Agriculture and Rural Development Directorate-General

Evaluation of the CAP measures related to hops

Short summary - 7 December 2009

This evaluation study contains both a description of the current situation in the EU hop sector in the international context and an evaluation of the effectiveness, efficiency, coherence and relevance of the Common Agriculture Policy measures related to the hop sector, in particular the effects of the CAP reform (decoupled aid as established by Council Regulation 1782/2003) on the hop sector.

The evaluation covered the period 2005-2007. It was based on an analytical framework consisting of various data collection and analysis tools:

1. The main databases: **FADN** (Farm Accountancy Data Network), **IHCG** (The International Hops Growers Convention) databases, the **Barth Report** and the **Hopsteiner guidelines for hops buying report,** and the **Brewers for Europe** website as well, and **Eurostat** and **DG AGRI;**
2. The economic tools: the use of the **Financial Economic Simulation** tool (FES) allowed us to judge the effects of the CAP reform at the farm level for the most critical indicators and th**e Face-IT** tool has been used to judge the relative profitability of hops growing farms compared to farms growing alternative crops.
3. **Desk research** consisted of identifying, reading and analysing secondary data information sources such as CAP Regulations, policy papers, Commission reports, etc.
4. **Interviews** of producers associations, traders and merchants, Ministries and Administrations, stakeholders at EU level;
5. In order to increase the empirical evidences and to deepen the analysis, **case studies** in specific regions of the Czech Republic (Zatec Ustecky region), Germany (Hallertau region), Spain (Castilla y León region) and the United Kingdom (Kent region).

I Description of the situation in the EU hop sector in the international context

I 1 Hops production and supply in the EU

Hops production is a niche sector taking European agriculture as a whole, but it is important to certain Member States, notably Germany and the Czech Republic. Germany is one of the leading producers of hops worldwide, accounting together with the US for more than half of annual global production. Germany’s share of EU production has been growing relative to the EU as a whole. The EU as such also accounts for more than half the area planted with hop worldwide despite a decline in the first half of this decade. However, recent plantings in the US make it likely that the EU share of world hops production will decline in the next few years.

In the last decade, the number of hops growers has been declining steadily in European hops-producing countries, but holding size – while varying considerably on average across the EU – has been rising. The ratio of areas sown to aroma and bitter varieties is around two to one. Yields of all varieties and of alpha acid production per hectare have increased significantly (but not constantly every year) since the beginning of the decade, alpha acid content has also increased but moderately.

Demand is largely determined by the consumption of hops-based beers. Beer production rose significantly in the first half of the decade, but has stabilised since – with brewers competing strongly for market share and a wave of consolidation in the last twenty years. Europe accounts for around one-third of world beer production. Demand for hops not only depends on total beer consumption, however, but also on consumer taste: demand is shifting towards less bitter beers requiring lower hops content.

Hops prices, particularly on spot markets, are strongly influenced by the weather and by the level of stocks. Some 40% of world production is traded between countries. Trade is particularly important to the EU as Europe accounts for around 80% of world exports (excluding intra-EU trade) and some 50% of imports.

I 2 The policy framework in the EU

Council Regulation (EC) No 1782/2003 established common rules for a reformed CAP. It introduces principles such as decoupled aid, partially coupled aid and Complementary National Direct Payment. In addition to this overarching Regulation, the present evaluation covers the provisions from Council Regulation (EC) No 1952/2005 of 23 November 2005 concerning the common organisation of the market in hops (CMO). The CMO covers the role of producer organisations, the certification process as well as marketing and trade with third countries.

In complement to this policy framework, we also integrated in our evaluation other intervening factors that could potentially impact the sector's evolution such as the production and the structure of holdings' evolution. Other intervening factors include the way in which Member States implement the legislation, and a number of others –ranging from the spill-over benefits of general improvements in agronomic practice and the state of the economy, to changes in technology and the weather conditions.

II Evaluation of the CAP measures related to the hop sector, in particular the effects of the CAP reform – Main conclusions

II 1 To what extent have the CAP measures supporting hops affected the production decisions of farmers in traditional areas?

Gross margins of hops growing appear to be very high compared to possible alternative crops. In almost all production regions, hop is the most profitable crop in terms of gross margin. With decoupling, producing hops has remained attractive compared to most alternatives, in particular to common wheat and sugar beet. The relative profitability of hops versus field horticulture declined. Furthermore, the analysis of production trends indicates that there has been no decrease of production following decoupling.

Moreover, the difference in margins has to be significant to act as the catalyst for a crop switch because of the sunk costs, e.g. in machinery and trellises. The need for crop-specific knowledge and the necessity of specific soil and climate conditions limit switching.

The role played by producer groups in different countries varies. Some producer groups are well staffed and offer considerable administrative assistance as well as support for modernisation of hops gardens (loan facilitation), the introduction of new varieties and research of disease control for instance. They often play an important role to support the production in traditional areas.

II 2 To what extent have the CAP measures supporting hops contributed to support the income of hops producers?

The EU support for hops is not a primary income source for European hop farms as it only constitutes around 5% of the total returns according to our simulation. However, the support is of importance for farmer income, regardless of whether this support is coupled or not. In principle, for the farmers' income, it does not make a significant difference whether the EU support is coupled or decoupled from production but on the other hand the way the CAP reform is implemented can influence the support.

The analysis shows that, for the average hop farm, decoupling does not cause any significant changes in farm income. The relatively high net farm income on hop farms before the reform remains high. For individual farms, on the other hand, the reform can cause some (minor) changes in their income position depending on the farm structure and on the implementation model. In case of transition towards flat rate payments, some farmers would be faced with declining income due to the high historical level of support.

II 3 To what extent have the CAP measures supporting hops induced structural changes of producing farms and changes in the geographical distribution of hops production?

Trends in production structures, i.e. the move to larger holdings and a smaller number of growers, and in geographical area, i.e. decreases in countries with lower production and a gradual dwindling elsewhere in most cases, are being driven by market forces, agronomic developments (including the launch of new bitter varieties with a higher yield per hectare) and demographic changes rather than by CAP measures.

II 4 To what extent have the CAP measures supporting hops contributed to ensuring sufficient levels of production with respect to the needs of the downstream sector and to what extent has it changed the geographical distribution of the latter?

Despite some stagnation in recent years, the trend of beer production has been increasing in Europe (and worldwide). The production of alpha acid, though volatile from year to year, is however stable overall. These are long-term trends. No robust causal link could be observed with CAP support measures, notably decoupling.

Forward contracts contribute to hops market stability and, as CAP measures related to hops, producer groups play a key role in facilitating this system, which brewers value for the relative guarantee of future supply.

Concerning the geographical distribution of processing industries, there is no relationship with decoupling of CAP support. The costs of hops are very small in relation to total cost of the industry.

II 5 To what extent have the CAP measures supporting hops contributed to stabilising markets and ensuring reasonable prices for supplies to consumers?

The current CAP measures play a role in ensuring the stability of the markets, especially through producer groups. Producer groups were not affected by the 2003 CAP reform. Decoupling does not seem to have any effect on the downstream sector and on market stability in particular. Producer groups manage to reduce the effects of price volatility on growers, although they cannot eliminate it. The producer groups' main tool to limit volatility is a market instrument, i.e. forward contracts that they conclude on the behalf of their members.

II 6 To what extent is the objective of ensuring sufficient levels of production (quantity and quality) in traditional production areas relevant with respect to the needs of user industries (e.g. in terms of added value of local production)?

The factors which lead brewers to decide to set up in a certain country do not relate to the availability of hops within a specific country or any requirement to be close to a traditional production area. Nevertheless, brewers that decide to use specific hops for aromatic reasons may choose for hops coming from specific regions but these breweries are active in a niche market. Large breweries use different hops varieties coming from different regions in the world.

II 7 To what extent have the CAP measures supporting hops promoted rural development in traditional production areas with respect to employment and economic viability?

Trends in the hop sector have been driven by the market, including the market stability resulting from strong producer groups, underlying structural oversupply, the age demographics of hops growers and input costs rising faster than incomes. There is no evidence that decoupling has affected employment or economic viability to any extent or to an extent such that hops growers are giving up hops as a result. There are very little new entries, thus confirming the likelihood that the hop sector is unattractive, probably due to the original significant investments that a hops farm establishment implies compared to its economic viability and to other agricultural activities. The strongest sectors are those of the Czech Republic (with large farms) and Germany (with strong producer groups and historical leader position in the hop sector). For the producers in the other Member States, we could consider that their economic situation would become problematic in the coming years if they do not succeed in reducing costs.

II 8 To what extent have the CAP measures applicable to the hop sector after the 2003 reform been efficient in achieving the objectives of these measures?

As far as the effectiveness of the CAP measures is concerned, we can conclude that the CAP measures related to hops have in general no major impact on the hop sector. The sector was market-oriented for years and the CAP measures such as producer groups have been in existence for several years. Nevertheless, the CAP measures such as decoupling, producer groups and quality standards could be considered as efficient because they do not create additional costs that are not balanced by sufficient benefits for the growers.

As far as the producer groups are concerned, we can also consider that they are efficient as they provide their members with different services and have a limited, but positive influence on the hop market as a whole. As a potential rough indicator of their efficiency, we noted that their members continue to financially support their producer groups even if they are not obliged to do so. Nevertheless, the CAP reform did not increase (nor decrease) their efficiency.

II 9 To what extent have the CAP measures supporting hops contributed to (or counteracted with) achieving a simplified and effective administration and management?

The 2003 CAP reform reduced consistently the administrative burden for the national authorities and generated savings in terms of time and human resources devoted to the process. The burden on producer groups is perceived as being reasonable and does not entail any significant cost. In cases where producer groups do not provide their members with help on how to file the request for subsidies to farmers, farmers incur additional costs that vary across the EU, as they have to outsource to external consultants. Decoupling can be considered as particularly efficient compared to the previous financial support (i.e. coupled to production) as farmers receive about the same amount of money, but do not have to provide the same amount of information to the EU. Less money has to be invested in administrative activities due to decoupled support.

Contract registration is not seen as burdensome but the current regulation on the registration of contracts is perceived by merchants as breaching commercial confidentiality because the information has to be reported to national authorities. If the only purpose of the registration is to provide “informative” statistics, we can consider this provision as inefficient. It remains to be seen whether there is value added from this provision in a system that is neutral to production choices.

II 10 To what extent have the CAP measures supporting hops coherent with the objective of a more competitive and market-related agriculture promoted by the 2003 CAP reform?

The EU’s dominant position in the hop sector is threatened by the United States where producers enjoy higher productivity and where the productive structure is more competitive. The CAP measures and the reform do not play a direct role in this. Decoupling and other CAP measures have not influenced the process of restructuring that is taking place in Europe. This market-driven process has obliged a number of producers to abandon hops, and has resulted in an increase in the average size of hops farms. Nevertheless the cultivated surface is decreasing. The new entities that have emerged should be more efficient thanks to the economies of scale.

European researchers managed to develop new varieties; growers have renewed hop gardens and have recovered much of the ground lost to the US in terms of productivity. This is the case for Germany, but not for other EU countries that are still lagging behind in terms of productivity. Germany has been successful because it managed to innovate and to quickly shift to high alpha varieties.

II 11 To what extent have CAP measures supporting hops affected the environment?

There are developments which could be or are beneficial for the environment in the use of new varieties, new irrigation systems (consuming less water), and the use of pesticide and fertilizers. However, there are no data which would make it possible to attribute cause and effect to CAP reform measures. As concerns a possible environmental risk of land abandonment, it does appear that land no longer used for hops is not abandoned, but it seems to be used for other crops. Nevertheless, robust evidence in this respect is missing.

Recommendations

We recommend that:

- the EU continues the provision of income support through decoupled payments instead of coupled aid as the former is in the hops sector more efficient and allows a better orientation for investment decisions.
- in order to increase market stability and to safeguard farmers' incomes, organisations of producers keep on stimulating on behalf of their members the concluding of forward contracts.
- the sector uses and develops instruments fostering investment and innovation in order to promote the structural change needed for increased international competitiveness and productivity.
- producer groups continue making farmers aware of the environmental implications of their production decisions, such as fertilizer and pesticide use.
- the EU and the Member States continue their efforts to ensure that the administrative burden of the CAP measures relating to the hop sector is reduced in all producing EU countries.