning the distribution of farms across the EU regions (NUTS 2 level), the tobacco sector is characterised by a strong territorial concentration. **Seven regions, ranked on the basis of the number of holdings, concentrate around 70% of the total number of holdings, 63% of the area under tobacco and 57% of gross income⁵.** Kentriki and Anatoliki Makedonia are the most important regions, representing altogether 60% of tobacco holdings, 25% of tobacco area and 21% of total gross income. In these two regions 50% of all specialised tobacco farms are concentrated.

A key features of tobacco holdings is that they are extremely heterogeneous across regions. The large farm size, both in terms of area and economic activity, of Umbria, Aquitaine and Veneto contrasts with the small dimension of holdings in Greece and in some other Italian regions (Campania and Puglia).

Problems of restructuring are still particularly acute **in some areas where tobacco production plays a very important economic and social role.** There, pulling out workers from the sector too rapidly would cause major social imbalances and rural depopulation if an adequate safety net is not put in place.

In Greece, tobacco has the highest relative importance, particularly in Anatoliki Makedonia, where it accounts for 20% of all holdings and 34% of all employment. In Italy, holdings growing tobacco represent just a small proportion of the total holdings, though the proportion is higher in Campania and Umbria, where tobacco accounts for, respectively, about 11% and 9% of all agricultural employment and about 10% and 19% of total gross income. Another region where tobacco production is relatively important for employment is Extremadura in Spain.

2.1.3. *The downstream sector*

According to the CEDT, the European Confederation of Tobacco Retailers, in 1999 the EU tobacco sector employed over 1 million people and 440 000 people as full-time equivalent.

⁵ Gross income is defined as the value of output from one hectare minus the cost of *variable inputs* required to produce that output.

Most of the first processing industry's input is raw tobacco produced in the Union. However, the tobacco used in the EU to be manufactured into cigarettes is mainly imported, the processed products then being either exported or consumed in the Union.

The first processing industry is mainly located in those Member States where the production of raw tobacco is concentrated. Italy, with 52%, and Greece, with 28%, have the bulk of the EU's first processing production.

Turning to **manufacturing**, the most important producers of cigarettes are Germany, the UK and the Netherlands. Production in these three countries represented 63% of EU manufactured cigarettes in 1999. The Netherlands and Germany are the main EU producers of cigars, with a 67% share of EU production, and pipe tobacco, 67% of the total. Sectoral employment is relatively important in Germany and the UK with 12 000 and 8 000 people respectively, out of 50 697 full time units for the whole EU tobacco manufacturing industry. Women's employment in this sector is very important (i.e. 53% in Spain compared to 23% for the whole economy).

As far as the **retail sector** is concerned, sales of tobacco products have surprisingly increased in recent years in terms of both volume and value. In 1999, total sales amounted to about € 93 billion.

Tax revenues generated by sales of manufactured tobacco are high in all Member States. The total added value generated in 1999 was € 12 billion. The "Manufacturers" contributed with 54% of the total, followed by "Retail sales" with 28%. Globally, the contribution of excise duties and VAT to Member State taxes was € 60 billion in 1999.

2.1.4. *Prices*

2.1.4.1. Prices of raw tobacco

Prices of raw tobacco differ significantly between the varieties, depending on the distinct values of the processed goods for which the variety is used and on the concentration in the supply of final product (various kinds of cigarettes and cigars). In practice, a **few multinational traders and manufacturing corporations act as price makers**, taking decisions on the demand for raw tobacco on the basis of a complex quality grid, as well as supply and the volume of stocks.

Developments over the last decade show that the strong concentration of manufacturing suppliers has not had a negative effect on prices. Rather, it helped the process of structural adjustment along the tobacco chain and, together with appropriate policies, contributed to increasing the value of the goods produced by the primary sector.

Prices of EU-produced raw tobaccos at international and domestic level are increasing as a consequence of the modernisation undertaken over the last decade.

Low prices are mainly incurred for the products marketed by small farms, as they are relatively more specialised in low quality varieties

2.1.4.2. EU competitiveness

The unit value of tobacco exports has been used to measure the relative competitiveness and value of the EU tobacco industry in an international framework.

At world level, the positive combination of market demand and quality makes the USA and, to a lesser extent, Turkey, the countries with the highest levels of unit values of tobacco exports. The USA mainly exports the varieties used for "American blend" cigarettes while Turkish exports are concentrated on oriental tobaccos.

Unit values of EU exports follow a slight upward pattern against a negative trend observed for the world unit export values. The EU unit export values remained below the world averages from 1989 to 1999, but with a clear trend to close that gap. Indeed, in 2000 EU unit export values were already higher than the corresponding world ones.

2.1.4.3. Prices by variety groups

Between 1993 and 2001, **prices for all varieties increased, except for "low qualities and declining varieties"**, despite the steady fall in production and cultivated area for these latter groups. The price decrease of these varieties is therefore the result of falling demand.

2.1.5. Trade

2.1.5.1. EU-15 Trade

EU tobacco trade is affected by two main factors:

- (1) **EU production of raw tobacco is insufficient to cover, both in quantity and quality terms, domestic demand** from the processing industry;
- (2) **European multinationals**, based mainly in the Netherlands, Germany and the UK, together with some US companies, **control a significant share of the world trade in cigarettes and cigars.**

The **EU occupies a top position in the world tobacco trade.** In 2000-2002, the EU imported, in value, 34,7% of the unmanufactured tobacco traded in the world, but only 5,4% of the manufactured tobacco. At the same time, the EU exports accounted for almost 20% of transformed and 7,6% of unmanufactured tobacco. The tobacco industry's trade balance is negative, but improving strongly thanks to increasing exports of processed tobacco.

Trade in manufactured tobacco products is relatively more important for the EU, the US and other developed countries, while the tobacco trade of developing countries is generally based on unmanufactured tobacco.

It is important to note that the production of manufactured tobacco in the EU is not located near to where raw tobacco is cultivated. Italy is a net importer of cigarettes, while Greek net exports of cigarettes are positive in some years and negative in others.

Tobacco intra-trade flows (average 2000-2002) are worth about € 5 000 mio. Italy, Greece and Spain are the main suppliers, while Germany followed by Belgium and the United Kingdom are the main buyers. The most traded varieties, both at extra-EU and intra-EU level, are "Flue Cured", "Light Air Cured", and "oriental varieties".

2.1.5.2. Tobacco trade: acceding and candidate countries

From 1998-2000, the acceding countries exported an annual average of 9 470 t and imported 92 060 t of raw tobacco. Exports are mainly towards the EU and imports from the EU, Brazil, USA and Zimbabwe.

Over the same period Bulgaria and Romania exported 22 275 t and 773 t, and imported 747 000 t and 20 809 t. Within the group of acceding and candidate countries Bulgaria is the only net exporter. Turkey is also a major net exporter (77 173t).

2.1.6. *Utilisation*

2.1.6.1. EU-15 utilisation

Raw tobacco is used ("consumed") by the processing industry, while final consumption refers to the number and value of cigarettes and processed tobacco products sold to consumers.

In the EU, patterns of raw tobacco and processed product use vary, as the European manufactured tobacco industry may acquire the raw product from EU producers, mainly based in Greece and Italy, and from non-EU sources. Similarly, internal raw tobacco production may be directed outside, rather than within, the EU. **The EU's overall degree of self-sufficiency in raw tobacco is 53%, with a slight tendency to further reductions.** On the other hand, internal production of cigarettes is rather stable, against a slight fall in cigarette consumption. **The EU's self-sufficiency in cigarettes is therefore positive and expected to improve.**

The EU accounts for a 10% share of the world's total raw tobacco consumption, behind only China (36%), and ahead of India (8%) and the USA (6%). In 2001, EU raw tobacco use amounted to almost 587 000 t, while EU consumption of cigarettes reached 628 000 t in 1999.

Recent data indicate that the number of smokers in the EU is falling faster than the total EU consumption of cigarettes, which means that fewer smokers are smoking more.

Figures for cigarettes per smoker are generally higher for Denmark, Greece, Germany and Spain, with the lowest levels recorded in Sweden, Portugal, Finland and Italy. The percentage of male smokers is higher than the percentage of female everywhere in Europe but Sweden.

Importantly, the evaluation report on tobacco produced by COGEA in 2002, pointed out that **consumption of cigarettes in the EU is not linked directly to the tobacco CMO.** In this case, changes to the CMO and consequently to EU production of tobacco would have no relevance to cigarette consumption across the EU.

2.1.6.2. Utilisation in acceding countries

On average, from 1998-2000 the biggest users of raw tobacco among the 10 acceding countries were Poland (69 109 t) and Hungary (23 266 t). Over the same period consumption levels in Romania and Bulgaria were 38 085 t and 19 772 t respectively.

2.1.7. *Tobacco production costs, margins and farm incomes*

2.1.7.1. Tobacco production margins

The analysis of profitability of tobacco production is based on FADN⁶ data 1999 and 2000 on the basis of a sample of specialised farms. Due to the limited number of specialised tobacco farms, the analysis can be only carried out for Greece, Italy and Spain at the regional level, in the framework of relatively homogeneous production conditions. The five regions for which costs and margins of tobacco production were estimated are Extremadura (Spain), Umbria (Italy), Makedonia-Thraki, Thessalia and Sterea Ellas-Nissi Egaeou-Kriti (Greece).

Indicators of profitability include **Market margin** (tobacco output without premia) and **Total margin** (tobacco output with premia), both of them calculated over variable costs, over total input, and over total economic costs.

Market margins

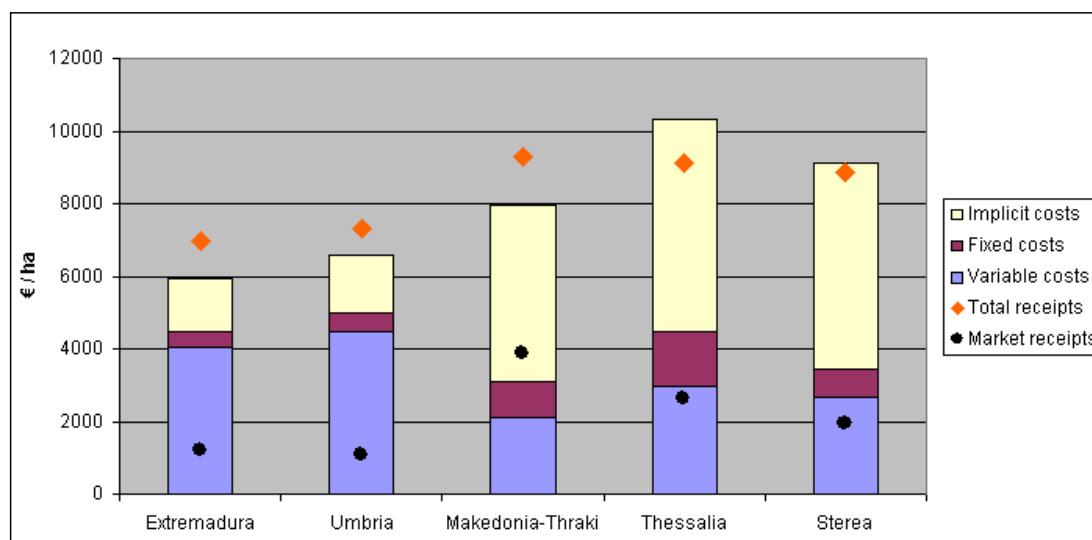
Market margins over variable costs and over total input are in general negative in all the regions considered, except in Makedonia-Thraki. This result is determined by the fact that the producer price of tobacco is much too low to cover the costs of the labour-intensive production activity, and it clearly proves that the profitability of tobacco production is highly dependent on subsidies. However, the production of tobacco in Makedonia-Thraki has positive margins, which is in part explained by the fact that in this region the share of high price-varieties is important. On the other hand, it is interesting to notice that in Makedonia-Thraki the main part of labour input comes from the farming family, and is not included in costs.

Total margins

The situation completely changes when considering the **total margins**, which also include the premium. The total margins over variable costs, but also over total input (variable + fixed costs), are largely positive in every region (and in particular in Greece, where the external factors are mainly unpaid), making tobacco production a very attractive agricultural activity.

⁶ Farm Accountancy Data Network.

Graph 1 – Average costs of production and margins per ha of tobacco specialised farms in some European regions (average 1999-2000)



Source: DG AGRI, FADN

Total receipts = market receipts + premium

Implicit costs = family labour and land ownership costs

2.1.7.2. Income of tobacco farms

To analyse the income situation of tobacco producers, it is interesting to compare the revenue of tobacco holdings with that of other types of farm.

In this context, the most common income indicator for the agricultural activity is the Farm Net Value Added per Annual Work Unit (FNVA⁷/AWU).

Two main elements playing a role in determining the profitability of the holdings are:

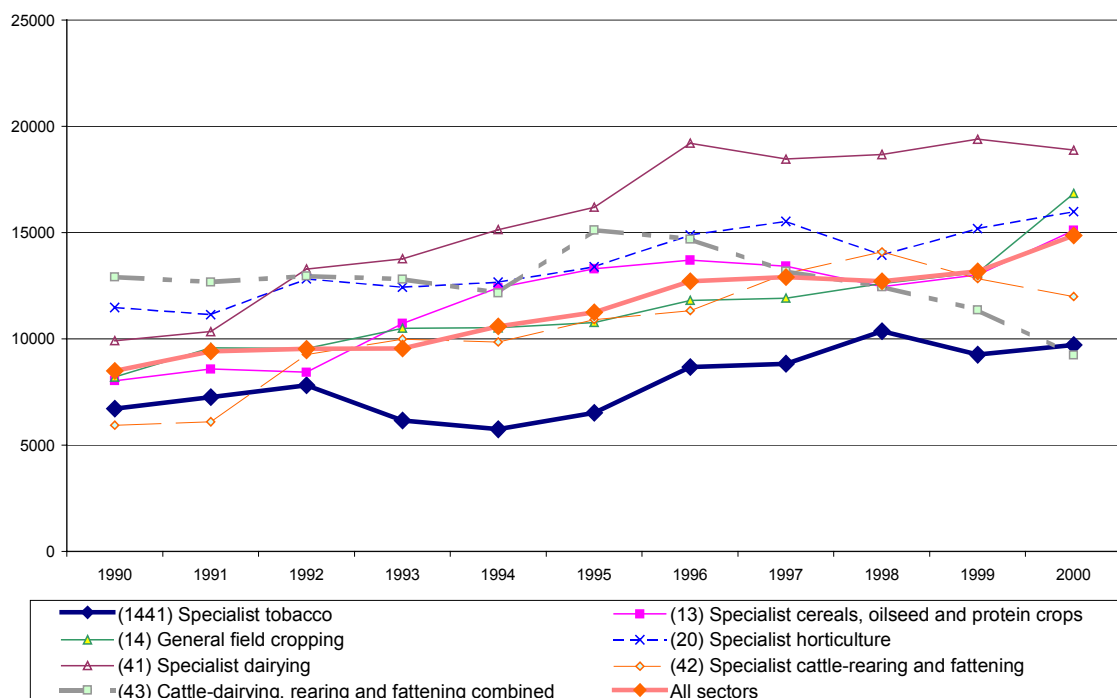
- (a) the level of margins per hectare expressed by the indicator FNVA/UAA,
- (b) the availability of agricultural area per Annual Work Unit.

Finally, it should not be forgotten that the total farm income is not only determined by the crop or animal production in which the holding is specialised, but also by other possible "secondary" activities.

⁷

Farm net value added = total farm output + balance current subsidies and taxes – intermediate consumption – depreciation.

Graph 2 – Income development (FNVA/AWU) in the EU (for the three main producer Member States) by type of farm – 1990-2000 (current prices)



Source: DG AGRI, FADN

The evolution of the indicator between 1990 and 2000 shows that tobacco producers in the EU suffer from a structural low level of income compared to other agricultural sectors (see graph above). In most cases, the revenue of tobacco holdings was the lowest among all farm types, with the exception of the specialised beef producers in the beginning of the period and of the mixed beef-milk in the last year. Not even the development of income over the 10-years-period has been particularly favourable to tobacco farms (+45% at current prices or 10% at constant prices and constant currency rates) compared to the average of all sectors (+75% in nominal terms or 47% in real terms).

However, the income situation varies considerably in the different Member States.

While in Italy and Spain, the income of tobacco producers is respectively equal and higher than the average of agricultural holdings in those countries, and anyway higher than the average for all three countries, the profitability of tobacco farms in Greece is the lowest among all the sectors and all the countries.

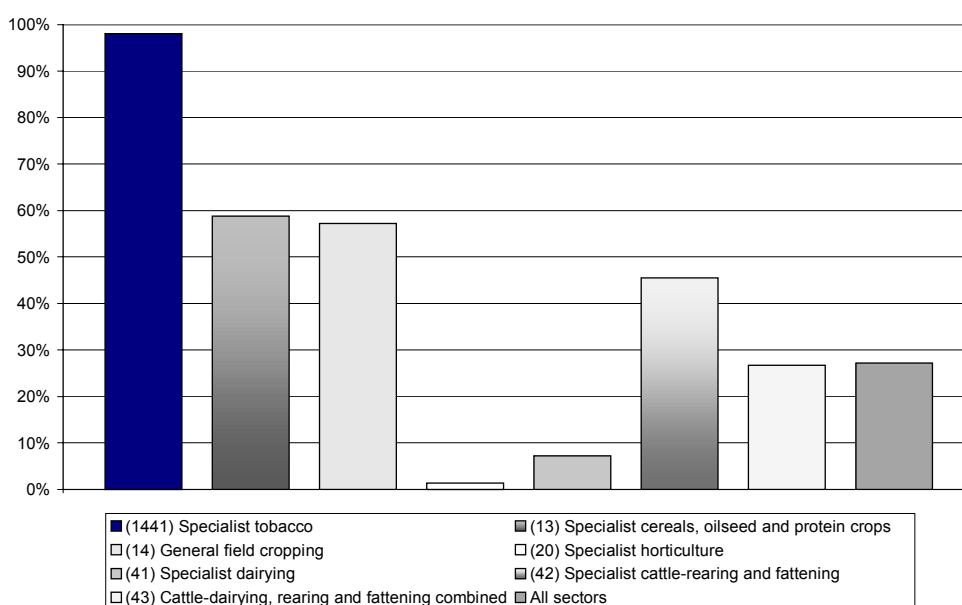
The low income of tobacco farms in the EU is therefore mainly determined by the situation in Greece, which is the most important tobacco-producing country.

Even if tobacco producers in Greece attain the best margins per hectare, their total income is the lowest. This can be explained by the very small size of tobacco farms in Greece, where the availability of UAA per working unit, and in particular of tobacco area, is very low, and the use of labour input per hectare is probably not very efficient.

Finally, another interesting conclusion can be drawn from the ratio between the balance of current subsidies and taxes and the net value added: for year 2000, this indicator, which measures the dependence of the agricultural revenues on the public

support, is equal to 98% for tobacco producers of the three considered countries, by far the highest value compared to other agricultural sectors.

Graph 3 – Ratio Balance current subsidies and taxes / Farm Net Value Added in EU (for the three main producer Member States) by type of farm – 2000



Source: DG AGRI, FADN

2.1.7.3. Conclusions

The picture emerging from the analysis based on FADN data strengthens the results of the structural analysis. As a fact, tobacco production uses labour very intensively, in particular in Greece, where the oriental varieties are produced. In the actual situation with low market prices, the producer's income is mainly guaranteed by the high level of support, which allows positive margins per ha. Without support, only the oriental varieties in Greece could be profitable. In this respect, the raw tobacco sector appears very fragile.

If on the one hand, the income situation of Greek producers appears particularly unfavourable, on the other hand the higher margins offered by the oriental varieties guarantee a better strength to the sector. Even taking into account that oriental varieties are more intensive in terms of labour, the extremely small size of the Greek holdings determines an apparent inefficient use of family labour force.

2.2. The common market organisation for tobacco

The common market organisation for raw tobacco is set out in Council Regulation (EEC) No 2075/92⁸. Commission Regulation (EC) No 2848/98⁹ lays down implementing rules. The CMO currently comprises:

- (1) a premium system,
- (2) a system of production limitation (national threshold and quota system) and of production orientation,

⁸ OJ L 215, 30.7.1992, p. 70.

⁹ OJ L 358, 31.12.1998, p. 17.

- (3) measures to convert production through the Community Tobacco Fund,
- (4) trading arrangements.

2.2.1. *Premium system*

The 34 tobacco varieties are classified into 8 groups.

One single premium is fixed for each variety group. The premium ranges from € 2,15 to 4,13/kg. A **supplementary amount** in the range of € 0,41 to 0,88/kg is fixed for some tobacco varieties in some Member States in order to compensate part of the premium lost as a result of the 1992 reform.

On average, the premium is € 2 900/t corresponding to € 7 800/ha.

Since 1999, the premium paid to producers is made up of a fixed part and a variable part (30% to 45% of the premium, granted as a function of the quality delivered).

The amount of the premium is reduced by a **deduction for the Tobacco Fund** and, since 1999, by a deduction for the specific aid to producer groups.

The Tobacco Fund has been financed by a deduction of, successively, 0,5% of the premium (1993 harvest), 1% (1994-1998 harvests), 2% (1999-2002 harvest) and 3% (2003 harvest).

The **specific aid** granted to producer groups for financing their activities to improve quality, environmental protection and regulation management amounts to 2% of the premium.

Upon accession, the new Member States will have the possibility either to apply the "*acquis communautaire*" or to pay tobacco support, along with support for all other agricultural commodities, in a simplified manner (flat rate aid per ha). Poland and Cyprus have already opted for this simplified system of payment.

2.2.2. *Measures to orient and limit production: guarantee threshold and quota system*

The Council has set an **overall guarantee threshold** per harvest for the EC and, within that quantity, individual guarantee thresholds for each group of varieties and for each producing Member State. The guarantee thresholds have been slightly reduced from 348 508 t of raw leaf in 1999 to 334 064 t in 2004.

The acceding countries have been granted a total of 52 353 t of guarantee thresholds, broken down as follows: Poland 37 933 t, Hungary 12 355 t, Slovakia 1 715 t and Cyprus 350 t.

Within each Member State quantities of thresholds may be transferred from one variety group to another, in a budget neutral way. This measure has permitted a shift of production towards varieties with a higher market demand and that fetch better prices.

In order to ensure respect of the guarantee thresholds the Council has imposed a **regime of production quotas**. Member States distribute the quotas by variety among producer groups and individual producers proportionately to the average quantity of tobacco they delivered to the first processing industry in the three years preceding the most recent harvest. To allow for some flexibility, producers can buy and sell quotas within Member State boundaries.

A national reserve of production quota, which may be set up with between 0,5% and 2% of the total national guarantee threshold, is an option for Member States.

The **auction procedure** envisaged for cultivation contracts has not been applied, because a lack of first processors does not allow for real competition in most producing Member States. In those Member States with sufficient first processors and where competition could take place, small processors were opposed to the scheme because they feared they would be unable to compete with the major processors. The industry has expressed interest in an auction system for raw leaf tobacco, rather than for contracts.

Producers who decide to leave the sector on a voluntary basis may sell their quota to the EU via the quota **buy-back programme**. National guarantee thresholds are reduced accordingly. Between 1999 and 2001 the quantity of quota withdrawn from the market in this way has been marginal. In 2002, however, as buy-back prices were increased, results have improved significantly.

2.2.3. *The Community Tobacco Fund*

The CMO allows for the creation of a Community Tobacco Fund¹⁰. Prior to 2002, this Fund was used to finance agricultural research into tobacco varieties and production methods, and information actions to improve public understanding of the harmful effects of tobacco consumption. As from 2003, the agricultural research aspect was transferred to the 6th framework research programme. Instead, the Fund may now finance actions that enable tobacco producers who have sold their quota in the buy back scheme to convert their production to other crops or economic activities that generate employment; and also studies into the possibilities for producers to switch to other crops or activities.

Funding of campaigns against tobacco consumption

In the past the Tobacco Fund was not fully used. From 1993 to 2001, € 31,4 million were spent on 19 information projects managed by DG SANCO. In 2001, DG SANCO launched a three-year prevention campaign against tobacco consumption among teenagers (12-18 years old) with an annual budget of € 6 million. In parallel, DG SANCO is developing new initiatives in order to improve knowledge in the field of tobacco prevention and also to support its political and legislative initiatives. Media experts consider this budget too low to have a critical impact.

Measures to reconvert production

Since 2003, Member States may set up national programmes for the conversion of tobacco growers to other crops and activities. Individual producers who have abandoned the tobacco sector and sold their quota in the buy back programme can present individual projects for conversion (switching to other crops, training for diversification, establishing infrastructure for marketing quality products).

Public authorities in the production areas and public research bodies in agronomy and/or rural economy can present projects of a general interest (studies, guidance and

¹⁰ See "Commission Report on the use of the appropriations from the Community Tobacco Fund" COM(2003) ... [currently under adoption procedure by the Commission].

advisory services, innovative demonstration projects). EU financing may cover up to 75% of the total amount for individual actions or 100% for collective actions of a general interest.

In 2003, 680 individual projects and 14 projects of a general interest were presented in the Member States. Individual conversion is mostly oriented towards (in decreasing order) horticulture, olive production, rural tourist facilities, processed horticulture products, fruit production and cereals.

2.2.4. *Trading regime with third countries*

The trading regime includes:

- **a common duty** with a rate depending on type and variety, from 11,2% of the imported value (with a minimum of € 22 and a maximum of € 56/net kg) to 18,4% (with a minimum of € 22 and a maximum of € 24/100 net kg).
- concerning bilateral or unilateral tariff preferences, the EU has granted **zero duty imports to ACP countries, and least developed countries** in the SPG system with the exception of Myanmar and the Andean/Central America group. A **reduced duty** has been granted to Mexico, South Africa and to the other SPG countries. Finally, Moldova, Hungary, Bulgaria and Romania benefit from a reduced customs duty within a preferential import quota.

There are neither preferential import quotas at WTO level, nor export subsidies, which were abolished under EEC legislation in 1993.

3. **SPECIFIC PROBLEMS OF THE CURRENT CMO IN A RESHAPED CAP**

The objective in reforming the tobacco regime is not only to increase global coherence between the main policies of the Union, in this case mainly between the CAP and the public health policy, but also to include this sectoral policy in the new reform process agreed in the Council compromise of 26 June 2003.

3.1. **Internal constraints**

With the reshaping of the CAP, some of the objectives formerly assigned to the tobacco CMO are no longer pertinent. Some instruments are not suited to the new context; others have under-performed and so failed to achieve their goals, even if these remain valid.

- **A heavy dependency on the premium** for tobacco cultivation is a major drawback of the present CMO. When considering the ratio of the premium to the total market and premium receipts, it represents on average 76%.
- Import prices still remain much higher than internal prices even if the latter have improved since the last CMO modification in 1998. In fact, the ratio market price/net premium remains rather low.
- The present CMO has ensured a high level of employment, in particular of the family labour force. However, the cost to the EU budget (€ 963 mio in 2002) is too high compared to other sectors. **The ratio between the weight of Gross Saleable Production/EU cost of support is highest** (1 to 6) for the tobacco CMO. The sector with the second highest support ratio is sugar, at 1 to 2,70, followed by cereals, with a ratio of 1 to 2,27.

- The balance between market supply and demand has improved but **some groups of varieties**, especially those oriented to traditional dark cigarettes, are in difficulties.
- The buy-back mechanism implemented to facilitate abandonment of the sector by less competitive producers appears to be largely underused and hence inefficient in achieving its goal although some improvements were made in recent years.

In addition to these problems, the current CMO, based on coupled "Amber box" (i.e. distortive) support, faces growing constraints in two areas:

- **environmental deterioration** due to the effects, already observable, of coupled support,
- the Community's proposal to the **WTO** and in particular the engagement to reduce Amber box support by 45%.

3.2. Reshaped objectives of the CAP and improved coherence with other EU Policies

Like the other CMOs, the common market organisation for tobacco has to redefine its objectives in line with the new economic context and the expectations of consumers and taxpayers. The main aspects of the reshaped CAP that are relevant to this CMO are the following:

- (1) **promoting a more market oriented and sustainable** tobacco production. This can be achieved by including the current coupled direct payment into the decoupled Single Farm Payment, based on historical references and subject to compliance requirements;
- (2) an agriculture sector which can achieve a **fair and stable standard of living** for agricultural producers **without receiving unacceptable subsidies**;
- (3) the need to provide a better balance of support and **strengthen rural development by transferring funds from the first to the second pillar of the CAP** and expanding the scope of instruments currently available for rural development;
- (4) contributing to a **simpler agricultural policy**;
- (5) strict respect of the **budgetary constraints** decided at the October 2002 Brussels Council in an enlarged Union.

3.3. Coherence with sustainable development objectives

At the Göteborg European Council, the Commission presented a communication on the EU's strategy for sustainable development¹¹ (May 2001) which specifically referred to the tobacco sector.

"Following on from the 2002 evaluation of the tobacco regime, adapt the regime so as to allow for a phasing out of tobacco subsidies while putting in place measures to develop alternative sources of income and economic activity for tobacco workers and growers and decide an early date accordingly".

¹¹ Communication from the Commission: A Sustainable Europe for a Better World: A European Union Strategy for Sustainable Development (COM(2001) 264 final of 15.5.2001).

As fully recognised by the European Council and clearly stated during the stakeholders' consultation, tobacco is an agricultural product with particular features, linked as it is with public health and rural employment.

In addition the sustainable development objective has to be achieved not only inside the Union, but also in the framework of policies promoted in the developing countries.

All these internal and external objectives make it necessary to determine whether tobacco production subsidies are compatible with policies of maintaining economic and social structures and reducing tobacco consumption in the European Union, and to examine different policy options.

4. REFORM OPTIONS

To resolve the problems inherent in the current CMO and attain the new objectives of the CAP, the common market organisation for tobacco could be reformed by modifying some measures and adopting a number of new ones. Three main options have been drawn up.

4.1. Option 1: Prolongation of the current CMO

If it is decided to prolong the current CMO, it will anyway be necessary to adjust some of the mechanisms currently used for market management.

- The commercial status of EU raw tobacco is idiosyncratic, as **producer prices are much lower than import prices**. However, the good quality of EU raw tobacco should ensure an increase in prices if **premium levels are reduced**.
- **The guarantee threshold for varieties** with no obvious market outlets **should be completely eliminated or reduced** during the first year of application of the new CMO. Supplementary support for some varieties should also be abolished.
- The abandonment of activity by marginal and older producers should be facilitated through a **buy-back programme** with the same conditions as at present.
- Compulsory implementation of the **auction scheme** for quantities produced should further improve quality and market efficiency. This would also mean that the very complicated application of the variable part of the premium could be abandoned.
- The savings obtained by reducing premiums and eliminating or reducing thresholds could be used to finance a **restructured Tobacco Fund**.

4.2. Option 2: decoupling along CAP reform lines

- Using a step-wise approach, an increasing part of the current coupled tobacco premium would be **decoupled and included in the Single Farm Payment**: subsidies become non crop specific and producers free to continue tobacco production or to reconvert to a different use of their land. Decoupling may be introduced gradually but will be full at the end of the phasing-in period.

A **step-wise implementation** of decoupling would be necessary to avoid disrupting production and local economies and to allow market prices to adjust to the new conditions. In order to **avoid any major changes in farm incomes** at

each step a fixed part of the current coupled tobacco premium would be decoupled and included in the Single Farm Payment.

- The Tobacco Fund, as such, would be phased out and replaced by a new tool, a **financial envelope for restructuring** tobacco producing areas, including measures for workers external to the producer's family in the production regions. It is important that rural development resources work together with the envelope for restructuring to maintain and reinforce the competitiveness of the rural tobacco zones. In order to keep the mechanism **as simple as possible**, it should cohere with existing Rural Development policy tools and create synergies. The possibility of specific measures being added to the framework of rural development plans should not be excluded.
- This option does not address the issue of financing the tobacco control campaigns, which will be dealt with in the relevant context.

Main features of the step-wise approach:

- During the phasing-in of decoupling, tobacco quotas would be kept as a means of fixing the coupled tobacco premium envelope. Production would be permitted outside of quota but without the payment of any coupled premium.
- In order to avoid threshold effects when phasing-out the coupled payments, a distinction would be made, in terms of the volume of production per holding, between the tranche of production from 0 to 3,5 t, the tranche from 3,5 to 10 t and the tranche of more than 10 t.
- At each step and for each tranche of production, part of the current coupled tobacco premium would be transformed into a decoupled producer payment and part would be transferred to the **financial envelope for restructuring**.
- *During the first step*, for all producers, the coupled payment corresponding to the tranche of production from 0 to 3,5 t would be **fully decoupled and added to each producer's Single Farm Payment**. Above the first 3,5 t **only part of the coupled payment would be decoupled, and part would be transferred to the envelope for restructuring**.
- *In the next two steps*, the remainder of the coupled payment would be phased-out by gradually increasing:
 - the **part to be decoupled** and added to each producer's Single Farm Payment;
 - the part transferred to the financial envelope for restructuring.
- Once fully implemented the decoupling process would have re-distributed the current coupled tobacco premiums **to the Single Farm Payment, and an Envelope for Restructuring totalling about € 150 mio** would be available. In addition, Structural Funds could be used to promote alternative activities.

4.3. Option 3: gradual phasing out within a sectoral approach

This approach keeps the current framework but gradually reduces the unit amounts, e.g. in ten cumulative steps of 10%.

- Support would be **phased out** progressively over a **10-year period, by 10% per year**. During this time the current CMO would continue to be applied without modification, except that the auction scheme for the allocation of quotas would be made compulsory.
- The Tobacco Fund would also be phased out and progressive **savings shifted entirely towards the financial envelope for restructuring** to take into account the new needs for restructuring across the whole tobacco sector. As under option 2, Structural Funds could be used to complement rural development measures implemented in the regions affected.
- This option does not address the issue of financing the tobacco control campaigns, which remains to be dealt with in the relevant context.

Summary table of the three options

	Option 1 Adapted current CMO	Option 2 Phased decoupling	Option 3 Phasing out current CMO
Coupled premium	maintained	decoupling in 3 steps	maintained*
Level of premium	phased down	maintained in full for historical small producers	phased out (10 years)
Threshold	reduced or suppressed according to tobacco groups	maintained during the transition period	maintained*
Quotas	maintained	maintained during the transition period	maintained*
Buy back scheme	maintained	abolished	maintained*
Auction system	compulsory	irrelevant (no more quota allocation)	compulsory
Tobacco Fund	maintained redefined (increased by part of reduced coupled premium)	abolished	abolished
Envelope for restructuring	–	phased in (increased by the part of reduced coupled premium not decoupled)	phased in* (increased by a part of reduced coupled premium)

* during the phasing out period

Any change in Community support to tobacco producers will first have to take into account the anticipated impact on areas and actors directly and indirectly involved, i.e. not only at production level, but also on marketing, processing, trade, rural development, public health, environment and monitoring.

5. IMPACT ANALYSIS

5.1. Market and income impact

5.1.1. *Impact on production and prices*

The impact of the different options on markets and prices must take fully into account certain relevant features particular to tobacco production, namely:

- the low average level of income due to the small size of farms and high costs,
- the **consequent high dependency for income on the coupled premiums** currently granted,
- the depressive effect of the premiums on **domestic price levels**, which are very low if compared to world trade prices

Option 1

As changes would be limited to an adaptation of the current CMO, including a reduction of premiums, the impact on production would also be limited. Indeed, as support would remain coupled, current production levels would still be necessary in order to maximise the premiums. Inefficient producers would therefore continue to produce tobacco. A small fall in production could only come from varieties for which the threshold would be abolished or reduced and this only if the producer could not convert to other varieties.

The consequence of this slight fall in production, combined with a cut in the premiums, would be to increase prices, in line with the current trend, as the current high level of premiums is known to have a depressive effect on domestic prices. The precise impact would very much depend on the level of cuts decided.

Compulsory implementation of the auction scheme for allocating quotas should have the effect of further improving quality and market efficiency.

Option 2

With decoupling, as the premium is no longer linked to the quantity produced but to a historical basis, producers will respond much more to markets signals and produce according to demand. This would imply the following changes:

- extensification for many producers and research of better quality varieties.
- farmers now producing at a loss in order to get the coupled premium would cease production.
- only quality varieties finding profitable outlets in the market would continue to be grown.

The result would be a sharp drop in production. The only regions where tobacco would continue to be grown on a significant scale would be in Greece, where varieties for which the market price covers the variable costs would predominate.

This qualitative and quantitative evolution of production should lead to an increase in domestic prices from their present relatively low levels.

Option 3

Under this option the phasing out of the premium, even over a long period (10 years), would result in a very sharp decline in production, even of better exportable qualities and taking into account the likely subsequent increase in domestic prices.

As for option 1, compulsory implementation of the auction scheme for allocating quotas should further improve quality and market efficiency.

5.1.2. *Impact on income*

The impact of the tobacco reform options was assessed by static simulations using FADN data. These simulations show the effects of a possible reduction in tobacco premiums, accompanied by a probable increase in tobacco prices.

The starting point for all simulations is the database of production costs, market receipts and premiums per hectare of tobacco, calculated for specialised holdings in five European regions. This database has already been used in the descriptive analysis. Based on this data, as well as on other information (for instance the average tobacco area and labour input) income from tobacco production is calculated for the current period, which is considered to be the baseline.

The income indicators¹² used in the analyses are Farm Family Income (FFI) and Farm Family income per Family Work Unit (FFI/FWU). FFI is defined as total market receipts plus premiums minus total inputs. The choice of this indicator is justified by the fact that, unlike Farm Net Value Added (which represents the remuneration of the farms whole labour force), it only refers to the earnings of the agricultural entrepreneur and his family, who are finally responsible for the production decisions on the holding.

Assuming that the cost structure remains unchanged over time, FFI and FFI/FWU for the reform options are calculated by applying the reduction in premiums envisaged by the option in question, as well as a likely price increase, to the baseline. The price increase is considered likely following the probable abandonment of some tobacco production after the cut in subsidies.

The impact of the different policy options on income from tobacco production is evaluated by comparing the income indicators of the simulations with the corresponding indicators in the baseline.

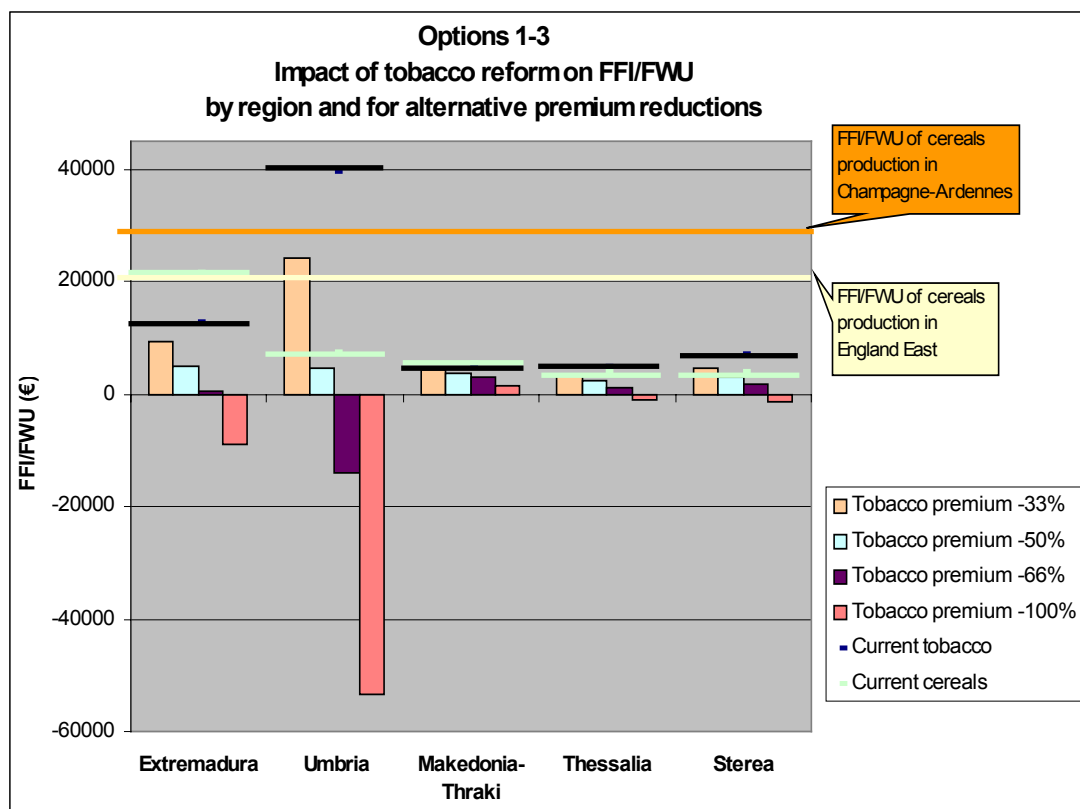
For all the analyses presented below it is assumed that if the coupled tobacco premium is at least one third lower than in the baseline, tobacco prices would increase by 100% in Italy and Spain and 25% in Greece. The huge gap between domestic producer prices for tobacco and prices paid by first processors for tobacco imported from outside the EU, also taking into account the different stages of processing, transport and insurance costs and differences in quality, shows that there is room for price increases of this magnitude.

5.1.2.1. Options 1 and 3

The impact of a reduction in the tobacco premium on the income of an average farm was simulated.

¹² Details in Annex 8.

The results show that already after a 50% reduction in the premium the average FFI/FWU from tobacco production, in all regions and particularly outside Greece, would be dramatically lower than at present, and lower than incomes from the production of cereals.



- Option 1: with a 33% reduction of the premium, generating corresponding financial resources to be transferred to a Tobacco Fund, the impact on incomes would be more variable. In the regions where the fall in income would be biggest (Umbria -39% and Sterea -33%) the profitability of tobacco nevertheless remains higher than for cereals. In particular in Umbria, where tobacco holdings are currently characterised by an extremely high level of revenue per work unit, incomes from tobacco production would be comparable to those for cereals specialists in Champagne-Ardennes and the East of England.
- Option 3: a total abolition of premia would have an even bigger impact on tobacco incomes, which would be negative in all regions except Makedonia-Thraki.

5.1.2.2. Option 2

Option 2 entails the gradual transformation of the current tobacco premium into a decoupled payment that would be integrated in the Single Farm Payment.

As the new payment is not crop-specific, the farmer is not obliged to continue producing tobacco, but can switch to another agricultural activity, or even completely cease production. If he converts to another crop or, more certainly, if he ceases production altogether, the farmer would have much lower production costs, especially as tobacco is a very input-intensive (and especially labour-intensive) crop.

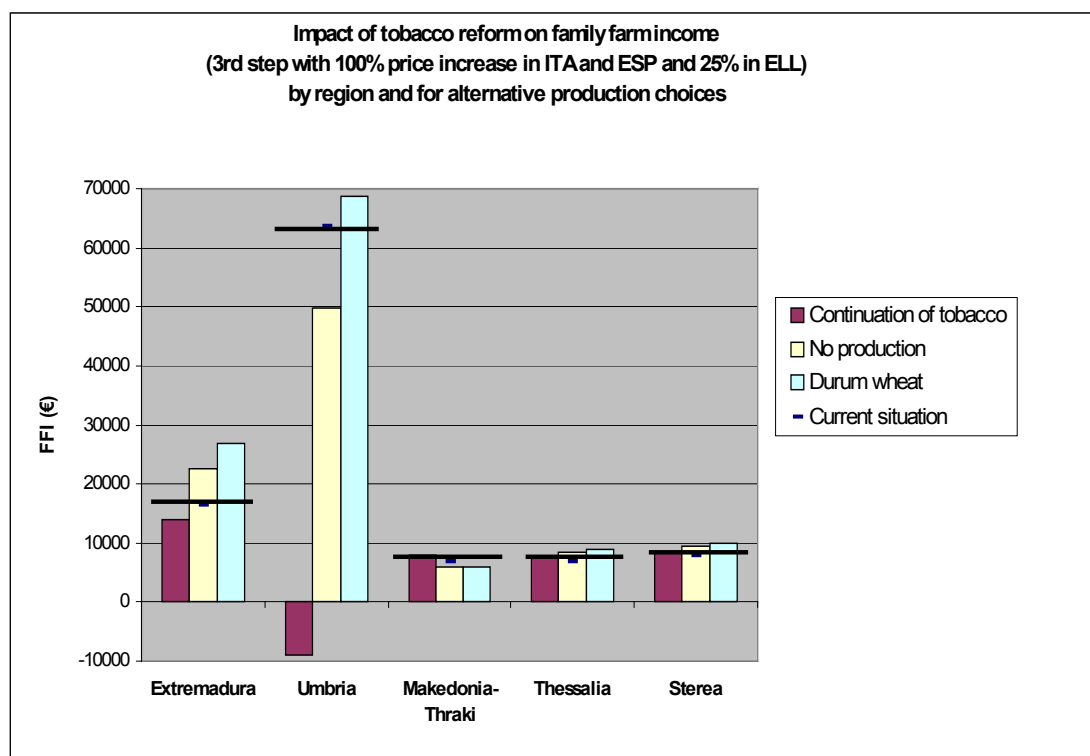
Under this option a differentiated treatment for tobacco farms is proposed, according to their size. When the system is fully implemented, the premium for the first 3,5 t of

tobacco will be maintained at the existing level, but in a decoupled form. For production between 3,5 and 10 t, 80% of the premium will be integrated in the Single Farm Payment, while the remaining 20% will be transferred to the Restructuring Envelope. On production exceeding 10 t, only 33% of the tobacco premium will be integrated in the Single Farm Payment to the producer, and 66% shifted to the Restructuring Envelope.

The impact of this policy option on the income of the average farm was simulated by comparing the average FFI under the current regime with the simulated FFI:

- if tobacco production is continued,
- if all agricultural activity ceases,
- if switching to an alternative crop, such as durum wheat. The FFI from durum wheat production was calculated for each region on the basis of average production costs, market receipts and premiums per hectare of durum wheat and on the area formerly used for tobacco.

The costs of conversion are not taken into account. If production is completely abandoned, only some minor cost items (land rental and interest repayments) and the decoupled premium are taken into account. Finally, production decisions are taken on the basis of the profitability of each alternative.



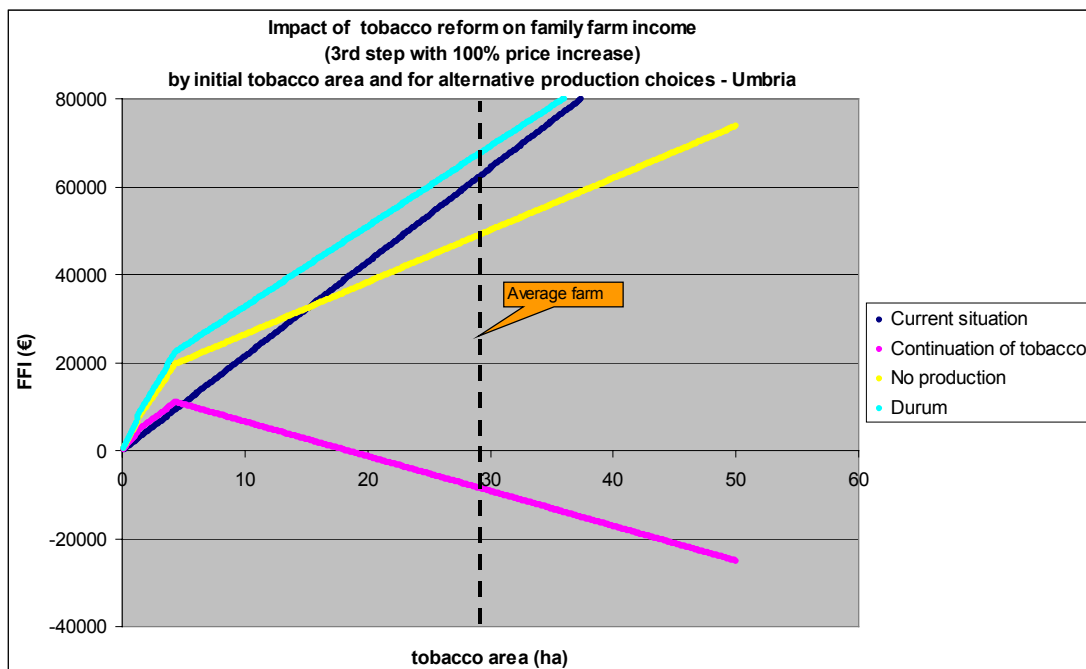
The results of the analysis show that, except for Greece, and in particular Makedonia-Thraki, FFI from tobacco production would drop, making the continued production of tobacco the least attractive choice for the farmer. Tobacco therefore would be largely abandoned as a crop.

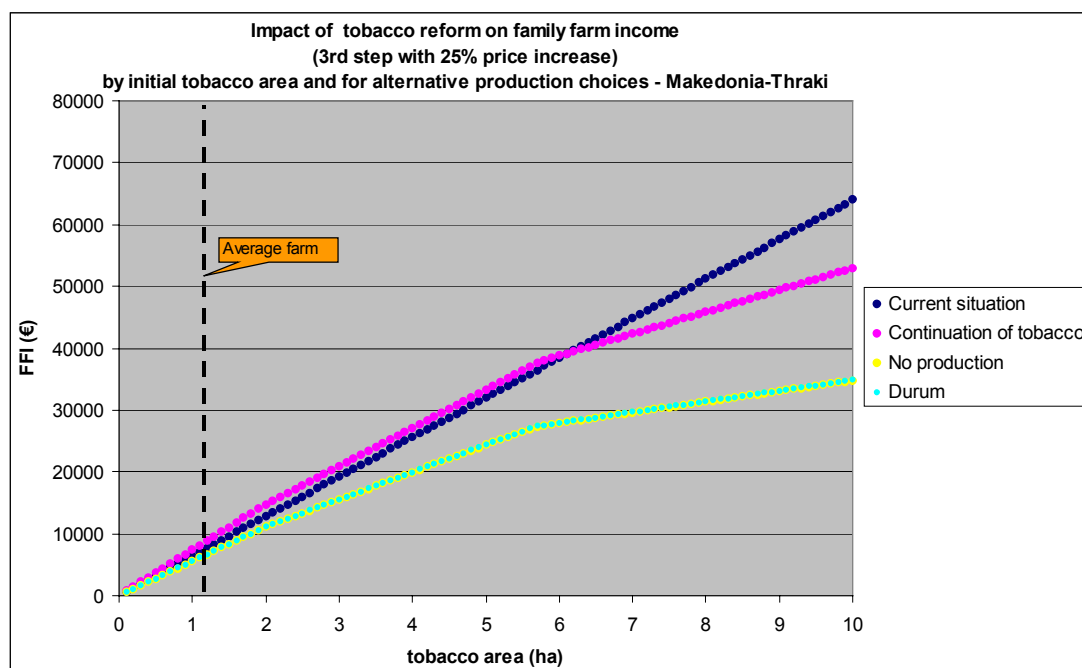
Looking at projected incomes for the most profitable production decision, it is clear that this reform option would guarantee farmers at least the same level of income as in the baseline. This is not surprising, as the aim of decoupling is to increase income transfer efficiency. The tobacco sector provides a good illustration of the positive effects of decoupling on agricultural incomes.

- In Umbria (Italy), a switch from tobacco to durum wheat would allow farmers to increase their income by 8%;
- in Greece, the income improvement generated by the best production option would vary between 15% and 28% but, given the low FFI of Greek tobacco farms, the difference would be just a few hundred €;
- only in Extremadura (Spain) would this option lead to a more substantial income improvement for producers switching to durum wheat.

This reform option therefore appears to be well balanced and, in particular, the fine-tuning of the three production bands and of the percentages to be shifted to the Envelope for Restructuring should ensure that any major increase in overall support is avoided.

Other simulations were carried out to study any possible differentiated impact on farm incomes depending on farm size (e.g. the available tobacco area). The results for Umbria and Makedonia-Thraki are presented in the graphs below, while similar graphs for the other three regions can be found in Annex 7.





A common characteristic of the development of FFI by tobacco area is that, compared to the baseline, the decoupling option allows small farmers to systematically improve their income. This is because, as the level of premium for the first 3,5 t of tobacco production is unchanged, the producer can either benefit from a higher tobacco price, or from lower production costs, if he prefers to cease production or switch to another crop.

As the farm size increases, and particularly when the tobacco area is more than that needed to produce 10 t, the 66% cut in the coupled premium leads to a sharp slowdown of income growth, so that from a certain threshold onwards, FFI in the reformed system is lower than the baseline, regardless of the production choice taken by the farmer.

In Umbria, continuing with tobacco appears to be the least profitable option and incomes fall, compared to the current situation, as soon as production exceeds 10 t. FFI even becomes negative for a tobacco area over 20 ha. Conversion to durum wheat seems to be the best option for producers, who could improve their income despite the reduction of payments, except if they have more than 40 ha of tobacco.

In Makedonia-Thraki the situation is completely different from Umbria. The farmer's best option is to continue producing tobacco, which allows a slight improvement of income, as long as the decoupled premium is paid fully or at 80%. As large farms are almost non-existent in this region, most farmers would benefit from the reform. Switching to durum wheat or ceasing production would not seem attractive alternatives for any size class of farm.

5.2. Impact on producing areas: social issues within EU-15 and developing countries, trade, environment

5.2.1. Social impact on EU-15 production areas

As shown by employment data directly or indirectly linked with tobacco cultivation, and clearly reiterated by local authorities during the Forum, any change in the

common market organisation will have to face up to the potential risks producing areas will be exposed to.

Tobacco production is typically highly labour intensive. It provides many jobs, not only for producers' families and employees, but also for workers in the processing industry.

In some regions, particularly in Greece, natural and structural constraints make tobacco cultivation and first processing the only options. This is why the majority of farms specialise in tobacco.

In Greece two regions, Kentriki and Anatoliki Makedonia, with a 60% share of the EU's tobacco holdings, represent 50% of all specialised tobacco farms but, due to the very small size of the farms, no more than 21% of the EU's tobacco area.

Besides tobacco cultivation, tobacco processing activities are also concentrated in these regions. Data provided by Prof. Mattas, of the University of Thessaloniki, show that about 85% of Greece's first processing industry for tobacco is located in this area. Jobs are provided for more than one third of the agricultural sector (which itself represents a high 35% of the total employment). In addition, these regions are among the poorest in the EU: for example, per capita GDP in Anatoliki Makedonia, a mountainous region, is about 57% of the EU average.

This situation is mirrored, but to a lesser extent, by farms in the Italian regions of Campania and Puglia.

Due to the very small size of many farms, even where an alternative crop might be possible, up to now none would provide as many jobs as tobacco production in all the regions concerned. A few limited possibilities exist to maintain the same levels of employment on the farm, for example, specific types of horticulture.

Under these circumstances, the impact of each option would be:

- **Option 1** – limited.
- **Option 2** – the decoupled payments would maintain the family labour but a large part of the non-family labour would not be retained.
Concerning employment in the first processing industry, some jobs could be lost temporarily while waiting for the positive effects of the Restructuring Envelope.
The combined effects of increased family income (see point 5.1.2) and successful implementation of the Restructuring Envelope would, in the medium term, improve cohesion.
- **Option 3** – would have the most radical impact on family, non-family and first processing employment

5.2.2. *Impact on trade and on developing countries*

At global level, the tobacco sector is characterised by an increasingly high level of production and consumption in developing countries. In 2000-2002, 81% of the world's production and 71% of the world's consumption of raw tobacco were concentrated in developing countries. The bulk of unmanufactured tobacco produced in developing countries remains within national boundaries to feed the growing consumption. Developed countries have a much higher share of trade, with four in

particular - Germany, the US, UK and the Netherlands - exporting half of all the cigarettes traded at world level.

As a significant net importer of raw tobacco and a major net exporter of cigarettes and other processed products, the EU plays an important role in world trade. While a good percentage of raw tobacco imports originate in developing countries, the European multinationals in the processed tobacco sector depend mainly on the United States for imports of high quality varieties (21% of all EU imports). Next in importance come Brazil (19,5%), Zimbabwe (15%), Malawi (8%), Turkey (5,5%), then a number of other countries with a roughly equal, small share of imports. Patterns in tobacco trade could be affected by changes in commitments, following China's entry into the WTO. China is the world's biggest producer of tobacco.

The current CMO for raw tobacco has been shaped by the abolition of price support measures, such as intervention and export refunds, while border protection has been maintained at a very low level, through the application of the common customs tariff. Current support mechanisms are based on production-linked premiums, together with quotas allocated by variety. In the notification of domestic support at the WTO, the current premium system is classified in the Amber box (that is, as a trade distortive measure) where it does not fall into the *price support* category but into the group of *Non-exempted direct payments* (see Annex 6).

Overall, the CMO **has not had the effect of depressing world prices**, as EU production has declined over the last decade faster than the fall recorded for world production. Equally, **enlargement should not produce major imbalances**, as tobacco production in Eastern Europe is declining faster than in the EU.

Leaving aside the status quo option, the **trade effects of options 2 and 3 are questionable**. In particular, it is uncertain to which extent decoupling will cause internal production to fall and so provoke an increase in raw tobacco imports to feed the needs of the EU processing industry. Some agents of the EU tobacco industry argue that abolishing premiums could induce a further and more decisive modernisation of EU production, strengthen integration in the tobacco chain, increase production of the best quality varieties, and, as a consequence, restrain the scope for further imports of these varieties.

According to International Labour Organisation (ILO) figures, **of the estimated 100 million people employed worldwide in all segments of the tobacco sector, 90% are in developing countries**. 1,2 million work in manufacturing, some 40 million in growing and leaf processing, 20 million in typical local industries (such as hand rolling in India and Indonesia) and the rest in tobacco-related processes and industries ranging from distribution, sales and promotion for tobacco use to those against tobacco consumption.

According to the ILO, while workers in tobacco manufacturing are among the best paid industrial employees in the world, tobacco farmers in developing and some transition countries are generally disorganised and unable to profit from the total value added generated by the industry. If the sector should be subject to a worldwide process of production limitation, counter-measures should be adopted to **avoid disruptive effects on employment and income capabilities**. Particularly vulnerable would be countries such as Malawi and Zimbabwe, where raw tobacco is a key product, with exports representing more than 70% of agricultural exports and a large share of total exports (66% and 45% respectively).

The consumption of tobacco has a serious impact on health in developing countries. It is estimated that 2,4 million people die each year in developing countries from tobacco-related diseases. Whereas tobacco consumption is slowly falling in many industrialised countries, smoking is increasing in many developing countries – especially among women and young people. Based on current trends, estimates have been made that the mortality figure in developing countries will have almost trebled by 2020.

The control of tobacco is gradually becoming an important health policy component in developing countries and is currently being promoted through an international commitment to agree on a **Framework Convention on Tobacco Control (FCTC)** under the auspices of the World Health Organization (WHO), already signed by the EU.

In this context, the European Commission has played an active role in showing how existing instruments of development cooperation can be used to address the control of tobacco in developing countries.

The main overall challenge is to resolve the internal contradiction between production-linked support for raw tobacco and the emphasis on tobacco control. This is also important vis-à-vis those developing countries where adaptation and diversification programmes for tobacco growers have already been implemented.

The EU stands to gain much in terms of credibility and coherence, and a further stimulus to cooperation and mutual trust with developing countries. From this point of view, the reform proposals under option 2 would have a very positive impact. Decoupling associated with renewed efforts to reconvert tobacco farms to alternative uses, and to enhance public health, would give the EU a solid standpoint in international talks and bilateral relations with developing countries.

5.2.3. *Impact on the environment*

The future revised tobacco CMO needs to fit into the current discussion of the CAP as well as into the general context of environmental policies, the Sustainable Development Strategy, the bio-diversity action plan, the 6th Community Environment Action Programme and the thematic strategies on soil and pesticides.

5.2.3.1. Tobacco farming and environment

The risks of environmental impact resulting from many agricultural products as tobacco production concern the leaching of nitrogen from fertilisers into ground- and surface water, strains on groundwater resources from irrigation. Particular risks are caused by unwanted side effects resulting from the usually high level of pesticide application. Tobacco cultivation requires such high pesticide levels in order to ensure a good leaf quality. The fact that tobacco is grown in monoculture also contributes to a high consumption of pesticides.

The leaching risk depends, among other factors, on the types of variety:

- "Virginia"-type tobacco is not very demanding on nitrogen. Nitrate problems in water are unlikely to occur;
- oriental tobacco varieties, largely cultivated in Greece, are produced with a more intensive use of nitrogen than Virginia.

Another factor influencing the presence and severity of environmental risk is the agri-climatic conditions of a certain area.

In addition to the risks resulting from the presence of tobacco, there are also risks due ceasing traditional tobacco cultivation, which is of particularly relevance in the mountain areas. In these environmentally fragile areas, land abandonment can contribute to the degradation of landscapes and soil erosion soils.

Finally, secondary effects may occur with respect to processing and transport specifically related to the cultivation of tobacco.

5.2.3.2. Key environmental questions and criteria

The impact of modifications of the tobacco regime on the environment will result from changes in the farmer's decision concerning tobacco production or land use in general. These decisions will affect the intensity of input use and the choice of alternative crops, which both can have positive or negative environmental consequences.

Therefore, the crucial environmental questions are:

- Which are the specific impacts on tobacco growing, processing, and transport resulting from the current system as compared to those resulting from a gradual phasing out or decoupling scenario? In this context, also the scope for re-conversion and the specific environmental effects of alternative crops matter.
- Are there different possibilities, in the different scenarios, that ensure the respect of environmental requirements through cross compliance?

In view of possible policy changes and related producer decisions concerning the cultivation of tobacco or alternative crops, the specific production intensity, as well as land abandonment, the following criteria would have to be considered:

- soil erosion (water and wind), soil organic matter, and soil compaction,
- ground and surface water quality (pollution with pesticide and nitrates),
- water resources,
- biodiversity and landscapes.

When discussing the effect of the different policy options, changes of the overall context, notably the 2003 CAP reform, have also to be taken into account. In this respect, cross-compliance implies, first, a better respect of existing environmental standards and, second, the requirement to keep land in "good agricultural and environmental condition".

Given the limited availability of studies specifically related to tobacco, only qualitative assessments can be developed. In this respect the context the following can be stated.

- **Option 1**, *adaptation of the present regime while keeping its main elements*, would change the current situation of environmental impact only to a very limited degree. Some effects might arise from reducing the relative profitability and from increasing the amounts spent on re-conversion. In order to identify whether such changes bring positive or negative net effects, it would be

necessary, however, to know what alternatives are developed and whether land abandonment becomes an issue. In any case, one can assume that cross-compliance will mitigate the potential for negative effects resulting from the presence of high production incentives. However, where land abandonment is an issue and where it involves whole farms, cross-compliance would not be applicable, given the lack of direct payments.

- **Option 2**, *full or stepwise decoupling of tobacco support and increasing efforts to reconvert production*, has the potential of yielding positive environmental effects. Whereas the special intensity of input use might remain unaffected on the more competitive farms, decoupling could encourage conversion to other types of land use. Then again, the question of positive or negative net effects depends on the alternatives eventually taken up. Negative effects due to land abandonment should normally not be an issue under this option, since with the continued granting of decoupled payments, the cross-compliance obligation of keeping land in "good agricultural and environmental condition" would apply, even where land is not used at all. The function of cross-compliance to better enforce existing statutory standards would apply here as with option 1. As regards secondary effects (transport and processing), the potential is reduced, alongside the reduction of production levels. Finally, the amounts available under the envelope for restructuring can be targeted towards agri-environmental measures, which is of particular relevance also for tobacco production since a number of problems (such as erosion, irrigation and pollution) can be resolved by using appropriate management techniques (e.g. integrated management practices).
- **Option 3**, *the phasing out of the tobacco regime accompanied by reinforced conversion efforts*, would bring tobacco production to the same level as would result eventually under option 2. In this respect the same reasoning applies as developed in the context of option 2. This concerns the policy implications for the special intensity, the switching alternative crops, and secondary effects. As under option 2, the Tobacco Fund can be used for agri-environmental measures. However, other than under option 2, cross-compliance would apply only where areas formerly used for tobacco production are farmed by farmers who own payment entitlements established under the single payment scheme. Similarly to option 1, particular problems arise with respect to land abandonment since, without direct payments, the application of cross-compliance, and specifically the rule to keep land in "good agricultural and environmental conditions", is not applicable.

Drawing conclusions from this brief qualitative assessment, it can be stated that option 2 would have the best score with respect to environmental objectives. This confirms what was spelled out already in the Explanatory Memorandum of the CAP Reform legal proposals, namely the beneficial environmental effects emerging from the decoupled single payment scheme in conjunction with the application of cross-compliance.

5.2.4. *Impact on public health and consumer interests*

As already stressed concerning the problem of coherence with development policy, the current tobacco policy is not consistent with the consumer and public health policies, which are among the priorities of the EU sustainable development strategy.

At the European Summit in Göteborg in June 2001 the Commission presented a communication on sustainable development, in which it proposed to "reorient support from the common agricultural policy to reward healthy, high-quality products and practices rather than quantity, adapt the tobacco regime at the end of its review in 2002 so as to allow for the phasing out of tobacco subsidies while putting in place measures to develop alternative sources of income and economic activity for tobacco workers and growers and decide on an early date accordingly."

5.2.4.1. Effects on health of tobacco smoking

According to the World Health Organization tobacco kills 500 000 Europeans each year, which means that it is the single most important cause of death. Smoking causes a substantially increased risk of mortality from lung cancer, upper airway and other cancers, heart disease, stroke, chronic respiratory disease and a range of other medical conditions. There are also health risks from passive smoking, and smoking during pregnancy adversely affects foetal development.

As a major public health risk, tobacco use must be treated very seriously, and every possibility engaged to reduce tobacco-related deaths. Even a 5% reduction would mean 25 000 fewer deaths annually. By way of comparison halving the number of people killed on the roads would save annually 20 000 deaths¹³.

In the EU tobacco smoking is the leading risk factor behind 12,3% of diseases for men and 5,7% for women. Corresponding figures for the whole European region are 17,1% for men and 6,2% for women¹⁴. However, now that women are smoking as much as men in many countries, health damage among women is on the increase.

Smoking is a significant cause of inequalities in health¹⁵ and is responsible for more than half the difference between adult male mortality in the highest and the lowest socio-economic groups. A reduction in the use of tobacco would therefore be an effective way of reducing health inequalities.

5.2.4.2. Impact of tobacco growing/farming on public health

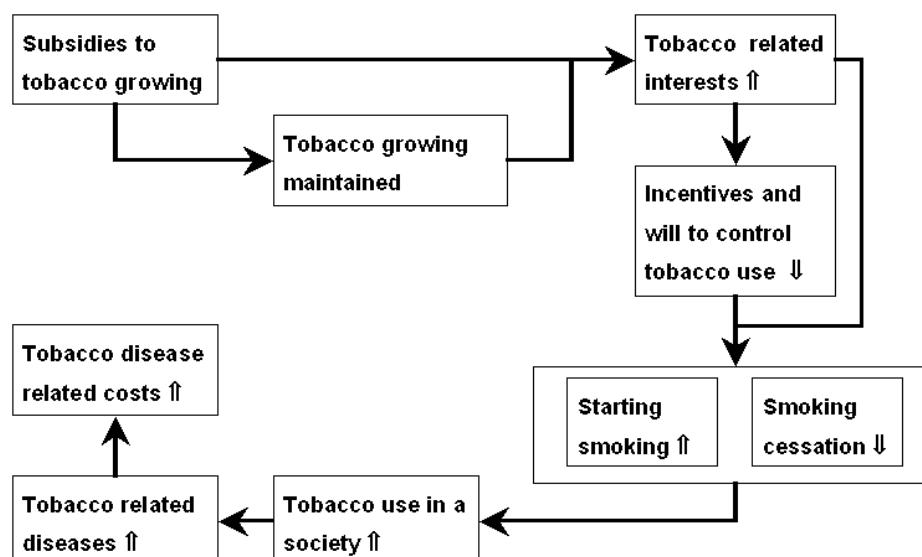
The health impact of tobacco subsidies is mediated through a complex sequence of intermediate steps. While there is strong evidence for each individual step, few studies have addressed the impact chain. The long delay between cause and effect in the implementation of tobacco control measures, the reduction of tobacco use and the improvement in health status further complicates studies.

¹³ European Commission: Press release IP/03/797, Brussels, 4 June 2003.

¹⁴ WHO. World Health Report 2002 Reducing Risks, Promoting Healthy Life. Geneva, Switzerland: World Health Organization, 2002.

¹⁵ Platt S, Amos A, Gnich W, Parry O. Smoking policies. In: Bakker M, editor. Reducing inequalities in health: A European Perspective. London, Great Britain: Routledge; 2002. p. 125-143.

Flow chart – Model used to analyse public health impact



Subsidies for growing tobacco contribute to promoting the use of tobacco and obstruct tobacco control measures. Policy makers become linked to tobacco related interests and a positive image of tobacco is endorsed.

In tobacco-producing countries, especially where it is an important crop, political and economic implications impact on the possibility of introducing effective tobacco control policies and measures.

The existence of tobacco subsidies undermines the credibility of tobacco control measures and hampers health efforts. Reference is frequently made in the media, European institutions and by non-governmental organisations to the incoherence of EU tobacco policies, which on the one hand support tobacco growing and on the other fight the use of tobacco.

Even if no quantified link has been established between cigarette consumption and the level of support for domestic tobacco production:

- the public health community and scientists widely consider that the abolition of tobacco subsidies is one of the means to combat smoking. A 5% decline in tobacco use would in the long run have a greater impact than most other public health measures;
- *option 1* clearly goes against the public health and consumer protection objectives of the EU;
- *options 2 and 3* could lead to a reduction in tobacco growing in the EU and would have some positive impact on tobacco control and public health.

5.3. Impact on sound and efficient management (budget, monitoring, simplification and controls)

5.3.1. Impact on budget

With € 973,4 mio spent in the 2001 budget year, EAGGF expenditure on raw tobacco represented 2,6% of total EAGGF expenditure under subheading 1a) and 2,3% of the EU's total agricultural budget expenditure. Raw tobacco production represents, in value, only 0,4% of the EU's final agricultural production.

In 2001, Greece was the producing Member State to benefit most from the tobacco CMO, with 38,6% of total expenditure, followed by Italy with 34,8%, Spain with 11,8%, France with 7,9% and the others (P, D, B, A) together totalling 5,8%. The expenditure position of Greece and Italy is inverted compared to production levels because the premium for the oriental varieties cultivated by Greece is higher than for the other groups cultivated in Italy.

At European Union budget level, all three options are based on the principle of budget neutrality.

The main difference between options 2 and 3 is in the rate and duration of the Tobacco Fund increase and the consequent shift between the two budget sub-headings.

The financial procedures necessary would be in line with those to be set up for the modulation scheme adopted under CAP reform.

5.3.2. *Impact on monitoring*

- **Option 1 adaptations** could result in a certain degree of simplification, however limited.

Cross compliance will in any case be enforced (as a result of the horizontal application to all direct payments agreed in the CAP reform).

In the long term, some problems could occur in implementing the system in the new Member States, when application of the simplified system comes to an end. All acceding countries obtained the possibility from the EU to pay tobacco support in a simplified manner (aid per ha) as from accession. Poland and Cyprus have already decided to opt for this system of payment.

- The **decoupled payment in option 2** could achieve a dramatic simplification of the regime, as it is intended to be incorporated into the Single Farm Payment. It will then be granted under conditions of cross compliance, as agreed in the CAP reform for other decoupled payments. The CMO regulation could be repealed and the remaining elements, mainly concerning trade rules, put in a specific horizontal regulation.

The Tobacco Fund under option 2 should be seen as a financial tool, and the amounts available to be used within the tobacco regions under existing rules in the framework of the Rural Development Plans. In other words, the principle of subsidiarity will be fully applied and there is no need to create additional procedures.

In addition, the decoupled payment would be, by far, the easiest system to implement in the new Member States when their simplified system comes to an end.

- **The phasing out envisaged by option 3** allows for no simplification prior to complete phasing out. The monitoring of the current complex system will then be necessary during the full phasing out period.

6. CONCLUSION

This assessment has considered the economic, social and environmental impact, whether positive or negative, the three reform options would be likely to have on the many different areas affected by tobacco production, as well as their consistency with stated Community policy objectives. The following conclusions can be drawn.

Options 1 and 3 would neither enable the CAP's new objectives to be met, nor solve the problems inherent in the current CMO.

Option 1 offers only modifications to the current CMO, which will not substantially improve the market situation or make the tobacco regime more consistent with other Community policies. In addition, many of the complexities of the existing regime would remain and be very difficult to apply in the acceding Member States after the transition period.

Option 3, by phasing out the current regime, risks seriously disrupting producers' incomes, employment and the rural fabric of the producing regions. Many of these are already fragile, with large sections of the population and the economy directly dependent on tobacco production. The restructuring envelope would help alleviate the negative impact of this option, but would be unlikely to prevent extensive problems remaining at the end of the phasing-out period.

Option 2, by decoupling support, should lead to an improvement in the market situation and would, when fully **implemented**, represent a simpler and more efficient method of supporting farm incomes, while avoiding the distortive external effects of the current coupled regime. The new Envelope for Restructuring would give impetus to conversion away from tobacco production and strengthen cohesion. The approach represented by this option is entirely consistent with the reformed CAP and its objectives. By offering decoupled, but focussed, support the new regime would help bring the CAP much more in line with other Union policies aimed at promoting public health, the environment and sustainable development.

Impact synthesis summary table

<i>OPTIONS:</i> IMPACTS ON:	Option 1 Status quo (current CMO adapted)	Option 2 Decoupling	Option 3 Premium Phased out
Production	Small decrease	Sharp decrease	Very sharp decrease
Producer prices	Increase (mainly due to premium cut)	Increase (mainly due to extensification)	Increase (mainly due to premium phased out)
Farmers' income	Slight or sharp decrease (depending on the premium cut)	Increased income transfer efficiency	Sharp decrease
Cohesion	No change	Reinforced	Sharp degradation
Economic structures	No change	Reinforced	Sharp degradation
Trade	No change	Limited increase of imports	Sharp increase of imports
Developing countries	EU policies incoherence	Increase coherence	Mixed impact
Public Health	EU policies incoherence	Increase coherence	Increase coherence
Environment	EU policies incoherence	Increase coherence	Increase coherence
Budget	Neutral	Neutral	Neutral (savings after 10 years)
Simplification	Small improvement	Achieved	No improvement
Controls	No change	Rationalisation	No change
Applicable in new MS	Difficult	Facilitated	Difficult

ANNEXES

- Annex 1: Interservice group mandate
- Annex 2: Commission DGs involved in the Inter-service steering group
- Annex 3: Stakeholders consulted
- Annex 4: Stakeholders' opinion and contributions
- Annex 5: Tobacco premium and threshold
- Annex 6: Economic nature of tobacco current support
- Annex 7: Graphs – Income impact in Greek and Spanish regions
- Annex 8: Income indicators
- Annex 9: Map

Annexe 1

MANDAT POUR LE GROUPE DE PILOTAGE INTERSERVICES TABAC

1. **Décision de la Commission d'établir un groupe de pilotage interservices tabac**

En arrêtant son programme de travail 2003¹⁶, la Commission a prévu pour juin 2003 une proposition de révision du régime applicable au tabac et a décidé que cette proposition ferait l'objet d'une étude d'impact approfondie sous la responsabilité de la DG AGRI, avec un groupe de pilotage interservices (GPI).

Cette décision se réfère à la communication sur l'analyse d'impact de juin 2002¹⁷, et notamment au passage suivant, qui établit le mandat du GPI.

Dans certains cas, la Commission peut décider que, pour les propositions qui ont un fort impact intersectoriel et sont de la plus haute importance politique, la direction générale responsable de l'analyse d'impact sera assistée par un groupe interservices, qu'en principe elle présidera et qui comprendra les directions générales les plus concernées et le Secrétariat général. La Commission fera en sorte que le concept de ces propositions tienne compte des aspects intersectoriels horizontaux, en particulier des incidences économiques, sociales et environnementales, le plus tôt possible dans le processus. Le groupe interservices aura pour tâche de définir la portée de l'analyse approfondie, d'en suivre l'avancement et de superviser la réalisation des rapports d'analyse d'impact pour les propositions transversales.

2. **Cadrement du dossier tabac**

Dans le cas du tabac, le fort impact intersectoriel et l'importance politique étaient déjà soulignés dans la communication de la Commission sur la stratégie de l'UE en faveur du développement durable¹⁸. Il prévoit l'action suivante qu'on trouve dans le paragraphe intitulé "Limiter les risques pour la santé publique" :

"A l'issue de l'évaluation du régime du tabac qui aura lieu en 2002, adapter ce régime de manière à permettre une élimination progressive des subventions tout en mettant en place des mesures destinées à développer de nouvelles sources de revenus et d'activité économique pour les producteurs et la main-d'œuvre, et arrêter en conséquence une date située dans un délai rapproché."

L'évaluation du régime tabac est en cours de finalisation. Elle est réalisée par un consultant externe, sous la responsabilité de la DG AGRI et avec l'aide d'un groupe de pilotage comprenant en outre les DG BUDG, COMP, ECFIN et SANCO.

3. **Étapes de travail du GPI tabac**

Les étapes de travail du GPI tabac devraient suivre le cheminement prévu dans la communication sur l'analyse d'impact:

¹⁶ COM(2002) 590 final du 30.10.2002.

¹⁷ COM(2002) 276 final du 5.6.2002.

¹⁸ COM(2002) 264 final du 15.5.2001.

3.1 Analyse des problèmes

La première question du processus d'analyse d'impact concerne l'identification et l'analyse du ou des problèmes dans un ou plusieurs domaines. Le ou les problèmes seront décrits en termes économiques, sociaux et environnementaux.

Dans le cas du tabac, deux documents contribueront à fournir la base d'informations pour l'analyse des problèmes par les services de la Commission :

- *le rapport d'évaluation;*
- *le rapport au Parlement européen et au Conseil sur le fonctionnement de l'organisation commune du marché dans le secteur du tabac brut¹⁹.*

3.2 Identifier les objectifs

Sur la base de l'analyse des problèmes, les objectifs d'action seront exprimés en termes de résultats escomptés dans un délai donné.

Dans le cas du tabac, la communication sur la stratégie de développement durable, citée plus haut, va déjà loin dans la fixation des objectifs pour la révision de l'OCM. Celle-ci devra tenir compte également des objectifs impartis à la PAC.

3.3 Identifier les moyens d'action possibles et les instruments de substitution

Il convient de toujours envisager les moyens ou instruments de substitution pour réaliser le ou les objectifs d'action dès les premiers stades de la formulation des propositions. Les principes de subsidiarité et de proportionnalité doivent également être pris en compte et étudiés à travers le processus d'analyse d'impact. Le scénario "politique inchangée" doit toujours figurer dans l'analyse comme point de référence dans la comparaison avec les autres possibilités.

Les options de politiques concernant le tabac seront établies en tenant compte de la communication sur la stratégie de développement durable et de l'approche générale retenue pour la révision à mi-parcours de la PAC.

3.4 Analyse de l'impact

Pour la possibilité d'action choisie et, si possible, pour les alternatives retenues, il y a lieu d'examiner toutes les incidences positives et négatives correspondantes et d'en faire état dans l'analyse d'impact, en insistant sur leurs dimensions environnementales, économiques et sociales. Ce processus comporte deux phases: les incidences concernées sont d'abord identifiées ("*screening*") et évaluées ensuite en termes qualitatifs, quantitatifs et/ou monétaires ("*scoping*").

Les Directions générales participant au GPI seront invitées à examiner les incidences des différentes options pour le tabac dans leur domaine de compétence.

3.5 Mise en oeuvre, suivi et évaluation *ex post*

L'analyse d'impact doit identifier toutes les difficultés éventuelles dans la mise en oeuvre des possibilités d'action évaluées et décrire comment elles seront prises en compte, par exemple dans le choix des périodes de mise en oeuvre ou par l'application progressive de la mesure. Les évaluations continues ou *ex post*

¹⁹ SEC(2002) 1183 du 6.11.2002.

ultérieures respecteront les modalités définies dans la communication relative à l'évaluation, à savoir une évaluation globale *ex post* ou intermédiaire d'une périodicité n'excédant pas six ans, en fonction de la nature de chaque activité.

4. Echéances et rapports

Problèmes posés et identification des options	fin janvier
Identification des impacts	fin février
Evaluation des impacts	mi-avril
Rapport final	fin mai

Annex 2

COMMISSION DGs INVOLVED IN THE INTERSERVICE STEERING GROUP

SG

DG AGRI

DG ECFIN

DG TRADE

DG ENV

DG DEV

DG COMP

DG SANCO

DG ELARG

DG BUDG

DG ENTR

DG EMPL

DG REGIO

OLAF

Annex 3

LIST OF PARTICIPANTS' IN THE TOBACCO STANDING COMMITTEE AND IN THE TOBACCO FORUM (04/06/2003)

Tobacco Standing Committee

Organisation	Name	Function	Sector
CEJA	Mr CHRAS Diamadis	P	AGRICULTURE
COGECA	Mr PFANGER Hermann	T	AGRICULTURE
COPA	Mr ABRUNHOSA Antonio	T	AGRICULTURE
COPA	Mr HERNANDEZ ROLDAN Juan	T	AGRICULTURE
COPA	Mr TRIVELLIZZI Walter	T	AGRICULTURE
COPA	Mr VEDEL François	T	AGRICULTURE
CELCAA	Mr BEUTHNER Ekkard	T	TRADE
CELCAA	Mr FERAT Michel	T	TRADE
CELCAA	Mr JACKSON Dennis	T	TRADE
CELCAA	Mr LIMNEOS Ioannis	T	TRADE
BEUC	Mr JOOSSENS Luc	T	CONSUMERS
COGECA	Mr FANZO Ciro	T	COOPERATIVES
COPA	Mr LIOLIOS Nikos	T	COOPERATIVES
COPA	Mr MANZANERO INIESTO Juan Jose	T	COOPERATIVES
COPA	Mr WULLEPIT Oscar	T	COOPERATIVES
CIAA	Mr DE VROEY Francis	T	INDUSTRY
CIAA	Mr OBERRECHT Wolfgang	T	INDUSTRY
CIAA	Mr PAULING Reinhard	FT	INDUSTRY
CIAA	Mme PEDERRIVA Antonella	FT	INDUSTRY
CIAA	Mr SANCHEZ HORNEROS GARCIA Tomas	T	INDUSTRY
CIAA	Mr VIDAL Maurice	T	INDUSTRY
EFFAT	Mr SCHORMANN Dieter	O	WORKERS
EFFAT- OBSERVATEURS	Mr DREUX Daniel	O	WORKERS
EFFAT- OBSERVATEURS	Mr OROSMANDO Francesco	O	WORKERS

P: Chairman

T and FT: expert

O: observer

Tobacco Forum (04/06/2003)

Public health:

1. Dr. Erkki Vartiainen
National Public Health Institute Department of Epidemiology- Finland
2. Mrs. Trudy Prins
STIVORO - Netherlands
3. Prof. Manuel Pais Clemente
Conselho Prevenção do Tabagismo - Portugal
4. Clive Needle
ENHPA netw - UK

Manufacturing:

5. ALTADIS
Mr Georges Podeur
6. EUROPEAN SMOKING TOBACCO ASSOCIATION – ESTA
Mr van den Driest

Consumers:

7. Luk Joossens
BUREAU EUROPEEN DES UNIONS DE CONSOMMATEURS – BEUC
Mr Thomas Gerard - France

Environment:

8. Birdlife international
Birdlife European Regional Office - Netherlands
9. Chatziparadeisis Christos
Teacher of Mechanology in high school – Greece
President of the committee for the protection of the environment of the region of Langada
10. Mauro Albrizio
European Affairs Director
Legambiente - European Policy Office

Local authorities:

11. Mr. Tsoutsos Ioannis
Mayor of Potamia Larissas - Greece
12. Sr. José Moreno Gomez
Alcalde de TALAYUELA - Spain
13. Fernanda Cecchini
SINDACO DI CITTA' DI CASTELLO - Italy

Development:

14. SOLAGRAL
Mrs. Hermelin

Producers:

15. UNITAB – France
François Vedel and Rémy Losser

Annex 4

STAKEHOLDERS OPINION

The services of the DG AGRI have met the stakeholders of civil society to take into account the largest possible opinion of European citizens. The contribution to analyse the impact of different options of the reform has been very rich and interesting.

1. Tobacco Standing group – 13 March 2003

The members have received a document giving the basic options for the future.

On that base, the representatives of the tobacco producers and tobacco co-operatives condemned the erroneous strategy followed by the Commission in its negotiations with the WTO. They categorically rejected the third option of gradually phasing out the subsidies. This option which had already been officially discarded both by the Council of Agriculture Ministers and the European Parliament. They considered that the second option (support decoupling from production) would have disastrous effects and would engender severe social problems in the tobacco growing regions. They asked the maintenance of the current system in the long term, possibly with the necessary settlements, to ensure that the tobacco producers could remain on the land and continue to work without anxiety in a stable framework while continuing their endeavours to improve quality. The existing regime had worked satisfactorily and had presented the fewest problems by comparison with the regimes that has been applied to other crops. Nobody had presented the viable alternatives to tobacco production which were acceptable to the tobacco producers. The other options are only artifices oriented to the radical cutback or even the abolition of tobacco subsidies. If the Commission formally accepted them there would be reactions and social upheavals.

The representative of the tobacco trade said that the options which involved eliminating of the Community regime are not in line with the agreements which had been made with the acceding countries. He asked for maintenance of the current system so that the tobacco industries could continue to operate.

The consumers' representative has not expressed a favourable opinion for a specific option but he has criticised the too high level of the Community support for the tobacco sector. Furthermore, he has pointed out that production quotas of the groups of varieties III and V should be transferred towards the other groups of varieties much more demanded by the market.

2. Tobacco Forum held on 4 June 2003 (list in Annex 3)

The participant stakeholders have received a document giving the basic options for the future, a document concerning a presentation of the farm structure of the sector and another document on the tobacco CMO functioning.

Mayors - On that base the three mayor representing the main areas of tobacco production in Italy, Greece and Spain have stressed that the first option would guarantee the maintenance of the current employment and the conservation of the landscape and avoid land desertification. The second option would lead to the abandonment of the production without profitable alternatives and consequently create big problems of unemployment. The Spanish mayor of Talayuela has said too

that the few remaining production would be of very low quality with a great danger for consumer health. The third option would have disrupting consequences on the employment and the EU tobacco would be replaced by imported production. The Italian mayor, has added that the level of income would decrease in the whole local area of production. A negative impact there will be too on the small mechanics industry linked to the tobacco sector. The Greek mayor of Potamia Larissas has confirmed the great risk of unemployment for the whole local community if the second or the third options were adopted.

The health experts explained the negative impacts of tobacco consumption on the citizen health. According to them tobacco is responsible of 500 000 deaths each year in Europe and of 10% of all diseases. They presented several health-related arguments, including that smoking is a get-away to drugs. They also underlined the incoherence of support to tobacco sector while the European policy on tobacco discourages use of tobacco and the advertising. The three experts agreed on the necessity to abolish tobacco support to production, and emphasised the need to look into the future of and enhancing competitiveness of the tobacco producing areas, the impact of the enlargement. One expert expressed his preference for the third option.

The consumer representative has observed that current support will not be sustainable at the moment of Bulgaria's and Turkey's accession in the EU. Alternative solutions will have to be found to help the economies of the production regions. The problem is political and DG AGRI will not be able to solve it alone.

The environment representative has observed the excess of support to the tobacco sector of which indirectly the tobacco multinationals are the beneficiaries. In fact this is the only case in the agricultural sector where the production prices are lower than the import prices. Economic alternative solutions must be found together with producers and the local communities throughout the reconversion way. He has stressed the problems caused by tobacco production in the water pollution. Furthermore, he has remembered to the participants the necessity to allow the exports of tobacco towards the EU by the less developed countries because, which, in several cases, is their only economic resource. Under these conditions the only viable option is the second. Another representative has remembered the high risk of desertification in the case of abandonment of tobacco production in the marginal areas. He thought that the option 1 is the better way to conserve an equilibrated environmental condition.

The tobacco manufacture industry representative explained that European tobacco production activity until now has supplied a product with low residues of pesticides and a very strict control on their use in the opposite of the tobacco imported. She has informed the participants that the USA, Japan and Switzerland give subventions to their tobacco production and European production would not exist without support because India and China are very competitive and already produce a comparable quality of tobacco.

The workers representative has observed that there exists a high risk of impact on the first processing industry and the employment with the second option. It is clear that tobacco is a legal product, better controlled in Europe than in the third countries and consequently the European production must not be criminalised. An equity solution is needed for everyone, producers, processors, workers and citizens.

The development representative has underlined the essential importance of tobacco export, produced by the less developed countries. In some cases it is the only goods that these countries are able to export because other productions are directly consumed inside for survival.

The producers representatives for UNITAB, have remembered the importance of the tobacco CMO either in terms of economy and of employment for European producers. Tobacco is a production with the highest level of labour force employed in agriculture. They have remembered, like the Spanish Mayor, the unacceptable moral critics concerning tobacco when all Member States draw € 63 billions from taxes applied on tobacco consumption. However, they are well aware of the public health problems. In any case, also without European tobacco production there will be tobacco consumption based on imports. They have stressed that it is very easy to say the tobacco producers must be creative but in reality the profitable alternatives to tobacco production do not exist. The tobacco producers are traumatised by the current situation. For the future there will be a need to ensure stability of income and to allow to producers to stay on the land. They asked before in order to take any decision of tobacco reform, it will be indispensable to have very serious studies of impact. Finally they informed the public that tobacco is a production less pollutant than others. In fact the fertiliser by nitrogen is of 200 kg per ha for maize production while for tobacco is only of 50 kg per ha. They think it would be better to stimulate production of food crops in the third countries than tobacco.

3. Tobacco bilateral meetings and written contributions

In addition, and on their request, DG AGRI services met stakeholders' representatives of producers and industry.

Written contributions were sent by several other stakeholders, including consumers' representatives, and were fully taken into account.

Annex 5

PREMIUM AMOUNTS AND GUARANTEED THRESHOLDS

1-

PREMIUMS FOR LEAF TOBACCO FOR THE 2002, 2003 AND 2004 HARVESTS								
	I	II	III	IV	V	VI	VII	VIII
	Flue-cured	Light air-cured	Dark air-cured	Fire-cured	Sun-cured	Basmas	Katerini	Kaba Houlak
EUR/Kg	2.98062	2.38423	2.38423	2.62199	2.14581	4.12957	3.50395	2.50377

2-

SUPPLEMENTARY AMOUNTS	
Varieties	EUR/kg
Badischer Geudertheimer, Pereg, Korso	0,5509
Badischer Burley E and its hybrids	0,8822
Virgin D and its hybrids, Virginia and its hybrids	0,5039
Paraguay and its hybrids, Dragon vert and its hybrids, Philippin, Petit Grammont (Flobecq), Semois, Appelterre	0,4112

3-

(t)

GUARANTEE THRESHOLDS FOR 2003 AND 2004									
	I	II	III	IV	V	Autres			Total
	Flue-cured	Light air-cured	Dark air-cured	Fire-cured	Sun-cured	VI Basmas	VII Katerini	VIII Kaba Koulak	
Italy	48 263	47 689	15 682	6 255	8 833		498		127 220
Greece	35 242	11 842			6 938	27 114	24 014	16 696	121 846
Spain	29 028	5 545	6 388	30					40 991
Portugal	4 906	1 028							5 934
France	10 490	9 262	5 170						24 922
Germany	4 728	2 588	3 731						11 047
Belgium		149	1 404						1 553
Austria	29	426	96						551
	132 686	78 529	32 471	6 285	15 771	27 114	24 512	16 696	334 064

4- Breakdown of EU tobacco production and labour force

Ranges (tons of tobacco)	Tobacco quantities** (tons)	Ranges tobacco (ha)	Number of holdings with tobacco*	UAA Total of tobacco holdings* (ha)	UAA per holding* (ha)	Total tobacco (ha)*	% Family labour force / total (AWU)	Total family labour force in AWU*	Total non- family labour force in AWU*	Total labour force in AWU*
<i>0 – 3,5</i>	106.373	0 - 1.31	55.190	351.220	6	39.790	91	65.300	6.090	71.390
<i>3,5 - 10</i>	105.518	1.31 - 3.74	20.000	243.840	12	39.470	78	29.790	8.510	38.300
<i>10 – 20</i>	37.213	3.74 - 7.48	2.740	68.100	25	13.920	54	3.760	3.150	6.910
<i>20 – 40</i>	25.638	7.48 - 14.96	950	46.730	49	9.590	36	1.220	2.130	3.350
<i>40 – 60</i>	13.581	14.96 - 22.44	290	21.020	72	5.080	22	350	1.240	1.590
<i>60 – 100</i>	13.902	22.44 - 37.41	180	28.000	156	5.200	13	210	1.410	1.620
<i>100 – 200</i>	15.826	37.41 - 74.81	120	24.680	206	5.920	9	160	1.620	1.780
<i>+ 200</i>	17.377	> 74.81	50	14.340	287	6.500	5	60	1.200	1.260
<i>> 10 ton</i>	123.537	>3.74	4.330	202.870	47	46.210	35	5.760	10.750	16.510
Total	335.428		79.520	797.930	10	125.470	80	100.850	25.350	126.200

Annex 6

ECONOMIC NATURE OF THE TOBACCO CURRENT SUPPORT

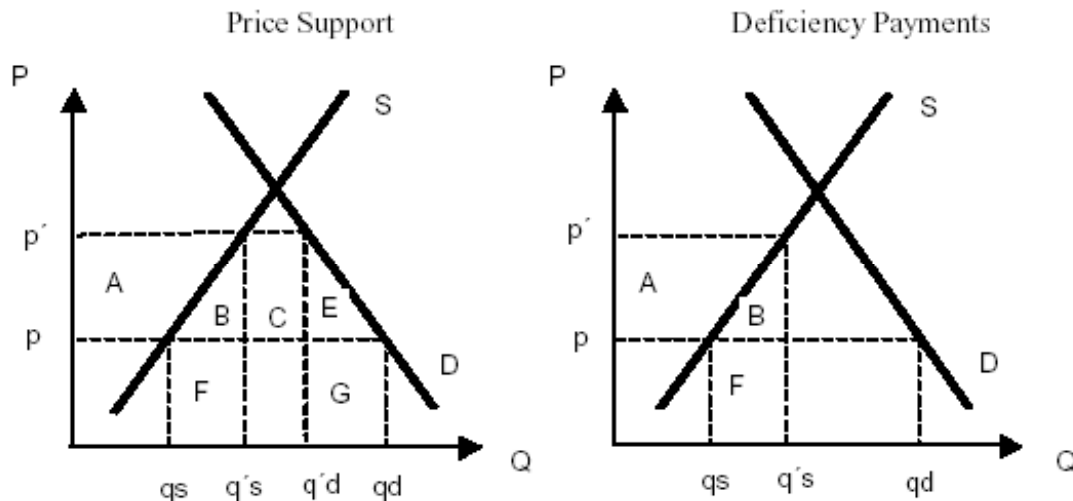
Deficiency payments and price support are two different policy tools with different economic impact.

The effects are analysed for the case of an agricultural products in a large net-importing country, that is for a situation which is similar to the one realised for tobacco on the EU market.

The premium paid for tobacco is classified, in the notification of domestic support at the WTO, within the Amber box (that is, as a trade distortive measure) where it does not fall into the *price support* category, but in the group of the *Non-exempted direct payments*.

The reason of this is simple. The support for tobacco is not implemented through a mechanism of guaranteed *market* prices, but with a system of guaranteed prices (up to a given quantity of production) paid to *producers' organisations* by the EU budget. In other words, the support policy applied to tobacco belongs to the family of the "deficiency payments".

The different characteristics of both instruments are shown in the following graph. Both diagrams show supply and demand in a simple price/quantity framework. The initial point of departure is the price p , which gives the supply q_s and the demand q_d . The distance between the two is the level of imports needed.



- Let us first consider the price support solution. The government sets the institutional price p' and that increases production to $q's$ and decreases demand to $q'd$. Another effect is a decrease in imports to the amount $q'sq'd$. In order to control this internal price independently of influence from the equilibrium price (world price), a system of trade barriers must also be implemented.
- In the case of deficiency payments, on the other hand, the government sets a target price p' at the level they want the farmer to receive for his products. This target price increases production to $q's$. The equilibrium price p , is still the market price, and consumers still buy q_d . In this case there is a decrease in imports to the amount $q'sq_d$.

The following table summarises the welfare economic effects of the two instruments:

	Price Support	Deficiency Payments
Producer Gain	A	A
Consumer Loss	A + B + C + E	
Taxpayer Gain	C	
Taxpayer Loss		A + B
Net Loss	B + E	B

In both cases the producers gain the same amount, the area A. In the situation with price support this gain is financed by the consumers, since they pay a higher price than the equilibrium price. The consumer loss is the area A+B+C+E. Because of the import levy, the government gains C. The net loss, or the welfare economic loss, of implementing a price support policy is B+E.

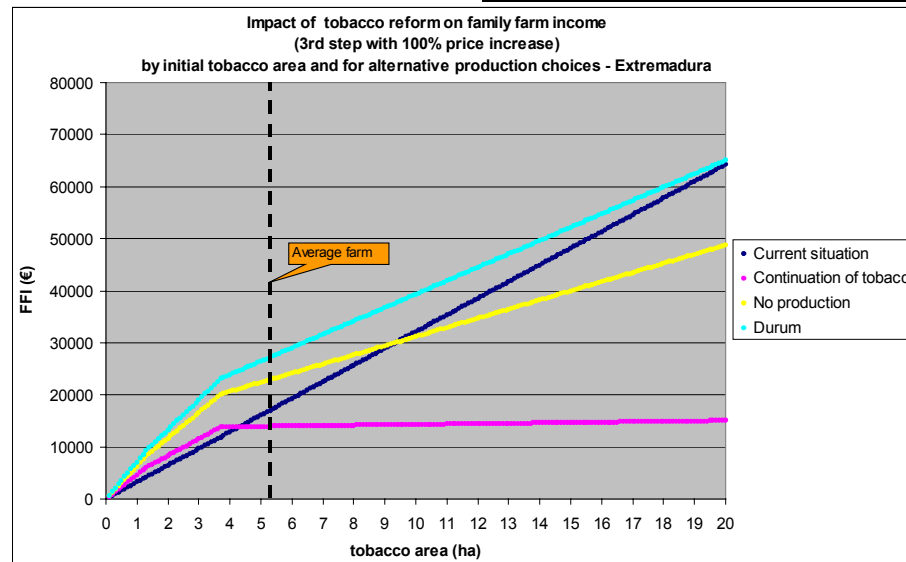
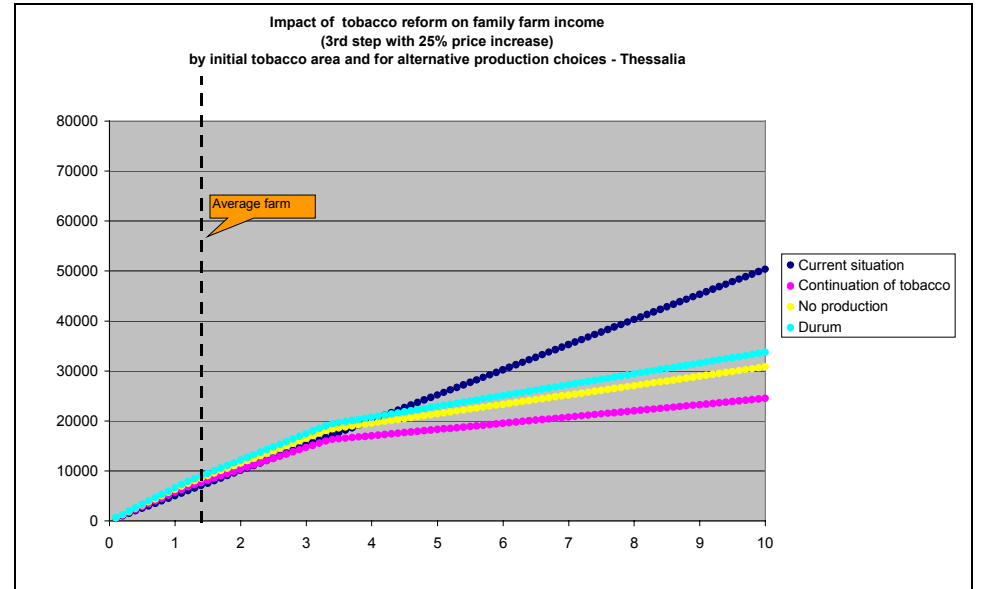
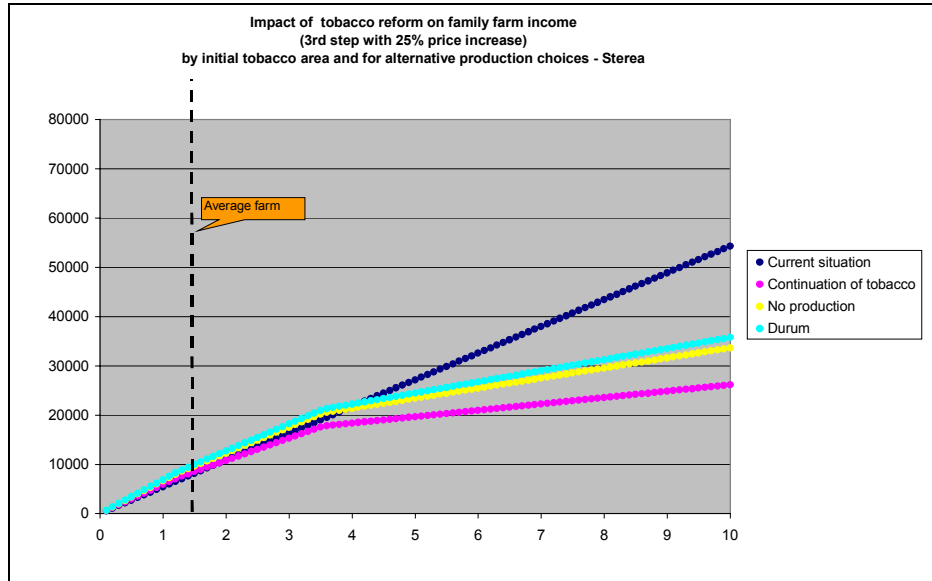
In the deficiency payments case the producers' gain is paid by the taxpayers, because the difference between the target price and the equilibrium price is transferred directly to the farmers from the fiscal budget. The taxpayers' loss is A+B. The welfare economic effect of implementing deficiency payments is B.

The graph does not show the effects of the internal policy on the world market, but because of the size of our country, the increase in production pushes the world market price down. In the first case this means that consumers have to pay a larger amount in price support; in the case of deficiency payments it actually means that consumers benefit from lower prices, but it also means that the amount directly transferred from the state to the farmer increases.

In synthesis both instruments transfer money to agriculture and increase production. The main differences, which also reflect on the welfare effects of the two instruments, are the control of the market price in the price support regime and the type of financing.

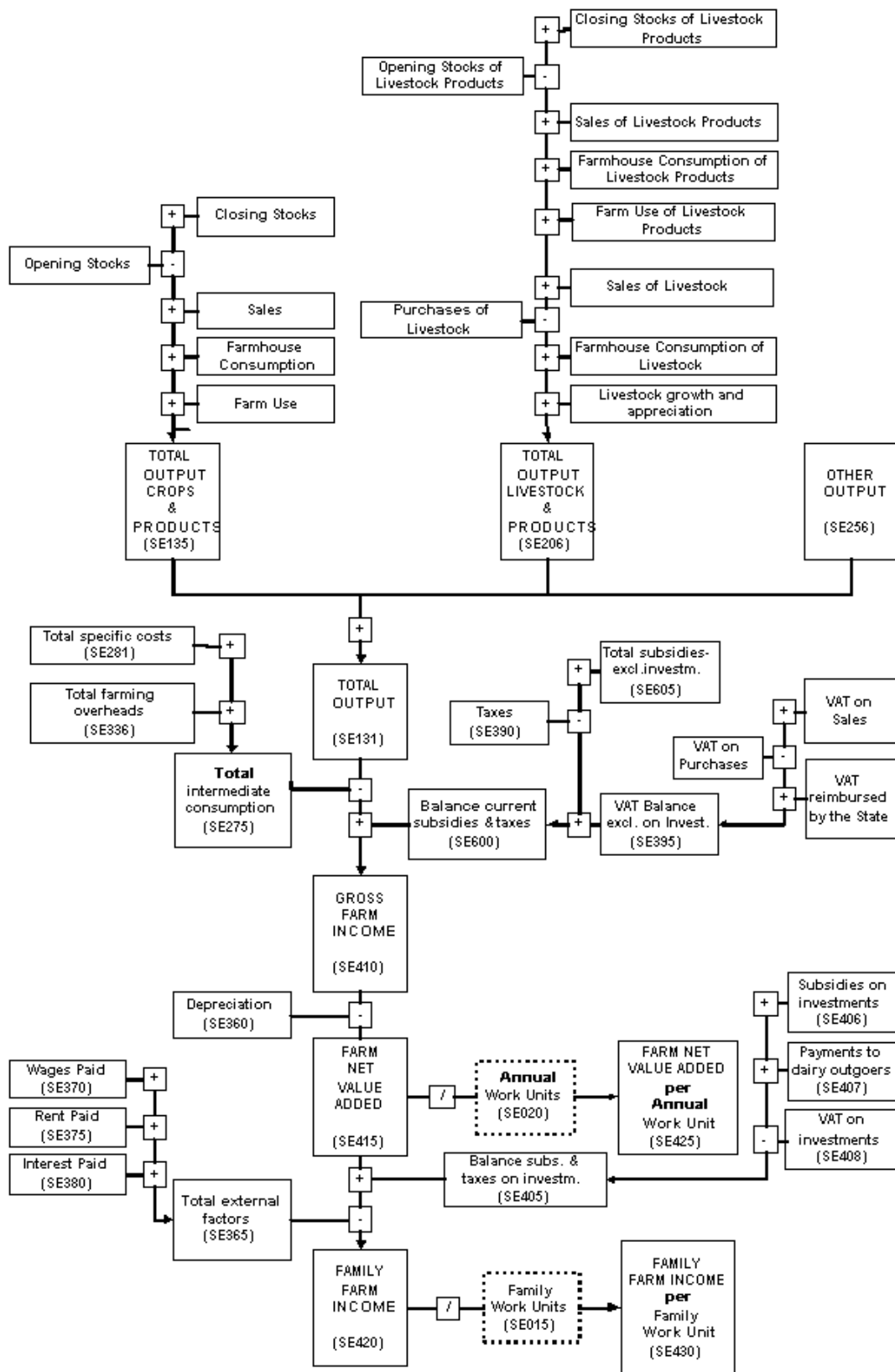
Annex 7

IMPACT ON INCOME



Annex 8

INCOME INDICATORS



Annex 9

