Proposal for a

COUNCIL REGULATION

amending Regulation (EC) No 1782/2003 establishing common rules for direct support schemes under the common agricultural policy and establishing certain support schemes for farmers, as regards the support scheme for cotton

(presented by the Commission)

{SEC(2007) 1481}
{SEC(2007) 1482}
EXPLANATORY MEMORANDUM

1) CONTEXT OF THE PROPOSAL

• Grounds for and objectives of the proposal

On 7 September 2006, the European Court of Justice annulled the 2004 cotton reform, concluding that infringement of the proportionality principle had occurred as:

- the EC failed to carry out an impact study;
- the EC failed to consider direct labour costs in the evaluation and decision process;
- the EC failed to take into consideration the impact of the new regime on the ginning industry which, although not included in the Protocol, is directly linked to the business of cotton production.

Consequently, a particular attention was devoted to these elements during the various steps of impact analysis conducted by the Commission's services.

This proposal introduces a new cotton regime which aims to encourage a competitive, sustainable and market-driven cotton sector, while safeguarding the Protocol commitments.

• General context

The cotton sector, despite being of limited significance to the EU as a whole, contributing only 0.15% to the final agricultural output, has strong regional importance in the two main producing Member States. Around 76% of the EU's total output (about 1.45 million tonnes of raw cotton) is grown in Greece. In 2005 9.0% of Greece's total agricultural production was cotton while in Spain, the other main EU producer, cotton contributed 1.3%. A small amount of cotton is also grown in Bulgaria; Portugal no longer grows cotton.

In Greece, most of the 380 000 ha devoted to growing cotton is located in three regions: Thessaly, Macedonia-Thrace and Sterea Ellada. In Spain, production is concentrated in Andalusia, mainly in the provinces of Seville and Cordoba. The total area under cotton in Spain was about 65 000 ha in 2007.

In the EU, most farms growing cotton are characterised by their small size (Greece 4.5 ha and Spain 11.0 ha) and large number (79 700 in Greece and 9 500 in Spain). In Greece, cotton holdings have a higher degree of specialisation; Thessaly is devoted almost exclusively to cotton production.

In recent years, the environmental impact of cotton has attracted attention. Dependent on irrigation and fertilisers, cotton is widely associated with low biodiversity and soil impoverishment. In addition, the intensive use of phytosanitary products, especially insecticides, and leaf defoliants to assist with harvesting are a source of concern.

At the processing level, a mixture of private enterprises and co-operatives convert the raw cotton to its usable state through the ginning process, which separates cotton fibres from the seed. The capacity of Spain's 29 ginning plants, nearly half of which are co-operatives, far exceeds its production. In Greece the ginning capacity is more in balance with production and a lower proportion of plants are run by co-operatives (20 out of 73).
Internationally, the EU is a minor player, contributing only about 2% to the world's total production of cotton. The main producing countries are China (24%), the USA (20%) and India (14%).

The EU is one of the world's net importers of cotton. World cotton exports are dominated by the USA, which currently exports about 2.75 million tonnes, or 36.5% of world trade.

The biggest cotton consumers are those countries with established manufacturing industries. China uses 32% of the world's cotton, followed by the USA (14%) and India (7%). EU's consumption of around 0.6 million tonnes of ginned cotton (2.7% of the world total) is mostly concentrated in Italy, Portugal and Germany.

The fact that the EU is a marginal producer of cotton implies that the impact of EU production on the evolution of world market prices has been negligible. This is further strengthened by the fact that the EU does not use export subsidies for this sector and offers duty free access. Though policies of other developed and developing countries have had a significant effect on world cotton prices, the main factor contributing to the price decline is increased competition from synthetics.

In Europe, the first cotton support regime was set up with the accession of Greece to the EC in 1980, then extended to Spain and Portugal in 1986. A Protocol annexed to the Accession Treaty stated that the Community shall ensure the support of cotton production in the regions where it is important for the agricultural economy. The support system should permit the producers concerned to earn a fair income and include the grant of an aid to production.

The initial regime was based on a "deficiency payment" granted to processors, who paid a minimum price to the farmers that supplied them with unginned cotton. The aid and minimum price were based on the difference between an internal target price and the world market price. This regime prompted a big expansion of the whole EU cotton sector.

In recent years the CAP has undergone a fundamental reform, aimed at increasing competitiveness, food safety and quality, stabilising farm incomes, integrating environmental concerns into agricultural policy, developing the vitality of rural areas, simplification and strengthening decentralisation. The main guiding principle of the 2003 CAP reform process is to move away from price and production support towards decoupled income support.

In order to bring cotton more in line with other sectors, the Council in April 2004 adopted a new regime for cotton, based on a decoupled income aid and a crop specific (area) payment, both paid directly to cotton farmers. It came into force in January 2006.

- **Existing provisions in the area of the proposal**

Chapter 10a of Title IV of Council Regulation (EC) No 1782/2003 of 29 September 2003 establishing common rules for direct support schemes under the common agricultural policy and establishing certain support schemes for farmers sets out rules for the specific payment for cotton. The provisions of this chapter have been annulled by the judgement of the Court of Justice of 7 September 2006 in case C-310/04. The effects of the annulment had been suspended until the adoption, within a reasonable time, of a new regulation.

- **Consistency with the other policies and objectives of the Union**

Not applicable.
2) CONSULTATION OF INTERESTED PARTIES AND IMPACT ASSESSMENT

- Consultation of interested parties

**Consultation methods, main sectors targeted and general profile of respondents**

In order to assist in the preparation of this proposal and its impact assessment, two independent studies were commissioned, respectively, to analyse the socio-economic aspects of cotton and to evaluate the environmental impact of the regime. In the framework of the two studies, data collection and the assessments of impacts were based on specific questionnaires addressed to stakeholders, and interviews carried out by experts.

The Commission services also organised workshops and seminars involving the interested parties. These consultations were in addition to the regular meetings with sector professionals organised in the framework of the Advisory Committee for Cotton and the Management Committee for Natural Fibres. Meetings were also organised with labour representatives and NGOs active in the field of development policy and environmental protection, as well as academics with specialist knowledge of the cotton sector and the authorities in the regions where the cultivation of cotton plays an important role.

An open consultation was conducted over the Internet from 8 May 2007 to 22 June 2007. The Commission received 320 responses. It provided additional feedback from a broader public.

- Collection and use of expertise

**Scientific/expertise domains concerned**

agro-economics and statistics

**Methodology used**

Independent studies and a consultation of stakeholders

**Main organisations/experts consulted**

See above

**Means used to make the expert advice publicly available**

The results of the consultation will be available on:


- Impact assessment

The Commission carried out an impact assessment listed in the Commission Legislative and Work Programme 2007 available on the Europa website.

3) LEGAL ELEMENTS OF THE PROPOSAL

- Summary of the proposed action

The new cotton regime should have the following goals:

- the continuation of agricultural activity as a component of the sustainable development of the cotton-producing regions;
the compatibility of the support options for cotton producers with the principles of the reformed CAP;

- the compatibility of the support options for cotton producers with the EU’s WTO commitments and the limitation of any negative impact on developing countries;

- the stability and control of the EU budget;

- the competitiveness and market orientation of the EU’s cotton sector;

- the reduction of the impact of cotton production on the environment;

- simplification of the management of the support regime for cotton producers.

In order to meet these objectives, this Proposal recommends that 65% of the resources devoted to supporting the cotton sector before the 2004 reform continue to be integrated in the Single Payment Scheme. Like other farmers benefiting from decoupled support, cotton growers will enjoy a certain stability of income, while having the freedom to adapt to market developments.

The remaining 35% would continue to be linked to cotton production, as an area payment. These coupled payments are designed to ensure the continuity of cotton growing at a level sufficient to safeguard the ginning industry in those regions where it represents an important economic activity.

The European Court of Justice raised, in particular, the question of the justification for the decoupling rate chosen. The question is how to embed the cotton regime in the CAP reform, while at the same time respecting the objectives of the Cotton Protocol in the Acts of Accession of Greece and of Spain and Portugal.

Analyses and complementary questionnaires carried out in the context of the Impact Assessment illustrated the different production structures and factors influencing the farmer's decision-making process. Quantitative modelling tools are unable to determine with certainty the relationship between supply and coupled payments. Nevertheless, there is consensus among the simulations carried out that, in the medium term, a coupled rate of support of about 35% would favour the continuation of cotton production – so respecting the Protocol – while adhering to the principles of the CAP reform.

In 2004 the Council decided to set the coupling rate at 35% although the Commission had proposed 40%. Returning to a higher rate of coupling would now entail a heavy workload for Member State administrations, as well as lowering the Single Farm Payment made to cotton farmers.

From an administrative point of view, any upwards modification of the coupling rate would imply a reduction of the decoupling rate and, consequently, the recalculation of all the payment entitlements allocated in 2006 to the historical producers of cotton in the Member States concerned. By contrast, maintaining the 35% coupling rate would not entail any further administrative burden.

If a higher decoupling rate than 65% were to be set, it would risk the extensive disruption of the cotton sector. Therefore, after analysing possible scenarios, as described in the Impact Assessment, the Commission has reached the conclusion that, in order to meet the stated goals, the current balance between coupled and decoupled support should be continued with some additional minor modifications to the regime.

It is proposed that the maximum area should remain unchanged at 450 597 ha (370 000 ha in Greece, 70 000 ha in Spain, 360 ha in Portugal and 10 237 ha in Bulgaria). The level of area
 payment would also remain unchanged and will be proportionately reduced in the event of payment claims exceeding the maximum area of a Member State.

Both the decoupled and crop-specific area payment will continue to be subject to cross-compliance criteria, which will lead to more environmentally-friendly cotton production in an income-neutral manner.

The crop-specific payment would be granted per eligible hectare of cotton, on condition that the area is maintained at least until harvest, with no obligation to deliver or sell cotton. The cotton would have to meet minimum requirements: "sound and fair" and of marketable quality.

It is proposed that inter-branch organisations should be supported, in order to help better coordinate the marketing of cotton, to draw up contracts between growers and processors and to promote quality.

The financial transfer for restructuring in the cotton-growing regions, provided for in Article 143d of Council Regulation (EC) No 1782/2003 (€22 million per year as from budget year 2007) has already been made available to the EAFRD and included in the annual breakdown by Member State of Community support to rural development, by Commission Decisions 2006/410/EC and 2006/636/EC. Thus, in the period 2007 to 2013, an additional amount of €154 million will be available as additional Community support for measures in cotton producing regions. This could allow Member States to further assist for instance the restructuring process of cotton-growing holdings and the ginning industry.

In order to support the promotion of EU cotton, the creation of a "label of origin" is recommended. This was explicitly asked for by stakeholders during the consultation process.

In March 2006, the Commission committed itself to undertake a policy review of the operation of Regulation (EC) No 510/2006 on the protection of geographical indications and designations of origin for agricultural products and foodstuffs. In this framework the Commission will study the possibility of including cotton in the scope of the Regulation.

To develop the image of Community cotton and promote its use, the Commission will analyse the relevance, efficacy and efficiency of including certain cotton products entirely produced and manufactured in the EU in the list of products eligible for information and promotion actions.

- **Legal basis**

  Article 37(2) of the Treaty establishing the European Community and Protocol No 4 on cotton (annexed to the 1979 Act of Accession).

- **Subsidiarity principle**

  The proposal leaves the important elements under the responsibility of the Member States:
  - approval of areas for cotton production,
  - approval of varieties,
  - approval of inter-branch organisations,
  - distribution of payment rights,
  - definition of environmental rules.
• **Proportionality principle**

The proposal complies with the proportionality principle because it corresponds to the general objectives of the common agricultural policy and at the same time respects the obligations imposed by Protocol No 4.

• **Choice of instruments**

Proposed instruments: Council regulation introducing a new support scheme on cotton which replaces the regime annulled by the Court of Justice by the judgement of the Court of Justice of 7 September 2006 in case C-310/04.

4) **Budgetary implication**

The national base area and the amount of aid per eligible hectare remain unchanged compared with the current situation. However, with the decrease of the coupled payment for farmers who are members of an approved inter-branch organisation from €10/ha to €3/ha, the amount granted to these farmers is reduced from €4.4 million to €1.4 million, which would offset any additional expenditure on information and promotion.
Proposal for a

COUNCIL REGULATION

amending Regulation (EC) No 1782/2003 establishing common rules for direct support schemes under the common agricultural policy and establishing certain support schemes for farmers, as regards the support scheme for cotton

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular third subparagraph of Article 37(2) thereof,

Having regard to the Act of Accession of Greece, and in particular paragraph 6 of Protocol No 4 thereto on cotton¹,

Having regard to the proposal from the Commission,

Having regard to the opinion of the European Parliament²,

Having regard to the opinion of the European Economic and Social Committee³,

Whereas:

(1) Chapter 10a of Title IV of Council Regulation (EC) No 1782/2003⁴ as inserted by Article 1(20) of Council Regulation (EC) No 864/2004⁵ sets out rules for the specific payment for cotton.

(2) By judgement of the Court of Justice of the European Communities of 7 September 2006 in case C-310/04⁶ Chapter 10a of Title IV of Regulation (EC) No 1782/2003 was annulled for breach of the principle of proportionality, in particular with reference to the circumstance that "the Council, the author of Regulation (EC) No 864/2004, [had] not shown before the Court that in adopting the new cotton support scheme established by that regulation it actually exercised its discretion, involving the taking into consideration of all the relevant factors and circumstances of the case, including all the labour costs linked to cotton growing and the viability of the ginning undertakings, which it was necessary to take into account for assessing the profitability of that crop" and that the Court had not been enabled "to ascertain whether the Community

² OJ C ..., ..., p. ....
³ OJ C ..., ..., p. ....
⁶ 2006 ECR I-7285.
legislature [had been] able, without exceeding the bounds of the broad discretion it enjoys in the matter, to reach the conclusion that fixing the amount of the specific aid for cotton at 35% of the total existing aid under the previous support scheme would suffice to guarantee the objective set out in recital 5 in the preamble to Regulation (EC) No 864/2004, namely to ensure the profitability and hence the continuation of that crop, an objective reflecting that laid down in paragraph 2 of Protocol No 4". The Court also ordered that the effects of the annulment be suspended until the adoption, within a reasonable time, of a new regulation.

(3) A new scheme of specific payment for cotton needs to be adopted in conformity with the Court's judgement in case C-310/04.

(4) The new scheme should meet the objectives, set out in paragraph 2 of Protocol No 4 on cotton annexed to the Act of Accession of Greece ('Protocol 4'), to support the production of cotton in regions of the Community where it is important for the agricultural economy, to permit the producers concerned to earn a fair income, and to stabilise the market by structural improvements at the level of supply and marketing.

(5) All the relevant factors and circumstances pertaining to the specific situation of the cotton sector, including all the elements necessary to assess the profitability of that crop, should be taken into consideration. To this end, an evaluation and consultation process was launched: two studies were carried out on the socio-economic and on the environmental impact on the cotton sector in the Community of the future cotton support scheme and specific seminars and an internet consultation were organised with stakeholders.

(6) The de-coupling of direct producer support and the introduction of the single payment scheme are essential elements in the process of reforming the common agricultural policy (CAP) aimed at moving away from a policy of price and production support to a policy of farmer income support. Regulation (EC) No 1782/2003 introduced those elements for several agricultural products.

(7) In order to meet the objectives underlying the reform of the CAP, the support for cotton should be largely de-coupled and integrated into the single payment scheme.

(8) A complete integration in the single payment scheme of the support scheme in the cotton sector is likely to bring a significant risk of production disruption to the cotton producer regions of the Community. Part of the support should therefore continue to be linked to the cultivation of cotton through a crop-specific payment per eligible hectare. Its amount should be calculated in such a way so as to achieve the objectives set out in paragraph 2 of Protocol 4 while also bring the cotton scheme into the mainstream of the CAP reform process and simplification. To that end, in the light of the evaluation carried out, it is justified that the total available aid per hectare per Member State is set at 35% of the national share of the aid that went indirectly to the producers. Such a rate allows the cotton sector to move towards long-term viability, promotes the sustainable development of the cotton-producing regions and ensures a fair income to farmers.

(9) The remaining 65% of the national share of the aid that went indirectly to the producers should be available for the single payment scheme.
For environmental reasons, a base area per Member State should be established in order to limit the areas sown under cotton. In addition, the eligible areas should be restricted to those authorised by the Member States.

In order to meet the needs of the ginning industry eligibility for the aid should be related to a minimum quality of cotton actually harvested.

In order to allow producers and ginters to enhance the quality of the cotton, the establishment of inter-branch organisations, to be approved by the Member States, should be encouraged. The Community should contribute indirectly to the activities of those organisations by increasing the aid to those farmers who are members of the organisations.

In order to apply the new cotton aid scheme from the beginning of the calendar year, this Regulation should apply as from 1 January 2008.

Regulation (EC) No 1782/2003 should therefore be amended accordingly,

HAS ADOPTED THIS REGULATION:

Article 1

Regulation (EC) No 1782/2003 is hereby amended as follows:

(1) In Title IV, Chapter 10a is replaced by the following:

"CHAPTER 10A
CROP SPECIFIC PAYMENT FOR COTTON

Article 110a – Scope

Aid shall be granted to farmers producing cotton falling within CN code 5201 00 under the conditions laid down in this Chapter.

Article 110b – Eligibility

1. The aid shall be granted per hectare of eligible area of cotton. In order to be eligible, the area shall be located on agricultural land authorised by the Member State for cotton production, sown under authorised varieties and actually harvested under normal growing conditions.

The aid referred to in Article 110a shall be paid for cotton of sound and fair merchantable quality.

2. Member States shall authorise the land and the varieties as referred to in paragraph 1 in accordance with detailed rules and conditions adopted in accordance with the procedure referred to in Article 144(2)."
Article 110c – Base areas and amounts

1. The national base areas are hereby established as follows:
   – Bulgaria: 10 237 ha,
   – Greece: 370 000 ha,
   – Spain: 70 000 ha,
   – Portugal: 360 ha.

2. The amount of the aid per eligible hectare shall be as follows:
   – Bulgaria: EUR 263,
   – Greece: EUR 594 for 300 000 hectares and EUR 342,85 for the remaining 70 000 hectares,
   – Spain: EUR 1 039,
   – Portugal: EUR 556.

3. If the eligible area of cotton in a given Member State and in a given year exceeds the base area laid down in paragraph 1, the aid referred to in paragraph 2 for that Member State shall be reduced proportionately to the overrun of the base area.

   However, for Greece the proportionate reduction shall be applied in respect of the amount of the aid fixed for the part of the national base area composed of the 70 000 hectares in order to respect the global amount of EUR 202,2 million.

4. Detailed rules for the implementation of this Article shall be adopted in accordance with the procedure referred to in Article 144(2).

Article 110d – Approved inter-branch organisations

1. For the purpose of this Chapter, an "approved inter-branch organisation" shall mean a legal entity made up of farmers producing cotton and at least one ginner, carrying out activities such as:
   – helping to coordinate better the way cotton is placed on the market, particularly through research studies and market surveys,
   – drawing up standard forms of contract compatible with Community rules,
   – orientating production towards products that are better adapted to market needs and consumer demand, particularly in aspects of quality and consumer protection,
   – updating methods and means to improve product quality,
   – developing marketing strategies to promote cotton via quality certification schemes.

2. The Member State in whose territory the ginners are established shall approve inter-branch organisations that respect criteria to be adopted in accordance with the procedure referred to in Article 144(2).
Article 110e – Payment of aid

1. Farmers shall be granted the aid per eligible hectare pursuant to Article 110c.

2. Farmers who are members of an approved inter-branch organisation shall be granted an aid, per eligible hectare within the base area laid down in Article 110c(1), increased by an amount of EUR 3.

(2) In Article 156(2), point (g) is replaced by the following:
"(g) Title IV, Chapter 10a, shall apply as from 1 January 2008 for the cotton sown as from that date."

Article 2

This Regulation shall enter into force on the day following that of its publication in the Official Journal of the European Union.

It shall apply as from 1 January 2008.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

For the Council
The President
1. **BUDGET HEADING:** (nomenclature 2007)

   05 03 01 02
   05 03 02 40

2. **TITLE:**

   Council Regulation amending Regulation (EC) No 1782/2003 establishing common rules for direct support schemes under the common agricultural policy and establishing certain support schemes for farmers, as regards the support scheme for cotton.

3. **LEGAL BASIS:**

   Article 37(2) of the Treaty

4. **AIMS:**


5. **FINANCIAL IMPLICATIONS**

   12 MONTH PERIOD

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5.2 **METHOD OF CALCULATION:** see Annex.

6.0 **CAN THE PROJECT BE FINANCED FROM APPROPRIATIONS ENTERED IN THE RELEVANT CHAPTER OF THE CURRENT BUDGET?**  
   YES  NO

6.1 **CAN THE PROJECT BE FINANCED BY TRANSFER BETWEEN CHAPTERS OF THE CURRENT BUDGET?**  
   YES  NO

6.2 **WILL A SUPPLEMENTARY BUDGET BE NECESSARY?**  
   YES  NO

6.3 **WILL APPROPRIATIONS NEED TO BE ENTERED IN FUTURE BUDGETS?**  
   YES  NO

**OBSERVATIONS:**

The proposal does not change the current ratio between coupled and decoupled aid and does not modify the provisions for the decoupled aid. As far as the coupled aid is concerned, this proposal does not entail any additional expenditure compared to the current regime as the base areas and the level of aid remain unchanged. However, the decrease of the coupled payment for farmers who are member of an approved inter branch organisation will produce a saving of €3 million.
## ANNEX

### 1 – Crop specific payment for cotton (Greece, Portugal, Spain) – budget item 05 03 02 40

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<th>Greece</th>
<th>Spain</th>
<th>Portugal</th>
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<td>Base area</td>
<td>300 000 ha</td>
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<tr>
<td>Level of aid</td>
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<tr>
<td>Base area</td>
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<td><strong>€72 730 000</strong></td>
<td><strong>€200 160</strong></td>
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*Increase of the level of aid for producers members of an approved inter-branch organisation*

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<th>Greece</th>
<th>Spain</th>
<th>Portugal</th>
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<td><strong>€72 940 000</strong></td>
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**Total EU 15 for each budget year**

€276 450 740

### 2 – Bulgaria : inclusion in the SAPS – Item 05 03 01 02

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<tr>
<td>Base area</td>
<td>10 237 ha</td>
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<tr>
<td>Level of aid</td>
<td>€263/ha</td>
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<td>Total</td>
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<td>2017 onwards</td>
<td>€2 692 331</td>
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**Total expenditure : 1 + 2**

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<th>Budget year</th>
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<td>€277 393 056</td>
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<td>€277 796 906</td>
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<td>€278 873 838</td>
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<td>2017 onwards</td>
<td>€279 143 071</td>
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