2 THE COMMON AGRICULTURAL POLICY

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The Treaty of Rome specifies a set of objectives for the Common Agricultural Policy (CAP) which are not dissimilar to those adopted by most of the developed countries. The policy seeks:-

- to increase agricultural productivity;
- to ensure a fair standard of living for those in farming;
- to stabilise markets;
- to ensure reasonable consumer prices:
- to guarantee regular supplies.

What is somewhat unusual about the CAP however, is the severity with which one objective - the desire to protect rural living standards - has come to dominate the way the policy has been implemented. In particular, support prices for the major farm commodities have been set at levels well in excess of those at which supplies could normally be bought or sold on world markets and, partly as a consequence of this, European farmers have been supplying a growing proportion of domestic requirements. Table 2.1 gives some estimates by the European Commission of the extent to which CAP support prices have exceeded those applying on world markets, and Table 2.2 indicates the way self-sufficiency in farm products has tended to increase over the past 15 years. The policy now covers all the major agricultural products produced within the EEC, with the exception of sheepmeat and potatoes, and policies directed towards these sectors are likely to be introduced soon.

One group who have suffered at the hands of the policy are producers in agricultural exporting countries who could reasonably have expected, in the absence of such a highly protected European agriculture, to have sold produce in Community markets. In contrast they sometimes find that they are having to compete with heavily subsidised exports from the EEC. The signatories to the Lomé Convention can, in a sense, count themselves as fortunate that so few of their agricultural exports compete with the bulk of Community produce. The two main exceptions are, of course, sugar and oilseed products, for which there are both temperate and tropical sources. However, many experts believe that there is a considerable potential in Lomé countries for exports to the Community of beef, some cereals, and some fruits and vegetables. Details of the specific policies adopted under the CAP for these commodity sectors (with the exception of sugar) will be found in Part II. In this chapter a broad outline of the way the policy attempts to control agricultural product markets is given.

Table 2.1

Prices of Certain Agricultural Products in the EEC as a Percentage of Prices on World Markets*

Product	Marketing Year				
	1968/69	1970/71	1972/73	1974/75	1976/77
Common Wheat	195	189	153	107	204
Rice	138	210	115	81	179
Maize	178	141	143	106	163
White Sugar	355	203	127	41	176
Beef and Veal	169	140	112	162	192
Pigmeat	134	134	147	109	125
Eggs	137	201	159	164	-
Butter	504	481	249	316	401
Skimmed Milk Powder	365	-	145	138	571
Olive Oil	173	155	125	113	207**
Oilseeds	203	131	131	80	127**

* Most of the figures in this table are calculated by deducting import levies and duties (paid on whatever quantity of produce is imported) from the minimum import price for the commodity in question. Thus the "World Price" is a rough estimate of the average price received throughout the year by exporters to the Community and this will not necessarily always be representative of the price at which the commodity is traded elsewhere in the world. For some products, the "World Price" has been estimated by deducting subsidies paid on EEC exports from the national support prices.

** 1975/76.

Source: EC Commission, Yearbooks of Agricultural Statistics.

Table 2.2

Degrees of Self-Sufficiency in Certain Agricultural Products

Product	Year			
	1956/60 Average EEC-6	1972		1976*
		EEC-6	EEC-9	EEC-9
Wheat	90	111	99	101
Maize	64	68	58	53
Rice	83	112	92	-
Sugar	104	122	100	105
Fresh Vegetables	104	100	94	95
Fresh Fruit	90	87	76	79
Citrus	47	52	34	43
Cheese	100	102	102	102
Butter	101	124	106	107
Eggs	90	99	99	100
Beef & Veal	92	81	84	99
Pigmeat	100	99	100	99
Poultry Meat	93	100	102	104
Vegetable Fats & Oils	19	31	-	26

* Some figures in this column relate to the 1975/76 marketing year.

Source: As Table 2.1

A. Policy Mechanisms

Figure 2.1 describes the essential features of a typical CAP* support system for a farm product (as applies, for example, to cereals or dairy products). Each year, the Council of Ministers sets a target price for the commodity in question. This price is intended as a guide to producers and a reference point for the operation of the policy. The main mechanism which ensures that internal market prices are kept near the target level is a levy on imports which varies in such a way that imported produce cannot undercut domestic supplies. This levy is calculated by setting a threshold price, a little below the target price to reflect the cost of transport from port to internal market centre, and then a tax is charged on importers equal to the difference between the threshold price and the world market price. 'World price' usually means, in this context, the lowest price at which a consignment of produce is being offered at a particular EEC port during some specified time period.

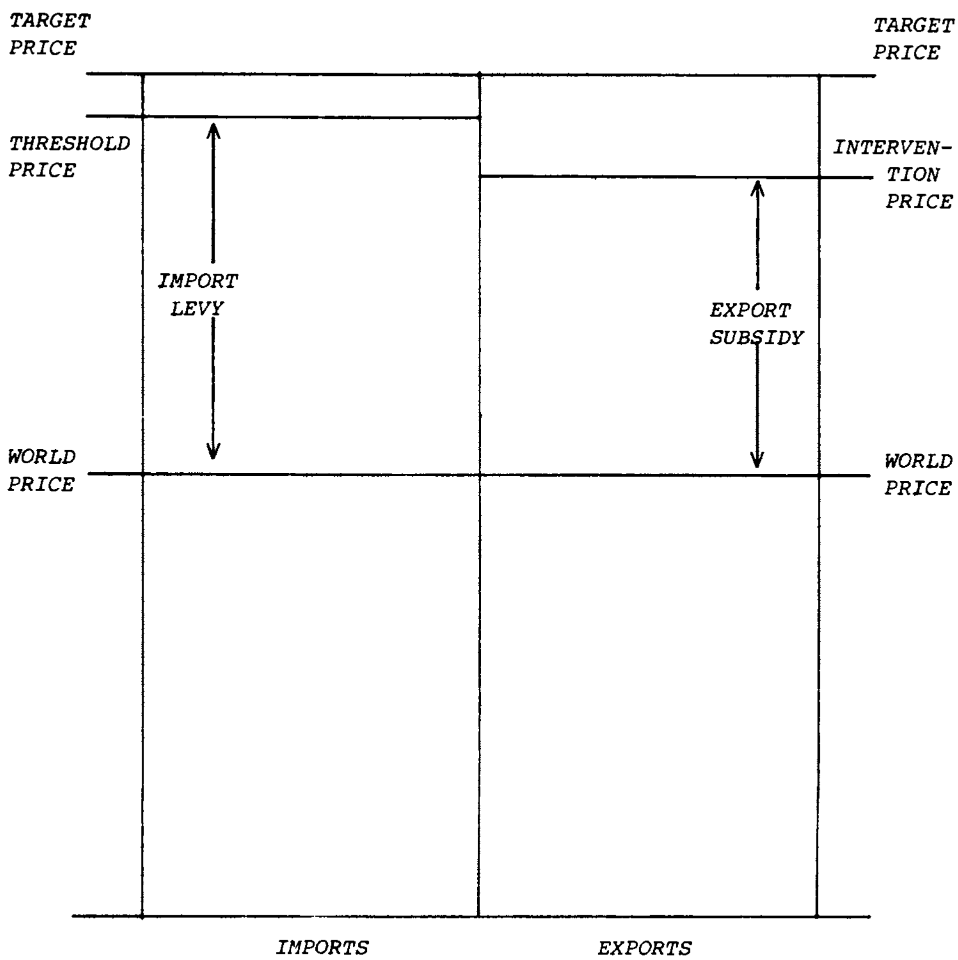
* For a general introduction to the CAP see Marsh and Ritson, 1971: Ritson, 1974; OECD, 1974; EC, 1977 H.

The import levy will, on its own, keep internal market prices near the target level as long as the country is less than self-sufficient in the commodity. If however, EEC farmers supply more of the commodity than can be sold on domestic markets at the target price, internal prices will begin to drop below target levels. For this eventuality, a second line of defence is required to prevent excess supplies (known as 'surpluses') from depressing producer prices. An <u>intervention price</u> is set, somewhat below the target price. If the internal market price should now fall to the intervention level, official intervention agencies will buy produce offered to them at the intervention price. The agency will then either store the produce or sell it to traders who export it with the aid of a subsidy (<u>restitution</u>) roughly equal to the difference between the intervention price and the world price. Similar subsidies are paid to private traders who export the product directly. For some commodities, other methods are used to dispose of surpluses. For example, both wheat and milk powder have been subsidised for use as animal feedingstuffs.

It is evident from Table 2.1 that for most agricultural commodities, for most of the time, CAP support prices have exceeded 'world' prices. However, during the 1973/74 commodity boom, some prices for food products on world markets did move above CAP support levels. For commodities in surplus, the EEC was able to restrain domestic price levels by imposing export taxes but, as a general rule, import subsidies were not introduced into the CAP system.

<u>Figure 2.1</u>

<u>Model of Typical CAP Support System</u>



B. Green Money

In principle, the market support system should operate uniformly throughout the EEC, with much the same import levy or export subsidy applying whichever Member State trades with third countries, and with internal market prices differing only on account of transport costs and because it often takes a considerable time before a movement of produce reconciles price differences (which can occur, for example, because of a bad harvest in one EEC Member State). This was indeed the case for a relatively brief period between 1967 and 1969. Since then, however, in a period of fluctuating exchange rates, the EEC Member States have found it increasingly difficult to reconcile their objectives towards domestic farm product prices with the ideal of a common EEC price level. Over the past few years, CAP support prices, when expressed in national currencies, have varied greatly between EEC Member States. Support prices in Germany have typically been ten per cent above those applying in the Benelux countries and Denmark: some twenty to thirty per cent above those in France and Italy; and as much as forty or fifty per cent above those applying in the United Kingdom. Corresponding differences apply to the levies charged in individual Member States on third country imports, and there is a complicated system of border taxes and subsidies (known as <u>monetary compensatory amounts</u>) on intra-EEC trade to bridge the price gaps*.

For the present, therefore, the exporter of farm products to the Community is not faced by the same import barriers throughout the Community, but by a level of protection which varies between what might (generously) be described as 'moderate' in the UK to 'extreme' in Denmark, the Benelux countries and Germany; and when a country like the UK devalues its "green rate of exchange" to cut the MCA applying to it, this puts up its national price level and raises, correspondingly, the tax on imports from third countries.

The importance of Europe's green money system from the point of view of potential exporters of agricultural commodities to the EEC is, first, that it is not the theoretical CAP "common" price level which is important, but the price levels which actually apply in the Member States. Harmonisation of prices in the EEC, if this involved the elimination of all existing MCAs, would <u>raise</u> the average level of protection against third country imports.

Second, it should be recognised that <u>most</u> increases in farm product prices now occur by changes in "Green" rates of exchange, which affect individual national price levels, rather than by agreed rises in "Common" prices. The unit of account used within the Common Agricultural Policy is, in effect, tied to the German Mark, which tends to appreciate against other countries. As it does, MCAs increase

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* The EEC's green money system is extremely complicated, but its effects are important and wide-ranging. Appendix 5 provides a brief explanation of why exchange rate movements should lead to both border taxes and subsidies on intra-EEC trade, and to variations in the barriers imposed by EEC Member States on third country imports of CAP products. A detailed discussion of the current operation of the CAP with emphasis on the green money system will be found in Heidhues et al, 1978. For an earlier interpretation, see Josling, T.E., and Harris, S., 1976. For a description of the operation of the green money mechanism, see Irving, R., and Fearn, H.A., 1975.

for some other Member States, who are put under pressure to devalue their green rates and put up their national price levels. This semi-automatic price inflation which is now built into the CAP allows the EEC to give a spurious impression of "moderation" in its approach to farm product prices. The recent 1978 farm product price package was heralded as a "responsible" one on account of the fact the prices in units of account were raised by only a little over 2 per cent. However, when green rate changes throughout the year are taken into account, the average price increase is about 8 per cent, ranging from 2 per cent in Germany to about 15 per cent in Italy.

C. Prospects for Exporters

When considering the prospects for further trade concessions on CAP products being granted to the ACP countries it is as well at the onset to be realistic. If the combined force of the desire to restrain consumer food prices in a period of rapid inflation and the often strident objections to the policies on the part of the USA* have failed to make any serious inroads into the highly protectionist nature of the CAP then, in truth, it seems unlikely that any major break-through will be made on this front in the course of the renegotiation of the Lomé Convention. In this connection it is worth noting that the EEC has specifically stated that it views Lomé II as an improved version of Lomé I and not as a radically new form of convention.

Nevertheless there will always be some room for flexibility; some areas where resistance will be less than in others. The Lomé countries will be better placed to exploit any such flexibility if they are informed concerning three aspects of the background to current developments in the Common Agricultural Policy. First, what are the real issues that lead the Community to find it necessary to guarantee such high prices to its farmers? Second, is the policy itself sometimes being justified on the basis of arguments that can in fact be contested? Third, are there objectives within the EEC which are consistent with improved access for ACP countries for CAP products?

It is against this background that the following observations are made concerning the CAP and its implications for ACP countries. Details of specific concessions on agricultural products will be found in the next chapter and in Part II of the report.

(a) Many of the Community's poorest people are small farmers. But some of its more prosperous inhabitants are now large commercial farmers and the policy of price support does more to help the latter than the former. Moreover, the CAP products of interest to LIC exporting countries tend <u>not</u> to be those of most significance to the incomes of small farmers. Over the past twenty years there has been a very rapid decline in the rural labour force - from about one in four of the working population to about one in twelve. Increasingly, the negotiations surrounding the level of support for farming in the EEC are tending to reflect, not so much a genuine desire, or indeed need, to raise the standard of living of the less well-off people in Europe, but a conflict between varying interest groups, of varying strength and varying prosperity.

(b) In the early years of the Community, the ability to forge a common policy in such a complex arena as agriculture was seen by many as the most significant evidence of a willingness, and ability, to move towards economic and political integration. As a result, Member States were

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* See, for example, Harris (1977).

sometimes prepared to seek agreement on CAP policies, almost (literally) at any price. In the 1970s, the CAP is no longer seen so much as the 'corner stone' of the EEC and there may, thus, be a greater willingness in some quarters to resist price increases, even at the risk of the survival of the policy itself.

(c) Experience suggests two guiding principles when it comes to the treatment of third country imports of farm products. First, there has been a willingness to grant concessions in association agreement which have the effect of either increasing one country's share of EEC imports at the expense of countries not granted preferences, or of increasing the proportion of consumer expenditure on a product which is allowed (via levy concessions) to pass through to the exporter (or both). In general, the Community has not been prepared to contemplate arrangements which would involve an increase in imports at the expense of domestic supplies. It has however negotiated arrangements which preserve existing trade flows - for example, in the case of Commonwealth sugar and New Zealand butter. 'What we have we hold' seems a fairly strong position in trade negotiations.

(d) The world food crisis/commodity boom has considerably impaired the prospects for liberalisation in the trade impact of the CAP. The high level of (high cost) output in Europe is now justified both as a means of ensuring supplies for European consumers in an uncertain world, and as a contribution to global food supplies in a hungry world (e.g. EC, 1974). It is for the ACP countries themselves to make it clear that they see it as in their interest (if indeed this is the case) to export CAP products to Europe, not to import them from Europe. In conjunction with this, it might be necessary for ways to be found to give assurances of supply security to the EEC, be this problem real or imagined, be the anxiety genuine or merely an excuse.

(e) The present nature of the EEC farm product price fixing system with its open-ended budget is inherently likely to lead to a protectionist agriculture. Each country seems often to have more stake in getting the price increase it wants rather than in preventing price increases it does not want. Until consumer interests - here perhaps strengthened in some cases by the desire to increase imports from Third World countries - can exercise as much strength on Governments to prevent the price rises they do not need, as to fight for the ones that they feel they do, then the CAP will not change its face.

Despite these observations, the overall impression remains that the major hurdle to overcome if the Common Agricultural Policy is to change in a way beneficial to LICs is the implied loss for Europe's farmers who, in some countries anyway, retain political strength which seems excessive relative to their numbers. The conclusion is that, if a change in the CAP involves, or even appears to involve, a loss to some European farmers, then it might simply be "not on", irrespective of how sensible the change may appear when looked at from other points of view.

There remains the possibility, however, that a major shift in the <u>emphasis</u> of the CAP might bring about changes in trade patterns of importance to LICs without radically affecting farm incomes, at least in aggregate. It is just this kind of change which is proposed by David Jones (1976) in an attempt to tackle the problem of improving the impact of the CAP on LICs in a way which might, conceivably, appear realistic from the point of view of the EEC. He suggests, in effect, that the Community should increase cereal production and reduce beef production. Some LICs could benefit from increased sales of grass-fed beef and others might benefit from subsidised EEC exports of cereals. Whether food importing LICs would really benefit in the longer term from a policy which would damage the world market for efficient cereal exporters; whether it truly is realistic to expect the EEC to compensate losses to beef producers by gains to cereal growers; and whether the benefit to beef exporters would offset the possible loss to LIC exporters of oilseeds and casava are all open to question.

Finally, it should be emphasised that what matters as far as exporting countries are concerned is that support given to EEC agriculture under the CAP induces a level of output in certain commodity sectors which is greater than would otherwise be the case, and is greater than can be justified when production costs are compared with those in the exporting countries. It is for this reason that this chapter has concentrated on the price level, rather than looking at more specific barriers to trade. In one sense, the measures themselves do not matter all that much since they all tend to lead to a re-location of production away from traditional agricultural exporting country towards domestic sources, whether the policy instruments apply at the frontier or internally. In the final analysis, the exporting country, be it ACP or developed, is only going to benefit if it can regain a part of a (perhaps expanding) market that has been diverted to domestic producers.

For example, even an agreed import quota of a CAP product from ACP countries is not going to be of much assistance if domestic support prices are not cut at the same time; for the result will merely be to displace either EEC or other third country supplies which will have to find a market somewhere outside the Community, perhaps thereby damaging other LIC export prospects. This is a point which emerges in several of the commodity chapters, but is perhaps most applicable in the case of sugar. However, before going on to consider the commodities in detail, it is necessary that the trade impact of the Common Agricultural Policy should be seen in the wider context of the Community's external policies, which is the subject matter of the next chapter.