

Phasing out European Union tobacco subsidies

Action on Smoking and Health

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Following the May 2001 European Commission proposal to phase out tobacco subsidies, this briefing explores the background to subsidies for tobacco growing in the European Union. We examine the rationale for a phase out and replacement with support for economic diversification and sustainable development. The arguments are set out under the following headings:

Summary	2
Introduction – the CAP and tobacco subsidies	3
European Commission proposal and Parliament’s endorsement	4
Reasons to phase out tobacco subsidies	5
Reason one: Health rationale	5
Reason two: Economic rationale	5
Reason three: Enlargement.....	6
Reason four: Recurring political embarrassment.....	7
Reason five: Trade negotiations	7
Reason six: Reform of the CAP	8
Conclusion and recommendations	9
References and links	10

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Summary

The European Commission has proposed that subsidies for growing tobacco be phased out and replaced with support for economic development and transition to alternative economic activities. The proposal has the backing of the European Parliament and was put to the European Council in Gothenburg, Sweden, on 15-16 June 2001. The Council made no specific comment on the proposal – indicating underlying disagreement. A review of the tobacco subsidy regime is due in 2002 and this creates the opportunity for substantial change. ASH strongly supports the Commission proposal for the following reasons:

- There is no justification for subsidising a product that kills 550,000 EU citizens each year;
- Better use could be made of almost €1 billion spent on subsidising tobacco growing – both in the support of rural communities and in promotion of health;
- The principles established in reforming tobacco subsidies will be a test case for wider Common Agricultural Policy (CAP) reform – the conversion of support for commodity production to supporting rural development and alternative sustainable economic activity is essential.
- Tobacco subsidies are the most indefensible of all CAP subsidies – if the CAP cannot be reformed for tobacco, then it probably cannot be reformed at all.

Wider CAP reform is essential for efficiency in the EU economy, Community enlargement and progress in a new WTO trade round. Reform of tobacco subsidies would contribute to these aims.

The Commission proposal lays the foundation for a substantial overhaul of the CAP tobacco subsidy regime to be formulated in the review required by 1 April 2002. The support of the main institutions is important in securing a mandate for reform. A new regime could comprise of:

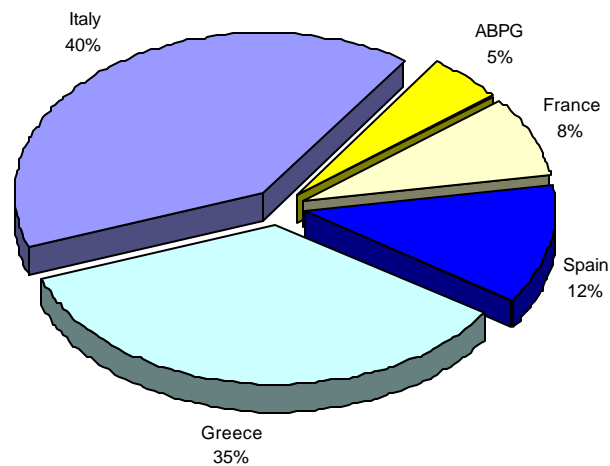
- A rapid tapering of all subsidies to tobacco production
- A transitional period from 2002-2006
- Buy-out of tobacco farming capacity and quota
- Funds for rural development and environmental protection to displace tobacco growing
- An expanded Tobacco Fund to support research and public health
- After 2006, support for sustainable development to be independent of the CAP, but still available to tobacco growers.

Introduction – the CAP and tobacco subsidies

European Union tobacco subsidies for tobacco growing were €984.5 million (£592.1 million) in the year to 15 October 2000.¹ It is estimated that there are 135,000 tobacco farmers in the EU (1997). The subsidy thus amounts to approximately €7,300 (£4,400) per person involved (if the 1997 figures remain roughly applicable).² The eight producer Member States under the EU tobacco regime are: Austria, Belgium, France, Germany, Greece, Italy, Portugal and Spain. EU tobacco production accounts for less than five percent of world output.

Greece and Italy consume the lion's share of CAP tobacco subsidies, and four countries: Austria, Belgium, Portugal and Germany (ABPG) consume less than 5 percent of the total subsidy.

CAP Tobacco Subsidies (1997)



Source: Parliamentary answer citing EAGGF Guarantee annual reports³

About 23% of the EU tobacco production is used within the EU (1997) – the main export markets being Former -USSR, Central and Eastern Europe, North America and North Africa⁴

The basic *modus operandi* of the CAP tobacco subsidy regime is set out in Regulation [2075/92](#) (as amended) with specific implementation in Regulation [2848/98](#), which introduced a series of reforms. The subsidy regime now pays according to three criteria – quantity produced, quality and price (previously there was a set payment per kilo). Farmers that produce higher quality receive higher subsidy payment. The system is a 'deficiency payment' arrangement in which premiums are paid to growers to compensate for the difference between standardised European production costs and world prices.

Article 26 of Regulation [2075/92](#) as amended by Regulation [1636/98](#) requires a review of the tobacco subsidy regime:

Before 1 April 2002, the Commission shall submit a report to the European Parliament and to the Council on the functioning of the common organisation of the market in raw tobacco.

This Commission's proposal on sustainable development (see following page) signals an intent to seek structural reform of the tobacco regime in time for new proposals to be made for this review. There is, therefore, an urgent requirement for proposals and political engagement of all relevant institutions.

European Commission proposal and Parliament's endorsement

The European Commission proposal for sustainable development in the European Union 'A Sustainable Europe for a Better World' includes a proposal to phase out tobacco subsidies from the Common Agricultural Policy.

...Reorient support from the Common Agricultural Policy to reward healthy, high quality products and practices rather than quantity; following on from the 2002 evaluation of 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. (Address threats to public health - page 11)⁵

The President of the Commission emphasized the point in his speech of 15 May 2001 to the European Parliament:

...redirecting support from the Common Agricultural Policy to ensure healthy products and to promote quality rather than quantity. This would mean, for example, phasing out subsidies to tobacco producers. Here as well we need to think about developing alternative sources of income and activity. (Romano Prodi- speech to the European Parliament)⁶

The European Parliament has supported the proposal. On 13 June 2001, it voted 294 to 197 votes (36 abstentions) to include the following paragraph in its resolution to the European Council to be held in Gothenburg.

23: Welcomes the Commission proposal to modify support from the CAP in order to reward high-quality products and practices rather than quantity and to phase out tobacco subsidies while putting in place some measures to develop alternative sources of income and economic activity for tobacco workers and growers;

Reasons to phase out tobacco subsidies

This is an important development and we believe the UK should lead in defining the framework in which these objectives could be realised. There are a number of advantages for doing this and these are set out below.

Reason one: Health rationale

Tobacco is responsible for ending the lives of over 500,000 European Union citizens and around one million Europeans in total each year. The global death toll is around four million and expected to rise to 10 million per year before 2030.⁷ There is no justification for public support for a product that is so harmful. The Council communication⁸ did not mention tobacco specifically, but did refer to healthy products:

To meet these challenges, the European Council agrees: that the Common Agricultural Policy and its future development should, among its objectives, contribute to achieving sustainable development by increasing its emphasis on encouraging healthy, high quality products,

Reason two: Economic rationale

The usual rationale for subsidising farming of any type is that it provides social benefits not adequately valued by the market for farm produce. These 'positive externalities' might include:

- Food security
- Environmental protection and sustainable development
- Maintenance of rural communities and poverty alleviation
- Fulfilment of psychological and nostalgic needs of food consumers and city-dwellers

In defending its CAP regime in trade negotiations, the EU refers to the 'multifunctionality' of agriculture to reflect these arguments.⁹ To the extent that society is willing to pay for these benefits, then subsidy to secure them is justifiable. However, the best way to structure a subsidy is to offer it directly to the activity that leads to the benefits – not channelled through production of uneconomic crops. For example, direct payments could be made for maintaining wildlife habitats, communities may be supported with structural funds, infrastructure development and incentives for businesses to locate to the region, and food security (not applicable to tobacco) can be achieved by stockpiling or through more sophisticated 'options' instruments in global commodity markets.

There are negative effects associated with subsidising production, including:

- tendency to provide a level of subsidy that exceeds the value of the externalities – a waste of money
- distortion of trade and retaliation by those for whom the subsidy is a trade barrier – diminishing economic gains expected from trade
- dissipation of signals to change to economic activities that are viable – this creates hurdles to development
- opportunity costs of spending public or consumer funds on agricultural production – greater good could be done if it was spent directly on beneficial activities
- high transaction costs in administering a subsidy scheme of great complexity¹⁰ – a waste of money

Where subsidies are used to support economic activity, the aim should be to make these *transitional* rather than simply a shift of long-term subsidy from tobacco growing to something else not viable. There may also be a good case for 'amortising' future subsidies and simply buying out tobacco farmers by offering (say) five years subsidy payments as a one off sum to leave the market – without specifying what alternative activity should be undertaken.

The UK government recognises the overall weakness in the structure of the CAP – that it secures whatever benefits are used to justify it through the unjustifiable support for commodity production:

*Ms Quin: The CAP is failing to deliver what farmers, the rural economy and the environment need. The Government are committed to securing a more economically rational CAP to enable the industry to respond flexibly to consumer wishes without being constrained by the market-distorting nature of the current CAP, and to securing a CAP which is compatible with the protection and enhancement of the natural environment*¹¹

The idea of endlessly supporting unviable industries is now widely recognised to be a poor long term economic policy and a barrier to modernisation. In other industries such as coal, steel, ship-building – which are far larger than tobacco growing – the emphasis shifted from ongoing support to diversification and structural change. There is no reason to treat tobacco, or agriculture, differently.

Reason three: Enlargement

A key direction for the European Union is enlargement to include states in Central and Eastern and Southern Europe. There are currently 13 'accession states' that have signalled their intention to join the EU and initiated the process of joining (Bulgaria, Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, Slovakia, Slovenia, Turkey). The table below shows that many of these are tobacco producers and would absorb extra subsidy if they joined on current CAP terms. Tobacco production for the EU and the accession states is shown in the table below:

Farmed area, Production and Productivity for EU and Accession States (1995)

	Farmed area (Ha)	Production (tonnes)	Productivity (tonne/Ha)
Italy	56,523	132,778	2.35
Greece	70,028	132,152	1.89
Spain	16,206	42,389	2.62
France	10,254	25,053	2.44
Portugal	2,910	6,239	2.14
Germany	3,726	5,010	1.34
Other EU	400	1,451	3.63
	160,049	345,073	2.16
Poland	30,624	57,821	1.89
Bulgaria	23,009	29,752	1.29
Hungary	9,004	16,015	1.78
Romania	11,004	15,031	1.37
'Czechoslovakia'	2,801	4,960	1.77
Turkey	239,236	210,730	0.88
	315,678	334,309	1.06

Source: derived from US Department of Agriculture: Tobacco Statistics (1995)¹²

Though there are likely to have been changes since 1995, the table gives an idea of the likely implications of enlargement. Excluding Turkey, which is expected to join later than the others, enlargement would increase subsidised production by 36%. If Turkey is included, tobacco production would almost double.

There is a broad initiative to prepare the European Union for enlargement, known as [Agenda 2000](#).¹³ This includes CAP reform as a central plank – see below.

Reason four: Recurring political embarrassment

Agreement to the Commission's proposal would be a credible response to ever-present criticism in the UK parliament. There are many examples of criticism. For example, the House of Commons Health Select Committee concluded in 2000:

We recommend that the Secretary of State makes immediate and urgent representations in Brussels to create a far more substantial unit to combat the enormous resources of the tobacco industry. We believe that European policy is already hugely compromised by the CAP subsidy, and that unless appropriate resources go into tobacco control European action in this sphere will lack credibility. (The tobacco industry and the health risks of smoking: para 200)¹⁴

It would enable the UK and European Union to negotiate a sensible text in the WHO Framework Convention on Tobacco Control, and avoid the continuing embarrassment of opposing text proposals such as that made by the Chairman of the negotiations:

(Government support for tobacco manufacturing and agriculture)

15. Each Party shall gradually eliminate subsidies for tobacco growing and manufacturing of tobacco products and, in accordance with the means at its disposal and its capabilities, promote alternative economic activities for tobacco workers and growers. (Chair's text)¹⁵

At the May 2001 Intergovernmental Negotiating Body meeting, European Union negotiators' response to this text was simply to stress the importance of the EU Tobacco Fund in promoting health and economic diversification. However, the Tobacco Fund is set at a level of just two percent of the price support offered to tobacco growing, and much of that is used to encourage improved quality and alternative uses for tobacco.¹⁶

Reason five: Trade negotiations

The European Union has acknowledged for some time that it needs to reform its agricultural subsidy regime in order to have a credible position in WTO negotiations.

New multilateral trade negotiations will start in 1999 as a follow-up to the Uruguay Round. Cutting border protection, reducing export subsidies and reshaping internal support towards more "decoupled" instruments will enhance the Union's negotiating stance in the new Round. Another, increasingly sensitive, issue is the need to introduce environmental and social standards at international level and to take into account consumer concerns. (Agenda 2000)¹⁷

However the EU has had to expend considerable negotiating capital on protecting its subsidy regime and shaping the GATT Agreement on Agriculture to accommodate the CAP. The WTO agreements also recognise the concept of different types of support, though with a different nomenclature –

Red box: subsidies that are not permitted under WTO Agreement on Agriculture.

Amber box: subsidies, such as price support, which are most trade distorting and should diminish over time (analogous to the 'first pillar').

Green box: subsidies for rural development and environmental expenditures.

Blue box: introduced by the EU to cover direct payments to factors of production (eg. capital grants), but not support for volume or price. The EU seeks to retain the blue box measures, though these are trade distorting and do not contribute to diversification and only indirectly to sustainable development – if at all.¹⁸

The European Union approach on agriculture presented to the WTO, stresses that the structure above should be retained, but again emphasises that the multifunctional role of agriculture must be recognised:¹⁹

The multifunctional role of agriculture. In the Union's view it is essential to ensure that progress on trade issues does not damage the ability of those employed in agriculture to supply public goods, in particular as regards the environment, (including combating desertification) and the sustained vitality of rural areas. Direct aid measures with no or minimal trade impact have an important role to play in this context.

However, there is robust defence of the 'blue box' mechanism:

4. It is clear that, as regards the Agriculture Agreement itself, there will be four main areas of negotiation:

(a) The question of whether any of the specific instruments provided in the Agreement itself need to be adapted.

[...]

5. As regards (a), and particularly having in mind the need for a rapid negotiation, the Community is not of the view that a major review of the specific instruments provided in the Agriculture Agreement is necessary or desirable. In particular: whilst it does not rule out some updating of the blue and green boxes, it believes that in concept they remain essential elements in the policy of reducing support and providing indispensable assistance to WTO Members to help them to move away from price support towards more transparent and non distorting policies.

While this sounds like the right direction, and consistent with the Commission's proposal to phase out agricultural subsidies, the flaw in this position is that the 'blue box' subsidies are trade distorting and do not directly contribute to the diversification of the rural economy, structural reform or sustainable development. The challenge for the EU reform of tobacco subsidies is to show that it can phase out blue box subsidies and replace them with *green box* subsidies – as far as these are justified.

Reason six: Reform of the CAP

Agenda 2000 relies on development of a 'second pillar' of rural development support through the CAP – the first pillar being price support for agricultural commodities. The idea is to shift support from the first pillar to the second pillar over time. Agenda 2000 states:²⁰

Rural development becomes the second pillar of the CAP. For the first time, the foundations have been laid for a comprehensive and consistent rural development policy whose task will be to supplement market management by ensuring that agricultural expenditure is devoted more than in the past to spatial development and nature conservancy, the establishment of young farmers, etc. The Member States will be able to vary, i.e. downwards, the direct aids awarded to holdings in line with criteria to be defined by each Member State relating to the amount of labour employed on a farm. Money released in this way is to be allocated by the Member State to agri-environmental schemes.

[...]

The efforts made, notably in terms of reducing support prices, represent an essential contribution by the European Community to stabilise the world's agricultural markets. The European Council considers that the decisions adopted regarding the reform of the CAP within the framework of Agenda 2000 will constitute key elements in defining the Commission's negotiating mandate for the future multilateral trade negotiations at the WTO.

The Commission proposal essentially follows this model and would be consistent with improved compatibility with WTO principles. The principles developed and political agreement secured in phasing out tobacco subsidies will be a 'vanguard' for the potentially much more difficult adjustments needed to major CAP regimes for beef, cereals and milk, which will need to be renegotiated starting in 2002. If reform cannot be made to work for tobacco, then it is unlikely to work for the other, larger and more pervasive elements of the CAP. Tobacco should be thought of as a test case in CAP reform – with the least political obstacles and thinnest justification for subsidy, it makes an ideal test for reforms.

Conclusion and recommendations

The tobacco subsidy regime of the Common Agricultural policy is untenable for health, economic and political reasons. It is a barrier to enlargement and progress in trade negotiations and an embarrassment to the European Union in tobacco control negotiations under the auspices of WHO.

As the most indefensible of all CAP subsidies, tobacco should be first to undergo major reform. The Commission's proposal to phase out tobacco subsidies and to promote rural development and diversification in the context of a sustainable development plan is welcome and timely. The review of the tobacco subsidy regime required by April 2002 presents an opportunity for reform which should be grasped.

There should be several elements to a reform package beginning as soon as possible after the Commission review of the tobacco subsidy regime.

- Inject urgency into the process of reform – for example, completion of the Commission review under Article 26 of 2075/92 (as amended) well before the deadline of 1 April 2002 would expedite the process of reform.
- Implement a steady decline in total subsidies for tobacco production – aiming to end this form of support in 2006.
- Strengthen the quota buyback scheme to encourage early departure from the tobacco-growing sector – such a scheme operates in the current regime, but would need to be reformulated if the subsidy regime was to change as recommended.
- Designate 2002-2006 as a period of redistribution of subsidy from the 'first pillar' (production) to the 'second pillar' (sustainable development) but retaining total support a constant level up to 2006.
- Promote subsidised commercial investment in the rural economies dependent on tobacco growing. This should focus on infrastructure development, support for start-up ventures, and training.
- Promote subsidised environmental investment. For example: organic farming; energy crops and renewable energy production; habitat protection; reforestation; wildlife and nature reserves; footpath maintenance; tourism and leisure services.
- Develop a solid sustainable development regime. Post 2006, support for sustainable development should move outside the CAP and into structural or cohesion funds, or a new sustainable development fund. There should be no special treatment for tobacco growing areas – each part of the European Union should seek sustainable development funding on its own merits.
- Expand the Tobacco Fund – this should retain its public health promotion role, but focus its research programme of supporting the diversification of tobacco dependent rural communities and support for investment in sustainable development in such communities.

References and links

- 1 [Parliamentary answer \(UK\), 7 March 2001.](#)
- 2 [Parliamentary answer \(UK\), 9 February 1999](#)
- 3 [Parliamentary answer, \(UK\) 29 July 1998](#)
- 4 [Parliamentary answer \(UK\), 9 February 1999.](#)
- 5 [Communication from the Commission:](#) A sustainable Europe for a better world: A European Union Strategy for sustainable development. The Commission's proposal to the Gothenburg European Council. 15 May 2001.
- 6 Romano Prodi, President of the European Commission, [Speech to the European Parliament](#), 15 May 2001
- 7 The World Health Report 1999: making a difference. World Health Organization. 1999
- 8 [Presidency Conclusions](#), Göteborg Council, 16 June 2001 para 31.
- 9 [WTO negotiations on agriculture - EC comprehensive negotiating proposal](#) (Agriculture Council November 2000)
- 10 See [Community legislation in force - Raw Tobacco](#) for details on the subsidy regime
- 11 [Parliamentary answer \(UK\), 9 May 2001.](#)
- 12 US Department of Agriculture: [Tobacco Statistics 1960 - 1995](#) Table 156 (acreage) Table 157 (production).
- 13 Communication of the European Commission: [Agenda 2000: for a stronger and wider European Union](#), July 1997.
- 14 House of Commons Health Committee: [Second Report Session 1999-2000 The tobacco industry and the health risks of smoking](#). The Stationery Office Limited, June 2000.
- 15 [Chair's text of a Framework Convention on tobacco Control](#) World Health Organisation, January 2001
- 16 Commission Regulation [1648/2000](#) on the Tobacco Fund. July 2000.
- 17 [Agenda 2000: reform of the Common Agriculture Policy](#)
- 18 [The blue box and other support measures to agriculture](#) – European Communities proposal 28 June 2000, WTO Committee on Agriculture
- 19 Preparations for the 1999 Ministerial Conference: EC approach on agriculture [WT/GC/W/273 \(99-3151\)](#) Communication from the European Communities to the WTO General Council 27 July 1999.
- 20 [Agenda 2000: reform of the Common Agriculture Policy](#)