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**The Common Agricultural Policy
of the European Community
A Blessing or a Curse for Developing Countries?**

Ulrich Koester
Malcolm D. Bale

WORLD BANK STAFF WORKING PAPERS
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ABSTRACT

The European Community is the major player in global agricultural trade. Not only is it the leading importer of agricultural goods, it is also the dominant exporter of a number of agricultural products. Further, its export dominance is growing over time. It is, therefore, imperative that policymakers in developing countries and those that advise them on agricultural matters understand the implications of the EC's common agricultural policy on them. There are two major types of effects. On the one hand, as exporters of agricultural products, developing countries may lose their EC market share as the level of self-sufficiency of the EC increases or they may lose market share in third markets in competition with subsidized EC exports. On the other hand, as importers of certain agricultural products, some developing countries may gain by buying agricultural goods on the international market that are made cheaper and more abundant by EC agricultural surpluses.

This paper spells out which commodities fit into each category in addition to explaining how the common Agriculture Policy operates. Where possible magnitudes of the gains and losses are given. Finally, some recently proposed options for modifying the CAP are given.

The paper provides information for policymakers on two very different topics. First, it will be useful in planning production and export activities. Products where the EC is seen to be a persistent exporter or habitually self-sufficient will be avoided or expanded with caution by developing countries. Second, by making the operation, the benefits and the disadvantages of CAP more transparent, the document will provide useful material for developing country trade negotiators when they meet with their European counterparts.

EXTRACTO

La Comunidad Europea es el actor más importante del comercio agrícola mundial. No solamente es el importador principal sino a la vez el exportador dominante de algunos productos agrícolas. Además, su dominio en el campo de las exportaciones va en aumento. En consecuencia, es imperativo que los encargados de la formulación de las políticas de los países en desarrollo y los que les prestan asesoría en materia agrícola comprendan los efectos que tiene sobre dichos países la política agrícola común de la Comunidad Europea. Esos efectos son de dos clases principales. Por un lado, como exportadores de productos de la agricultura, los países en desarrollo pueden perder su participación en el mercado de la Comunidad Europea a medida que crezca el nivel de autosuficiencia de ésta, o pueden perder su participación en otros mercados al tener que competir con las exportaciones subvencionadas de la Comunidad. Por otro lado, como importadores de ciertos productos agrícolas, algunos países en desarrollo pueden obtener una ganancia al comprar en el mercado internacional aquellos productos que se vuelven más baratos y más abundantes debido a los excedentes agrícolas de la Comunidad Europea.

Este documento explica cuáles productos básicos caen dentro de cada categoría y cómo funciona la política agrícola común. Cuando ello es posible, suministra datos sobre la magnitud de las ganancias y pérdidas. Finalmente, presenta algunas opciones propuestas recientemente para modificar la política agrícola común.

El documento ofrece información sobre dos aspectos muy diferentes entre sí que son de interés para los encargados de la formulación de políticas. Primero, el documento será de utilidad en la planificación de las actividades de producción y exportación. Los países en desarrollo evitarán o aumentarán con cautela aquellos productos respecto de los cuales se observe que la Comunidad Europea es un exportador persistente o es habitualmente autosuficiente. Segundo, al exponer en forma más clara el funcionamiento, los beneficios y las desventajas de la política agrícola común, el documento proporcionará material útil para los negociadores comerciales de los países en desarrollo en su trato con sus contrapartes europeos.

La Communauté européenne joue un rôle prééminent dans le commerce agricole international. C'est non seulement le principal importateur de produits agricoles mais aussi le principal exportateur de certains d'entre eux. En outre, son rôle prédominant en ce qui concerne les exportations ne fait que s'accroître. Il est donc impératif que les responsables des pays en développement et leurs conseillers en matière agricole comprennent les incidences qu'a pour eux la politique agricole commune de la Communauté. Ces incidences sont essentiellement de deux types : d'une part, les pays en développement risquent, en tant qu'exportateurs de produits agricoles, de perdre leur part du marché de la Communauté européenne à mesure que celle-ci se rapproche de l'autosuffisance, ou bien ils risquent de perdre leur part du marché de pays tiers du fait de la concurrence d'exportations subventionnées de la Communauté. Par contre, en tant qu'importateurs de certains produits agricoles, certains pays en développement peuvent être gagnants en achetant sur le marché international des produits agricoles devenus meilleur marché et plus abondants grâce aux excédents agricoles de la Communauté.

Ce document indique dans quelle catégorie entrent les différents produits et il explique en outre le fonctionnement de la politique agricole commune. Chaque fois que cela est possible, l'ampleur des gains et des pertes est indiquée. Il expose enfin différentes formules récemment proposées pour modifier la politique agricole commune.

Ce document fournit des renseignements aux responsables sur deux points très différents. Tout d'abord, il leur sera utile pour planifier les activités de production et d'exportation. Les produits qui semblent être exportés régulièrement par la Communauté européenne ou pour lesquels elle se suffit généralement à elle-même seront évités par les pays en développement, ou bien ceux-ci n'en accroîtront la production qu'avec prudence. Deuxièmement, en fournissant des éclaircissements sur le fonctionnement de la politique agricole commune et sur ses avantages et inconvénients, le document constituera une référence utile aux responsables des pays en développement lors de leurs négociations commerciales avec leurs homologues européens.

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THE COMMON AGRICULTURE POLICY OF THE EUROPEAN COMMUNITY:
A BLESSING OR A CURSE FOR DEVELOPING COUNTRIES?

I. INTRODUCTION

The European Communities' (ECs) agricultural policy including its agricultural trade regime is, coincidentally, Europe's most illustrious accomplishment and its prodigal son. By almost any physical measure it has been eminently successful. Over the last two decades output has grown at over 3 percent per year and exports by more than double that amount so that now an embarrassment of plenty prevails. Yet the extravagant expenditures to support farm prices (approximately \$16 billion in 1983) have alienated European consumers, angered the EC's trading partners, and been deemed inadequate and inequitably distributed by European farmers.

As the Community has increased its level of self-sufficiency in agriculture it has moved from being an importer of many agricultural commodities to becoming an exporter. As a consequence, countries that were former exporters to the EC and now find themselves competing in third markets with subsidized EC exports have, over the last decade, expressed increasing concern over the effects EC policy is having on commercial agricultural trade. The countries expressing most concern are largely the temperate-product exporters led by the United States. More recently, the wider repercussions of the common agricultural policy (CAP) on the food production systems, agricultural

prices, and rural development of developing countries have become an issue as the extent of the spillover effects of the CAP on agricultural development have been studied and better understood.

It is the latter issue that is the primary concern of this essay. Having a basic understanding of the complex operation of the CAP and its wider ramifications is important for economists, planners and policymakers working in the agricultural sector of developing countries. Since changes in EC agricultural policies can affect the success and profitability of various agricultural projects or export development schemes in developing countries, it is useful that those involved in planning and implementing development projects have some understanding of the CAP. Second, to the extent that high-level policymakers in developing countries are better informed on the effects of the CAP so they can be more influential in international, multilateral or bilateral fora where the subject is discussed.

The essay is organized into four parts. In the introduction trade between the EC and developing countries is outlined together with a sketch of the establishment and evolution of the CAP. The second section deals with the operation of the CAP. The third section examines the implications of the CAP for developing country exporters and importers, while the final section concludes with some policy options for modifying the CAP. 1/

EC Agriculture and Trade with Developing Countries

While the EC is a large producer of agricultural products, it is and has been since its inception, the world's largest importer of agricultural

1/ The most recent and comprehensive description of the CAP and its operation is Harris et al.

commodities. Over the period 1973-78 the EC's share of world agricultural imports was approximately 27 percent compared to (say) 12.5 percent for Japan. ^{1/}

The EC is the major market for agricultural exports from developing countries accounting for 30 percent of their agricultural exports in 1973-78 and amounting to nearly \$27 billion in 1979, compared to a figure of less than 12 billion for the next largest importer of developing country agricultural products--the U.S. The importance of the Community as a market for developing country exports has declined somewhat over the period as exports of temperate-type products have declined to almost zero while exports of tropical products not produced in the EC, such as beverages, have increased only modestly. Major imports are tea, coffee, cocoa, sugar, tobacco and fruits. Yet there are a number of products that developing countries would like to export in larger volumes but are prevented from doing so by the border regulations. These are sugar, beef, olive oil, tobacco and its products, fruits (especially citrus) and vegetables.

As an agricultural exporter, the EC is the world's second largest after the U.S., its agricultural exports being valued at \$27 billion in 1980. Major agricultural exports are milk products and cereals--all sold at prices considerably below their domestic prices. Over the period 1973-80 its market share has increased by over 10 percent from 9.4 percent to over 11 percent of the world market while the relative shares of other major exporters declined. The value of EC agricultural exports to the developing countries amounted to nearly \$13 billion in 1980 making it the second most important

^{1/} The shares cited here are from the European Commission, 1982.

supplier of agricultural goods to the developing world after the U.S. Further, its share has increased from 15 percent to 18 percent of developing country agricultural imports from 1973 to 1980.

The EC's dominant role on the world food markets is even more evident when disaggregated by product as in Table 1. This shows that the EC was the world's largest exporter in the following markets in the early 1980s: butter, cheese, non-fat milk products, wheat flour, broilers and fresh eggs for consumption. The market shares were 53 percent for butter, 43 percent for cheese, 52 percent for non-fat milk products, 65 percent for wheat flour, 36 percent for broilers and 39 percent for eggs. The EC was the second largest exporter of sugar and beef and veal with a market share of 18 percent for each, and the third largest exporter on the wheat and total grain markets with market shares of 16 percent and 10 percent respectively.

This clearly highlights that CAP and changes in CAP will have a significant impact on the world food economy and especially on developing countries. Actual or potential exporters of food products should take into account the EC's role on the world food markets. If growing EC surpluses are expected on specific agricultural markets, developing countries would be well-advised to avoid an export strategy based on these products. Given current EC export regulations (explained later) it is not possible for foreign exporters to compete with EC exporters.

The Reason for Establishing the CAP

From the very conception of a common market in Europe it was clear that economic integration was only considered as a means to achieve a politically united Europe. Economic integration was viewed as a process which would eventually remove the obstacles for political integration. Six European States (France, West Germany, Italy, Belgium, the Netherlands and Luxembourg)

Table 1: EC'S EXPORT SHARE IN WORLD AGRICULTURAL EXPORTS /a

	1971-72	1973-74	1975-76	1977-78	1979-80	1980-81	1981-82	1982-83
Wheat	8.1	8.3	12.9	6.8	12.1	15.6	15.2	17.1
Wheat flour	47.6	60.0	54.4	54.0	61.6	66.4	67.3	61.5
Total grains		7.8	9.1		8.2	10.1	8.6	
Beef and veal	2.6	6.3	8.9	2.9	18.4	18.2	13.9	
Butter	31.1	47.5	18.4	43.1	57.2	59.3	52.6	46.8
Non-fat dairy products	22.9	29.9	28.5	36.8	62.9	56.9	49.5	50.3
Cheese	28.1	26.9	36.6	36.6	38.5	41.1	43.6	44.5
Broilers	36.6	26.5	39.0	38.0	37.4	35.4	34.7	39.3
Shell eggs for consumption					20.0	28.0	37.5	52.4
Sugar	6.2	4.3	3.4	9.5	13.8	16.2	18.4	18.5

/a EC export quantities as percentage of world export quantities, excluding intra-EC trade.

Source: Fred Sanderson, Seminar on Agricultural Trade Issues, Brookings Institution, Washington, D.C., April, 1983.

signed the Treaty of Rome in 1957 agreeing to integrate their economies. "The whole concept of the Economic Community is built on four freedoms: the freedom to move goods; the freedom of workers to move; the freedom to exercise a trade or profession; and the freedom to move payments and capital" (Fennel, p. 6). While these principles can only be achieved if all sectors of the economies are included in the integration scheme, it was considered of special importance to find an adequate integration scheme for the agricultural sectors of the member states. There were several reasons for this priority. First, agricultural policy among the member states differed considerably due to different economic situations and policy objectives in the country. Second, it was felt that different agricultural price levels could have significant effects on real wages and, hence, the competitiveness of industries. Third, "it was clear that France, the Netherlands, and Italy would not agree to open their markets to industrial goods if Germany in particular did not admit their agricultural exports" (Tracy, p. 268). Finally, it was hoped that the Community could gain in efficiency if the agricultural sectors of the member states were forced to adjust to a pattern based on comparative advantage.

However, while the six members agreed to include agriculture in the common market, the Treaty remained vague as to the nature of the common agricultural policy. It could consist of common rules of competition or of coordination of national market organizations or of a 'European' market organization. It was to take nearly three and a half years of argument to settle the basic principles of a common policy after the Treaty was signed. It took another 3 years, from 1962 through 1964, to agree on one of the key questions, a common level of cereal prices. The second key question, to find a long-term agreement for financing the CAP, was solved after a further one and a half years.

The fact that agreement was reached reflects a strong political commitment in favor of a Common Europe by all members. National interests diverged considerably. Possibly owing to Hallstein, the first president of the European Commission, the price agreement was finally settled in 1964. When the Commission submitted the proposal for the unification of cereal prices to the Council of Agricultural Ministers, the Council rejected the proposal first and asked for a modified version which would more closely match individual national interests. Hallstein, a strong personality, resubmitted the original proposal after only half an hour arguing in favor of the unification of Europe. He asked the Council to accept the proposal unanimously or accept the resignation of the Commission. This contributed to the sense that a Common Europe dominated national interests. Since then, the Commission has never again fought national interests in favor of Community interests so convincingly and so crucially.

The Evolution of the CAP Since 1964

Concerning formal aspects, the integration of national agricultural policies has made remarkable progress. Common market organizations were set up for nearly all agricultural products. In 1981, more than 90 percent of agricultural production was included in common market organizations and the Community received access to so-called 'own resources' whereby the Common Policy is financed by funds which are directly under the control of the Community. However, despite the integration of national agricultural policies, agricultural markets within the Community may be less integrated today than before the existence of the EC and agricultural production may be more distorted than ever. This is based on the following evidence.

First, price harmonization between national agricultural markets is nonexistent. At the beginning the EC was successful in harmonizing prices,

but prices have differed more in recent years than in the pre-EC phase or during the early formation of the EC (see Table 2). While, in the spirit of a customs union, the CAP sets uniform prices within the EC, expressed in terms of "European Currency Units" (ECUs), this does not mean that agricultural prices are uniform across members of the community. The "green" currency exchange rates for agriculture ensure this result. Thus, the price of wheat converted from ECUs to US dollars at official exchange rates was \$180/ton in France and \$213/ton in Germany, the price of sugar was \$390/ton in Britain and \$511/ton in Germany (Bale and Lutz, 1981). The intent of the "green" rate is to compensate producers from member countries differently. In order to assure that intra EC trade will occur at a common price despite the apparent different producer prices, a system of "Monetary Compensatory Amounts" (MCAs) approximately equal to the difference between the official and "green" exchange rate for each country, are administered. Thus a member country with a strong currency receives a positive MCA for each unit of agricultural output which it exports, and a member country with a weak currency incurs a negative MCA for its agricultural exports. Since exchange rates change daily, a series of bizarre rules, complex provisions and numerous exceptions prevail. Administering these rules, monitoring the trade and exchange rates, and the negotiating of the MCAs and rules are cumbersome, time-consuming and costly activities. The MCAs in reality are internal customs duties or import subsidies, depending on the country, designed to negate the need to adjust to market forces. They are perhaps the most eloquent example of a deviation from the spirit of price harmonization which yet appears to safeguard the letter of the principle of price harmony.

Second, regional integration will be more likely to increase efficiency in production in the Community if the average degree of protection is

Table 2: SELF-SUFFICIENCY OF THE EC IN AGRICULTURAL PRODUCTS a/

	<u>1967-1971</u>	<u>1978</u>	<u>1982-1983</u>
	percent		
Sugar	82	125	159
Butter	91	118	114
Milk fat	100	112	119
Barley	103	112	112
Rye	100	108	98
Wine	97	107	104
Poultry	101	103	111
Soft Wheat	-	102	121
Beef	90	95	105

a/ Included in the internal consumption are the quantities disposed of by the aid of subsidies.

SOURCE: Statistical Office of the European Communities.

not increased. This has not been the case for the EC. From the very beginning the average degree of protection increased. The strong farmer bias in annual price decisions in the EC, virtually neglecting world market prices, broke the most important relationship--the nexus between EC prices and world prices. In this respect CAP has frozen or slowed the structural adjustment of agriculture in the countries making up the EC. Further, it has not contributed to smoothing out regional income disparities that would be expected from economic integration.

Third, there is the divisive problem of the unequal method by which the costs and benefits of the budget are distributed among member states and among products within states. Rates of protection are much higher for products which are mainly produced in the northern part of the EC--such as cereals, milk and sugar--but less for Mediterranean products--such as fruits and vegetables. The equity question of which farmers and which regions will benefit stimulates lengthy debates in the decision-making councils. Some countries in effect view their contributions as transfer payments to the agricultural sector of other members whose production is often surplus to EC needs. The problem is concentrated in the dairy sector, which has consistently received between 40 and 45 percent of the entire agricultural expenditure, and to a lesser extent in the grains and sugar sectors which each receive around 26 percent of the agricultural budget.

Fourth, the administrative complexity of the CAP mechanisms, such as calculating the grain-content of livestock for the purposes of levies or restitutions, the monitoring and setting of green exchange rate movements, and the daily determination of fruit and vegetable prices in order to set reference prices differentiated by product, season and quality, are bureaucratically cumbersome and expensive to maintain.

But the variable levies are the "Maginot Line" for agriculture in the European Community since it is not possible for would-be exporters to lower prices in order to get under the tariff. ^{1/} Foreign competition is stopped at the border while protected domestic production flourishes.

Yet, like the Maginot Line the CAP is often breached or bypassed. The Community reflex in such cases, in accordance with an established tradition aimed at inhibiting short-term changes without addressing longer term structural adjustment, has been to plug the breach. Piecemeal policy of shorting up the Maginot Line results. Still, such policy is not tenable since when one breach has been plugged another opens up, such is the pressure due to the excessive difference between world and community prices. Thus, for example, the protection given to EC grain producers has given rise to imports of non-regulated substitute product--cassava pellets, corn gluten, citrus pulp, soybean meal, etc.

Summing up, the economic performance of CAP is much less convincing than the progress in formal integration. This can be explained by the fact that Community decisions have not been dominated by Community interests. Instead, compromises between diverging producer interests in member countries have dominated, producing welfare losses for the EC as a whole. National producer interests in CAP diverge not only due to different economic conditions and policy objectives, but the institutional framework of the EC contributes to the divergence of national interests (Koester, 1977). The principle of financial solidarity has led to a common financial system which allows individual member countries to externalize the costs of national policy strategies. Moreover, the present cofinancing arrangements make it impossible

^{1/} The metaphor was first used in this context by Mahe and Roudet.

to find a price solution that is not detrimental for at least one country. This adds an additional difficulty to the decision-making process. Thus the establishment of a common financial system is a major contributing cause for the lack of economic integration of European Agriculture.

II. OPERATION OF THE COMMON AGRICULTURE POLICY

The General Operation of CAP

Most national agricultural policies in the EC member states have been widely replaced by CAP. The CAP is an elaborate mechanism which supports EC domestic prices well above world levels by a complex system of tariffs and variable levies. The politically determined internal price is maintained for most agricultural products by imposing variable levies on imports of an amount equal to the difference between the "threshold price" and the world price. By this mechanism, price competition by foreign suppliers is prevented. In some cases the intervention price is also maintained by government purchases in the domestic market. In these cases, as for wheat and certain milk products, export restitutions financed by EC funds are used to "dump" the products on world markets or divert them to inferior uses (such as animal feed supplements). Agricultural output has grown much more rapidly than consumption as is shown in Table 2. As a result of the protective structure for agriculture, European Community consumers pay five times the world price for milk powder, four times the world price for butter, two and a half times the world price for white sugar and soft cheese, twice the world price for beef and one and a half the world price for grains (based on 1976-78 figures from European Commission and Bale and Lutz). As a result of CAP, EC consumer expenditures

on food products are significantly higher than they would be under many alternative policies; a contravention of one of the articles of the EC treaty.

The relatively short history of CAP reveals a mixed performance. Policymakers have been quite successful in harmonizing national policies with respect to the policy instruments. In general, the same policy instruments are applied in all member countries. Important decisions on farm prices based on proposals prepared by the EC Commission are made by the Council of Agricultural Ministers during the annual price review. The EC Commission represents the overall interest of the EC, while the national interests of individual members are reflected by the national ministers who are members of the Council. This division of authority implies that the EC Commission must harmonize national interests without impairing the welfare of the Community as a whole. Actually, the Commission is not able to play this role given the present pattern of decision making. The EC Commission is supposed to submit proposals to the Council of Ministers. The Council may accept the proposal by a majority vote if none of the member countries declares that essential national interests are at stake, in which case the treaty asks for unanimous decisions. In reality, unanimity is the general rule. The EC Commission takes this into consideration by attempting to determine national interests in the issue, then submitting a proposal which it thinks will be acceptable to all countries. It is questionable whether this procedure is consistent with wider Community interests. Ministers of agriculture are more interested in the income of the farm sector and less in the economic welfare of their country let alone the EC. Insiders agree that the annual price round in Brussels is dominated by two criteria; income of farmers and budgetary costs. Thus the Commission cannot submit proposals which represent Community

interests and hope to find a unanimous agreement in the Council. The constraint to submit acceptable proposals forces the Commission to consider criteria which do not correspond to maximization of Community welfare.

However hard the Commission has tried to find agreeable proposals it has never quite succeeded. Often it takes several months for the Council to agree upon a modified version of the first proposal. The general ritual in the negotiations is: a delegate of a certain country argues that the proposal neglects essential national interests and is not acceptable in the present form. Special modifications and concessions are necessary if the country is expected to agree. The first objection to the initial proposal is equivalent to blowing the horn for hunting. The delegates of the other member countries ask in turn for modifications of the proposal in order to meet their national needs. The revealed preferences of the individual member countries are then taken into consideration in the second proposal of the Commission (Eisenkraemer, p. 59).

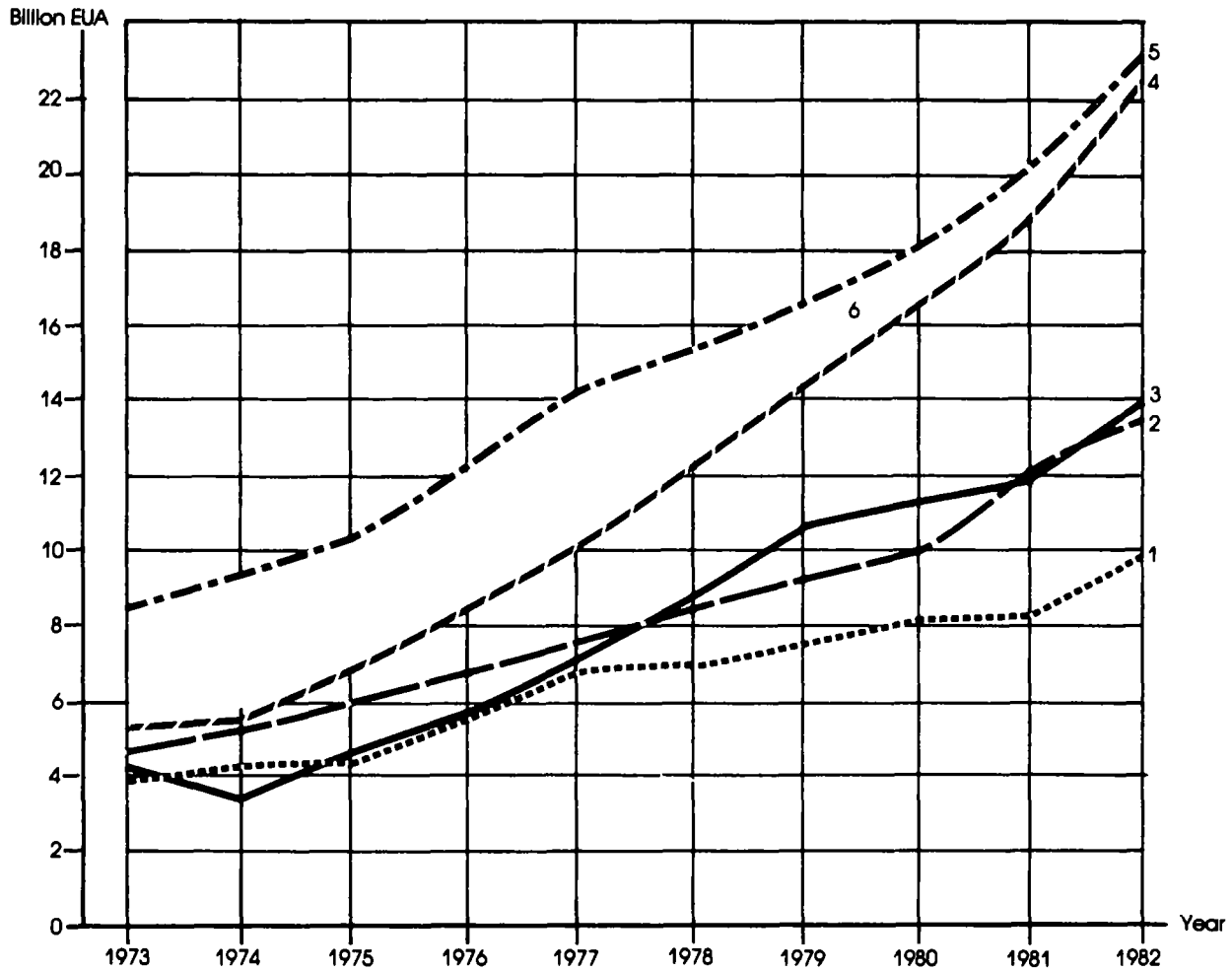
This procedure virtually guarantees that the final decision is inconsistent with Community welfare. But National ministers of agriculture are mainly interested in farmers' income and not in national welfare, thus the commission is forced to respond mainly to this objective. Obviously it is quite easy to find an acceptable proposal if the costs of the decision have to be borne by those who cannot articulate their interests during the negotiations. Third countries and EC consumers and taxpayers are negatively affected in favor of EC producers. If the EC Council of Agricultural Ministers decides to increase agricultural prices in the EC it will affect EC demand negatively and EC supply positively. Consequently, EC's imports will go down and/or exports will go up. A decline in world market prices is the consequence. As

a result exporting countries will be affected negatively and importing countries positively. Thus the interests of developing countries in CAP is widely divergent. This explains why there is no overall criticism of CAP by developing countries and why it is unlikely that developing countries will unite to act in concert against CAP.

The short history of CAP illustrates the importance of externalization in making decisions. In the first few years of CAP, the EC was an importing region for nearly all agricultural products. Hence, it was possible to raise agricultural prices without significant negative budget effects. Consequently, it was much easier to find unanimous decisions in the Council. However, the surplus situation on nearly all EC agricultural markets in recent years has changed the effectiveness of price policy decisions. A price increase in the EC widens the gap between the EC and world market price level and results in higher payments of export restitutions. Consequently, it is much more obvious how taxpayers' and consumers' interests are neglected in raising agricultural prices in order to help farmers. In recent years it is especially the budgetary effect which imposes a constraint on policy decisions in Brussels. Such a binding constraint was not effective in the early years of CAP. The member countries had to pay the amounts to the EC budget which were needed to finance the Common Policy. Gradually, the Commission has got access to more 'own resources' and now has to limit its expenditure to the funds available. The 'own resources' of the EC are composed of revenues from tariffs and levies imposed on imports in the EC, up to one percent of the harmonized value-added tax base of the member countries, and the co-responsibility levy for sugar and milk. Figure 1 shows the very limited excess amount to be spent in recent years. Figure 2 highlights the steep

Figure 1

Revenue, Expenditure & Budgetary Constraints (1973-1982)¹

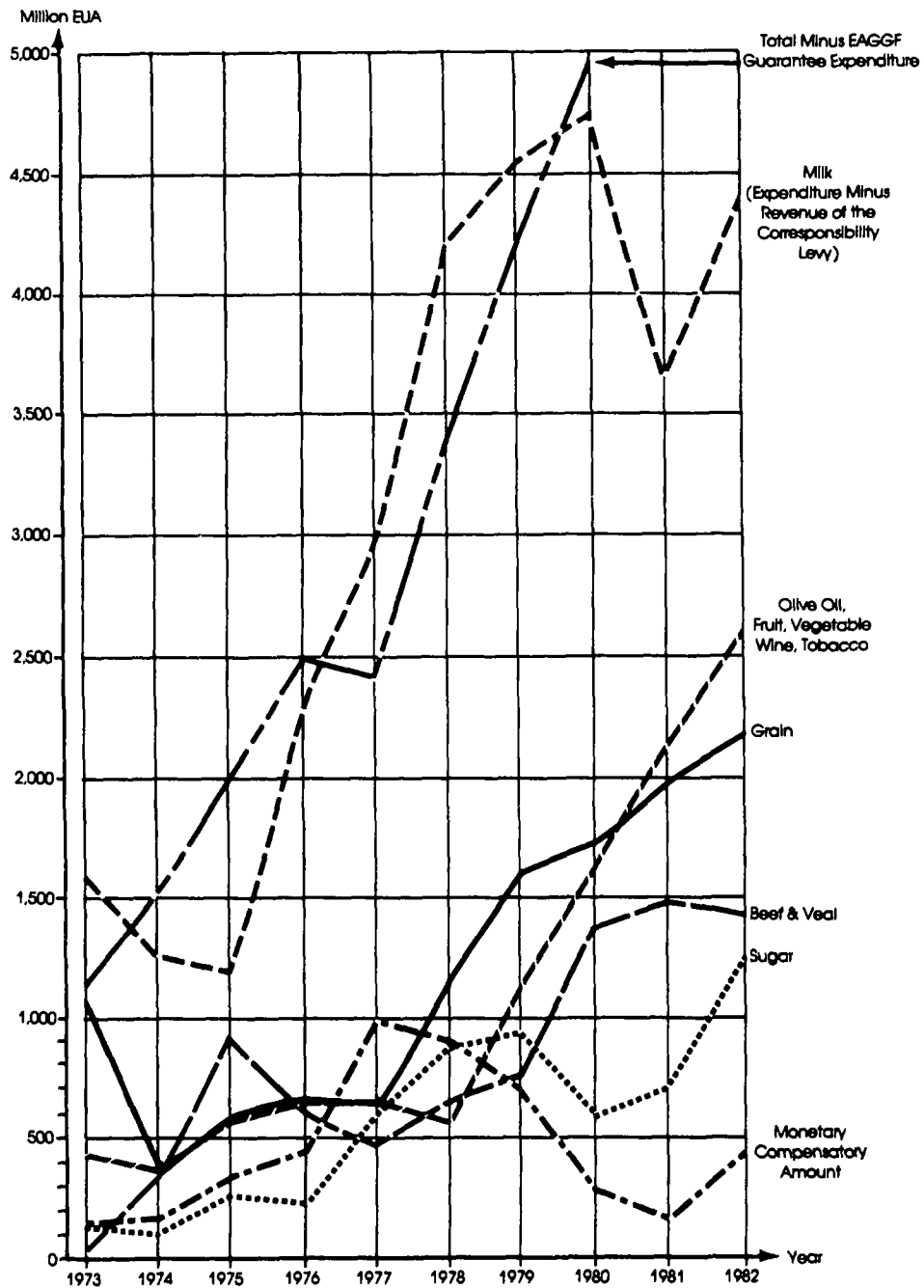


¹ 1981, 1982 estimated

- (1) Revenue in the form of customs duties, trade levies & sugar levies.
- (2) Potential revenue of the value added tax.
- (3) EAGGF guarantee expenditure
- (4) Total expenditure.
- (5) Total potential revenue
- (6) Budgetary surplus.

Source Ryll, E., Der EG-Haushalt: Konsequenzen für die Agrarmarktpolitik In: Betriebswirtschaftliche Mitteilungen für den Wirtschaftsberater Landwirtschaftskammer Schleswig-Holstein No. 325 (April 1982), p. 42

Figure 2
Expenditures of the Common Agriculture Policy (1973—1982)¹



¹ 1981, 1982 estimated

Source: Ryll, E. Der EG-Haushalt: Entwicklung und Bestimmungsgründe. In: Betriebswirtschaftliche Mitteilungen für den Wirtschaftsberater. Landwirtschaftskammer Schleswig-Holstein. No. 323 (February 1982), p. 7

increase in spending for individual market organizations. Annual price negotiations are expected to be much more difficult in coming years than in the past because of limited funds. Price negotiations in Brussels are further complicated by the differing rates of inflation among member countries and by variations of exchange rates.

So far CAP has been dominated by the market and price policy with structural policy being only a minor concern. Financial cost sharing has negative consequences for the Community as it creates additional distortions in national planning activities. It often pays to increase agricultural production from the national point of view but not from the Community point of view. Sharing in financial costs for investments, as implied by the EC regulations, distorts national decisions even more in favor of violating Community interest. Strangely, through its policies, the Community gives incentives to increase production in the member countries and accepts responsibility for disposing of the surplus production.

Operations of the CAP for Grains

Grain is a keystone in agricultural production. This is because there is a close relationship between grain prices and other agricultural production prices. First, grain is important for producing pork, poultry, eggs, beef and milk. The revenue from these products and from grains accounts for about 66 percent of the EC's total agricultural revenue. Second, grain competes with other agricultural products for land. So grain prices determine the allocation of land to these products, and, therefore, their prices. Hence, the market organization for grains was one of the first to be set up, yet it took from 1962 until July 1967 to set into operation a common market organization for cereals with unified grain prices.

Differences in the mechanisms of the common market organizations are only due to specifics of products and market conditions. In principle all market organizations follow the same fundamental principles and serve the same objectives. The principles as 'unified market,' 'Community preference,' and 'common financial solidarity' have already been discussed above. The objectives of CAP, spelled out in Article 39 of the Treaty of Rome, are: to increase agricultural productivity by promoting technical progress; to ensure a fair standard of living for the agricultural community; to stabilize markets; to assure the availability of supplies; and to ensure that supplies reach consumers at reasonable prices. Besides these officially declared objectives of CAP, the officially declared objective of Community trade policy (Article 110 of the Treaty) states that the member states intend to contribute to development of international trade by a stepwise abolishment of barriers to trade, and by a reduction in tariffs. The objectives are not well-defined and are partly contradictory. There is more than one policy mix which might fulfill the stated objectives. But, it is worthwhile to investigate the extent to which the market organizations meet the objectives.

The common organization of the markets in cereals is characterized by special border regulations and by internal market regulations. The border regulations are crucial for internal price formation and international trade flows. The main element is given by the threshold price which is set for a standard quality. Foreign supply is only allowed to enter the Community at the threshold price. The gap between the threshold price and a given offer price of foreign supply is bridged by levies in the case of imports or export restitutions in the case of exports. Thus, the entry or exit price is unaffected by variations of the world market price. While the general idea of

the variable levy or export restitution is quite simple, application of the system presents some problems. First, if one supplier dominates imports to the EC offer prices may be affected. For cereals it is not unlikely that EC import prices for some high quality varieties are higher due to the system.

Second, it is difficult to cope with the problem of differing qualities for a given type of grain. To make different qualities comparable, the EC applies coefficients of equivalence. But these were calculated almost 20 years ago and no longer represent the free-market premia paid for higher quality wheat. The price differential between high- and low-quality wheat in the EC favors consumption of high-quality wheat in the EC.

A third problem is the timing of trade within a year. Since traders face a fixed EC price, they have no incentive to import at times where world market prices are low and to export when world market prices are high.

Fourth, as EC grain prices are totally disconnected from the world market, expectations about world market prices for grain are irrelevant for private EC stockholders. The difference between year to year prices in the EC is the result of a policy decision which in the past increased insufficiently to compensate for annual storage costs. Accordingly, there are negligible privately owned stocks of grain in the EC.

The fifth concern is that the EC grain economy is not allowed to adjust to changes in the price ratios for individual types of grain. Hence, the EC does not contribute to stabilizing price ratios on the world markets and accepts welfare forgone within the EC. Sarris and Freebairn have demonstrated that world wheat prices are 9 percent below, and world price variability is 20 percent higher, than what they would be in the absence of CAP.

The final problem is that the EC grain market border regulations entail a special problem for trade in products with grain content. Trade of

processed grain products, including grain-fed livestock, is included in the grain market regulation with the levy or restitution related to the grain content of these products. Ascertaining the actual grain content is problematical. Due to technical change over time and price induced substitution of grain ingredients by non-grain ingredients it is not possible to know the exact grain content. The EC authorities assume a constant grain content over time. Thus, the domestic processing industry, such as wheat flour mills, the pasta industry, or pig and poultry producers, are much more protected than intended by this procedure.

The EC does not only influence internal grain market conditions by border regulations but by direct internal interventions as well. In order to guarantee the price spread inside the EC, the Council of Ministers sets not only an annual target price for individual types of cereals but an intervention price as well. The target prices are the upper bound of market prices because foreign supply can be offered at this price. The intervention prices which are announced for feed wheat, durum wheat, rye barley, and maize are the lower bound of market prices on the wholesale level. Intervention agencies are supposed to buy at this price any amount of cereals above a well-defined quality. In 1982/1983 there were 850 intervention centers for wheat in the EC.

Intervention prices were introduced to stabilize markets under rare circumstances. However, as the EC cereal market developed to a surplus situation, intervention prices became more and more crucial over the years. In recent years, intervention agencies have had to buy huge quantities of cereals in order to prevent market prices from falling below the intervention prices. Later most of the quantities were exported at a loss.

The switch from the deficit to a surplus region has changed the significance of the price spread. The market prices do not fluctuate from the

lower to the upper bound depending on market conditions. Rather, they are determined completely by the lower bound, the intervention prices.

In setting prices for individual cereals, the EC has not accepted world market price ratios between wheat, barley, maize and oats, but instead uses the feed value of individual cereals. Thus, it is intended that barley prices be 2 percent above intervention prices, wheat prices 6 percent, and maize prices 10 percent. This policy causes further distortions in production patterns and impairs welfare for the EC as it does not allow for profitable grain arbitrage between the EC and the rest of the world. As the grain market organization is the heart of CAP, it is unlikely that a significant change will occur in the foreseeable future. A continuation of the present policy will definitely increase EC grain surpluses. Projections for 1985 and 1990 indicate an export surplus for total grains of 11.5 and 25.3 million tons as compared to 3.0 million tons in 1980 (Koester, 1982).

Operation of the CAP for Animal Products

The model of the market organization for cereals, modified for specific aspects of other products, served as a guideline for other market organizations.

Border regulations for milk and milk products are most similar to those of the grain market organizations. The Council of Agricultural Ministers annually sets threshold prices for four milk products and the gap between threshold prices and world market prices is made up by a variable levy or export restitutions. Thus, the system is basically the same as for the grain market. However, it generates more problems than cereals, one of which is the difficulty of determining the relevant world market price for milk products in a thin world market dominated by the EC.

Levies are imposed on imports of sheep and sheep meat. But the levy actually charged on the main products (live animals, fresh, chilled or frozen meat) is limited to 10 percent ad valorem as a result of voluntary restraint agreement by exporters to the EC. Border regulations are equivalent on the pig and pigmeat market and on the market for poultry and eggs. They include levies and tariffs. A variable levy is supposed to make up for differences between feeding costs for foreign suppliers and EC producers. This means calculating costs of production for the products. Production costs vary widely, depending on the breed, feeding technique, opportunity costs for labor and other factor inputs. Biased estimates of costs will likely result as the animal producing industry provides the information and it has an interest to over reporting producer costs. Also, production costs depend on prices for the mix of different inputs, but the EC assumes a constant mix of inputs (grains) over time in producing poultry, eggs and pigs. But European farmers feed more cereal substitutes, such as manioc and corn gluten, since they are considerably cheaper than grain in the EC due to the border regulations. Thus European livestock producers are protected more than intended (see Koester, 1982).

Border regulations on the beef and veal market include a tariff and, under certain circumstances, a levy. The levy is imposed on imports if the Community import price plus the 16 or 20 percent tariff is below 106 percent of the guide price. For exports of beef and veal as well as of bovine animals exports refunds may be paid, and the authorities have a large amount of freedom in fixing the restitution.

EC's beef and veal production has increased more than EC consumption over the last 15 years. Exports came up to 5 percent of annual production in

1981-82. A continuation of the trend in exports is expected. The growth will be even greater if some of the proposed reforms, discussed later, are adopted.

The Operation of the CAP for Fruits and Vegetables ^{1/}

Because of the seasonal nature of fruit and vegetable production and trade, the regulations covering these products are somewhat more complex than those covering cereals and livestock products.

First, imports of fruits and vegetables from non-EC countries are subject to tariffs specific to products, seasons, and countries. Imports from ACP countries are usually duty-free under the Lome Conventions and many Mediterranean countries have negotiated preferential rates. During the EC production season, tariffs are higher than during the off-season. For example, the tariffs on tomatoes are divided into six time zones and for Morocco (a preferential exporter) range from 4.4 percent from November through April to 18 percent from May 15 through October.

In addition, reference prices, differentiated by product, season and quality standards are set annually by the EC Council of Agricultural Ministers. Thirteen products ranging from zucchinis and eggplants to cherries and mandarins are specified (in 1982) and the other vegetables are under consideration for inclusion.

On every market day import prices of products from third countries (net of import duties) are determined at certain markets in the EC and the importer must pay the difference between the import price and the reference price (called a countervailing charge) if the import price is at least 67¢/100 kg. under the reference price for two consecutive days. Thus the reference

^{1/} This section draws on Alvensleben (1982) where further details are given.

price becomes the floor market price with the countervailing charge becoming prohibitive when import prices remain under the reference price for several days.

Export rebates are available for most products included in the reference price system to bridge the gap between the reference price and the world market price. In addition, an intervention system exists for many fruits and vegetables where authorities must intervene by buying produce at a "buying-in" price. In the 1980-81 season about one million tons of fresh fruit and vegetables were withdrawn from the market and destroyed at a cost of approximately \$108 million.

For processed fruit and vegetables import tariffs, levies and licenses are in effect and export rebates and production subsidies are available. The cost of these are very large. For example the estimated expenditure for fruit and vegetable processing subsidies in 1981 was \$672 million.

There are several criticisms levied at the current fruit and vegetable policy. First, it seems to have been used more as an instrument of regional policy for Mediterranean regions than as a product policy which leads to a change in product mix of fruit and vegetables (Alvensleben, 1981). Second, there is great human concern over the destruction or inferior use of wholesome fruits and vegetables. Third, the price supporting effects and the extent of the subsidies represent a double implicit tax on consumers. The direct support cost for the fruit and vegetable policy in 1982 was budgeted at \$950 million and was expected by independent observers to exceed this by \$100 million (Alvensleben, 1982).

III. IMPLICATIONS OF THE CAP FOR DEVELOPING COUNTRY IMPORTS

Exporters of Cereals

The high protection of the EC grain economy causes EC production of cereals to be higher than with a liberalized EC grain economy. Estimates indicate that the EC might produce about 39 percent less wheat, maize and barley if the EC grain economy were liberalized (see Koester, 1982). It follows that world market prices for cereals are depressed due to the protective EC grain policy. Koester estimated that wheat prices are depressed by about 10 percent, maize prices by 2 percent, and barley prices by 14.3 percent as a result of the CAP. Sarris and Freebairn derived similar results. Consequently, developing countries' exports of cereals would be 12.4 percent higher by volume or 20 percent by value with a liberalized EC grain economy.

The effects would be the most significant for high-income countries of North Africa/Middle East. The export volume of these countries would be about 260,000 metric tons higher, a change of 13 percent. But some low-income developing countries would be considerably better off as well. Low-income countries of Sub-Saharan Africa could increase exports by 24,770 metric tons (13.8 percent), and low-income countries of Asia could increase exports by 15,530 metric tons (50.1 percent).

While it is clear that exporters of cereals lose due to the present EC grain policy, the welfare loss is quite small as a percentage of GNP. All developing countries lose about 0.04 percent of GNP. Bangladesh is the only country which might lose as much as 1.2 percent of GNP (Koester, 1982).

Exporters of cereals are not only negatively affected by depressed world market prices due to the protective EC grain policy, but by the trading

activities of the EC as well. Koester (1982) shows empirically and Bale and Lutz (1979) show theoretically that instability of world market prices is higher as a result of the EC policies towards grain marketing and stockpiling.

Exporters of Close Substitutes

Depressed grain prices on the world market due to the EC grain policy affect world market prices of some other agricultural products which are closely related to grain prices. This is due to substitution in production and/or consumption. From the developing countries point of view the most significant effects are on the market for vegetable oils, for cassava and corn gluten feed, for grain-fed animal products, and for grain processed products. The effect of EC grain policies on world market prices for vegetable oil is particularly interesting.

The EC imports more than 50 percent of world imports of soybeans and of soybean meal but only 12-13 percent of world imports of soybean oil. Soybean meal and soybeans are substitutes for feedgrains, but not for vegetable oils. Under a more liberalized grain trade, EC demand for soybeans and soybean meal would be reduced through substitution. This in turn would decrease the world demand for soybeans and soybean meal. As a result soybean production would decline and thus the production of soybean oil (a joint product of soybean meal) would decline. Since there has been no change in the demand for vegetable oils, the price of substitute vegetable oils would rise. Therefore the current EC grain policy lowers the price of vegetable oils. This presumably benefits those developing countries that are edible-oil importers such as India and Singapore, but causes a loss of revenue for those developing countries that are edible-oil exporters such as Malaysia, Philippines and Indonesia. Since on net developing countries are oil exporters, the impact of the EC grain policy on them is negative.

Also of interest is the development of cassava imports. High protection for the EC grain economy has created a new market for cassava. Since the EC market organizations were designed mainly to improve farm income, they were established only for commodities produced within the EC. The founders did not consider that domestic users might switch to substitute products not grown in the EC. Cassava is a case in point.

There were literally no imports of cassava in 1970, nearly 6 million tons in 1978 and almost 11 million tons in 1982. The protection of domestic grain has created a new market for imported cassava. Exporters of cassava (mainly Thailand) gain due to the EC grain policy. But since these exports are at the mercy of policy decisions within the EC, it is risky to invest in production and marketing facilities of these products. This has been the lesson learned by Thailand, Indonesia and Brazil which, in May 1983, signed a "voluntary export agreement" with the EC to limit exports of cassava to the EC. Such "voluntary agreements" are typically made under duress of more severe market access if exporters fail to accede.

Exporters of Fruit and Vegetables

In some developing countries fruit and vegetable exports as a share of merchandise trade is very high. Many, located in the Mediterranean region, are strongly influenced by the CAP for fruits and vegetables. Some examples of these countries and the importance of fruits and vegetables in their total exports are Turkey (34 percent), Cyprus (26 percent), Jordan (23 percent), Morocco (22 percent), Lebanon (16 percent) and Israel (11 percent).

Over the last decade intra-EC trade in fruit and vegetables has grown much more rapidly than trade with third countries, especially developing countries (2.4 percent per annum versus 0.7 percent per annum for fresh fruit). This is in part due to increasingly restrictive regulation on imports

into the EC. Unfortunately, no comprehensive study exists which estimates in disaggregated form the protective effect of the EC policy on fruits and vegetables for developing country exports. However, one aggregate study (Sarris) and a few products or country-specific studies (e.g., Elfring and Alvensleben, and Hormann) exist from which the general direction and size of the protective effect of the EC fruit and vegetable restrictions can be gauged. General conclusions that arise from the work indicate that a strong supply response has resulted from production subsidies for certain fruit and vegetables in the EC which have in turn displaced imports, that the reference price system often has a prohibitive effect on trade, that fruit and vegetable trade is becoming further restricted over time as more types of fruit and vegetables are added to the CAP and as seasonal restrictions are expanded, that export prices for fruits and vegetables over the next decade will decline as a result of growth of production and membership of the EC, and that specific developing countries will bear a disproportionate burden of the impacts. Morocco, Israel, Tunisia, Egypt and Turkey (in descending order) will be most seriously affected with tomatoes, citrus fruit, olives and olive oil, early potatoes and other fresh fruit and vegetables being the products of concern.

The ACP Exceptions Under the Lomé Convention

The Lomé Convention is intended as an economic cooperation agreement between the EC and those countries from Africa, the Caribbean, and Pacific (ACP) which first signed the Convention in 1975 and those which joined later. In 1983 there were 63 ACP countries.

The Lomé Convention provides exceptions or preferential concessions to imports from ACP countries to the EC, an arrangement for stabilizing ACP export earnings (STABEX), and specific quotas for sugar and beef from specified ACP countries (see Harris for further details).

The sum of the concessions are not particularly generous for agriculture. Waiving common customs tariffs is not relevant for agricultural products where border regulations always contain other duties, and STABEX has not and was not intended to increase trade.

However, the duty-free quotas on sugar are important to those few ACP countries that received them. The privileged countries are allowed to export, duty free, 1.3 million tons of white sugar to the EC each year. Since EC prices are normally considerably higher than world prices, the preferred countries receive a product-tied income transfer equal to the differential between EC prices and world prices multiplied by the exported quota (Koester and Schmitz). The transfers which individual developing countries receive are completely arbitrary and do not correspond to any official objective of EC development policy. But, nevertheless, they are generally sufficient--apart from India--to compensate these exporters for the effect of depressed world market prices for sugar due to the EC protectionist sugar policy. A particular irony of the sugar protocol is that the EC already produces more sugar than it consumes. Hence sugar imported under the protocol must be exported in addition to the EC's export surplus at the lower world price. This indicates the extent of the distortions of the world sugar economy due to the CAP and this agreement.

The operation and effects of the beef protocol are completely analogous to those of sugar (Schmitz). Both agreements reflect pent-up demand for access to the EC created by the highly protective CAP. While these agreements helped the EC buy goodwill for its protective agricultural policy by compensating preferred countries, non-preferred countries are worse off by such agreements and world agriculture is even more distorted.

While supporters of the CAP interpret the Lomé agreement as indicative of the flexibility and concern of EC policymakers for developing country interests, others view it with a more jaundiced eye. In particular, their concern is that only the signatories of the convention are eligible for concessions while non-signatories are excluded, and that even those developing countries that are members are excluded from exporting certain products to the EC. Rather than an attempt to liberalize agricultural trade, it is viewed as a further example of "managing" trade under a "Maginot Line" mentality.

Food Importing Developing Countries

The EC has evolved into one of the most important food processing regions. Thus, EC food policy decisions not only impact on the EC food economy but on the world food economy as well. In general, developing countries are better off if world food production is higher due to a specific policy in a large producing country.

Table 3 shows the effects of EC liberalization of grain trade. EC grain production would drop considerably--up to 40 percent for wheat--and grain production in the rest of the world would go up slightly. The total net effect would be slightly negative. Consequently, the present protective EC grain policy contributes marginally to an improvement of world food availability and keeps grains cheaper for importing developing countries. Developing countries' production of grain is somewhat lower and consumption somewhat higher due to the protective EC policy (Table 4).

But EC grain trade liberalization would have significant effects on the pattern of world trade in grain. Calculations presented in Table 4 indicate that developing countries' imports of grain would decrease by nearly 7 million tons and exports would go up by about 2 million tons. Consequently,

Table 3: CHANGES IN GRAIN PRODUCTION CAUSED BY A LIBERALIZATION OF GRAIN TRADE

<u>Grain</u>	<u>European Community Production</u>	<u>Production of Major Exporters</u>	<u>Production in the Rest of the World</u>	<u>Total</u>
 percent			
Wheat	-40.0	9.0	3.6	-0.02
Maize	-40.0	2.0	0.8	-0.00
Barley	-36.8	14.3	0.6	-3.30
Wheat, maize, & barley	-38.8	6.3	2.5	-0.90

Source: Koester, 1982, p. 29.

Table 4: EFFECTS OF A REDUCTION OF EUROPEAN COMMUNITY TARIFFS ON
WORLD TRADE IN GRAIN

Region	Change in Imports		Change in Exports	
	Absolute	Relative	Absolute	Relative
	(1,000 metric [percent] tons)			
Developed countries	-986.19	-4.2	17,506.69	17.2
Developing countries	-6,828.49	-19.8	1,889.13	12.4
Sub-Saharan Africa				
Low income	-93.41	-9.9	24.77	13.8
High income	-65.24	-5.4	1.80	20.0
Asia				
Low income	-3,157.62	-39.1	15.53	50.1
High income	-386.31	-7.9	22.92	1.1
North Africa/Middle East				
Low income	-373.26	-11.2	3.63	5.3
High income	-1,640.63	-26.9	261.39	130.7
Latin America				
Low income	-4.11	-4.9		
High income	-1,105.90	-11.1	1,764.01	14.0

Source: Koester, 1982, p. 29.

NOTE: A positive sign indicates an increase; a negative sign indicates a decrease.

the net grain imports of developing countries would be reduced considerably. Higher world market prices for grain would induce a more balanced world grain trade, but at the costs of less grain available in developing countries, especially for low-income countries in Asia.

The other less tangible effect of the CAP is on the extent of international price variability from year to year. Particularly damaging are the global destabilizing effects of widely fluctuating prices that arise when the EC intermittently dumps its surpluses. Bale and Lutz (1979) have shown theoretically that of a variety of policy instruments designed to protect domestic agriculture, variable levies as used by the EC have the largest impact on increasing price variability in the rest of the world. Koester (1982) shows empirically that world price instability is higher as a result of the EC policies towards grain marketing and stockpiling. In brief, the EC, through its variable levies, is stabilizing its prices while transmitting all the price instability onto the rest of the world. Throwing additional price instability onto the rest of the world would not be a problem if price instability had no role in farmers output decisions or on macro-planning. But it does and especially so in developing countries. Risk averse farmers are likely to produce less and to switch to crops that display more stable price behavior. Planners of the macroeconomy must make provision for sufficient foreign exchange to cover food imports at an unknown price and therefore remain more liquid than they would at more stable prices, or they must maintain higher levels of stocks. There is an opportunity cost of having funds tied up for food security purposes.

The Welfare Effects on the EC

Estimating welfare effects of CAP is problematic because a judgement must be made on the alternative policy with which the comparison is made. The

usual comparison is based on a free-trade regime where any divergence from it induces welfare losses. However, it has been argued that this is an inappropriate norm because it ignores non-economic benefits that may result from a policy of "other than free trade" and, in the case of the EC, does not represent a realistic policy alternative given the revealed preference of policy-makers in the EC for the current system which may be the only acceptable one in a supranational union such as the EC. Nonetheless, the free-trade norm does value resources at their international opportunity cost and therefore does represent a set of prices at which resource use and allocation would be optimized in an economic sense. It is the base adopted by most studies on this topic.

Buckwell et al. calculate the costs of the present price support policy compared to free trade and to Community autarky in agricultural products now in surplus. These costs, disaggregated by countries, are presented in Table 5. The figures highlight the inefficiency of CAP as a means for supporting agricultural income. The non-agricultural sector incurs a loss which is significantly higher than the benefit for agricultural producers. Given the present tax system in the EC countries, we can assume that the burden of non-agriculturalists is equal to the costs for the consumers and the taxpayers. Hence, the non-agricultural sector has to pay \$1.32 or \$1.50 respectively in order to raise farmers' income in the EC by \$1.00 as compared to a situation of Community self-sufficiency or free market conditions.

The relative burden of the non-agricultural sector varies considerably among EC members. Some countries--like the Netherlands, Ireland and Denmark--are better off with the present price support policy than with Community autarky or with free market conditions. This could not happen if the individual countries were responsible for the disposal of their surplus

Table 5: THE COSTS OF THE CAP: CHANGES IN ECONOMIC WELFARE, BY TWO ALTERNATIVES, 1980
(million US\$)

Country	Community Self-Sufficiency				Free Market			
	Producers	Consumers	Government	Net	Producers	Consumers	Government	Net
EC-9	-12,642.50	9,400.30	7,347.60	4,105.40	-28,650.70	32,286.80	10,731.50	14,366.30
Germany	-3,309.80	3,185.00	2,410.20	2,284.10	-8,444.80	11,722.10	3,519.10	6,796.40
France	-3,109.60	1,934.40	1,812.20	638.30	-6,757.40	6,986.20	2,648.10	2,876.90
Italy	-998.40	1,142.70	800.80	945.10	-3,304.60	5,021.90	1,170.00	2,886.00
Netherlands	-1,465.10	421.20	444.60	-598.00	-2,876.90	1,491.10	650.00	-735.80
Belg./Lux.	-705.90	440.70	348.40	83.20	-1,515.80	1,344.20	508.30	338.00
United Kingdom	-1,631.50	2,002.00	1,275.30	1,645.80	-3,229.20	4,830.80	1,862.90	3,463.20
Ireland	-625.30	124.80	62.40	-438.10	-900.90	299.00	92.30	-509.60
Denmark	-796.90	149.50	192.40	-455.00	-1,621.10	592.80	282.10	-747.50
Total	-25,285.00	18,800.60	14,693.90	8,210.80	-57,301.40	64,574.90	21,464.30	28,733.90

Source: A. E. Buckwell, et al., p. 169.

production. The relative burden is highest for UK, followed by Italy and West Germany. National costs of CAP vary even more among member countries if calculated for individual products.

While such cost estimates are impressive in their size and useful as a guide to the welfare forgone by such policies, perhaps more useful to decisionmakers than the costs and benefits of complete abandonment of CAP are the costs and benefits from marginal changes in CAP. All studies taking such an approach have concluded that the present financial system leads to an additional divergence in costs and the net importing countries (UK, Italy and Germany) are the losers.

The Net Welfare Effects on Developing Countries

The agricultural policy of the EC affects the welfare of developing countries in three ways: by the effect on the level of world market prices; by the effect on the variability of world market prices; and by the effect of preference agreements.

Literature cited earlier has shown that world market prices for agricultural products are depressed due to CAP. Consequently, countries which export those products where the EC acts on the world markets are worse off. However, the present pattern of world trade in agricultural products reveals that the EC and developing countries only compete to a limited extent on world markets. Valdes and Zietz (1980) found that trade liberalization of OECD countries would largely affect export commodities of developing countries which are not grown under temperate climatic conditions. But a few commodities, such as sugar, beef and tobacco, grown in both temperate and tropical climates, are export commodities that would benefit the most from trade liberalization of OECD countries. Some sugar exporting countries incur a significant welfare loss due to EC sugar policy. Cuba lost \$69 million in

1979 and the Philippines and Thailand each lost \$42 million (Koester and Schmitz). The welfare effects of beef exporting countries are probably of less importance but are important for some countries. For example, beef is the most affected export commodity for Kenya and Tanzania (Valdez and Zietz). These countries exported 112 tons and 27 tons, respectively, in 1980. World market prices for beef would go up approximately 12 percent under a liberalized CAP so gains for these two countries would be quite small until their beef exports were considerably larger (Schmitz). The depressing effect on world market prices of CAP are beneficial for most developing countries which import temperate agricultural products. Few of the present importing countries would possibly be exporters if world market prices were higher. But not all of them would be better off with higher world market prices. The outcome depends on the magnitude of price changes and domestic reactions of supply and demand with respect to price changes.

In brief, the effect of CAP on the level of world market prices is most likely positive, but unevenly distributed for developing countries. Further, CAP increases the variability of world market prices and raises the uncertainty for exporting and importing countries alike. Developing countries are less capable of bearing additional uncertainty and consequently have to implement policies to deal with it.

The higher variability of world market prices as a consequence of CAP is negative for both exporting and importing developing countries. The implied uncertainty about future world market prices favors production of domestically consumed products as compared to exportables. A less integrated world economy is the consequence with losses in welfare for all trading partners (Feder et al.). It is difficult to estimate the resulting loss in welfare. However, it is likely that developing countries are more seriously

affected than developed countries since their ability to bear risk is less. It is quite reasonable that some less-developed countries in Africa which are land rich abstain from export strategies based on agricultural products due to the growing EC surpluses for all temperate zone agricultural products.

It is questionable how effective and how equitable are the preferential agreements. As far as the EC sugar protocol is concerned, all but one of the preferred countries are overcompensated. However, non-preferred countries are worse off and trade patterns are frozen because of the preferred rights to import.

IV. POLICY OPTIONS FOR CAP

Many economists and observers have adopted a critical attitude toward the CAP because of the apparent absurdities of many elements of it, because of the burdensome administrative details and associated costs of it, and because of its seeming ability to completely seal the domestic market from foreign competitive pressures. ^{1/} But as Professor Tangermann observes, each part of CAP has its history and tradition, and one can explain why and how each part came into existence. Whatever is decided within the EC, CAP serves the interests of some group otherwise it would not have been implemented.

However, a fundamental change in the sources of criticism occurred beginning in 1980. Prior to that CAP was faulted by outsiders such as academ-

^{1/} Two examples of apparent absurdities in the agricultural support system are where vegetable farmers receive above free-market prices for tomatoes that are so much in surplus that they are plowed under so providing manure for next year's tomato crop, and where farmers receive subsidized dried milk as an ingredient in the formula feed, some of which is fed to dairy cows which then produce more surplus dairy products (including dried milk).

ics, public interest groups and the press. But beginning in 1980 those actually formulating the policy and setting price levels, such as the Commission and the Council of Ministers, began to reconsider the CAP under the pressure of the threat of a budget crisis in the EC. CAP expenditures have grown much faster than the sources of funding for CAP, but increasing the financial resources of CAP by increasing the "own-resources" is an unlikely solution since all national governments must approve such a change and all national governments must ratify it before it could be operable.

While a reform of the CAP is desirable from an economic point of view and is urgently required from a budgetary viewpoint, none of the proposals to reshape the CAP seem to be politically acceptable. ^{1/} Any reform that alters the present delicate "equilibrium" in the distribution of the benefits of CAP among member countries could not receive the unanimous vote of the Council. Thus, in accordance with tradition, the most likely outcome is marginal changes in the CAP in the direction of further regulation and protection of EC agriculture.

The Commonwealth Secretariat, drawing on the economic maxim that the least harmful way to achieve income support objectives is through direct transfers, has shown that if subsidies for grains, sugar and beef replaced existing interventions in Germany, France and the United Kingdom, such that farmers incomes were left unchanged, then commodity prices would fall to world levels, global price instability would be reduced, agricultural imports (mainly from developing countries) would increase by about 70 percent, EC food consumption would increase and budget expenditures on EC farm programs would decline. All in all, a very provident outcome.

^{1/} Possible reforms of the CAP are discussed in Josling, et al.

A change in the milk market regime is the most pressing issue from the budgetary standpoint given the proportion of the budget that it absorbs. While economists agree that policies to curtail excess milk production are needed, politicians are loathe to adopt a policy that could reduce farmers' income. Proposals based on a restrictive dairy price policy with farmer-tied direct income transfers have been made and the potential welfare gains are remarkable. Gains for West Germany could amount to 0.3 percent of GNP, a gain larger than almost any other single policy decision within the existing framework (Koester and Tangermann). Yet, despite the fact that the Council of Advisors to the German Ministry of Food and Agriculture proposed such a restrictive milk price policy and tied income transfers over an adjustment period, it is unlikely that the proposal will be adopted. Farmers' Unions and some member governments oppose direct support payments because of their visibility to the public which in turn would stimulate a more enlightened debate on the merits of income-support policies. In the dairy industry, for example, direct payments would make it immediately obvious that Italian consumers are subsidizing French (and other nations') farmers. The EC Commission favors more dirigistic solutions to the CAP problem such as a quota system for the milk market. Such a policy would have the side effect of increasing the supply of beef and veal and would thus lower their prices on the world market, which in turn would decrease export receipts from beef exporting countries.

Another proposal of the Commission is to restrict the non-grain feed trade that now enters nearly duty free. The "voluntary export restraints" (VER) of Thailand, Brazil and Indonesia, mentioned earlier, is an initial step. But if such agreements are limited to a few exporters of a specific commodity then substitution of products and countries occurs so that the

effect on the EC is almost negligible. ^{1/} But the agreements and further restrictions on imports of cereal substitutes do have an effect on the world economy and on developing countries. First, world production patterns are forced to diverge even further from those indicated by comparative advantage in order to circumvent the agreement. Second, VERs can be viewed as just the first step along the road to serfdom to the CAP. A typical evolution of trade restrictive devices is from VERs to formalized quotas, to more restrictive quotas, to tariff quotas, and so on. Each time the argument is that the next step is merely a further formalization of the status quo. The danger foreseen with the current VER for cassava is that it will follow this path. Proposals by the Commission to include restrictions on other cereal substitutes, specifically corn gluten and citrus pulp pellets imported from the United States, and of the imposition of a tax on vegetable oils, of which the United States is a major exporter, also threaten developing countries. Not only do they increase the level of uncertainty for traders, but a trade war could break out which could ultimately precipitate a global man-made food crisis.

It is claimed that the European Community, as one of the two pillars of the Western political and economic system, has a special global responsibility for the functioning of the world trading system. But the EC is failing to carry out this responsibility and thus represents a crumbling "pillar" of the international trading system (Wolf). It is tempting to argue that the CAP is the adolescent offspring of a mixed marriage, and that political exigencies prevent its rehabilitation. This has clearly been the attitude within the halls of EC decisionmaking in the past. But the recent experience of the CAP,

^{1/} The speed and ingenuity with which exporters can adjust to VERs is described for the case of footwear imports into the United States by Mutti and Bale.

limping along from one crisis to another with various creative stop-gap measures put into place to tide it over the crises, is scarcely tenable in the long run and is forcing the Community to re-examine this position. They may well conclude, as have numerous European scholars, that the CAP no longer serves the interests of European agriculture, nor European political relations with the rest of the world. It is expensive and cumbersome to operate. Protection is too high and unbalanced. Commodity expenditures are poorly allocated and their redistribution effects aggravate inequalities. In the final analysis, rather than being a unifying institution within the EC, the CAP in its present form threatens the political equilibrium of the Community and endangers the international trading system.

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The Johns Hopkins University Press. July 1982. 528 pages (including appendixes and glossary/index).

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The English-language edition is out of print.

French: Résultats obtenus en matière d'exportation par les pays en voie de développement. Dunod Editeur, 24-26, boulevard de l'Hôpital, 75005 Paris, France. 1969.

LC 67-28942, 10 francs.

Spanish: La experiencia de los países en desarrollo en materia de exportaciones. Editorial Tecnos, 1969.

200 pesetas.

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Oxford University Press. 1982.

224 pages (including index).

LC 82-6309. ISBN 0-19-520211-2.

\$22.50 (£10.50) hardcover. (A specially priced edition will be available in India from Oxford University Press branches.)

Industrial Country Policy and Adjustment to Imports from Developing Countries

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Stock No. WP-0492. \$3.00.

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Helen Hughes, editor

The Johns Hopkins University Press. 1973. 310 pages.

LC 72-12369. ISBN 0-8018-1498-7. \$20.00 (£12.00) hardcover.

ISBN 0-8018-1500-2, \$6.95 (£4.25) paperback.

Spanish: Las perspectivas del comercio internacional: industrialización y políticas comerciales en la década de los 70. Editorial Tecnos, 1974.

ISBN 84-309-0497-2. 575 pesetas.

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On Protectionism in the Netherlands

K.A. Koekkoek, J. Kol, and L.B.M. Mennes

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World Bank Staff Working Paper No. 396. June 1980. 46 pages

Stock No. WP-0396. \$3.00.

The Structure of Protection in Developing Countries

Bela Balassa and others

The Johns Hopkins University Press. 1971. 394 pages (including 5 appendixes, index).

LC 77-147366. ISBN 0-8018-1257-7. \$25.00 (£15.00) hardcover

Spanish: La estructura de la protección en países en desarrollo. CEMLA, Departamento de Publicaciones, Durango 54, Mexico 7, D.F., Mexico. 1972.

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