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Paper prepared for presentation at the I Mediterranean Conference of Agro-Food Social Scientists. 103<sup>rd</sup> EAAE Seminar 'Adding Value to the Agro-Food Supply Chain in the Future Euromediterranean Space'. Barcelona, Spain, April 23<sup>rd</sup> - 25<sup>th</sup>, 2007

## **THE REFORM OF THE CMO IN FRUITS AND VEGETABLES: A HOLISTIC APPROACH**

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### **Abstract**

The main characteristics of EU's market in fruits and vegetables are trend towards overproduction, price fluctuations, and relatively low protection and public support. The key instruments of the CMO are processing aids and support to Operational Funds. The current regulation has been more successful in encouraging improvements in quality and marketing than in stabilising prices and guaranteeing adequate income levels, mainly in fruits and in the great southern countries. The lack of common European action in the fields of import control and access to new foreign markets creates more pressure in the common market.

The proposal of CMO's reform comes after the great CAP's change of 2003 -and its new paradigm- and the budget agricultural agreement until 2013. In practice, this reduces the real policy options for the new regulation. Main changes should occur in processing aids, where forces to decouple are strong; given that exports refunds are already phasing out and markets withdrawals are in decline. The main political defy is how to promote horizontal concentration through PO and to avoid the price crisis. To solve the issue of stability (or decline) of the human consumption, more can be done from the policy. The farmer's influence in political decision seems weak. The scope for radical changes in fund distribution will be possible at national level.

# **THE REFORM OF THE CMO IN FRUITS AND VEGETABLES: A HOLISTIC APPROACH**

## **1.- INTRODUCTION**

There is not a complete and definitive theory about the policy reform yet. In the field of the agricultural policies, several theories have been used to explain the political economy of changes but the results light only some aspects on it. The core of the traditional analysis is based on neo-classical and public choice theories. Consequently, the main topics in this literature are the effects of different instruments over the efficiency (Buckwell et al., 1982) and the role played by agricultural lobbies in the special EU decision making-process (Senior Mello, 1984; Rieger, 1996). The most recent analysis focus on institutions and the mechanisms of institutional change. Although a theory of institutional change in the field of new institutional economics doesn't exist (Compés, 2003), the great CAP reform of 2003 can be best understood using the main arguments of New Institutional Economics (NIE), as path dependence, adaptative efficiency and compensation (Compés, 2004). The power of farms lobbies seems to be smaller than before (Tracy, 1997), although it still must be taken into account, and the EU decision-making continues creating strong rigidities in the nature, ambition and scope of changes. Then, a holistic approach is needed.

The Common Market Organisation (CMO) in fruits and vegetables has been traditionally different from the main CAP's CMO. Its instruments have been specific (with a relative pro-market orientation) and their reforms have occurred in different times. The results are a great competition in the European market of fruits and vegetables and a stability of CAP payments towards this sector. The Commission has

announced a reform of the current 1996's CMO. During 2005 several documents of analysis and proposals have been released and even the European Parliament has discussed the problems and alternatives. The fresh sector is closer to the market than ever, their main issues come from market failures and some of them are outside of the CMO contents.

The reform is not going to happen in an empty institutional framework. There is a path defined by the CAP reformed in 2003, by the EU position in –at the moment suspended- Doha Round and by the stand by in the process of European political integration. Using the theories referred before, the main prediction is that the demands of farmers trying to maintain or, improve, the *status quo* will have relatively little influence on the key topics, that the main changes will be consistent with the past and current path and that the changes will let countries in a relatively similar budget position ex-post. This means that the next reform will be more effective on the efficiency improvement than on the redistributive, being the countries the responsible of making changes in this field. Even if the final decision is not taken, the paper tries to explore the plausibility of these arguments given the known information.

Besides, this paper seeks to explain why the next reform should pay attention to the most important market failures and why, if it doesn't, the European institutions will show the unimportance of this CMO and some of their institutional failures.

The paper is organized as follows. Section Two describes the main facts of the fruit and vegetable sector in EU. Section Three explains the current regulation and Section Four discusses the possible scenarios for the future reform. Finally, Section Five concludes.

## **2.- EU FRUIT AND VEGETABLE SECTOR**

The fruit and vegetable (F&V) sector is one of the key sectors in EU agriculture, accounting for 17% of EU final agricultural production (European Commission, 2006a). In some countries, notably Greece, Spain, Portugal, Malta, Italy and Belgium this share is even higher than the EU average, with Italy and Spain being the main F&V producers. The main products are apples, citrus and tomatoes. However, all countries in the EU have significant F&V production, and show some specialisation in specific products. During the 1900s there was a reduction in the number of F&V producing farms together with a reduction in fruit planted area while that for vegetable production increased. Total F&V demand has been relatively stable, though in recent years there has been a decrease in per capita consumption levels, with large variations between EU countries (Freshfel, 2004). Reasons behind this fall in F&V consumption include changes in life style towards convenience and perceived lost of flavour among consumers. Generally speaking, there is a trend towards overproduction. The average income level for fruit production farms is lower than the EU average and that for vegetable production farms. Price fluctuations are not unusual during certain (peak) periods in the marketing season.

The EU is a key global trading partner in F&V, being the first world importer and second world exporter. Its current net trade balance is negative; the EU currently has the largest F&V world deficit accounting for a significant share of the EU total agro-food trade deficit. This trade deficit has increased since 2000, with 8.4 billion euros in fruits and 1.3 billion euros in vegetables in 2004. The main imported products in volume terms are apples, oranges, lemons and pears. Costa Rica, Ecuador and South Africa are

the principal sources of origin in terms of quantity, while the USA, Turkey and South Africa are the dominant sources in terms of value. The major export markets for the EU are, in terms of quantity, Russia, Switzerland and Egypt, and, in terms of value, Russia, Switzerland and the USA. For processed F&V, the mainly EU imports are from Turkey, Brazil and China, while EU exports are sent to the USA, Russia and Japan.

### **3.- THE CURRENT REGULATION AND EFFECTS**

The Common Market Organisation for F&V differs from other CAP regulations applied to other agricultural products. The basic regulations covering fresh F&V, processed F&V, and a system of Community aids granted to certain citrus fruits were laid down in 1996, although the basic regulation has been subjected to a number of amendments since 2000. For fresh products, the system is characterised by support to Producer Organisations (POs) under Operational funds as well as and intervention measures through market withdrawals compensated with Community funds. Processed products are guided by a system based on direct aids to producers according to national thresholds with penalties if processed volumes increase beyond fixed limits.

The level of support to the F&V sector is one of the lowest in EU agriculture. There is little evidence regarding the size of economic transfers through price interventions. Anyway, the CAP expenditure on F&V was 1.8 billion euros in 2005, which accounted for 3.4% of the EAGGF – Guarantee section budget. Since 1996, public expenditure has remained relatively stable around 1.5 billion euros per year. The most important budget component is the expenditure allocated to Operational Funds, followed by processing aids to tomato producers, direct payments to banana producers, processing aids to citrus producers, aids to dried grapes and fig producers, processing aids to apple, pears and

prune produces, direct payments (since 2005) to nut producers, market withdrawals, and export subsidies. While the budget allocated to the Operational Funds has increased in recent years, market intervention expenditure has decreased. Most of the budget concentrates on Southern European countries. The Member States with higher shares of the total F&V budget in 2003 were Spain (31%), Italy (27%), France (17%) and Greece (13%).

The assessment of the system reveals both positive and negative aspects. The share of total F&V production controlled by POs is close to 50%, which is a positive development but still below of that considered as desirable, taking into account increasing concentration at retail level. Moreover, this share is not uniform across EU producing regions, being lower in main producing countries such as Spain and Italy (Commission Européenne, 2004). Operational funds and programmes have been an interesting tool to promote supply concentration but producers' groupings have yet to prove their attractiveness. Operational programmes have also promoted quality improvements and taken account of environmental concerns. Market withdrawals have dramatically decreased, which in theory is a good indicator towards stronger market orientation. Withdrawals have also been discouraged by the existing environmental constraints on biodegradation and the use of withdrawn products for animal feeding. However, the existing system has been ineffective in protecting producers from surplus, market disturbances and periodical price crises (Compés and Lázaro, 2006). Processing aids have been helpful in proving the agro-food industry with European raw materials. However, for some products, the processing industry has become an outlet for surplus in the fresh market.

If the objectives of the CMO are to stabilise prices, guarantee adequate income levels for producers and to encourage improvements in quality and marketing of their products, the CMO has not been very effective in achieving the first goal, but it has shown better results in the second aspect. The EU F&V sector is facing the challenge of (i) strengthening the POs by increasing their size, in particular in those regions where their presence is still weak; (ii) continuing to improve quality and environmentally friendly production; (iii) transforming market withdrawals into a mechanism used by PO for crisis management; and (iv) guaranteeing supplies to the agro-food industry.

Furthermore, the CMO set aside other regulatory issues which affect the core of the F&V Community market. These issues basically refer to the access to the Community market for imports from third countries as well as to the existing non-tariff barriers faced by EU exports in third country markets. On the former, the entry price system has not been an effective guarantee for the Community preference –gradually eroded by the implementation of free trade agreements with significant actors in the world F&V market. Procedures for control compliance with quality and phytosanitary standards are ineffective and lack harmonisation. Regarding market access in third countries, the Community remains weak given the fact that each Member State has to undertake bilateral negotiations on strict requirements.

#### **4.- SCENARIOS FOR A NEW CMO**

The forthcoming Commission's reform of the CMO reform is framed within a context characterised by (i) the CAP reforms in 2003 and 2004 which established a 'single payment scheme'; (ii) the negotiating pressures on the EU under the Doha Development Agenda, which will cause a substantial reduction of border protection, domestic



support, and a possible phasing out of export subsidies; c) the EU's financial framework which applies a principle of financial neutrality on the F&V sector, at least until 2013; and d) a mainstream liberal policy coupled with a clear willingness to simplify the CAP (European Commission, 2005; Herranz-Garcia, 2005).

These restrictions severely constrain F&V reform options. The CAP simplification and the pressures on the EU at the Doha negotiations jeopardise the continuation of both the processing aids and the market withdrawals. These measures can be considered as 'amber box' policies that will have to be significantly reduced. The phasing out of export subsidies will not be so detrimental for EU F&V markets as the reductions in other forms of support. Though financial neutrality is not compulsory from Community legal texts, in practice, increase in public expenditure on certain F&V measures could only be the result of reallocating expenditure from other budget sections. In the field of current and dominant political principles, there is a tendency towards lower levels of public support and greater market orientation.

The reform of the CMO should in principle be able to encourage and correct many of the current weaknesses in a coherent manner within the existing restrictions. Though three reform scenarios could theoretically be foreseen –'adjusted **status quo**', '**radical change**' and '**intermediate reform**'-, in practice the number of policy options is quite restricted.

If market withdrawals continue under the present technical and budgetary conditions, their scheme should be simplified and made less complex to manage. Animal feeding could absorb substantial shares of withdrawn volumes. Phasing out withdrawals would

require the introduction of new measures for crisis management. The new system should maintain certain elements of the old withdrawal system, especially in terms of the management and use of the products. Key elements of the new regime would include: its funding –Community funding with national contributions-; its rules for activation, -percentage of price reductions related to production costs or to reference price levels; the use of withdrawn products –free distribution, animal feeding and promotion of consumption; and its management –the POs keeping a key role.

On one hand, European Commission (2006b) considers four options to prevent and overcome short-term crises: status quo, insurance premiums against crises resulting from natural causes, a cofinanced fund or to incorporate specific arrangements between POs and the processing industry for dual use products. On the other hand, POs expect more help to face this kind of crises (COPA-COGECA, 2000).

Community aid to POs under the operational funds should be maintained and even enhanced. Incentives should be granted to improve PO attractiveness and size. This can be reached by increasing the Community contribution over the existing 4.1% of the commercial production value and over the 50% of public contribution to the fund. Higher national contributions to the funds should be allowed for Member States where production marketed through POs is lower than the Community average.

European Commission (2006b) stresses the importance of the setting up of inter-professional agreements and the coherence between the CMO and the rural development programmes. POs consider that the operational funds are insufficient to

improve the situation of farm holdings of members of producer organisations and to achieve the objectives of the agri-environmental policy.

The '*status quo*' scenario would consider the continuation of processing aids, but national ceilings should be adapted to the situation of the producing Member States. Nevertheless, these aids are not sustainable in the long term given the amount of budget they absorb and since they belong to the 'amber box' category of WTO subsidies. More realistic seems to be the 'radical reform' scenario where processing aids are partially or fully decoupled. These new payments allocated to the 'single payment scheme' would pose crucial problems of distribution: a) the allocation of the budget among Member States depending on the national ceilings, the volumes actually processed or the cultivated area; b) allocation among farmers depending on the payment received in a reference period, on a per hectare basis, or on other eligibility criteria. Full decoupling based on reference payments would give way to competition problems and would penalise farmers who produce for the fresh market. If a full decoupling approach involves lack of supply for the processing industry, the decoupling scheme should be limited by keeping the aids to double-purpose products during a five year transitional period.

Any reform has to consider that many of the F&V market problems are horizontal in nature. For example, as for bilateral trade negotiations, there is a need for a political will of Community authorities to negotiate with third countries all questions related to market access, on harmonised bases. Similarly, quality and phytosanitary controls should be fully harmonised as well as the protocols signed with third countries where phytosanitary risks are possible. As for import duties and entry prices, the Community

should select those products most vulnerable to foreign competition as sensitive products. The special safeguard clause should be a more flexible and effective than it is nowadays. Finally, human consumption in the EU should be actively promoted, especially for young people, given the positive public effects of these products.

Actually, European Commission (2006b) wants to take international commitments into account and even points out a “Co-development” option to support producer organisations in third countries. The need for Community standards for trade is considered since 1996 and now a new way is being explored to get it (synergy between public and private standards). In order to promote the consumption of fruits and vegetables, for better health and to fight obesity, an European Action Plan will be proposed.

However, POs states that fruits and vegetables are considered as a bargaining currency in the Commission’s negotiations of bilateral and multilateral agreements and, as a consequence of this, European production is faced with an increasingly competitive market.

A review of the 2003 reform is planned for 2008 under the “Health check”. The review of the present financial framework for 2007-2013 will likely affect the CMO. Regarding budget impacts, eliminating withdrawals and restitutions -a “radical approach” outcome- will reduce F&V expenditure by 60 million euros. The budgetary savings will be larger if the expenditure allocated to operational funds is stabilized. Thus, the “radical reform” is expected to reduce F&V expenditure by 360 million euro in 2013 compared to the “status quo” spending. Consequently, “radical reform” involves a

significant decrease in F&V budget, which would be clearly insufficient to meet the sector needs. The “intermediate” scenario could take advantage of the foreseen growth in operational funds under the “status quo” option plus a desirable increase in the percentage of Community funding (a 15% increase means +100 million euros per year). Savings in restitutions and withdrawals could be reallocated to crisis management, promotion and the ‘*Observatory*’ option. The decision on decoupling all processing aids or keeping some of them for double-purpose production will not change total expenditure but only its structure. The final decision would be taken by Member States under procedures regulating the national envelopes.

## **5.- CONCLUSION**

Explaining CAP reform’s process is still a great academic challenge. From the current literature, EU policy-making analysis and institutional change theory seems to offer the most useful insights. About the reform of the CMO in fruit and vegetables, promoted by the European Commission and foreseen for the 2007, this approach allows us to prospect, on one hand, that transformations aids will be converted in (total or partial) decoupling payments, the export restitutions removed and withdrawals removed or severely reduced and, on the other hand, that changes of budget among EU countries will be minor, although more freedom into each country to use funds will be allowed in the framework of national envelopes.

Farmers lobbies are pushing for keeping the status quo, but its position will have little influence over the Commission final proposal to the Council. We’re afraid that the new CMO approved by the Council will not be effective to correct the most important weaknesses affecting the sector in the future. For example, the lack of horizontal

concentration, related to that, the limits of farmers to integrate into the supply chain in good conditions to be able to negotiate with the final distribution, and the decreasing demand trend.

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