



Bi-weekly Bulletin

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EUROPEAN UNION: OILSEED SITUATION AND OUTLOOK

In 1999, the European Union (EU) agreed to a reform of its Common Agricultural Policy (CAP). However, additional reforms are expected to prepare for enlargement of the EU into Central and Eastern European Countries (CEECs) and for upcoming World Trade Organization (WTO) agriculture negotiations, and to address concerns over spending. Recent food crises such as the Bovine Spongiform Encephalopathy (BSE) and Foot and Mouth Disease (FMD) have added further impetus for reform. The EU is a major producer and consumer of oilseeds and oilseed products and the proposed changes are expected to reduce production and increase imports, which is expected to support world oilseed prices. This issue of the *Bi-weekly Bulletin* investigates the situation and outlook for oilseeds and oilseed products due to Agenda 2000 in the EU and assesses the impact of these changes on Canadian exports.

AGENDA 2000: PARTIAL REFORM OF THE EU CAP

With Agenda 2000, agreed to at the Berlin summit on March 25-26 1999, the EU CAP underwent a number of sweeping changes, largely in response to budgetary issues as the EU prepares to expand into CEECs. Agriculture is by far the largest item of expenditure within the EU and accounts for about one-half of the EU budget. While far-reaching, the changes to the CAP represented a watering down, and a phasing in, of the original proposals first introduced by the European Commission (EC). Nevertheless, Agenda 2000 is generally regarded as a step in the right direction towards increasing the competitiveness of EU agriculture.

The stated goals of Agenda 2000, are to: (1) improve the competitiveness of EU agriculture, (2) further integrate

EU agriculture in the world economy and fulfill the EU's international commitments (e.g. WTO) (3) facilitate the expansion of the EU to CEECs, and (4) increase the consideration of environmental concerns and enhanced rural development.

However, several deficiencies have been noted in Agenda 2000. Some of these are: (1) the reduction in price supports may not be large enough to guarantee greater access to world markets without export subsidies while incorporating the CEECs, (2) while the alignment of internal support is a step to improving the competitiveness of European agriculture ahead of upcoming multilateral trade negotiations, more discussion of the magnitude and justification for direct payments is expected, (3) milk and sugar quotas remain unreformed so far, and (4) environmental issues need to be clarified.

Under provisions of Agenda 2000, the EU total budget was projected to remain stable at around i 89.6 billion annually for 2000-2006 (1i =CAN\$1.32). However the EU's executive commission has urged that the budget be increased to i 100 billion for 2002 due to unexpected costs incurred through sector reform and combatting BSE and FMD. Agriculture expenditures are expected to rise from i 40.92 billion in 2000 to i 43.77 billion in 2003, before declining to roughly the 2000 level by 2006, due to the reform of the CAP.

Approximately one-tenth of agricultural expenditures are ear-marked for rural development. Additional reforms of the CAP are expected as a result of enlargement of the EU into CEECs, and to address concerns over spending and to prepare for the WTO agriculture negotiations. Recent food safety

crises are adding further impetus for reform.

BOVINE SPONGIFORM ENCEPHALOPATHY

BSE, more commonly known as "Mad Cow Disease", was first detected in the United Kingdom (UK) in 1984 and was specifically diagnosed in 1986. By 1990, about 14,000 cases of BSE, out of a total cattle population of 10 million head (Mhd), were diagnosed in the UK. The outbreak peaked in 1992-1993 at about 1,000 head a week and with the introduction of control measures, new outbreaks have fallen off to about 100 cases per week. The disease has also been detected in several other member states.

BSE is a fatal disease that affects the brains of cattle and is one of several diseases categorized as Transmissible Spongiform Encephalopathies. The disease is generally considered to be caused by a "self replicating" protein, known as a prion. BSE was thought to be spread through the livestock food supply when bone, meat, feather and blood meal (MBM) was fed to livestock. The EU had implemented a ban on

feeding MBM to ruminants several years ago. The EU temporarily extended this ban to all farm livestock beginning January 2001, resulting in the displacement of approximately 2.5 million tonnes (Mt) of MBM annually. Animal fats are not banned, but are subject to a 0.15% level of impurities and protein.

Consequently, imports of protein meals, most notably soybean meal, were forecast to increase by about 3 Mt annually, although these estimates have subsequently been reduced to 1.0-1.5 Mt. The demand for protein meal will be mostly filled through increased imports of soybeans, followed by soybean meal, which will mostly originate from South America. Consumption of domestic and imported canola/rapeseed and canola/rape meal, sunflowerseed meal, feed grains, corn gluten, field peas and beans is expected to increase. While the ban on feeding of MBM was originally imposed for six months, it has been extended until early 2002. Proposals to extend the ban and make it permanent have been rejected by a majority of member states.

FOOT AND MOUTH DISEASE

An outbreak of FMD was confirmed in the UK on February 20, 2001. On May 3, 2001, less than three months after the first outbreak was confirmed, Britain reportedly culled over 3.5 million animals, out of a total livestock population of over 60 Mhd. The culling was an attempt to prevent the disease from spreading by isolating and removing animals within a containment zone. The British government has paid out approximately CAN\$2.3 billion to farmers in compensation for slaughtered animals and the total cost of the disease is expected to exceed CAN\$4.6 billion. By the beginning of May 2001, more than 1,600 cases of FMD in British livestock have been confirmed with 26 cases in the Netherlands, 2 in France and 1 in Ireland.

At the time of publication, assessing the long run impact of the FMD on European livestock production, and protein meal demand, remains premature. However, in the short run, exports of chicken from Thailand to the EU have increased by 10% in response to reduced meat production in the EU. Consequently, soy meal

AGENDA 2000 CHANGES

Measure	EU Council Decision
Intervention Price for cereals	15% cut, in two equal steps, ie. 110 i /t in 2000-2001; 101.31 i /t in 2001-2002.
Monthly increments	Maintained as at present.
Area payment for cereals	Increase in two equal steps, i.e. 58.67 i /t in 2000-2001; 63 i /t in 2001-2002.
Area payment for oilseeds	Three step reduction commencing in 2000-2001 to 63 i /t in 2002-2003.
Area payment for pulses	Proposal retained.
Area payment for linseed	Three step reduction commencing in 2000-2001 to 63 i /t in 2002-2003.
Aid for grass silage	In member states where maize is not a traditional crop, grass silage is eligible for the cereal payment, within a specific base area, without increasing the total base area.
Compulsory set-aside	Set at 10% for the whole period.
Specific measures	Increase in reference yield for Spain and Italy. In Finland and Northern Sweden, additional 19 i /t for drying cereals and oilseeds.

Source: *Agenda 2000 Cap Reform Decisions, Impact Analysis*, (Feb 2000) European Commission, Directorate General for Agriculture.

EU: OILSEEDS AND OILSEED PRODUCTS SUPPLY AND DISPOSITION

October-September crop year	1999 -2000	2000 -2001	2001 -2002f
.....million tonnes.....			
OILSEEDS ¹			
Carry-in Stocks	1.74	1.71	1.38
Production:			
Rapeseed	11.44	9.16	8.78
Soybean	1.15	1.04	1.24
Sunflowerseed	3.21	3.39	3.38
Other	<u>0.83</u>	<u>0.73</u>	<u>0.79</u>
Total Production	16.63	14.32	14.19
Imports	<u>22.19</u>	<u>23.39</u>	<u>24.00</u>
Total Supply	40.56	39.42	39.57
Exports	1.36	0.70	0.50
Total Domestic Use*	<u>37.49</u>	<u>37.34</u>	<u>37.57</u>
Total Use	38.85	38.04	38.07
Carry-out Stocks	1.71	1.38	1.50
EDIBLE OIL ²			
Carry-in Stocks	1.90	1.73	1.57
Production	10.46	10.39	10.90
Imports:			
Canola/Rapeseed	1.30	1.30	1.30
Soybean	0.50	0.50	0.50
Palm	2.90	3.10	3.20
Other	<u>3.11</u>	<u>3.25</u>	<u>3.20</u>
Total Imports	<u>7.81</u>	<u>8.15</u>	<u>8.20</u>
Total Supply	20.17	20.27	20.67
Exports ^{2a}	1.59	1.59	1.46
Total Domestic Use*	<u>16.85</u>	<u>17.11</u>	<u>17.41</u>
Total Use	18.44	18.70	18.87
Carry-out Stocks	1.73	1.57	1.80
PROTEIN MEAL ³			
Carry-in Stocks	1.35	1.35	1.35
Production	20.36	20.80	21.20
Imports:			
Soymeal	16.52	17.47	18.17
Other	<u>5.19</u>	<u>4.48</u>	<u>4.18</u>
Total Imports	<u>21.71</u>	<u>21.95</u>	<u>22.35</u>
Total Supply	43.42	44.10	44.90
Exports ^{3a}	1.47	1.48	1.60
Total Domestic Use*	<u>40.60</u>	<u>41.27</u>	<u>41.95</u>
Total Use	42.07	42.75	43.55
Carry-out Stocks	1.35	1.35	1.35
* Domestic Use is residual			
¹ Includes canola/rapeseed, soybean, sunflowerseed, cottonseed, peanut, copra and palm kernel.			
² Includes canola/rapeoil, soyoil, sunoil, cottonseed oil, palmoil, olive oil, fish oil, and coconut oil.			
^{2a} Rapeoil and soyoil			
³ Includes canola/rapemeal, soymeal, sunmeal, cottonseed meal, peanut meal, copra, palm kernel meal, and fish meal.			
^{3a} Soymeal			
f: forecast, AAFC, July 2001			
Source: USDA, Cocereals			

consumption in Thailand has increased in response to BSE and FMD in the EU.

SITUATION: OILSEED PRODUCTION DECLINES ON STABLE CONSUMPTION

The EU-15 is a major trader and consumer of oilseeds. It is the world's largest importer of soymeal, the second largest importer of soybeans, after Asia, and the world's fourth largest crushing region, after the U.S., Latin America, and Asia. The EU is also a major consumer of rapeseed, sunflowerseed, rapemeal, sunmeal, and corn gluten feedmeal. Total protein meal consumption, on a soymeal equivalent basis exceeds 43 Mt compared to 31 Mt for the U.S. and 27 Mt for China.

Under the terms of the Blair House Agreement, the key agreement between the EU and United States (U.S.) that was fundamental to the successful conclusion of the Uruguay Round of trade negotiations, the area seeded to oilseeds in the EU was limited to 5.48 million hectares (Mha) (see *Bi-Weekly Bulletin Volume 9 Number 14*). Any excess over this area is subject to penalties. An exception is the planting of oilseeds for industrial use, such as bio-diesel, on set-aside land. Since the oilseed area in the EU did not exceed the EU Maximum Guaranteed Area (MGA) in 1999, no penalty was implemented on oilseed producers for 2000.

For 2000-2001, the area seeded to oilseeds declined by 9% due to a combination of low market prices and the drop in direct area subsidy from 94.2/t in 1999-2000 to 81.7/t. Consequently, EU oilseed production has reportedly declined by 14%, to 14.3 Mt, as a result of below normal yields due to the cold and wet growing conditions.

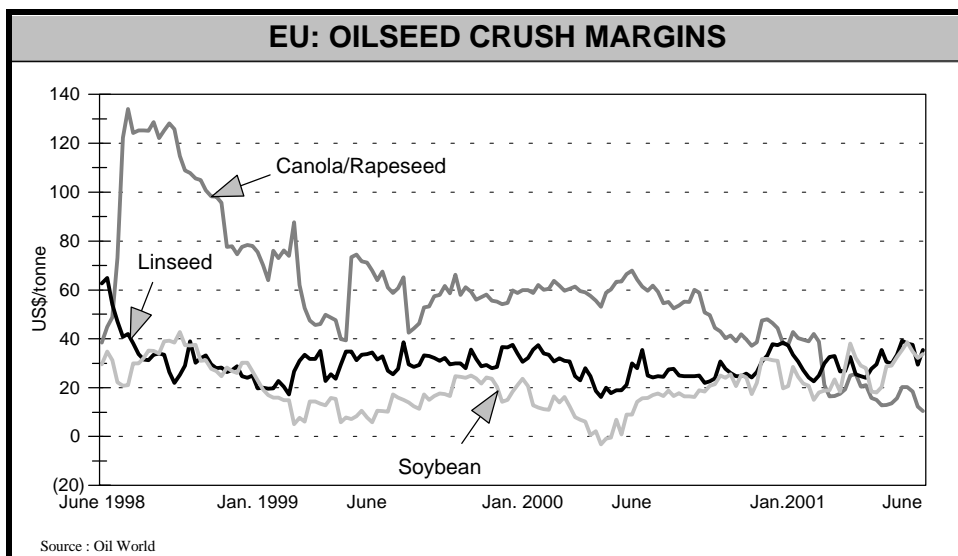
Rapeseed production makes up almost two-thirds of total EU oilseed output. The trend towards increased rapeseed production was reversed for 2000-2001 as output declined by 19% due to a combination of lower harvested area and reduced yields. However, the decline in supplies was partly mitigated by an increase in imports. EU crushing of rapeseed is projected to decline by 0.7 Mt, to 9.3 Mt, for 2000-2001, due to pressure from burdensome world vegoil supplies and declining crush margins.

Soybeans make up less than 10% of total EU oilseed output and production has declined by about one-third since the record high set in 1997-1998. After falling in 1999-2000, imports are projected to rebound slightly for 2000-2001, but remain below the record high established in 1997-1998. Most of the soybean imports originate from the U.S. and Brazil and are used for crushing. The EU also imports a limited quantity of soybeans from Canada for crushing and for niche markets which require the use of identity preserved marketing, such as non-genetically modified organism (GMO) soybeans.

OUTLOOK

For 2001-2002, the area seeded to oilseeds declined slightly, as a result of lower market prices and the drop in direct area payments, resulting in a shift into wheat and coarse grains. Oilseed production is projected to decline slightly due to lower than normal yields as a result of less than ideal growing conditions in France and the UK. Total oilseed supplies are projected to rise due to an increase in soybean imports from the U.S. and Brazil.

For 2001-2002, EU consumption of oilseeds is expected to rise due to increased crush volumes, which are expected to rise as higher oilseed supplies and stronger protein meal usage offsets pressure from low crush



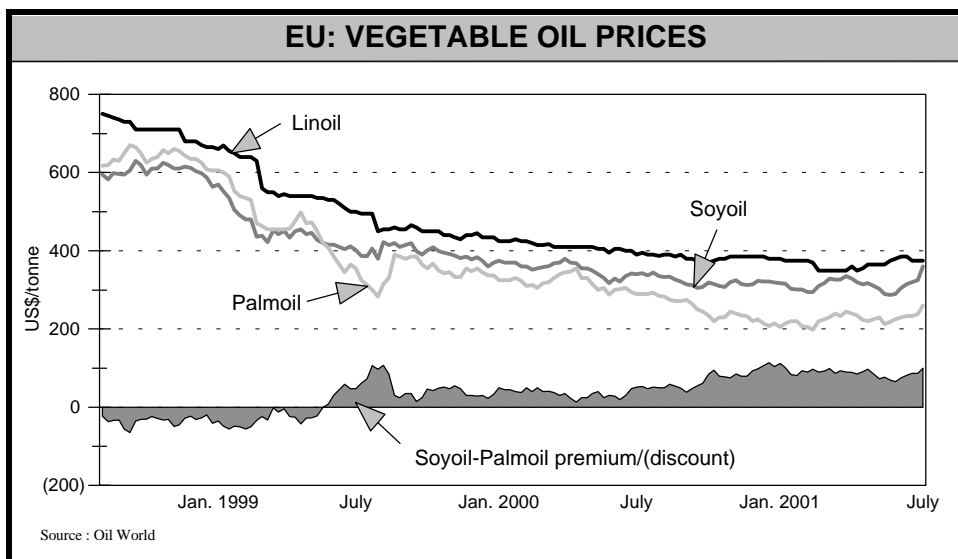
margins, and weak vegoil prices. Concurrently, exports of oilseeds are expected to be constrained by competition from burdensome U.S. and South American soybean supplies.

Production of vegetable oils and protein meals are forecast to increase slightly as the result of the increased crush. However, imports of both commodities are expected to increase slightly due to burdensome world supplies and historically low prices. Soymeal imports are projected to increase by about 0.9 Mt for 2001-2002 in response to the EU-wide ban on meat and bone meal in livestock rations.

Record High Vegoil Consumption

Vegoil production is forecast to rise by about 5% for 2001-2002, but remain slightly below the record high established in 1998-1999, as reduced yields from crushing offset the increased volume of oilseeds.

Supplies of vegoils are expected to increase, as the EU supplements the rise in production with increased imports. Total vegoil consumption is expected to rise by 2%, to a record high 17.4 Mt, due to an increased per-capita consumption driven by sharply lower prices. At the same time, exports are projected to decline due to competition from burdensome soyoil supplies in the U.S. and Argentina and palmoil supplies in Malaysia and Indonesia.



Soyoil production is expected to increase from 2000-2001, to near record highs. With imports of soyoil expected to remain unchanged, supplies are expected to rise at a rate similar to the change in output. Domestic consumption is forecast to increase from 1999-2000 lows, but remain below the record high set in 1992. Exports are projected to decrease slightly under pressure from burdensome world supplies.

The production of rapeoil is also forecast to decline by 7% from the record highs of 1999-2000, to slightly under 3.5 Mt due to reduced supplies of raw rapeseed and pressured crush margins. Supplies of rapeoil are projected to decline by 6% for 2000-2001 as the drop in production is compounded by a decline in imports. Consumption of rapeoil in the EU is projected to rise to 3.15 Mt, an increase of 5 % since 2000-2001, but exports are projected to drop by 12 %, from the record 1.87 Mt, set in 1999-2000.

Protein Meal Usage Rises

For 2001-2002, the supply of protein meals in the EU is projected to rise slightly due to an increase in production combined with an increase in imports. EU consumption of protein meals is projected to rise by about 9% as the region-wide ban on meat and bone meal increases the demand for alternative sources of vegetative protein. This rise in EU protein meal demand will be tempered by the decline in livestock population resulting from heavy culling in the EU's attempt to staunch the spread of FMD. Consequently, the consumption of soymeal is projected to rise by about 4%, while the usage of canola/rapemeals will be restricted by tight supplies of raw seed.

Medium-Term Outlook

In July 2001, the EC published a report entitled, "Prospects for Agricultural Markets 2001-2008." Based on the EC's outlook and stated assumptions on domestic agriculture policy and trade environment, the area

seeded to oilseeds (including non-feed use) is expected to decline from 5.6 Mha in 2001-2002 to 5.2 Mha in 2002-2003 when the Agenda 2000 CAP reform is fully implemented and cereal and oilseed intervention prices are aligned. The drop in compensatory payments to the same level as cereals was very controversial and was one reason why a mid-term review of the new policy was agreed to for 2002. Area seeded to oilseeds is projected to recover starting in 2005-2006 and reach about 5.4 Mha by 2008-2009, due to the expected strengthening of world oilseed prices. Soybean area is expected to decline by 0.1 Mha from 2001-2002 to 0.3 Mha in 2002-2003, and remain at that level over the medium-term. Rapeseed area is projected to fall slightly to 2.9 Mha in 2002-2003, and then stabilize at 3 Mha from 2005-2006 onwards. In contrast, the area seeded to sunflowers is projected to increase slightly to 2.1 Mha by 2008-2009, rebounding from a slight drop early in the projected period.

EUROPEAN UNION: DEVELOPMENT OF POLICY SUPPORT FOR OILSEEDS

The EU oilseed support scheme changed in 1991 from deficiency payments to the oilseed crushing industry to a system that paid oilseed producers a per hectare subsidy directly. The May 1992 MacSharry reform, together with the Blair House accord of the Uruguay Round trade negotiations, put a restriction on the areas planted to rapeseed, soybeans and sunflowers. This Maximum Guaranteed Area (MGA) was 5.128 Mha for EU-12 (base EU Membership), increasing to 5.482 Mha for EU-15 (expanded EU membership). A minimum set-aside rate of 10% of base area applies.

The area payment is based on a pre-determined level of compensation per tonne. The per tonne amount is converted into area payments based on the average historic regional yields per hectare, a world reference price and a fixed ratio between oilseeds and cereals prices. This payment is constrained by the MGA with the amount of the payment reduced by 1% for every 1% that the MGA is exceeded. The 1999 reform (Agenda 2000) introduced progressive reductions to the area payment for oilseeds through 2002-2003, when the oilseed payment is aligned to the level of payment for cereals at 63 euro per tonne. The EU believes that the MGA provisions do not apply from 2002-2003, the argument being that the payment rate will then be the same as for cereals.

The area payments are viewed by many as having distorting effects on production and trade since such payments are linked to production. Producers are required to plant their eligible base area to one of the three types of oilseeds to receive the payment.

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Non-food oilseed (mostly rapeseed) area is projected to stabilize around 0.8 Mha over the medium-term.

Yields are projected to rise and reach 2.8 tonnes per hectare by 2008-2009. However, oilseed production is projected to decline in the short run, to 13.2 Mt by 2002-2003, a drop of 3.4 Mt from 1999-2000, due to the decline in seeded area. Then it is expected to rebound to 15.2 Mt by 2008-2009. Production of non-food oilseeds is forecast at about 2.4 Mt annually over the medium-term.

Under the Blair House Agreement, production of non-food oilseeds is limited by provisions that protein meal by-products not exceed 1 Mt, on a soy meal equivalent basis.

Consumption of oilseeds is projected to increase slowly over the medium-term, to around 34-35 Mt annually, with most of the increase occurring in the import and processing of soybeans. Food-grade, vegoil consumption is also forecast to rise slowly, due to slow population and income growth. Non-edible vegoil usage is projected to rise, with the rate of growth to be determined by world crude oil prices and the US\$/i exchange rate. Assuming a permanent ban on meat and bone meal usage in livestock rations, vegetative protein meal use is expected to rise slowly after the sharp increase in 2001-2002. The rate of growth could be limited, depending on the long run impact of BSE and FMD on EU livestock production.

The production of biodiesel is expected to increase significantly within the EU with 7 new factories reportedly under construction and 7 more planned in Germany. These 14 plants are expected to have an annual capacity of about 1.0 Mt, which is in addition to the current capacity of 0.25 Mt a year for Germany. If these plants are built, the industrial demand for rapeseed is projected to rise to

about 3.0 Mt a year, approximately one-third of the total EU production of rapeseed.

IMPACT ON CANADA

Canada exports a relatively small volume of oilseeds to the EU, although it is the major exporter of flaxseed and non-GMO soybeans. The non-GMO portion of soybeans is growing in importance although it makes up only a portion of total Canadian soybean exports. Canadian exports have declined sharply in recent years, largely due to the EU's inability to advance the approval of genetically modified canola produced in Canada.

EU member state governments have reacted to intense political opposition to GMO's by some interest groups by delaying the approval process. The moratorium on approval also reflects the public's mistrust in regulatory agencies stemming from the regulatory crises associated with BSE and FMD outbreak. As well, major EU supermarkets and major food manufacturers have removed GM food products from their lines in a response to campaigns of some activists and a negative reaction from EU consumers.

There are no health, food safety or environmental reasons to block GMO canola from being approved for the EU market. This has been confirmed by two favourable opinions by the EU's independent scientific committee on plants. Key industry observers are of the opinion that the EU is at least two or three years away from approving the import of GMO products.

Over the medium-term, reform of the CAP and other agricultural issues is expected to support Canadian exports of flaxseed and non-GMO soybeans.

CANADA: OILSEED AND OILSEED PRODUCT EXPORTS TO THE EU

	1999 -2000	2000 -2001f	2001 -2002f
.....million tonnes.....			
Soybean	0.17	0.16	0.16
Soy meal	0.02	0.01	0.01
Linseed	0.38	0.55	0.60
Linoil	0.10	0.03	0.03
Canola meal	0.04	0.03	0.03

f: forecast, AAFC, July 2001
Source: Statistics Canada

As well, by decreasing production distorting direct aid payments, the EU is moderating one of the market-distorting subsidies that are pressuring world, and Canadian, oilseed prices.

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