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COVER NOTE

from: Mr Vítor CALDEIRA, President of the European Court of Auditors
date of receipt: 14 June 2012
to: Mr Nicolai WAMMEN, President of the Council of the European Union
Subject: Special report No 7/2012: The reform of the common organisation of the
market in wine: Progress to date

Sir,

I enclose a copy of Special report No 7/2012 "The reform of the common organisation of the market in wine: Progress to date" together with the Commission's replies.

The Special report, which is shortly to be published, was adopted by the Court at its meeting on 7 March 2012 and is accompanied by the replies from the Commission, which was notified of the preliminary findings on 15 November 2011.

(Complimentary close).

(s.) Vítor CALDEIRA

Encl.: Special report No 7/2012: The reform of the common organisation of the market in wine:
Progress to date¹

¹ In English only. The other languages of this report are available on the European Court of Auditor's website: <http://eca.europa.eu/>.

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Special Report No 7/2012

(pursuant to Article 287(4), second subparagraph, TFEU)

The reform of the common organisation of the **market in wine**: Progress to date

together with the Commission's replies

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GLOSSARY

By-product distillation measure: Support granted for the voluntary or obligatory distillation of by-products of wine making (grape marc and wine lees) which has been carried out in accordance with the conditions laid down in point D of Annex XVb of Regulation (EC) No 1234/2007.

Chaptalisation: The process of adding sugar to unfermented grape must in order to increase the alcohol content after fermentation.

Concentrated grape must: Concentrated grape must is uncaramelised grape must which is obtained by partial dehydration of grape must carried out by any authorised method other than by direct heat.

Concentrated must (rectified): Rectified concentrated grape must is the liquid uncaramelised product which is obtained by partial dehydration of grape must carried out by any authorised method other than direct heat; and has undergone authorised treatment for de-acidification and elimination of constituents other than sugar.

Crisis distillation measure: Support granted until 31 July 2012 for voluntary or obligatory distillation of surplus wine decided upon by Member States in justified cases of crisis so as to reduce or eliminate the surplus and at the same time ensure supply continuity from one harvest to the next.

Enrichment: The increase in natural alcoholic strength by volume of fresh grapes, grape must or wine still in fermentation by adding sucrose, concentrated grape must or rectified concentrated grape must or by partial concentration;

Green harvesting measure: Green harvesting means the total destruction or removal of grape bunches while still in their immature stage, thereby reducing the yield of the relevant area to zero. Support for green harvesting may be

granted as compensation in the form of a flat rate payment per hectare to be determined by the Member State concerned.

Grubbing-up premium: Support granted to vine growers for the permanent withdrawal of all vines in a parcel or holding.

Harvest insurance measure: Support aimed at contributing to the safeguarding of producers' incomes where these are affected by natural disasters, adverse climatic events, diseases or pest infestations.

Investments measure: Support granted for tangible or intangible investments in processing facilities, winery infrastructure and marketing of wine which improve the overall performance of the enterprise and concern one or more of the following: (a) the production or marketing of products referred to in Annex XIb of Regulation (EC) No 1234/2007; (b) the development of new products, processes and technologies related to the products referred to in Annex XIb.

Mutual funds measure: Mutual funds provide assistance to producers seeking to insure themselves against market fluctuations. Community support for the setting-up of mutual funds may be granted in the form of temporary and degressive aid to cover the administrative costs of the funds.

Planting rights: Within the EU, the planting of vines of wine grape varieties is prohibited, except if that planting is covered by planting rights – the right, granted in hectares, that entitles vine growers to plant vines. These rights can take the form of (i) individual replanting rights, granted to a farmer following the grubbing-up of previously existing vines; or (ii) new planting rights and rights from a national or regional reserve managed by the Member State, not yet allocated to specific growers. Additional requirements of the planting right system are described in articles 85f through 85n of Regulation No (EC) 1234/2007.

Potable alcohol distillation measure: Support granted, in the form of per-hectare aid, until 31 July 2012 to producers, for wine which is distilled into potable alcohol.

Promotion measure: Support for information or promotion measures concerning Community wines. The promotion measure relates to wines with a Protected Designation of Origin or Geographical Indication, or wines with an indication of the wine grape variety. This measure may consist only of: (a) public relations, promotional or advertisement measures, (b) participation at events, fairs or exhibitions of international importance, (c) information campaigns, (d) studies of new markets, necessary for the expansion of market outlets; and (e) studies to evaluate the results of the promotional and information measures. The Community contribution to promotion activities shall not exceed 50 % of the eligible expenditure.

Restructuring and conversion of vineyards measure: Support for restructuring and conversion of vineyards may only cover one or more of the following activities: (a) varietal conversion, including by means of grafting-on; (b) relocation of vineyards; (c) improvements to vineyard management techniques. The normal renewal of vineyards which have come to the end of their natural life shall not be considered as a restructuring and conversion activity. Support for restructuring and conversion of vineyards may only take the following forms: (a) compensation of producers for the loss of revenue due to the implementation of the measure; (b) contribution to the costs of restructuring and conversion.

Single Payment Scheme (SPS): An aid scheme which replaced most of the pre-existing direct aid payments and in which aid is decoupled from any obligation to produce. Instead, full payment of aid is subject to the condition that farmers keep all their land in good agricultural and environmental condition (GAEC) and respect statutory management requirements (SMRs) – the ‘cross-compliance’ requirement.

Usable production: Production of must intended for wine processing and equivalent to total production deducted of uses other than wine, in particular, of must intended solely for grape juice and losses due to evaporation.

Use of concentrated grape must: Support granted until 31 July 2012 to wine producers who use concentrated grape must, including rectified concentrated grape must, to increase the natural alcoholic strength of products in accordance with the conditions laid down in Annex XVa of Regulation (EC) No 1234/2007.

Vineyard inventory: A database containing information on the wine production potential of each Member State.

Wine year: The production year for wine products (described in part XII of Annex I of Regulation (EC) No 1234/2007. It begins on 1 August each year and ends on 31 July of the following year.

ABBREVIATIONS

CAP: Common agricultural policy

COM: Common organisation of the market

EAFRD: European Agricultural Fund for Rural Development

EAGF: European Agricultural Guarantee Fund

EU-27: European Union of 27 Member States

ha: Hectare

hl: Hectolitre

SPS: Single payment scheme

SUMMARY

I. The European Union (EU) is the world's biggest wine producer. With 3,5 million ha of vines, the EU produced during wine year 2007/08 approximately 160 million hl of wine . This accounts for around 60 % of the world's wine production. Wine production is estimated to represent approximately 5 % of the EU agricultural output. France, Spain and Italy are the largest wine producing Member States.

II. In 2008, the Council introduced a reform of the common organization of the market in wine aimed essentially at improving the competitiveness of EU wine producers and balancing supply and demand in the wine sector, this in a context of a long persisting structural surplus of supply and falling demand. The main financial instruments of this reform included a temporary grubbing-up scheme and the setting up of national support programmes: a specific budget made available for each Member State, which can choose the measures (among 11 available) best adapted to its particular situation.

III. The main objective of the audit was to assess the progress achieved to date as regards one of the main objectives of the reform: improving the balance between supply and demand. The audit focussed on the,'grubbing-up' and 'restructuring and conversion of vineyards' measures, the two largest areas of spending.

IV. Faced with an overall (EU-27) long standing situation of structural surplus and loss of international competitiveness, the reform created or redesigned tools to tackle the main problems in the wine market. It is too early to assess the effectiveness of the measures, other than grubbing-up and restructuring, introduced with the setting-up of national envelopes which take into account the diversity of market circumstances at the level of each Member State.

V. For the grubbing-up measure, which was an important tool to balance supply and demand, ostensibly by eliminating or at least significantly reducing the market imbalance, the audit found that, the aid rates were set at too high

levels in the first two years of the scheme. Each year, the demand for the measure exceeded the target even when the rates were maintained at their previous levels in the third year. The Court considers that, in these circumstances, the scheme could have been more efficient – since it is likely that smaller increases or even keeping the aid rates at their previous levels would have made it possible to achieve more significant results with the resources made available or the same results with less resources.

VI. However the expected volume reduction did not materialise, because other measures did not have the impact foreseen. The target of 175 000 ha grubbing-up was not sufficient to correct the existing market imbalance. It was based on criteria which did not materialise as, for example, the discontinuation of enrichment with sucrose, as well as the impact of other measures such as green harvesting and promotion.

VII. As regards the restructuring and conversion measure, which is now made available to Member States as part of the national envelopes, a significant impact has been achieved for large areas of vineyards across Europe. The measure facilitates and therefore accelerates the process of qualitative adaptation of supply to demand and the modernisation and rationalization of vineyards. However, the Member States have used the flexibility accorded to them in implementing the measure to select a wide range of operations to be covered as well as very different aid rates. In addition, increases in yields which result from restructuring without any discernible impact on overall consumption partially off-set the effects of grubbing-up in Spain and Italy.

VIII. Despite the Commission's preparatory work being, for the most part, extensive in scope and depth, some of its initial proposals failed to materialise, whilst the planned liberalisation of planting rights, lacked sufficient research.

IX. On the basis of these observations, the Court recommends:

- The Commission should establish an estimate of the balance between supply and demand in the wine sector based on updated data, including the planned liberalisation of planting rights. On the basis of that estimate it should determine whether any measures are necessary to address possible imbalances.
- Should further grubbing-up measures be considered necessary the grubbing-up of modernised vineyards should be avoided by establishing additional eligibility criteria linked to the vineyard itself and not only to the farmer.
- Given the wide range of operations defined by Member States in implementing the restructuring measure, the Commission should establish a more precise definition of eligible restructuring operations, in particular those allowed under the regulatory heading 'Improvements to vineyard management techniques'.
- In order to avoid overcompensation in those cases where payments to beneficiaries are based on flat rates per hectare, the Commission should require Member States to check, at least on a sample basis, that the EU subsidy does not exceed the eligible percentage of the actual costs.
- While on the one hand the EU finances the grubbing-up measure in order to reduce the surplus of wine produced, on the other hand the restructuring and conversion measure leads to increases in vineyard yields and therefore volumes produced which go against the objective of balancing supply and demand without securing new market outlets; the Commission should therefore ensure that an appropriate policy mix is available to address this tension.

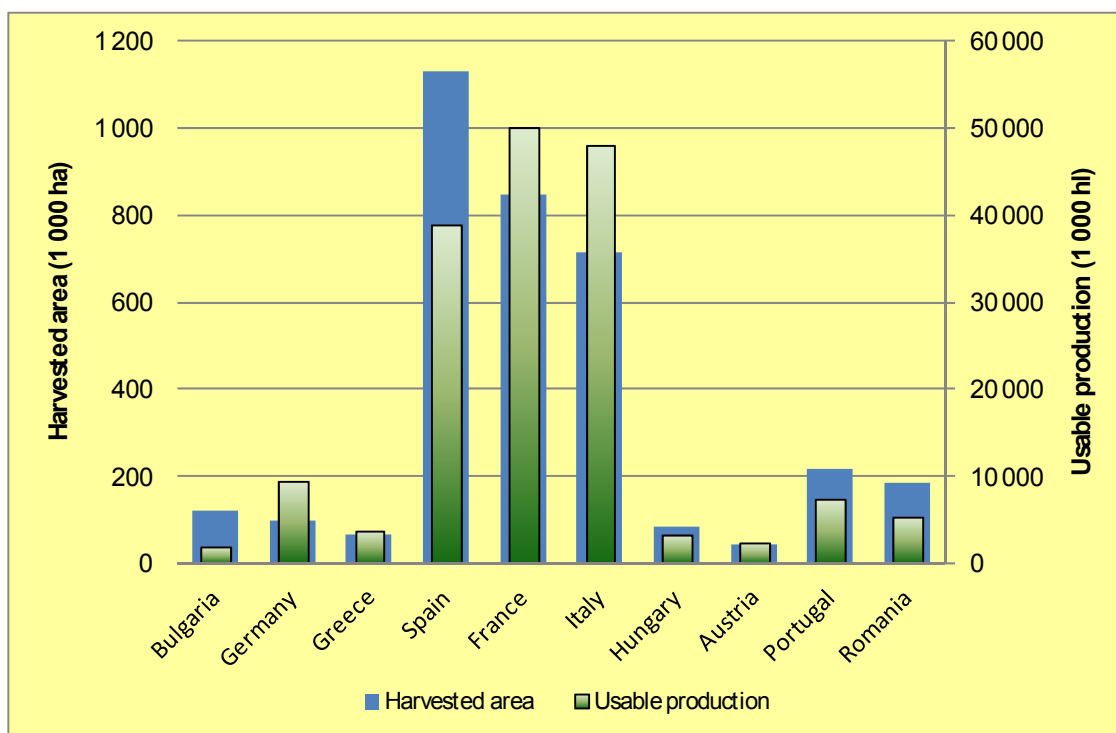
- As regards statistical data, the Commission should define key performance indicators, relevant to the objectives of the reform, that could provide a timely measurement of its success.

INTRODUCTION

Description of the audit area

1. The European Union is the world's biggest wine producer. With 3,5 million ha of vines, the EU produced during wine year 2007/08 approximately 160 million hl of wine². This accounts for around 60 % of the world's wine production and represents about 5 % of the EU agricultural output. France, Spain and Italy are the largest wine producing Member States.

Graph 1 - Vineyard harvested area and usable wine production (average from 2003/04 until 2007/08)¹



Source: Eurostat, supply balance sheet and crops products annual statistics.

¹ Only Member States with an average production over 1 million hl are shown in this graph. Values shown for production refer to a smoothed average which excludes the highest and lowest values for each country during the period in question.

2. The Common Organization of the Market (COM) in wine was created in 1962. At that time, there were only a few legislative instruments regulating the

² European Commission/Agriculture and Rural Development DG, vineyard inventory and Eurostat - supply balance sheet, respectively.

wine market. The COM then supported production with virtually guaranteed sales through intervention measures such as distillation and export refunds, which resulted in a structural surplus. From 1976 a ban on new planting and the obligation to distil the surplus production were introduced and towards the end of the 1980's financial incentives for grubbing-up vineyards were increased. The 1999 reform of the COM for wine aimed at achieving a better balance between supply and demand in the market by financing the restructuring of a large part of the total vineyard area of the EU and reinforcing intervention measures such as export refunds and support for distillation and storage. Notwithstanding the reinforced intervention measures, a balance between supply and demand was not achieved, as those measures effectively maintained a subsidised outlet for the wine surplus.

Overview of EU wine sector at the time of the reform

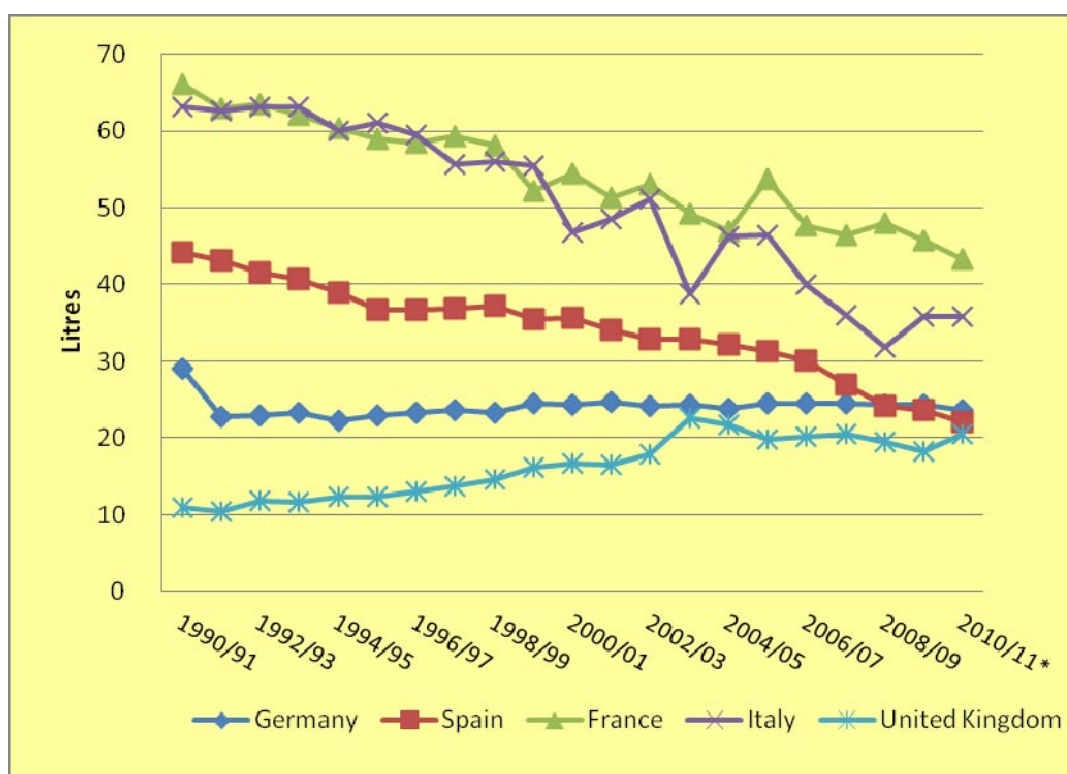
3. This structural surplus of production has been a constant feature of the European wine market over the last decades and has been repeatedly mentioned as a key concern in the various reforms of the COM. In 2005, when the Commission initiated its preparatory work for the latest reform of the COM, accumulated wine stocks represented the equivalent of one year of production and the structural surplus was estimated at approximately 14,5 million hl³, equivalent to 8,5 % of the total production. The Commission estimated that the subsidized potable alcohol distillation scheme increased this surplus by a further 4 million hl to 18,5 million hl. The effect of this excess of supply over demand was to put a downward pressure on wine prices at producer level.

4. On the demand side, overall wine consumption in the EU decreased in the 20 years to 2009. This is largely due to a significant fall in consumption in the

³ Because total production may vary significantly from one year to the other as a result of climatic conditions, structural surplus is best measured using averages of more than one single year. The estimate of 14,5 million hl is based on the Commission's analysis for the period 1999-2003 and the Court's own analysis does not show material differences.

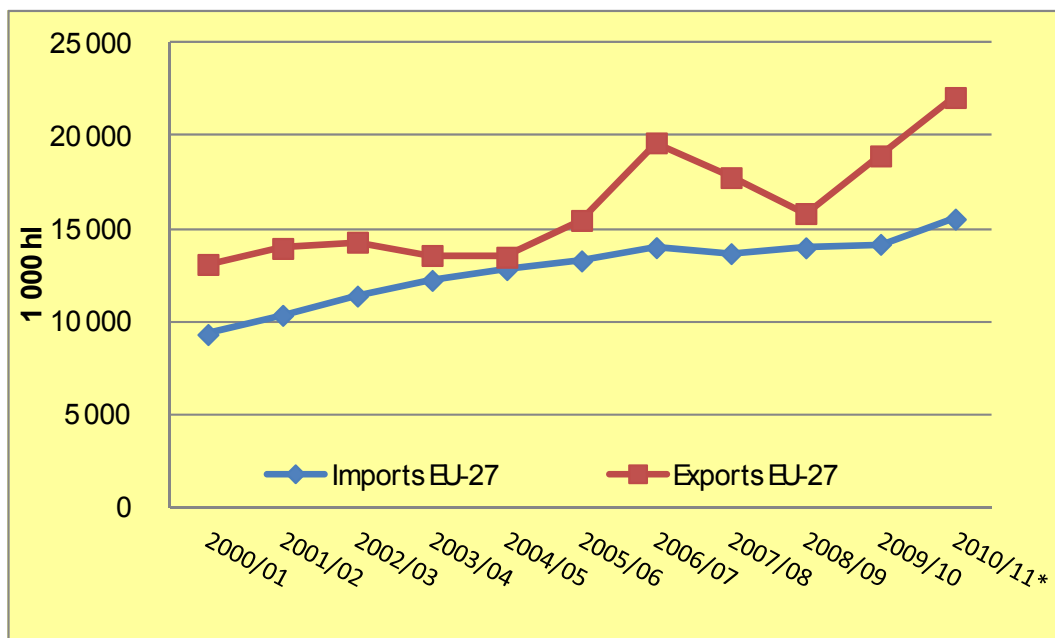
main producing Member States (**Graph 2**). While some Member States have increased their consumption of wine, this increased demand has largely been met by imports, the levels of which have grown until 2007 and are stable since then (**Graph 3**), denoting an overall loss of competitiveness of the European wine production. As the Commission noted in 2006, 'the positive evolution of wine consumption in non wine-producing Member States has not led to a benefit for the sales of EU wines, since the additional volumes consumed almost entirely corresponded to an increase in the consumption of wines imported from third countries'. At the time of the reform, exports had risen, but at a lower rate than that of imports.

Graph 2 - Wine consumption per capita in selected Member States



Source: Eurostat, wine supply balance sheet.

(*) Data concerning wine year 2010/11 are provisional.

Graph 3 - Extra-EU wine trade

Source: Eurostat, wine supply balance sheet.

(*) Data concerning wine year 2010/11 are provisional.

5. The last special report issued by the Court on the COM wine was published in 1987 and covered essentially the Community's wine distillation measures⁴. Already at that time it was clear that supply was exceeding demand, owing to a combination of increasing yields (which off-set measures aimed at reducing the area under vines) and falling demand. Besides finding shortcomings both in the governing regulations and in their implementation at Member State level, the Court concluded that the distillation measures were actually contributing to the structural surplus of supply by providing an assured outlet at excessively attractive prices. In fact, the main effect of the distillation measures was to transfer the problem of structural surplus from the wine to the alcohol market. The adverse effects of the distillation measures, together with the wider problems of persistent imbalances in the wine market and the relative ineffectiveness of the grubbing-up measure (partly due to an off-setting effect

⁴ Special Report No 4/87 (OJ C 297, 6.11.1987, p. 14).

from replanting support schemes), were also noted by the Court in Annual Reports of subsequent years⁵.

The objectives of the reform

6. The primary reason for reforming cited by the Commission in its 2006 communication to the Council and the European Parliament – ‘Towards a sustainable European wine sector’⁶ – was the growing imbalance between supply and demand. As additional reasons, the Commission noted the complexity of the existing regulatory framework; the increased use of crisis distillation, which was becoming a regular practice; decreasing consumption; increasing competition from third countries; the limited success of planting rights in controlling the production potential; and the negative effects of planting restrictions in the process of rationalising the structure of holdings.

7. In the light of those problems, the objectives of the reform were therefore ⁷:

- to create a wine regime that operates through clear, simple and effective rules that balance supply and demand;
- to increase the competitiveness of the Community's wine producers;
- to strengthen the reputation of Community quality wine as the best in the world;

⁵ The Court's annual reports concerning the financial years 1991 (OJ C 330, 15.12.1992, p. 1), 1993 (OJ C 327, 24.11.1994, p. 1), 1996 (OJ C 348, 18.11.1997, p. 1) and 1999 (OJ C 342, 1.12.2000, p. 1) contain specific references to these issues.

⁶ COM(2006) 319 final, 22.6.2006.

⁷ Recital 5 of Council Regulation (EC) No 479/2008 of 29 April 2008 on the common organisation of the market in wine, amending Regulations (EC) No 1493/1999, (EC) No 1782/2003, (EC) No 1290/2005, (EC) No 3/2008 and repealing Regulations (EEC) No 2392/86 and (EC) No 1493/1999 (OJ L 148, 6.6.2008, p. 1).

- to recover old markets and win new ones in the Community and worldwide;
- to create a wine regime that preserves the best traditions of Community wine production, reinforcing the social fabric of many rural areas, and
- to ensure that all production respects the environment.

8. Council Regulation (EC) No 479/2008 on the new COM in wine came into force on 1 August 2008 and provided the overall framework for a wine sector reform. In August 2009, that regulation was repealed⁸ and the wine COM was integrated into the single COM established by Council Regulation (EC) No 1234/2007.

Box 1 – The main features of the reformed COM

The main financial instruments, supported by an annual budget of 1,4 billion euro, are:

- Voluntary grubbing-up of vineyards, limited to a period of 3 years.
- National financial envelopes: a specific budget is made available for each Member State which can choose the measures (among 11 available⁹) best adapted to its specific situation.
- Rural development and environmental protection in wine-producing areas.

⁸ Council Regulation (EC) No 491/2009 of 25 May 2009 amending Regulation (EC) No 1234/2007 establishing a common organisation of agricultural markets and on specific provisions for certain agricultural products (Single CMO Regulation) (OJ L 154, 17.6.2009, p. 1)

⁹ Article 103m of Council Regulation (EC) No 1234/2007 of 22 October 2007 establishing a common organisation of agricultural markets and on specific provisions for certain agricultural products (Single CMO Regulation) (OJ L 299, 16.11.2007, p. 1) lists the measures available to Member States: single payment scheme; promotion; restructuring and conversion of vineyards; green harvesting; mutual funds; harvest insurance; investments; by-product distillation; potable alcohol distillation; crisis distillation; and use of concentrated grape must.

Other features of the wine reform include:

- Immediate withdrawal of intervention measures such as export refunds and storage and the gradual withdrawal of other intervention measures (e.g. crisis distillation) which should end by 2012. The latter measures are included in the national envelopes.
- The extension of the planting rights regime until the end of 2015 with a possibility for Member States to extend the regime to the end of 2018.
- The adaptation of wine-making practices in line with those established by the International Organisation of Vine and Wine (OIV).
- New wine classification rules, according to three categories ('Protected Designation of Origin', 'Protected Geographical Indication' and other wines including varietal wines).
- Simpler labelling rules.
- Cross-compliance requirements (wine growers now have to respect the good agricultural and environmental conditions defined in Council Regulation (EC) No 73/2009).

AUDIT OBJECTIVE, SCOPE AND APPROACH

9. The audit aimed primarily at assessing the progress achieved to date as regards particularly one of the main objectives of the reform: improving the balance between supply and demand. The audit focused on the 'grubbing-up' and 'restructuring and conversion' measures, because they are the two largest areas of spending and because they are crucial to the achievement of the objective of improving the balance between supply and demand. The grubbing-up measure is designed to reduce supply and one target of the restructuring and conversion measure is to adapt supply to demand. Although a general review of the design of other measures was carried out, the audit did not assess their effectiveness, as they have only been implemented from 2009

onwards. At the time of execution of the audit such an assessment would have been premature.

10. The Court conducted audit missions to Germany, Spain, France, Italy and Romania and to the Commission, to interview the officials responsible for the reform preparation, implementation and monitoring. In the Member States selected, the audit included the review and analysis of national legislation, statistical data and internal procedures on the basis of samples of transactions, as well as audits on the spot to beneficiaries – the wine growers. The transactions reviewed were sampled from expenditure made during the financial year 2009¹⁰ – the first year of implementation of the reform.

OBSERVATIONS

The design of the reform

In general, an extensive review undertaken by the Commission

11. In preparing the reform, the Commission undertook a wide-ranging review of the wine sector. Between 2005 and 2008, it undertook an ex-post evaluation of the pre-existing regime, consultation with stakeholders, an impact assessment and research on specific aspects of the wine sector.

12. In addition to the grubbing-up and restructuring measures, which are covered in detail in the following sections, the reform included the following important features:

- (a) The creation of national envelopes which means that, given the diversity of the wine sector, Member States¹¹ are able to choose the measures best adapted to their specific situation including the above mentioned

¹⁰ The EAGF financial year n runs from 16 October n-1 to 15 October n.

¹¹ The wine sector in each Member State varies significantly, not only in terms of the diversity of products, but also in terms of the structure of production and the balance or imbalance between national production and consumption.

restructuring measures. Indeed, wine is not an undifferentiated commodity: there is an important product diversity as well as a different market situation in the different Member States. Adaptable national envelopes can be an appropriate response to these diverse national market circumstances.

- (b) The gradual end of intervention measures such as storage and distillation, which were being used systematically, as shown in **Box 2**, is designed to eliminate alternative, non-market based outlets for wine production.

Box 2 – Use of ‘crisis distillation’ and ‘storage’, quantities distilled and EU expenditure during 2000-08				
Use of crisis distillation			Storage of wine and grape must	
Wine year	Quantities distilled (hl)	Expenditure (euro)	Financial year	Expenditure (euro)
2000/01	5 923 000	120 400 000	2001	61 706 018
2001/02	6 679 000	165 160 000	2002	68 534 023
2002/03	-	-	2003	53 182 036
2003/04	-	-	2004	50 206 010
2004/05	7 058 000	175 053 000	2005	69 571 712
2005/06	4 880 000	120 300 000	2006	90 332 117
2006/07	-	-	2007	85 452 311
2007/08	-	-	2008	73 821 269
Total	24 540 000	580 913 000	Total	552 805 497
<i>Source: European Commission, Agriculture and Rural Development DG.</i>			<i>Source: European Commission, general budget.</i>	

However, an important issue not sufficiently researched by the Commission

The end of the planting rights regime

13. One of the key elements of the COM in wine is the planting rights regime, in force since 1976, which significantly restricts the planting of new vineyards. Although the COM in 1999 planned that the regime should end in 2010, the

reform of 2008 maintains it until the end of 2015, and allows the Member States to continue enforcing it in all or part of their territory until the end of 2018¹².

14. In internal memoranda, the Commission briefly analysed the impact of the abolition of planting rights and concluded that there was no risk of an increase of plantations subsequent to the end of the planting rights regime, considering that after the end of the market support mechanisms, 'producers will only plant if they are sure of a commercial outlet'. However, the Commission did not carry out an in-depth impact assessment of the potential consequences - risks and opportunities - arising from the extension of the planting rights regime¹³.

And some initial Commission proposals were not adopted

The distillation for potable alcohol scheme

15. Earlier versions of the COM , included support for wine distilled into potable alcohol – which can then be used in drinks such as port wine or brandy. Such support was calculated on the basis of the volume of wine actually distilled. During the preparation stage of the latest COM, the Commission considered both a reduction in the aid for distillation and its termination. Behind these alternatives was the concern that the previous aid rates for distillation were too attractive compared to wine market prices, thereby artificially promoting the production of low quality wine and hindering the restructuring of the sector. In the end, the Council decided to maintain the scheme during a limited transitional period of 4 years, but in the form of a per-hectare aid (independent from the volume of wine distilled), to be paid to producers whose production is used for wine distillates. While this decision has a positive short-term effect on the balance in the wine market, it does not address the negative effects of the scheme.

¹² Article 85g(5) of Regulation (EC) No 1234/2007.

¹³ This was in contrast with what happened in other markets subject to significant changes e.g. the milk market after the abolition of the milk quota regime.

Enrichment

16. In years when weather is unfavorable, enrichment may be necessary to produce wine with the required alcoholic strength. In Europe, an average of 27 million hl of wine are enriched every year using concentrated must or rectified concentrated must and 28 million hl using sucrose (the latter process is also known as 'chaptalisation'). The total of 55 million hl corresponds to 30 % of the total EU wine production. Enrichment on this scale uses 5 million hl of must and 90 000 tonnes of sucrose.

17. The Commission initially proposed to abolish aid for the use of concentrated must and to ban the use of sucrose. Shifting from enrichment with sugar to rectified concentrated must would not pose significant technical difficulties, but would increase production costs, such as the costs of transporting the rectified concentrated must. The Commission envisaged that this would have led to savings of 130 million euro per year and would have helped balance the market (4,4 million hl through the replacement of sucrose with rectified concentrated must). However, the proposal faced strong opposition from some Member States which argued that it would negatively affect the competitiveness of the producers concerned and force a change in traditional practices in regions where no structural surpluses exist. The Council decided to abolish the aid for the use of concentrated must as of wine year 2012/13 while continuing to allow the use of sucrose in some regions (as defined in Annex XVa of Regulation (EC) No 1234/2007). Thus, the theoretical 4,4 million hl reduction could not be achieved.

Limited measures to address short term production fluctuations

18. Historic records have shown that total wine production can vary between two consecutive years by more than 15 %¹⁴. The reform terminated those

¹⁴ Wine usable production reached 168 million hl in 2003 but rose to 194 million hl in 2004, i.e. an additional 26 million hl of wine between 2003 and 2004.

market support mechanisms (such as storage, distillation or export refunds) that helped wine producers to deal with variable production levels. The two measures introduced by the reform with the objective of minimising the negative effects of such variability (green-harvesting and mutual funds) either have so far had a limited take-up or are limited in scope¹⁵. Green-harvesting, which is the measure offering the greatest potential to address harvest variations, has the additional inherent shortcoming of being limited to a period between June and July¹⁶ during which farmers may not yet have a clear picture of the year's harvest. Thus, this new measure cannot have a substantial impact on the wine balance.

The impact of the grubbing-up and restructuring measures

The grubbing-up scheme

A well-suited instrument

19. The transitory 'grubbing-up scheme' is a major feature of the reformed COM designed to provide a quick and permanent response to the structural surplus through a reduction in production. In essence, it provides compensation to farmers who opt to permanently dig up their vines and lose the corresponding planting rights. By supporting the permanent withdrawal of vineyards, the grubbing-up scheme is a more effective instrument to deal with a structural

¹⁵ During financial year 2009, only Slovenia used green-harvesting, for an amount of 131 000 euro, or 3,7 % of its national envelope. The take up increased in 2010 (16,8 million euro) but is still limited to Italy, Slovenia and Cyprus. As regards mutual funds, there was no expenditure under that measure in both financial years 2009 and 2010, and none is foreseen until the end of the programming period, 2013.

¹⁶ Article 12 of Commission Regulation (EC) No 555/2008 of 27 June 2008 laying down detailed rules for implementing Council Regulation (EC) No 479/2008 on the common organisation of the market in wine as regards support programmes, trade with third countries, production potential and on controls in the wine sector (OJ L 170, 30.6.2008, p. 1) - Claims must be submitted between 15 April and 31 May whilst the actual harvest and final control must take place between 15 June and 31 July.

surplus of wine than the previous intervention measures, such as the storage and distillation measures, which simply provided a temporary solution to a structural problem. In these circumstances, the success of the grubbing-up scheme is essential to achieving a structural balance between supply and demand in the wine market.

20. Although a similar scheme already existed in previous versions of the COM ('abandonment premium'), the scope of the measure was enlarged, in particular because the option previously given to Member States to decide whether or not to apply the measure in their territory was removed. Between 1996 and 2008 access to this measure by farmers was dependent on national rules, with the result that the area actually grubbed-up during that period was insignificant in most Member States¹⁷. With the latest reform, each individual farmer is free to apply for the measure, extending its potential scope to all EU vineyards¹⁸.

21. Regulation (EC) No 479/2008 established the budget available for the grubbing-up measure at 1 074 million euro, to be used throughout its 3 year application period as follows:

				<i>(million euro)</i>
Wine year	2008/09	2009/10	2010/11	Total
Budget available	464	334	276	1 074

¹⁷ In the period prior to the latest COM reform, in particular between 1988 and 1996, more than 500 000 ha of vineyards have been grubbed up, mostly in Spain, Italy and France, the biggest producing Member States. This corresponds to a reduction of more than 1/8 of the EU-12 vineyard area existing in 1988 – approximately 4 million ha. After 1996, however, Member States were given the option to restrict the application of the measure in their respective territories, which resulted in the area grubbed-up after that date being significantly reduced (between 1997 and 2008 less than 30 000 ha have been grubbed up, principally in France).

¹⁸ However, Member States did retain the possibility of limiting the impact of grubbing-up in certain regions or once the area actually grubbed-up reached certain pre-defined thresholds.

But aid rates set at too high levels and demand for the measure exceeded the target even when the rates were maintained at their previous levels

22. The Commission decided, without evident justification, to increase the rate of aid by 20 % in the first of the 3 years of application of the scheme and by 10 % on the second, while the rates were maintained at their previous levels for the third and last year¹⁹. This was based on the premise that premium levels should cover at least 5 years of farmers' profit margin. However, areas of the EU vineyard inventory accounting for substantial grubbing-up activity²⁰ were already meeting that criterion prior to the reform. The Court estimates that these increases in aid rates cost the EAGF approximately 100 million euro, or 10 % of the total cost of the grubbing-up scheme.

23. When, the reform of the COM was implemented in 2008, the combined effect of higher aid rates and largely unrestricted access led to a significant increase in the demand for this measure in many wine-producing Member States, exceeding the funds available in each of the three years of the measure. The Commission had therefore to limit the acceptance of claims in each Member State to a given percentage of the monetary amount of the claims received. The overall situation is shown in **Table 1**.

¹⁹ Aid rates per hectare in the grubbing-up scheme are calculated as a function of the historical yield of the holding concerned, although certain derogations are foreseen in case that information is not available. They vary between 1 450 euro/ha and 12 300 euro/ha for the lowest and highest yield categories respectively. However, these rates were increased by 20 % during the first year of application of the scheme and by 10 % during the second.

²⁰ The Commission's own analysis shows that for Castilla – La Mancha (where 44 % of the overall grubbing up during the 3 year campaign took place) the previous aid rates were already covering 6,5 years of margin, while Languedoc-Roussillon (where 10 % of the overall grubbing up during the 3 year campaign took place) almost meets the criteria (4,9 years of margin).

Table 1 - Grubbing-up scheme - Areas claimed, accepted after application of percentage of acceptance and grubbed-up

Wine Year	Area claimed (ha)	% acceptance	Area accepted (ha)	Area grubbed-up (ha)	% grubbed-up
2008/09	159 949	45,9	73 377	68 903	93,9
2009/10	108 064	50,1	54 182	47 613	87,9
2010/11	83 210	59,6	49 612	44 033	88,8
Total	351 223	50,4	177 171	160 550	90,6

Source: Agriculture and Rural Development DG, Communications from Member States.

24. Because the demand for the grubbing-up measure during the three years of its duration largely exceeded the funds available, a prioritization was needed, indicating that, at the levels set, many more farmers were willing to grub-up than those who actually benefited from the scheme. This situation even occurred in the third and last year of the measure, when the aid rates were equal to those in force prior to the reform. This calls into question the scale of the increase of the aid rates and consequently the efficiency of the measure: the large demand for the measure indicates that the same grubbed-up area could have been achieved with fewer resources, by smaller increases in the aid rates or even by keeping the aid rates at their previous level.

However the expected volume reduction did not materialise largely because other measures did not have the impact foreseen

25. Initially, taking into account the proposed termination of the distillation measures, the Commission estimated the structural surplus of wine to be 18,5 million hl (see paragraph 3), and calculated that reducing supply by this amount would require the grubbing-up of 400 000 ha over a 5 year period, with a cost of 2,4 billion euro. Later, in 2007, the Commission assumed that other reform measures such as the ban of sucrose, green-harvesting, rural

development, promotion and labelling, would reduce the wine surplus by 10 million hl. As a result, the target of the grubbing-up scheme was revised to 175 000 ha, with an associated budget of some 1,1 billion euro.

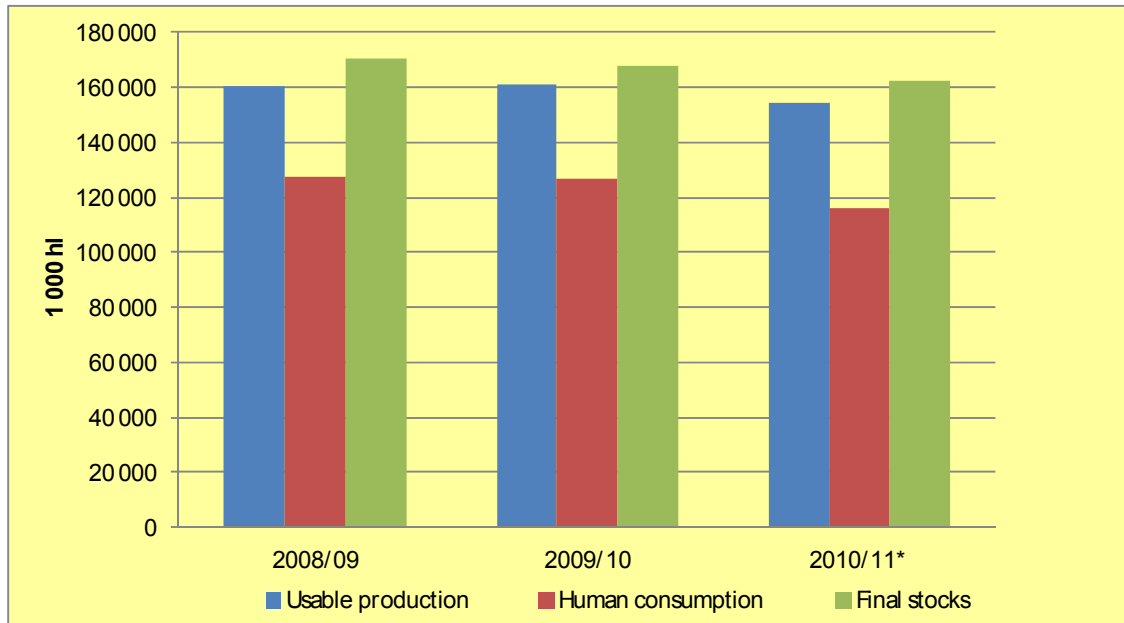
26. However, some of these assumptions did not materialize: the ban of sucrose was not taken on board in the final text of the reform whilst green-harvesting and promotion have had, as yet, a limited effect. The Court considers also that the increase in demand expected from promotion, labelling and rural development lacked specific quantitative evidence to support such expectations. In the absence of the planned impact from other measures, the target of 175 000 ha from grubbing-up was not sufficient, by itself, to address the Commission estimated structural surplus at the time of the reform.

27. Thus, although demand for grubbing-up exceeded 350 000 ha (**Table 1**), its impact was limited by the fixed target of 175 000 ha and at the end only 160 550 ha were grubbed up. The Court estimates that the grubbing-up scheme finally reduced the vineyard inventory area by around 5 %²¹ corresponding to approximately 10,2 million hl of wine withdrawn or 6 % of the usable wine production²². As shown in **Graph 4**, EU-27 usable wine production and stocks decreased slightly in wine year 2010/11 but wine consumption also decreased. Even if such reduction in production and stocks were confirmed in the long term, a significant increase in exports would be necessary to tackle the remaining market imbalances.

²¹ 3,5 million ha as of wine year 2007/08.

²² The estimate of the total usable production permanently withdrawn through the grubbing-up scheme is based on the official communications from Member States to the Commission on the number of ha grubbed-up and their classification in yield classes, this for the 3-year period of campaigns 2008/09 to 2010/11. The average usable production for the period 2000-08, as published by Eurostat, was of 176,3 million hl.

Graph 4 – Recent evolution of usable production, consumption and stocks

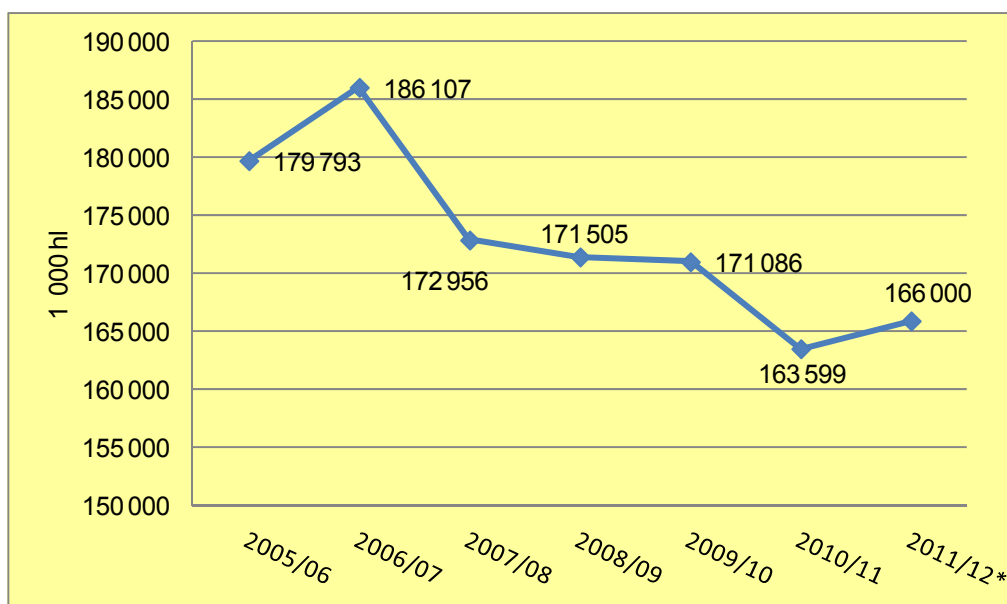


Source: Eurostat, supply balance sheet.

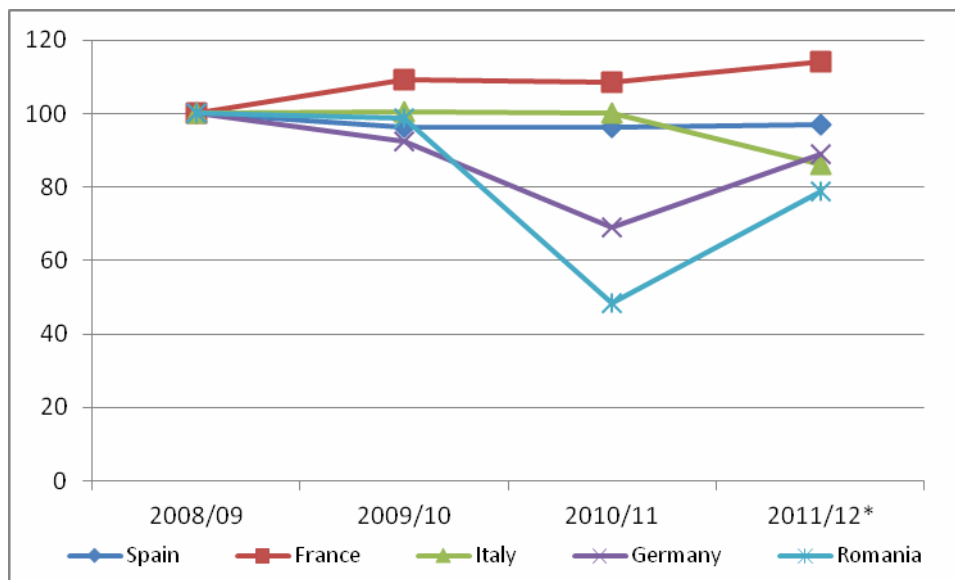
(*) Data relating to wine year 2010/11 are provisional.

28. **Graphs 5 and 6** show the latest available data on wine production until wine year 2011/12, which follows the three wine years of implementation of the grubbing-up measure.

Graph 5 – EU-27 wine production



**Graph 6 – Evolution of the wine production for some Member States
(2008/09=100)**



Source: Agriculture and Rural Development DG.

(*) Data relating to the wine year 2011/12 are provisional.

29. Overall EU-27 wine production decreased in wine year 2010/11 but not in the Member States that had grubbed up the largest area during the two first campaigns: Spain (68 447 ha), Italy (20 532 ha) and France (16 674 ha). Without new market outlets some of the reduction in productive capacity can be off-set by an increase in yields in certain regions (as described in more detail in paragraphs 36 and 37). The EU-27 wine production decrease in wine year 2010/11 is mainly due to a decrease in Germany and Romania where the total area grubbed up was respectively 56 ha and 185 ha for the two first wine years of enforcement of the scheme. In wine year 2011/12, wine production increased compared to 2010. The Court considers that account taken of the climatic conditions, grubbing-up did not yet cause the expected reduction in wine production.

Grubbing-up not targeting the less viable vineyards

30. The opening up of the aid to most vine growers as well as the criteria established by article 85s(5) of Regulation (EC) No 1234/2007 which gives

priority to farmers above 55 years old or those who opt to grub up their entire holdings, means that grubbing-up is not necessarily targeting the less competitive or less viable vineyards. This reflects the objective of the scheme which leaves it to producers to decide whether their vineyards are viable²³. However, it creates the risk of the scheme financing the grubbing-up of vineyards that had already been restructured and were in principle competitive. The Court found such cases of modernised vineyards which were nevertheless grubbed up with EU funds (see **Box 3**). There is thus an inherent tension between the grubbing-up scheme and the restructuring measures leading to inefficiencies in the use of EU aid.

Box 3 – Example of a modernised vineyard which was grubbed-up

One of the farmers visited by the Court in Spain opted for the grubbing-up of a parcel of approximately 55 ha which had been planted only 11 years previously with a red wine variety (tempranillo) and in espalier structure [espaldera] – conditions that match the pattern for which restructuring aid was also being made available to other wine growers. The EAGF contributed approximately 420 000 euro for this operation. This highlights the fact that the policy is financing the restructuring of older vineyards whilst simultaneously funding the grubbing-up of vineyards already having a modernised, market-oriented structure; and illustrates that the grubbing-up aid can be unduly attractive even in the case of modern competitive vineyards.

Shortcomings found in national implementing rules

31. After grubbing-up, farmers are subject to ‘cross-compliance’ conditions, i.e. subject to possible reduction of the grubbing-up premium in case of non-compliance with certain requirements²⁴ on their holdings for a period of three

²³ Recital 68 of Regulation (EC) No 479/2008 mentions that ‘Where producers consider that the conditions in certain areas are not conducive to viable production, they should be given the option of cutting their costs and permanently withdrawing these areas from wine production [...]’.

²⁴ Cross-compliance refers to the statutory management requirements and the good agricultural and environmental condition mentioned in Articles 3 to 7 of Regulation (EC) No 1782/2003 of 29 September 2003 establishing common rules

years²⁵. However, in France this obligation is waived for beneficiaries who stop entirely their agricultural activity, on the basis that in such cases the beneficiaries no longer correspond to the definition of 'farmer' in the regulation. This interpretation however undermines the main objective of the obligation, which is to 'guarantee the responsible treatment of the grubbed-up areas'. Therefore in the Court's view the part of the regulation stating that 'entitlement to the premium should be dependent on compliance by the producers concerned with the applicable environmental rules²⁶' remains valid, even when farmers cease agricultural activity.

Restructuring and conversion measure

Important measure to improve adaptation to demand

32. The restructuring and conversion of vineyards has been a cornerstone of the COM in wine since the reform in 1999. The objective of the measure is to increase the competitiveness of wine producers through paying compensation for the loss of revenue while a vineyard is being adapted, and as a contribution to the costs of restructuring and conversion.

33. Substantial EU resources have been allocated to the measure, not only in absolute terms (4,2 billion euro over the decade 2001-10, an average of 420 million per year) but also as a share of the total funds of the COM (approximately 32 %). This trend continued after the introduction of the latest reform, as Member States continued to place a strong focus on the measure, now an option among others within their national envelopes. At a total cost of

for direct support schemes under the common agricultural policy and establishing certain support schemes for farmers and amending Regulations (EEC) No 2019/93, (EC) No 1452/2001, (EC) No 1453/2001, (EC) No 1454/2001, (EC) 1868/94, (EC) No 1251/1999, (EC) No 1254/1999, (EC) No 1673/2000, (EEC) No 2358/71 and (EC) No 2529/2001 (OJ L 270, 21.10.2003, p. 1).

²⁵ Article 85t of Regulation (EC) No 1234/2007.

²⁶ Recital 71 of Regulation (EC) No 479/2008.

some 326 million euro in financial year 2009, it was the main choice for all Member States, with the exception of Spain (which allocated the largest part of its envelope during financial year 2009 to distillation) and other smaller producing Member States, which opted to transfer a substantial part of their envelopes to SPS²⁷.

34. The impact of the measure is significant. For the two largest wine producing regions Castilla-La Mancha and Languedoc-Roussillon, respectively 16 % and 21 % of their total vineyard area has been restructured over the last 10 years with the support of EU funds²⁸.

Table 2 – Impact of EU-financed restructuring in some Member States and regions

	Italy	Spain (Castilla- La Mancha)	France (Languedoc- Roussillon)	Germany
Total vineyard area 2000 (2002 for Languedoc-Roussillon) in ha	724 860	566 380	295 464	101 541
Number of ha restructured between wine years 2000/01 and 2008/09	127 177	90 000	63 166	16 016
% Restructured	18	16	21	16

Source: Data collected from Eurostat (Basic and Annual Vineyard Survey) and the national and regional authorities visited.

35. Certain factors are key to ensuring the competitiveness of a vineyard: grape variety (whether or not it is adapted to market demand), yield (productivity) and cost structure (the cost of production). In this context, the restructuring

²⁷ Greece, Luxembourg, Malta and the United Kingdom (as of 2010) opted to irrevocably transfer a substantial part of their envelopes to the single payment scheme.

²⁸ In some regions, such as Languedoc-Roussillon in France where the restructuring measure was already being applied since the decade of 1980, the impact was even higher – According to data provided by the French paying agency FranceAgriMer almost 40 % of the vineyard existing in 1977 was restructured or approximately 164 000 ha.

measure, which includes support for varietal conversion²⁹, relocation of vineyards or improvements to vineyard management techniques, is generally acknowledged as a fundamental tool in promoting competitiveness³⁰, as it facilitates the farmer's efforts to adapt production to demand and to make gains in productivity and/or savings in cost³¹.

Without new market outlets increased yields from restructuring and conversion of vineyards can partially off-set grubbing-up effects

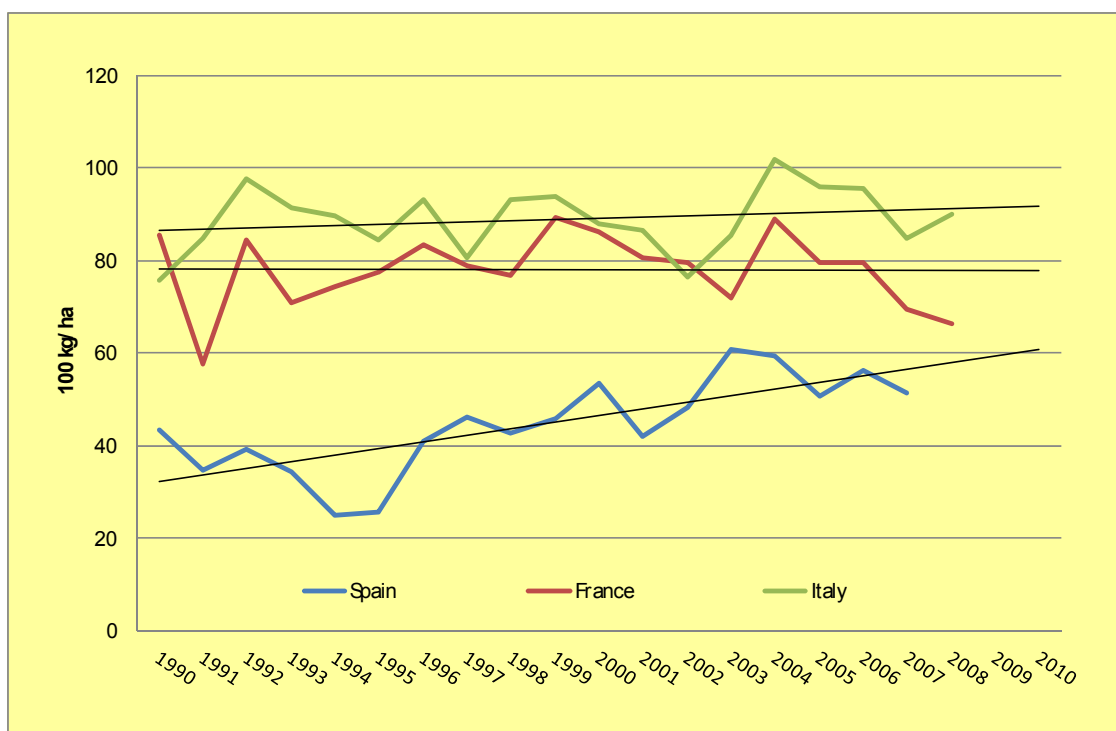
36. On the other hand, where restructuring leads to increases in vineyard yield, this can partially cancel out the effect of grubbing-up in reducing the market imbalances unless new outlets are found. This is in particular the case as the new EU rules on restructuring no longer prohibit such increases, as was the case in the reform of 1999³². Although the overall results of the most recent restructuring projects are yet to be established, there have been increases in yields during the past two decades, particularly in Spain where historical yields had been low relative to other wine-growing regions (see **Graph 7**).

²⁹ The Court noted, for example, a substantial change in the pattern of varieties used by vine growers, who increased their focus in red-wine varieties during the period 2000-10. The red-wine area increased by 18 percentage points (pp) in Spain (to 55 % of the total vineyard area), 8 pp to 32 % in Germany, 5 pp to 75 % in France, and 5 pp to 56 % in Italy.

³⁰ Article 103q(1) Regulation (EC) No 1234/2007: 'The objective of measures relating to the restructuring and conversion of vineyards shall be to increase the competitiveness of wine producers'.

³¹ An example of a potential cost-saving factor is mechanization: although not covered by the restructuring measure, mechanization of certain vineyard operations is only possible with a specific vineyard structure (e.g. espalier) – a transformation which in turn, is directly supported by the restructuring and conversion measure.

³² This issue has been noted in the past, and the Court's conclusions in Special Report No 4/87 refer specifically to it. Commission Regulation (EC) No 1227/2000 (OJ L 143, 16.6.2000, p. 1) on production potential seeks to prevent increases in yield by establishing that 'Member States shall lay down rules restricting the use, in implementing a plan, of replanting rights which arise from grubbing-up as set

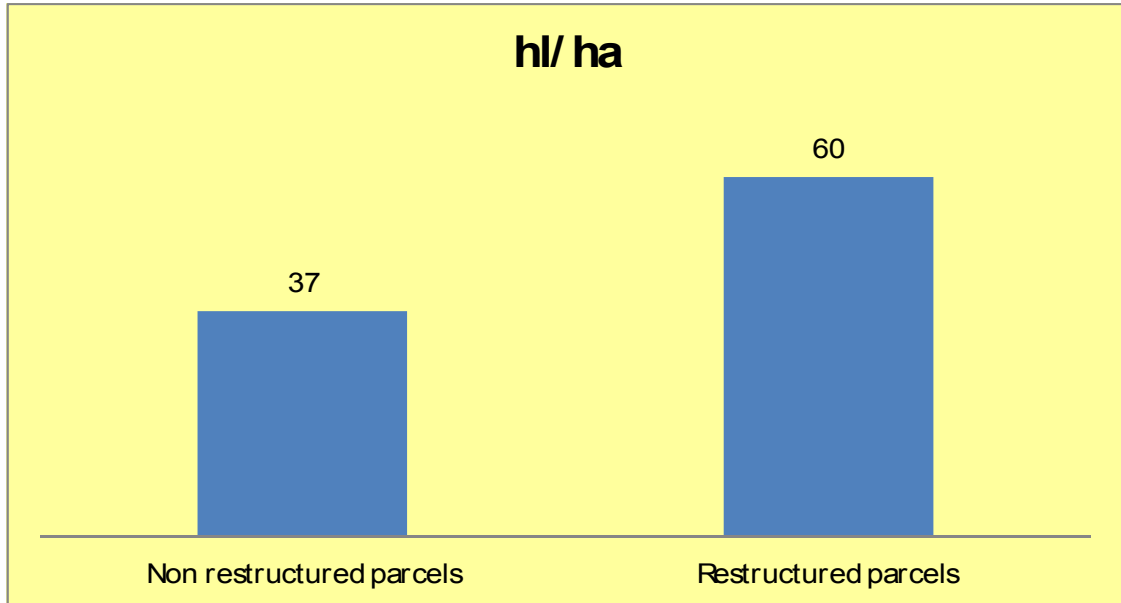
Graph 7 - Trend of the wine grape yield

Source: Eurostat crops products annual statistics.

37. In Castilla – La Mancha, the Court's analysis of the vineyard register showed that restructured parcels have average yields that exceed those of un-restructured parcels by almost 60 % (see **Graph 8**). **Graph 9** illustrates how the effect of grubbing-up on wine production has been partially cancelled out by the yield increase in Spain and Italy. If this increased production fails to find a market outlet, the problem of the long-standing surplus will grow.

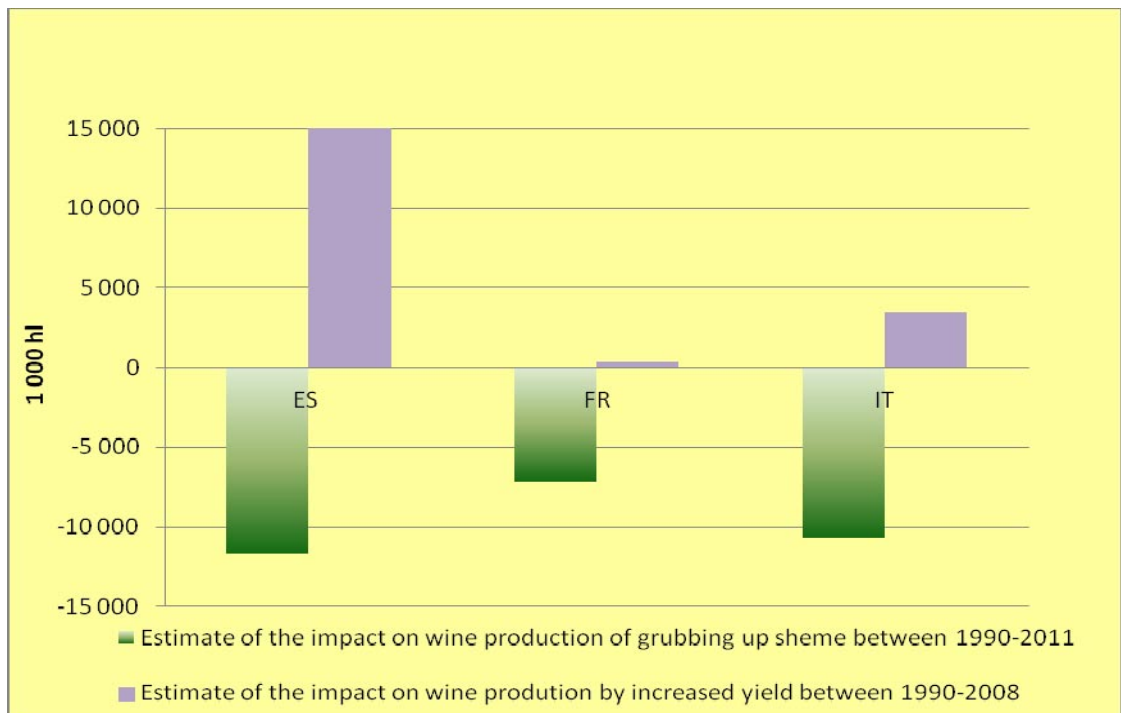
out in the plan where so doing would lead to a possible increase in the yield of the area covered by it'. Such requirement no longer exists in the new COM.

Graph 8 - Average yield comparison between restructured and non-restructured parcels in Castilla – La Mancha for the period 2007-09



Source: Vineyard register, Castilla – La Mancha.

Graph 9 - Court's estimate of the grubbing-up and yield increase effect on wine production for Spain, France and Italy



Source: Court's estimate based on Eurostat crops products annual statistics and Agriculture and Rural Development DG 's figures.

38. The impact of restructuring on production is also increased by the fact that projects are eligible for aid even when they are based on planting rights coming from a national or regional reserve. The Court noted that in Romania the restructuring measure is effectively financing the expansion of vineyard area, instead of renewing the existing holdings, many of which are not adapted to current market demand. The Court estimates that the impact on production could reach up to additional 250 000 hl or 5 % of Romania's average production during the period 2000-08³³. Again, this can contribute to the persistence of market imbalances at European level, if increased overall demand does not accompany such increased production.

Ineligible operations together with wide variability of costs found in restructuring and conversion

39. Article 103q of Regulation (EC) No 1234/2007 establishes that support for the restructuring and conversion of vineyards may only take the forms of compensation to producers for the loss of revenue due to the implementation of the measure and/or of a contribution to the actual costs of restructuring and conversion of vineyards which may not exceed 50 % or 75 % in the convergence regions. The Regulation also establishes as activities that can be covered by the measure varietal conversion, relocation of vineyards and improvements to vineyard management techniques.

40. The specification 'vineyard management techniques' is wide in scope and leave a considerable room for interpretation by the Member States which ultimately carry the responsibility for the implementation of the measure. The absence of further guidance, particularly in the implementing Regulation (EC) No 555/2008, has two important consequences on the effectiveness and the efficiency of the measure:

³³ This estimate is based on the 9 169 ha of planting rights available in the Romanian national and regional reserves, at an average yield of 27 hl/ha.

- (a) Member States have defined a wide range of activities, some of which are hardly comparable between each other, while others do not relate to restructuring projects at all – examples found by the Court's audit and also by the Commission are shown in **Box 4**:

Box 4 – Ineligible actions financed under restructuring and conversion measure for the wine year 2008/09

In the Czech Republic, the audit services of the European Commission found that active and passive protection against birds and wildlife actions have been financed under the restructuring and conversion measure on the condition that at least 300 hours should be spent in protecting the vineyard.

Land consolidation – the process of rearrangement of land parcels and their ownership - is supported as a rural development operation under Council Regulation (EC) No 1698/2005, Article 30). In Germany, the Court found that an additional amount of 1 500 euro per ha is paid as restructuring aid, in cases involving land consolidation. The Court considers that neither of the situations described above should be eligible for support under the vineyard restructuring and conversion measures - as they fall outside of its normal scope as provided by article 103q of Regulation (EC) No 1234/2007: varietal conversion, relocation of vineyards and improvements to vineyard management techniques.

- (b) The Member States' estimates of the costs of each operation are highly variable, as are also the EU aid rates calculated for each operation. Discrepancies of up to 200 % in the estimated costs of similar operations were found, even in cases of similar density of vines per hectare.

41. With the exception of Spain, the Member States visited use flat rates per hectare to calculate payments and not a percentage of the actual costs borne by the beneficiary. Whilst this procedure is foreseen in the regulation, without further controls made by the paying agencies to ensure that the EU subsidy does not exceed the regulatory limit of 50 % or 75 % of the actual costs at individual level, there is no assurance that farmers are not being overcompensated.

42. In addition, the Court found specific cases (collective restructuring plans in France) of compensation wrongly being paid for loss of income to farmers who were not replanting but simply grubbing-up their vineyards; and of over-compensation for farmers who were both grubbing-up and replanting (up to 6,5 years of lost income, which exceeds the normal time when a new vineyard is not productive).

43. Finally, in France (in the region of Bordeaux), the Court found that access to the aid for restructuring a vineyard with a protected designation of origin is conditional on farmers joining a specific regional body and paying a levy for that participation, an obligation which does not apply to those who opt to restructure without EU support. The Court considers that levy to be an undue reduction of the EU subsidy to which those farmers are entitled and consequently that such an obligation does not comply with article 11 of Council Regulation (EC) No 1290/2005³⁴ nor article 96 of Regulation (EC) No 555/2008, both of which require payments to be made in full to beneficiaries.

The implementation of national envelopes and control systems at national level

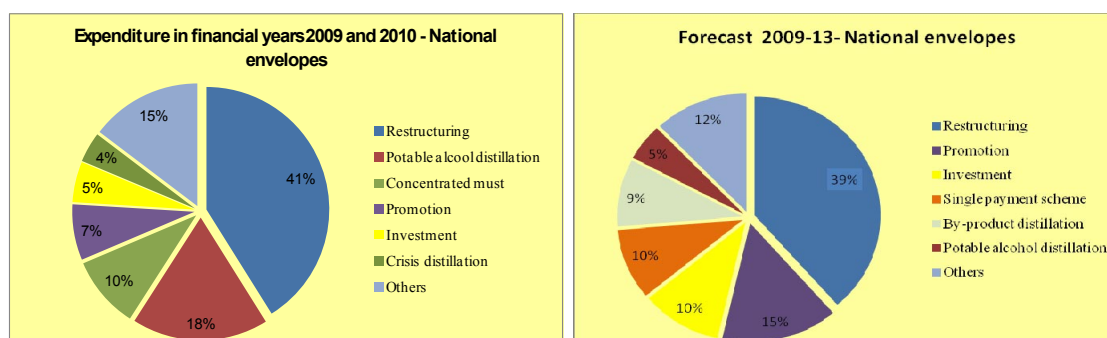
National choices with a strong focus on restructuring

44. The ability of Member States to choose the measures best adapted to their local circumstances is a key feature of the reform of the wine COM. In the financial years 2009 and 2010 (**Graph 10**), Member States chose to place a strong focus on the restructuring and conversion measure, which represented 41 % of the total expenditure of the national envelopes for those years

³⁴ OJ L 209, 11.8.2005, p. 1.

(714 million euro³⁵ out of a total 1 737 million euro) and almost 27 % of the total wine COM budget.

Graph 10 - National programmes - actual expenditure in 2009 and 2010 by measure and the forecast for the 5 year period 2009-13



Source: Communications from Member States as per Annex IV of Regulation (EC) No 555/2008.

45. Whilst restructuring is a measure conducive to increased competitiveness, not all the choices of Member States in implementing their national programmes were in line with the objectives of the reform. In a communication to the Commission of 1 March 2011, Spain is forecasting to allocate almost 450 million euro, or 30 % of its national envelope between 2009-2013, to SPS, one of the measures provided for in the regulation. However, in Spain, the largest part of the required SPS entitlements were calculated on the basis of historic aid for potable alcohol distillation, thereby creating a permanent economic advantage to a specific group of vine-growers - those whose production was distilled rather than marketed. Unlike those who opted for grubbing-up, these vine-growers may continue to supply wine to the market. This expenditure therefore runs counter to the objectives of the reform, as it neither promotes a balance between supply and demand nor constitutes an incentive to improve the market competitiveness of vine growers.

³⁵ During the financial years 2009 and 2010, expenditure in restructuring and conversion was particularly notable in Italy (168,7 million euro), France (148,6 million euro), Spain (134,7 million euro) and Romania (83,2 million euro).

National control systems in general work well

46. For the Member States selected (see paragraph 10), the Court found that, in general, control systems covering the legality and regularity of transactions worked well, this despite the fact that some features of the regulations are particularly demanding for Member States.

47. For example, field measurements according to article 75 of Regulation (EC) No 555/2008, which are essential for the calculation of grubbing-up and restructuring payments, are now based on the actual area occupied by vines and no longer on the total size of the relevant parcels - which was the criterion used in the past and still is reference for the Land Parcel Identification Systems (LPIS) as well as Vineyard Registers. This forced some Member States to carry out new on-the-spot measurements of parcels and then to maintain databases holding up to three different measurements for the same parcel.

But shortcomings found in specific areas

48. Despite the Court's generally positive evaluation of national control systems mentioned in paragraph 46, the situations described in the following paragraphs call for a review of the discretion given to Member States to administer the measures and for additional monitoring by the Commission.

49. All vineyards without corresponding planting rights are unlawful after 1 January 2010 and must be grubbed-up at the farmer's own cost. Despite this obligation, several Member States acknowledge the persistence of unlawful vineyard in their territories, whilst stating that the process of compulsory grubbing-up is on-going.

The Commission's monitoring role: information available but limited analysis

50. In order to allow the Commission to fulfil its monitoring role, Regulation (EC) No 555/2008 lists the information which should be transmitted by Member States at specific dates. The Court considers the information requirements to be thorough. However, the Court notes the lack of specific performance

indicators that could support an analysis of how the reform is performing in relation to its objectives. Relevant indicators, based on timely data, would be, in particular, those linked with the increase in competitiveness of EU wine producers (imports, exports, prices, volumes) and with the balance between supply and demand (production, consumption, stocks).

CONCLUSIONS AND RECOMMENDATIONS

Conclusions

51. Faced with a chronic structural surplus and the loss of international competitiveness across the EU, the reform developed or redesigned tools designed to tackle the main problems of the wine market. This is the case, in particular, for the longer-standing measures that account for most of the spending, grubbing-up and the restructuring and conversion of vineyards.

52. For the most part, the Commission's work in preparing the reform was extensive in scope and depth, but some of its proposals lacked sufficient research. Among these, the Court highlights the planned liberalisation of the system of planting rights. In addition, for particular areas, the targets set were based on criteria which did not materialise, such as the proposal for the discontinuation of enrichment with sucrose, as well as the effect of complementary measures such as green harvesting and market promotion.

53. The grubbing-up scheme is a quick and permanent way of reducing production potential, and is therefore a key part of the Commission's aim of reducing the structural surplus. Although the scheme resulted in a reduction of supply of approximately 10,2 million hl of wine, the target of 175 000 ha proved insufficient to eliminate the structural surplus in existence prior to the reform, largely because the assumptions on which that target was based did not materialise. The achievement of one of the main objectives of the reform will depend upon a significant increase in exports to tackle the remaining market imbalances.

54. Furthermore, the grubbing-up scheme was, with the latest reform, made available to the general vine-growing community, as opposed to the situation in the past, where Member States had the option to restrict farmers' access to it. This, together with an increase in the corresponding aid rates without evident justification by the Commission, generated, in most producing Member States, a large demand for the scheme, double the funds available. The Court considers that, in these circumstances, the scheme could have been more efficient – since it is likely that smaller increases or even keeping the aid rates at their previous levels would have made it possible to achieve more significant results with the resources made available or the same results with less resources (Court estimate of a 100 million euro cost of these increases in aid rates for the EAGF).

55. The objective of correcting the market imbalances can be hampered by the effect of the restructuring and conversion measure observed in certain wine producing regions, which experienced a gain in yield per hectare over the last two decades. The effects of grubbing-up were partially cancelled out by the yield increase in Spain and Italy. An increase in yield would not be a problem if the additional wine that is produced is in effect competitive and meets additional market demand without replacing other EU production. However, this will require new market outlets outside the EU as wine consumption is diminishing in the EU.

56. Nevertheless, the restructuring and conversion measure has clearly had a significant and positive impact at the level of vine growers, by supporting the adaptation of supply to demand of a large area of vineyards and contributing to the improvement of vineyard management techniques. However, the Court found that too much discretion was left to Member States in implementing the measure, allowing them to finance operations which go beyond the measure's scope and permitting wide differences in the flat rates used to calculate payments.

57. Despite receiving a large amount of information from Member States on the implementation of the various measures, the Commission's monitoring role, which should include an assessment of whether the reform is meeting its objectives, is limited by the absence of key performance indicators. Such a definition is crucial to have a timely measurement of the success of the reform.

Recommendations

58. As regards the grubbing-up measures, taking into account planting rights:

- The Commission should establish an estimate of the balance between supply and demand in the wine sector based on updated data, including the planned liberalisation of planting rights. On the basis of that estimate it should determine whether any measures are necessary to address possible imbalances.
- Should further grubbing-up measures be considered necessary the grubbing-up of modernised vineyards should be avoided by establishing additional eligibility criteria linked to the vineyard itself and not only to the farmer.

59. As regards the restructuring measures:

- Given the wide range of operations defined by Member States in implementing the restructuring measure, the Commission should establish a more precise definition of eligible restructuring operations, in particular those allowed under the regulatory heading 'Improvements to vineyard management techniques'.
- In order to avoid overcompensation in those cases where payments to beneficiaries are based on flat rates per hectare, the Commission should require from Member States a check, at least on a sample basis, that the EU subsidy does not exceed the eligible percentage of the actual costs.

60. As regards the key objective of the reform, to improve the balance between supply and demand:

- While on the one hand the EU finances the grubbing-up measure in order to reduce the surplus of wine produced, on the other hand the restructuring and conversion measure leads to increases in vineyard yields and therefore volumes produced which go against the objective of balancing supply and demand without securing new market outlets; the Commission should therefore ensure that an appropriate policy mix is available to address this tension.

61. As regards statistical data, the Commission should define key performance indicators, relevant to the objectives of the reform, that could provide a timely measurement of its success.

This Report was adopted by Chamber I, headed by Mr Michel CRETIN, Member of the Court of Auditors, in Luxembourg at its meeting of 7 March 2012.

For the Court of Auditors

Vítor Manuel da SILVA CALDEIRA
President

REPLIES OF THE COMMISSION TO THE SPECIAL REPORT OF THE COURT OF AUDITORS

"THE REFORM OF THE COMMON ORGANISATION OF THE MARKET IN WINE: PROGRESS TO DATE"

SUMMARY

II. & III. Joint reply

The 2008 wine reform aimed primarily at "increasing the competitiveness of EU wine producers" (see Recital (5) of Council Regulation (EC) No 479/2008).

The wine reform is based on a 'two phase' process. It was first essential in the first phase of the wine reform to reach a market balance by cleaning-up the existing market situation through a 3 years grubbing-up scheme (see Recital (59)), while the distillation measures were in parallel either abolished or phased-out. It must be reminded that the grubbing-up scheme was also meant to help non-competitive wine producers to abandon the sector. Then, the second phase of the reform aimed at shifting progressively to structural measures (national support programmes) helping wine producers to enhance their competitiveness in order to be able to compete on world markets, bearing in mind the expiration of the planting rights regime.

IV. The Commission considers that other key decisions of the reform, like the phasing-out of the subsidised distillation measures have had already a relevant impact on the sector. The wine reform should not be examined measure by measure but as a set of complementing measures (among others a grubbing-up scheme and national support programmes which contain 11 measures).

V. In order to encourage wine producers to grub-up non-competitive vineyards with the view to having a better market balance it was essential to make the measure attractive. The Commission therefore decided to increase the premiums by 10% on average (less than 20% the first year and 10% the second year) as compared to previous levels. The Commission considers that the measure has been a success, especially if compared to the previous scheme.

VI. The fact that the ban of sucrose had not been implemented has not impacted the stocks due to the positive evolution of the market. The latest data show in fact that stocks have diminished by 6.2 million hl in 2010 (-4 %). The latest evidence available, stock declarations at July 2011, do show an equilibrium between production and stock levels: PDO stocks equal 18 months of production, other categories only 8-9 months of production.

In the wine sector, some 'stocks' are inherent to the nature of wine since most wines are aged (3 – 36 months) before being released on the market. This is particularly the case of PDO/PGI wines which represents more than 62 % of the EU wine production.

Although the Commission proposal on grubbing-up was more ambitious, the fact is that the trend in EU wine production has been declining since 2007, whereas exports have increased since 2010 and stocks have diminished. This, in spite of lower consumption in various EU Member States.

Wine producers are competing on world markets, with good results, despite relatively low world market prices.

The 2008-2011 grubbing-up scheme has reduced the EU production by an estimated 10,5 million hl per year.

VII. The key goal of the wine reform is to enhance the competitiveness of the sector. The restructuring measure is one of the measures which allows wine growers to gain market shares by improving the quality of wines and by adapting their vineyards to the market demand (varietal changes). Lower production costs and higher yields, in particular if combined with improved quality, contribute decisively to make the sector more competitive. In this sense the grubbing-up measure was aimed at uncompetitive wine growers and was not aimed at reducing the volume of production of competitive wines.

VIII. The decision to end the transitional planting rights regime had already been taken in 1999 by the Council, therefore no impact study was necessary. The 2008 reform only prolonged the regime up to 2015.

IX. First and second indent: The Commission evaluates the situation of the wine market periodically and in particular in the 2012 report to Council and Parliament

IX. Third indent - For the next programming period (2014-2018), the Commission will propose to reinforce the definition of eligible restructuring operations.

IX. Fourth indent - For the next programming period (2014-2018), the Commission will require Member States to verify that no overcompensation in the costs/flat rates established for these operations exists.

IX. Fifth indent - The forthcoming 2012 report to Council and Parliament will address this issue.

The key goal of the wine reform is to enhance the competitiveness of EU wine producers. The restructuring measure is one of the measures which allows wine growers to gain market shares by improving the quality of wines and by adapting their vineyards to the market demand (varietal changes). Lower production costs and higher yields, in particular if combined with improved quality, can contribute decisively to make the sector more competitive. In this sense the grubbing-up measure targeted uncompetitive wine growers and was not aimed at reducing the volume of production of competitive wines.

IX. Sixth indent - The indicators on imports, exports, prices, volumes, consumption, stocks, etc. allow the Commission to assess the implementation of the reform especially as regards the competitiveness of EU wine producers. However, final balance sheet data on the 2009-2010 campaign (which is the first campaign under the new wine CMO), is only available since March 2011.

Furthermore, the Commission launched a tender for an evaluation study on the implementation of the reform, which will provide a formal analysis on different aspects of the Wine CMO. This evaluation covers aspects such as wine producers' revenue, exports in volume and value, evolution of wine products, etc.

All this information will be used for the drafting of the 2012 report, in combination with other indicators provided for by Member States relating to the national support programmes and to the grubbing-up scheme.

INTRODUCTION

4. According to the latest data imports remain since 2007 almost stable, whereas exports have increased since 2010 at a higher pace than imports despite the economic crisis.

5. The Commission endorses the Court's conclusion that distillation measures were contributing to the structural surpluses. In fact, it has been observed that the phasing-out of the distillation measures has contributed to an increase in exports and reduction in wine stocks.

7. The final package approved in December 2007 is the result of a long and difficult political discussion at Council level and at the end reflects the balance of different Member States positions and interests.

OBSERVATIONS

14. The decision to end the transitional regime had already been taken in 1999. In 2008 the decision was just to prolong it, it was not a new measure proposed in the context of the reform. No impact study was necessary on a short term prolongation of the regime as initially foreseen by the Commission.

15. In its first proposal, the Commission proposed to abolish all distillation measures. At the end of the negotiations, some distillation measures remained on a temporary basis. This should help to reduce the surplus of wine with the view to better achieving a wine market balance (first phase of the wine reform).

18. Regulation (EC) No 1234/2007 also foresees another measure to address short term production fluctuation. EU Support may be granted until 31 July 2012 for voluntary or obligatory distillation of surplus wine decided upon by Member States in justified cases of crisis so as to reduce or eliminate the surplus and at the same time ensure supply continuity from one harvest to the next (Article 103x). From 1 August 2012, Member States may grant national aid to wine producers in the same case (Article 182a).

As regards green harvesting in case of excess production, due to the fact that the wine market has been in balance, it is logical that this measure has not been widely applied and could not have the "expected positive impact".

19 & 20 - Joint reply

The rules on the grubbing-up scheme, as designed in Regulation (EC) No 1234/2007, have been adjusted bearing in mind that the former grubbing-up scheme did not achieve its intended results. Indeed, the prior obligatory grubbing-up measure as provided for in the former Wine CMO regulations was burdensome and has hardly been applied since 1995.

The 'one-off' grubbing-up scheme (1) is a measure aiming at reducing stocks with the view to reaching a market balance³⁶ and (2) is to be regarded as a measure for uncompetitive wine growers who prefer to leave the sector due to their incapability to withstand competitive pressures of the global wine market.

³⁶ see Recital (59) of Council Regulation (EC) No 479/2008.

Grubbing-up scheme targets wine producers who decide to grub-up (1) the totality of their vineyards and (2) wine producers of more than 55 years old³⁷.

Whereas the grubbing-up scheme has been adjusted, it is still subject to strict conditions³⁸. Member States do have the possibility to target the measures according to local circumstances (e.g. excluding mountainous areas, areas with terraces or with slopes, etc.) and to adjust the premium depending on the yields³⁹.

22. & 24. Joint reply

In order to guarantee the "success" of the grubbing-up measure, the premium had to be defined at EU level and set at an attractive level to target all those regions in order to encourage wine growers to grub-up non-competitive vineyards with the view to having a better balance of the market. For this reason the level to which the aid was set did for the first year not exceed 20% compared to the aid level given the previous years. The second year the increase in aid was limited to 10% only. Even with such levels, grubbing-up has been hardly applied for in France and in Germany (respectively 2,6% and 0,1 % of the vineyards), whereas it has been largely applied in Spain, Cyprus and Hungary (8,5%, 11,4 % and 6,7% of the respective vineyards).

The aid rates had to be set at attractive levels, based on objective and non-discriminatory criteria, for most of the 'problematic surplus regions' (including notably those which used to produce for distillation). The risk was to slightly overcompensate certain regions, an unavoidable feature of the EU policy. However, the specific value of the premium at national level is established by a decision of the Member States concerned, within the limits of the scale approved at EU level. The possibility existed for the premium to be set at a lower level in order to avoid grubbing-up of competitive vine areas. This measure has been effective, with a high demand by wine growers. It results in lower volumes of production:

- 2009: 4.1 million hl less;
- 2010: 7.5 million hl less;
- 2011 onwards: 10.5 million hl less yearly.

The Commission therefore underlines the success of the grubbing-up regime.

26. The fact that the ban of sucrose had not been implemented has not impacted the stocks due to the positive evolution of the market. The latest data show in fact that stocks have diminished by 6.2 million hl in 2010 (-4 %). The latest evidence available, stock declarations at July 2011, do show an equilibrium between production and stock levels: PDO stocks equal 18 months of production, other categories only 8-9 months of production.

Before 2008, the distillation measures gave rise to a wine production exclusively intended for distillation and thereby generated an artificial 'surplus'. Since 2008, Member States only made moderate use of the various still available distillation measures.

In the wine sector, 'stocks' are inherent to the nature of wine since most wines need to be aged (3 – 36 months) before being released on the market. This is particularly the case of PDO/PGI wines which represents more than 62 % of the EU wine production.

³⁷ see Recital (68) and Article 102(5) of Council Regulation (EC) No 479/2008.

³⁸ see Articles 85q and 85u of Regulation (EC) No 1234/2007 and Article 68 of Regulation (EC) No 555/2008.

³⁹ see Article 85r of Regulation (EC) No 1234/2007.

Plantation rights have an important influence on volumes produced but do not impose a volume per hectare and/or producer. Contrary to other quota systems, most likely the volumes/ha have been adapted to market expectations. Quality improvements with lower yields per hectare have taken place in the absence of a distillation outlet.

27. The 2009-2011 grubbing-up scheme should have reduced the production by 10.5 million hl of wine per year. Without grubbing-up, the 2011 production would have reached 176 million hl.

In addition, EU production has decreased over the last period: wine production (volumes/ha) has not remained stable and stocks have also decreased.

The most important goal of the reform was to produce wines which find a commercial outlet, which may imply also an increase of the competitiveness of EU wine producers. Indeed in the last two years exports have grown by more than 10 % annually.

28. As already mentioned, the increase of yields has not generated an increase of the whole wine production in the EU.

Production in the EU has decreased by 17.3 million hl (comparing 2004-2007 with 2008-2011). Where locally an increase in yields has taken place, it can have a positive impact on efficiency, as production costs are reduced. Important is to improve the competitiveness of EU wine producers.

29. The grubbing-up scheme has mainly been used in producing wine regions without PDO/PGI, whereas Germany mostly produces PDO/PGI wines.

30. The grubbing-up was aimed at achieving a balance between supply and demand (Phase 1) and to help non-competitive farmers to leave the sector. The scheme leaves it to producers to decide whether they apply for the premiums; however it is not logical that viable wine growers would apply for this scheme given the level of the premiums.

Box 3 – Example of a modernised vineyard which was grubbed up

The case raised by the Court is quite unique and therefore cannot be considered as a general practice in Spain or in the EU. The success of an individual restructuring project, which is co-financed by the EU at 50 %, depends also on the extent to which the farmer concerned is sufficiently professional. The rules of implementation demanded that grubbing-up premium could not been given to vineyards that had benefited from restructuring measure in the previous 10 years, among other eligibility criteria (see Article 85q of Regulation (EC) No 1234/2007).

In the present case, there is no 'simultaneity' of the two measures, since there is a lapse of time of 11 years.

31. The Commission will further analyse the Court's findings and, if necessary, it will follow them up via the conformity clearance procedure.

36. The grubbing-up has been applied mainly in areas/farms where the capacity to produce quality wines (PDO/PGI) was lower or difficult to achieve. Therefore, there is no contradiction but complementarity in Member States where both the grubbing-up scheme and the restructuring and conversion measures have been applied. This was foreseen in the reform. Higher yields are not negative if they result in more competitive quality products that find an outlet.

Surplus is not necessarily resulting from high yields but more specifically from production which is not adapted to market demand. Production of wines for which a market demand exists, should be stimulated whatever the yield class.

37. In 'Castilla-La Mancha' for example, there is a real potential for the production of 'varietal wine'⁴⁰, which pre-supposes an adaptation of the vineyard and the wineries. From an economic point of view, there is more advantage to produce this kind of products in the EU rather than importing 'varietal wines' from third countries.

40. Support to normal management of vineyards is not allowed. The programmes presented or modified afterwards by Member States have been assessed according to this principle.

40(a) For the next programming period (2014-2018), the Commission will reinforce the assessment of the restructuring measure.

Box 4 – Ineligible actions financed under restructuring and conversion measure for the wine year 2008/2009

First indent. The specific cases mentioned by the Court (CZ) are followed-up under the clearance of accounts procedure.

Second indent. The Commission services will seek further information from the German authorities.

Third indent. [*see above*] On this particular aspect the potential financial consequences will be determined by the Commission services in the framework of the ongoing conformity procedures linked to certain Member States. At the time of the on-the-spot audits carried out by the Commission services, the Court's observations were already indicated in the audit reports.

40(b) For the next programming period (2014-2018), the Commission will require Member States to verify that no overcompensation in the costs/flat rates established for these operations exists.

The Commission will address the issue through an appropriate document (internal vademecum, guidelines for Member States or modification of Regulation (EC) No 555/2008).

42. The Commission services will seek further information from the French authorities.

43. The Commission will examine the situation described by the Court and will, if necessary, follow it up under the clearance of accounts procedure.

45. The allocation of 450 million € to SPS foreseen by Spain is linked to the removal of the widely used 'potable alcohol distillation', essential to remove structural surpluses and adapt supply to demand.

By removing the potable alcohol distillation measure, an important outlet has disappeared for wine leading logically to an income loss for vine-growers and a decrease of wine prices. This aid per hectare compensates this price fall, as it exists in other sectors.

49. Following the communications sent by Member States according to (EC) Regulation (EC) No 555/2008 and the last Commission appraisal, Member States have to a large extent improved the management of unlawful vineyard. Less than around 2900 ha should be grubbed-up.

⁴⁰ As defined in Article 118z(2) of Regulation (EC) No 1234/2007 and in Article 62 of Commission Regulation (EC) No 607/2009. There are wines without PDO/PGI which bear on label the indication of the vine grape varieties used for the production and the vintage year.

51. The Commission has launched an evaluation study on the implementation of the reform, which will provide a formal analysis on different aspects of the Wine CMO, such as wine producers' revenue, exports in volume and value, evolution of wine products, etc. The indicators on imports, exports, prices, volumes, consumption, stocks, etc. allow the Commission to assess the implementation of the reform especially as regards the competitiveness of EU wine producers. They will be used for the drafting of the 2012 report, in combination with other indicators provided for by Member States relating to the national support programmes and to the grubbing-up scheme.

However, final balance sheet data on the 2009-2010 campaign (which is the first campaign under the new wine CMO), is only available since March 2011. Besides, in the context of the CAP post-2013, Article 110 of the proposal for a regulation of the European Parliament and of the Council on the financing, management and monitoring of the common agricultural policy addresses specifically the monitoring and evaluation of common agricultural policy including, among others, the wine sector.

CONCLUSIONS AND RECOMMENDATIONS

53. The end of the transitional planting rights regime was decided in 1999. The 2008 reform prolonged temporarily the end; it was thus not necessary to evaluate the impact of the prolongation.

54. The latest data show in fact that stocks have diminished by 6.2 million hl in 2010 (-4 %). The latest evidence available, stock declarations at July 2011, do show an equilibrium between production and stock levels: PDO stocks equal 18 months of production, other categories only 8-9 months of production.

In the wine sector, some 'stocks' are inherent to the nature of wine since most wines are aged (3 – 36 months) before being released on the market. This is particularly the case of PDO/PGI wines which represents more than 62 % of the EU wine production.

Although the Commission proposal on grubbing-up was more ambitious, the fact is that the trend in EU wine production has been declining since 2007, whereas exports have increased since 2010 and stocks have diminished. This, in spite of lower consumption in various EU Member States.

The phasing-out of market measures such as distillation, has forced wine producers to adapt volumes/ha to demand and to compete in the world market, with good results, despite relatively low prices.

55. The Commission observes the success of the grubbing-up measure, in particular compared with the previous scheme. In order to guarantee this, the premium had to be defined at EU level and set at an attractive level to encourage wine growers to grub-up non-competitive vineyards with the view to having a better balance of the market.

56. Grubbing-up and restructuring aim to adapt the production to the demand. As long as a market demand exists, an increase of yield can have a positive effect on efficiency, income and competitiveness.

Latest trade information available shows that exports outside the EU account for more than 20 million hl (resulting in a positive trade balance of 4.4 billion euro).

57. The objective of measures relating to the restructuring and conversion of vineyards is to increase the competitiveness of wine producers. For the two first types of operations (varietal conversion and relocation of vineyard), there is no room for interpretation. The third type of operations concerns the "*improvements to vineyard management techniques*" which shall be structural operations; Support to normal management of vineyards is not allowed. The programmes presented or modified afterwards by Member States have been assessed following this principle. For the next programming period (2014-2018), the Commission will propose to reinforce this assessment of the restructuring actions, including the flat rate/overcompensation issue. Furthermore, the cases mentioned by the Court are followed-up under the clearance of accounts procedure.

58. Regulations (EC) No 555/2008 and (EC) No 436/2009 determine the data that Member States have to transmit to the Commission. The corresponding indicators on imports, exports, prices, volumes, consumption, stocks, etc. allow the Commission to assess the implementation of the reform especially as regards the competitiveness of EU wine producers. However, final balance sheet data on the 2009-2010 campaign (which is the first campaign under the new wine CMO), is only available since March 2011

Furthermore, the Commission launched a tender for an evaluation study on the implementation of the reform, which will provide a formal analysis on different aspects of the Wine CMO. This evaluation covers aspects such as key performance indicators on wine producers' revenue, exports in volume and value, evolution of wine products, etc.

All this information will be used for the drafting of the 2012 report to Council and Parliament, in combination with other indicators provided for by Member States relating to the national support programmes and to the grubbing-up scheme.

59. First & second indent - The Commission evaluates the situation of the wine market periodically and in particular in the 2012 report to Council and Parliament.

60. First indent - For the next programming period (2014-2018), the Commission will propose to reinforce the definition of eligible restructuring

60. Second indent - For the next programming period (2014-2018), the Commission will require Member States to verify that no overcompensation in the costs/flat rates established for these operations exists.

61. The 2008 wine reform aimed primarily at "*increasing of the competitiveness of EU wine producers*" (see Recital (5) of Council Regulation (EC) No 479/2008).

The reform was designed in a two phases approach. It was first essential to reach a market balance, through a 3 years grubbing-up scheme (see Recital (59)), which contributes to the second phase of the reform focusing exclusively on tools to strengthen the competitiveness of EU wine producers.

61. First Indent - The forthcoming 2012 report to Council and Parliament will address this issue.

The key goal of the wine reform is to enhance the competitiveness of EU wine producers. The restructuring measure is one of the measures which allows wine growers to gain market shares by improving the quality of wines and by adapting their vineyards to the market demand (varietal changes). Lower production costs and higher yields, in particular if combined with improved quality, can contribute decisively to make the sector more competitive. In this sense the grubbing-up measure was a measure for uncompetitive wine growers and was not aimed at reducing the volume of production of competitive wines.

62. The indicators on imports, exports, prices, volumes, consumption, stocks, etc. allow the Commission to assess the implementation of the reform especially as regards the competitiveness of EU wine producers.

However, final balance sheet data on the 2009-2010 campaign (which is the first campaign under the new wine CMO), is only available since March 2011.

Furthermore, the Commission launched a tender for an evaluation study on the implementation of the reform, which will provide a formal analysis on different aspects of the Wine CMO. This evaluation covers aspects such as wine producers' revenue, exports in volume and value, evolution of wine products, etc.

All this information will be used for the drafting of the 2012 report to Council and Parliament, in combination with other indicators provided for by Member States relating to the national support programmes and to the grubbing-up scheme.