

Agricultural Outlook Forum 2001

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## **GRAINS AND OILSEEDS : A EUROPEAN PERSPECTIVE**

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The grains and oilseeds markets of the European Union (EU) have been under constant change during the last years. These changes were first of all driven by reforms of the EU's Common Agricultural Policy. The MacSharry reform from 1995/96 to 1997/98 was the first step towards a more market-orientated agricultural policy in the grain sector. Reforms under the Agenda 2000 decisions were started in July 2000 with the intention to increase the competitiveness of EU grains on the world market. Today, additional pressure for change has emerged from the second BSE crisis. The following paper outlines some of these changes.

### **I Agenda 2000 – Goals and Achievements**

The grain intervention prices (guaranteed prices) of the EU were cut by over 30 % between 1995/96 and 1997/98 (MacSharry reform). Under Agenda 2000 – the second set of agricultural policy reforms in the EU agreed in Berlin in 1999 - grain intervention prices will be reduced further by 15 %, implemented in two equal steps of 7.5 % on July 1, 2000 and July 1, 2001, respectively.

Both the MacSharry reform and Agenda 2000 helped to restore the competitiveness of EU grain for feeding purposes. While in the 1980s feed grain consumption in the EU fell by 1 to 2 mln tons per year and grains were increasingly substituted by non-grain feed ingredients (NGFI), today approximately 25 mln tons more grains are being used for feeding than in 1992/93.

Grain feeding during the 2000/01 marketing year is estimated at 113 mln tons, up nearly 5 mln tons from the year before and 25 mln tons above the 88 mln tons fed in 1992/93. To be fair one has to say that a good part of the 5 mln-ton increase in 2000/01 has to be attributed to the weakness of the Euro and the corresponding higher prices for imported feed materials. In 2000/01 nearly 54 % of all grain being harvested in the EU is being used for feeding compared to 48 % in 1992/93. Today, grains contribute nearly 50 % to the raw material supply of the EU compound feed industry. Wheat took the lion share of the increase in grain use for feed; in the current marketing year about 41 mln tons of wheat will be consumed for feed, up by more than 3 mln tons compared to the previous year.

The higher grain incorporation led to lower usage of NFGIs. Accordingly, the import volume of NFGIs dropped from over 40 mln tons in 1993 and 1994 to 34 mln tons in 1998 and recovered in 1999 and 2000 to 37-38 mln tons. For 2001 EU imports are forecast at a good 36 mln tons.

The intervention price cuts will bring EU domestic prices closer to world market levels as market prices normally follow the development of the intervention price. Based on forward price quotations EU grain market prices in 2001/02 will not longer be determined by the intervention price as it has been in the past. At the same time price volatility in the EU domestic market will increase, simply following the pattern on international markets.

The cuts in the EU intervention price for grain will make EU grain exports less dependent on export subsidies. Based on a Euro/Dollar exchange rate of 0.925 US\$ for 1 Euro the 2000/01 grain intervention price of 110.19 €/ton equals about 102 US\$/ton and EU wheat could be exported to the world market without the use of export subsidies (restitutions). However, the competitiveness of EU grain on the world market is highly dependent on the development of the Euro/Dollar exchange rate. For example at a parity between Euro and US Dollar (1 Euro equals 1 US\$) world market prices for wheat have to be at around 110 US\$/ton to allow the EU to export without restitutions. If the Euro strengthens again and goes back to the level of close to 1.2 US\$ for 1 Euro, as it had been the case when the Euro was introduced, the EU intervention price would equal over 130 US\$, a price level that we have not seen on the international wheat market since mid-1997.

It has been mainly due to the strong US Dollar that the EU had no problem with the WTO limit on subsidized grain exports. During 2000/01, the EU is allowed to export 25.2 mln tons of grain with export refunds. Actual exports are forecast at around 27 mln tons, nearly 2 mln tons above the WTO limit. These actual export figure is only possible because of export without restitutions during nearly all of the first half of the marketing year (July to December 2000). During that period about 3 mln tons of wheat and 3.7 mln tons of barley were exported by the EU without the use of export subsidies. Since the beginning of this year, the EU again needs export subsidies for wheat, whereas barley can still be exported without subsidies. The lack of roll-over (unused subsidies from the previous years not allowed to be carried over any more) will force the EU to constantly monitor and review if the intervention price cut of 15 % under Agenda 2000 is already sufficient to make the EU more or less independent from export subsidies. Therefore the Agenda 2000 package contains a provision for the so-called "Mid-term Review". This review is going to be conducted during the course of this year and results will be presented by the EU Commission early 2002. Based on this review, the EU member states will decide on the necessity to cut the grain intervention prices further to achieve the goal of lasting independence from export subsidies for grain (see below).

The lowering of the EU intervention price will also increase the potential for higher grain imports into the EU, especially of quality wheat. This is due to the fact that the minimum import price is not allowed to exceed 155 % of the EU's grain intervention price. With each reduction in the intervention price the minimum import price and the applicable import levy drop accordingly.

The Agenda 2000 package foresees the removal of the special (higher) direct aid payments for oilseeds acreage. From 2002/03 onwards, grain and oilseeds farmers will receive the same acreage-based direct income payment. The equalization of direct aids for grain and oilseeds will allow the EU to no longer restrict oilseeds plantings to the maximum guaranteed area agreed in the Blair House Agreement back in 1992. This maximum guaranteed area has been fixed at 5.4 mln ha minus the prevailing set-aside rate (but at least 10 %). According to this formula, EU farmers of rapeseed, sunflowerseed and soybeans were allowed to plant a maximum of 4.9 mln ha to be able to receive the full direct aid for oilseeds. Due to the high oilseed prices in 1996/97 and in 1998/99 plantings exceeded the maximum guaranteed area and farmers were penalized by severe cuts in the direct payments. The much lower world market prices for oilseeds led to reductions in plantings and since 1999/2000 the planted area (excluding plantings for non-food purposes and of so-called small producers) did not reach the maximum guaranteed area of 4.9 mln ha.

For the 2000 harvest, the oilseed plantings dropped to 5.4 mln ha, the lowest level since 1996/97. Counted against the MGA were less than 4.5 mln ha. Due to the harmonization of the grain and oilseeds aid payments it is not expected that the maximum guaranteed area of 4.9 mln ha will be reached during

the next years. However, much depends on the development of world market prices as the EU production fully depends on them.

The Agenda 2000 package also removed the special treatment for feed pulses. The supplement to the grain aid was cut substantially and made the protein crops less competitive in farmers' crop rotations. Accordingly, the acreage planted to feed peas and feed beans fell in 2000 to a low of 1.1 mln ha. A recovery can be expected only if either the supplemental aid will be increased again or protein prices on the world market go up sharply.

## **II The BSE Crisis and its Consequences**

Since the discovery of the first BSE case in Germany on November 24 of last year the EU is experiencing a real crisis. BSE (bovine spongiforme encephalopathy) has now been found in nearly all EU member states (except for Austria, Sweden, and Finland). Consumers (and politicians) lost confidence in food safety to a very large and for many observers unpredictable extent.

Currently, beef consumption in the EU is down between 25 and 50 % depending on the EU country. Cattle slaughterings are between 40 and 50 % lower in most EU countries. For calendar year 2001, the drop in beef consumption is forecast at at least 15 % if not more. Many countries banned imports of EU cattle and beef and according to the EU Commission, the beef surplus in 2001 may exceed 1 mln tons (about 13 % of production). Therefore the EU Commission agreed with the member states to start a so-called "Purchase for Destruction Scheme". Under this scheme up to 2 mln cattle will be slaughtered for destruction to reduce the surplus on the market and to stop beef and cattle prices from falling further. These 2 mln cattle equal about 1.5 - 2 % of the total cattle inventory.

As meat and bone meal as well as animal fats in milk replacers are the most likely source of BSE transmission the EU extended the already existing ban on the usage of meat and bone meal for cattle to all animal feed. This ban is for the time being valid for six months from January to June 2001. During this period a scientific review whether a complete ban is justified has to be completed. The scientific review will have to focus on the question whether the current technique for the production of meat and bone meal (temperature of 133° Celsius, pressure of above 3 bar, treatment for at least 20 minutes) is really sufficient to destroy the BSE pathogen.

In addition to the ban of the domestic use of meat and bone meal, the EU banned the export of these products to EU third countries. Furthermore a ban on fishmeal for ruminants was put in place and the EU Council agreed to test all cattle older than 30 months for BSE during slaughtering.

Germany implemented even stricter rules and banned the use of fishmeal completely (with the exception of fishmeal for fish) and introduced a ban on the use of all animal fats in animal feed.

The EU used a total of about 2.4 mln tons of meat and bone meal in the year 2000. This quantity, based on protein, is equivalent to approximately 3 mln tons of high-pro soymeal (48 %) or 14.2 mln tons of wheat. Theoretically the EU's demand for soybean meal would have to rise by 3 mln tons. However, this is not going to be the case.

When looking into the year 2001, the cattle inventory (mid-year) will be down only 1 - 2 % compared to mid-2000. Overall industrial compound feed output is expected to decline slightly with a significant drop of around 5 % for cattle feed. The drop in beef consumption is going to be only partially offset by higher consumption of hog and poultry. Substitution with white meat might increase during the second

half of 2001, however, currently many consumers really reduce meat consumption in total due to an overall lack of confidence in food safety.

Accordingly, the EU's compound feed production for hogs is forecast to increase by only 1 % and for poultry by 2 % during calendar year 2001. Therefore the EU's soybeanmeal consumption is expected to be only 1 mln tons higher at 28 mln tons. In addition, as mentioned earlier, grain feeding is going to increase by about 3 mln tons.

The BSE crisis will have far-reaching consequences for the EU feed industry. Meat and bone meal, a highly regarded feed component, is lost at least till the end of June of this year. The ongoing scientific review might come to the conclusion that meat and bone meal is safe for hogs and poultry when produced under state of the art conditions. However, it is completely open at this point in time whether or not the agricultural policy makers will follow that advice. To regain the confidence of the consumers there is a high possibility that the ban on meat and bone meal might be extended indefinitely.

More or less agreed are several other measures to increase the transparency in the EU feed industry. Among these are the so-called open declaration and a positive list. The open declaration demands all feed processors to clearly state on a label the composition of the compound feed. In other words, they have to show ingredients used for the manufacture of a feed in descending order, maybe also with the exact percentage in the formula.

Currently, the EU is working with a regulation on undesired substances in compound feed and feed raw materials (for example lead, cadmium, aflatoxin). In the future this so-called negative list will be replaced by a positive list. The positive list will show all feed raw materials allowed for the production of compound feed. A product that is not on the list will no longer be allowed. It is crucial that this list is being compiled on a scientific basis and not up to political interests.

An agreement among EU member states and the Commission has been reached also on the introduction of quality assuring schemes. These schemes will become obligatory for the whole feed chain.

The EU Commission, Germany and some other EU member states also would like to introduce full traceability for all feed materials. The EU Commission made the demand for traceability part of their "White Paper on Food Security" that was released a year ago. The concept of traceability is going to be tested for feed raw materials produced full or partly from genetically modified plants. Currently, the EU Commission is drafting the so-called Novel Feed Regulation. The Novel Feed Regulation regulates the circulation and labelling of GMO feedstuffs in the EU market. The intention is to label all feedstuffs derived from GMO plants if the GMO content exceeds a certain threshold, most likely 1 %. The Commission plans to demand traceability including full documentation on GMO on a trait-by-trait basis.

### **III Future of the EU's Common Agriculture Policy**

The BSE Crisis increased the pressure to change the Common Agriculture Policy of the EU in a radical way. Criticism is mounting and especially Germany is demanding a complete overhaul of the current system of support.

The new German Minister for Consumer Protection, Nutrition and Agriculture, Mrs. Renate Künast, made very clear that consumer issues have to be put first. She also demanded to fully implement the precautionary principle. In addition, the new slogan is to demand "class instead of mass", in other

words: less intensive farming practices and a much higher share of organic and environmental-friendly farming. In this respect it is discussed to introduce minimum quality standards for production, processing, and trade of all agricultural products.

Strong pressure to continue the reform of the EU's agriculture policy is also coming from an increasing tightness in the EU's agriculture budget. The extra costs of the BSE crisis are seen at around 2 bln Euros. With these extra costs the upper limit of the EU's agriculture budget will be reached and it very well might be that additional funds are needed. It has been decided that additional funds cannot come from other sources than the agriculture budget. Therefore any additional money has to be taken away from other support programs.

Taking these points into consideration it is safe to say that reform of the EU agriculture policy is going to become an ongoing process. The basis for this process has been laid already in the Agenda 2000 decisions in Berlin back in 1999. Part of the Agenda decisions is to undertake a so-called "Mid-term Review" during the year 2001 with consequences drawn in the first half of 2002. Due to the budget pressure, the lack of full competitiveness on international markets and the EU enlargement by the countries from Central and Eastern Europe, more severe modifications in support to farmers - maybe already from 2003/04 onwards - will be implemented.

Among these additional cuts in support a further reduction in the grain intervention price by at least 5 % is highly likely. This cut again will be partly compensated by higher direct aid payments. At the same time the agriculture ministers of the EU might decide to introduce a degression of direct payments to be able to cope with the challenges of the enlargement. In addition, measures will be taken for a shift towards more extensive farming practices, first of all in the livestock sector. Furthermore there seems to develop strong support for so-called "cross compliance regulations". Under cross compliance farmers will be demanded to fulfil minimum standards during production. If they do not fulfil these requirements their direct aid payments will be cut (current regulation foresees a cut of 10 %). In addition, more and more mentioned is the so-called "modulation". Under a modulation scheme the direct aids being given to farmers will be cut and the freed money will be used for the development of rural areas and environmental purposes.

With respect to the grain and oilseeds markets these further reform steps will allow the EU to export grain without subsidies much more regularly than today. In fact, export subsidies should become necessary only in times of extremely low international grain prices. Intervention of grain will become a pure safety net and the use of grain for feeding purposes will continue to rise to the detriment of imports of non-grain feed ingredients.

Finally, the broader use of the precautionary principle as well as the introduction of minimum standards will increase the conflict potential in the World Trade Organisation and especially about the Agreement on the Application of Sanitary and Phytosanitary Measures.

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Grains and Oilseeds Luncheon**

***Grains and Oilseeds: A European Perspective***

by  
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***Grains and Oilseeds: A European Perspective***

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1. Goals and Achievements of the Agenda 2000 Reform
2. The BSE Crisis and its Consequences
3. Future of the EU's Common Agricultural Policy

## Agenda 2000- Agricultural Policy Goals

- Improve Competitiveness of EU Agriculture
  - ➔ domestically
  - ➔ on the world markets
- Further Shift from Price Support to Direct Payments

## Agenda 2000 Decisions for Grains and Oilseeds

	1999/00	2000/01	2001/02	2002/03 <sup>1)</sup>	change 02/03 on 99/00
<b>Grain Intervention Price</b>	€/ton	119	110	101	-15%
	\$/ton	110	102	94	
<b>Direct Aid Grains</b>	\$/ha	231	250	268	15%
<b>Direct Aid Oilseeds</b>	\$/ha	429	348	268	-38%

1) to be reviewed in 2002  
 1 Euro (€) = 0.925 USD (\$)

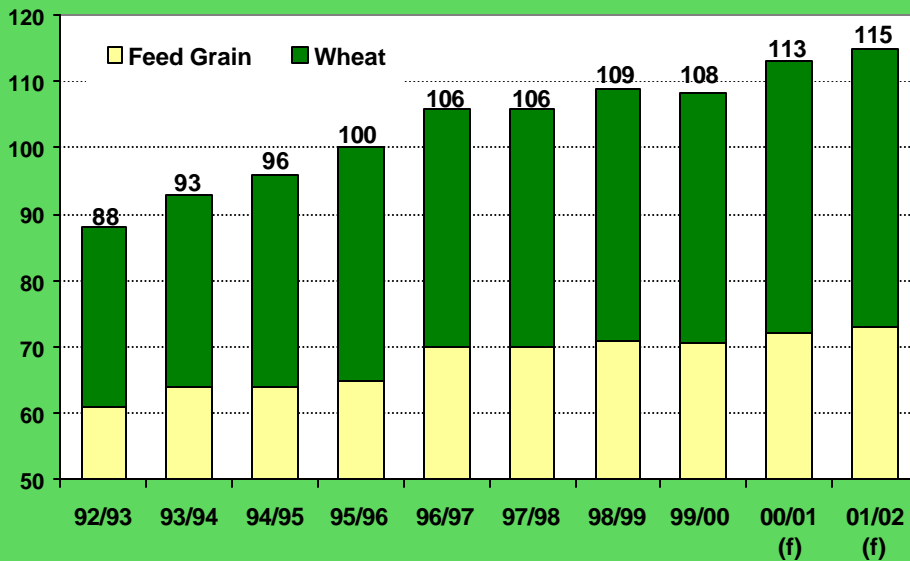
## Agenda 2000

### Achievements for Grains and Oilseeds

- P EU Domestic Prices Closer to World Market Level
- P Increased Price Volatility in EU Domestic Market
- P Domestic Use of Grain Increasing
- P Less Grain Export Subsidies Needed
- P Higher EU Imports of Quality Wheat Possible
- P Acreage Limits on Oilseeds No Longer in Force
- P Feed Pulses Loose Competitiveness

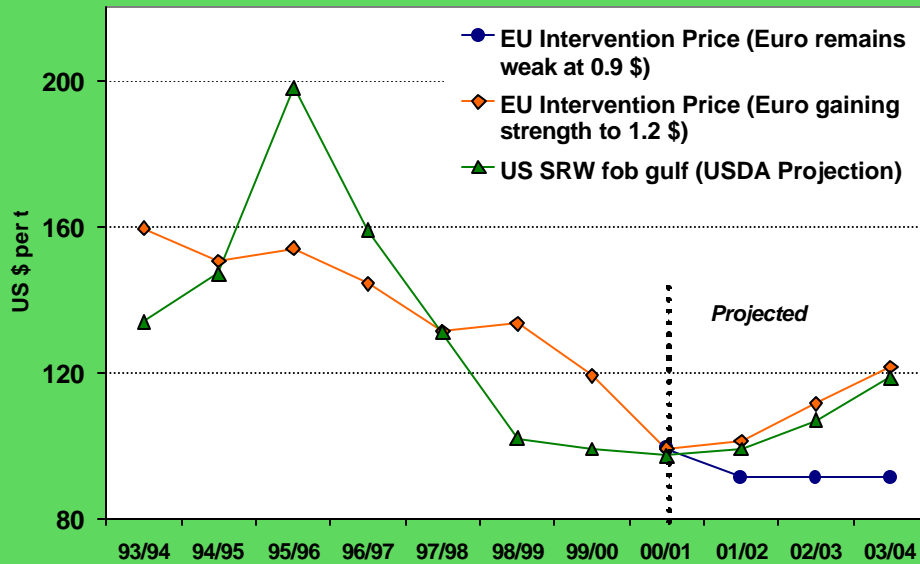
## EU Feed Use of Grains

in mln tons





## EU Grain Intervention Price and World Market



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Chart 7

## EU Grain Exports and WTO Limits in mln tons

	1998/99	1999/00	2000/01	2001/02
<b>Actual</b>	<b>27.5</b>	<b>34.0</b>	<b>27.0</b>	<b>29.0</b>
<b>WTO Limit</b>	<b>28.8</b>	<b>27.0</b>	<b>25.2</b>	<b>25.2</b>

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Chart 8

## EU Grain Import Duty and Agenda 2000

		1999/00	2000/01*	2001/02**
		----- Average, in Euro/t -----		
<b>Durum</b>	HAD2	12.2	0.0	0.0
<b>Soft Wheat</b>	HRS2 14%	22.6	0.1	0.0
	HRW2 11.5%	61.4	14.9	1.0
	SRW2	75.6	40.2	26.3
<b>Corn</b>	YC3	81.8	52.3	38.4

\* Average up to Feb 2001

\*\* Intervention price cut 7.5%

all other determinants - prices, freight, exchange rate - assumed unchanged on 2000/01

Source: EU Official Journal, own calculation

## EU Oilseed Plantings and Blair House Limit

- **Maximum Guaranteed Area of 4.9 mln ha did not Restrict Oilseed Plantings During the Last Two years**  
**Reasons: Low Oilseed Prices, Cut in Direct Payments**  
**Agenda 2000: Oilseed Aids Minus 40% - Grains Plus 15%**
- **Development of Oilseeds Production Fully Dependent on World Market Prices**
- **From 20002/03 Same Aid Level for Oilseeds and Grains**

## **EU BSE Crisis and the Beef Market**

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- **EU Beef Consumption Currently Down 25 to 50 %**
- **Reduction in 2001: At Least 15 %**
- **Many Countries Banned Imports of EU Beef and Cattle**
- **Beef Surplus in 2001 of Over 1 mln tons**
- **Up to 2 mln cattle to be Slaughtered for Destruction  
(equal to 1.5 – 2 % of cattle inventory)**
- **Meat & Bone Meal and Animal Fat in Milk Replacers  
most likely Source for BSE Transmission**

## **EU BSE Crisis – Immediate Consequences**

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- **Ban on the Usage of Meat & Bone Meal Extended to All  
Animal Feed for Six Months from January to June**
- **Scientific Review whether a Complete Ban is Justified (to be  
completed in June)**
- **Export Ban for MBM**
- **Ban on Fish Meal for Ruminants**
- **Germany also Banned the Use of Fish Meal**
- **Ban on All Animal Fats in Germany**
- **All Cattle Older than 30 Months to be Tested for BSE**

## Meat & Bone Meal Usage in the EU

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- EU's MBM Usage in 2000: 2.4 mln tons
- MBM has more than 60% Protein
- 2.4 mln tons of MBM are Equivalent to
  - 3.0 mln tons of Hi-Pro Soymeal (48% Protein) or
  - 14.2 mln tons of Wheat (11% Protein)

## BSE- Consequences for the EU Feedstuff Markets in 2001

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- Cattle Inventory down 1 to 2 % (mid-year count)
- Total Industrial Compound Feed Output Only Slightly Down by 0.3 %
  - Cattle - 5 %
  - Hogs + 1 %
  - Poultry + 2 %
- Soybean Meal Consumption up 1 mln tons to 28 mln tons
- Grain Feeding up 3 mln tons

## **BSE – Consequences for the EU Feed Industry**

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- **Meat & Bone Meal Ban to Stay?**
- **Open Declaration**
- **Positive List**
- **No Antibiotics for Disease Prevention**
- **Quality Assurance Schemes**
- **Traceability**
- **Novel Feed (GMO)**
- **White Paper on Food Security**

## **BSE Crisis and Public Debate**

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- **Consumers First**
- **Precautionary Principle**
- **„Class Instead of Mass“**
- **Strong Support for Organic Farming**
- **Minimum Quality Standards for Production, Processing and Trade (?)**
- **Budget**

## **Modifications in Support to Farmers (from 2003)**

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- **Grain Intervention Prices to be Reduced Further (minimum 5 %), Partly Compensated by Higher Direct Aid Payments**
- **Degressivity of Aid Payments to be Introduced ?**
- **Shift Towards More Extensive Farming Practices**
- **Cross Compliance (minimum standards)**
- **Modulation**

## **Market Implications**

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- ➔ **Grain Exports Without Subsidies to Become Normal**
- ➔ **Intervention a Pure Safety Net**
- ➔ **Feed Grain Use to Increase – Imports of NGFIs to Decrease**
- ➔ **Higher Conflict Potential in WTO, SPS**