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Can the Common Agricultural Policy Be Reformed?

by Professor Dr Ulrich Koester and Stefan Tangermann, Göttingen *

Much criticism notwithstanding, the essentials of the common agricultural policy have up to now scarcely been changed. What kind of basic changes would have to be introduced for a new agricultural policy to become also politically acceptable? The following article suggests alternatives to the present agricultural policy — suggestions which the authors first made in a report prepared for the Federal Ministry of Food, Agriculture and Forests.

The agricultural policy of the EC has many faces. Some observers see it as a powerful motor dragging the Community towards European integration; others regard it as a living proof of the thesis that political interventions tend by their very nature to grow into bureaucratic *dirigisme*. The tone of the criticism swells or diminishes in accord with the fluctuations in the political and economic situation. The focal point of the discussions is the most important instrument of the Common Agricultural Policy, i.e. price support for home producers by means of internal and external economic measures. The fact that, in spite of criticisms from many sides, the essentials of such a policy have up to now scarcely been changed, may serve for many as proof that at least in the eyes of those practically engaged in agricultural policy-making there are no alternatives to the present system or that there is no sufficiently clear case for change.

Are there then none the less trends at work which would seem to make it advisable to continue discussing agrarian reform? What elements are essential to a new agricultural policy and in what form would such a policy have to be presented to be politically acceptable? Can the possible advantages of an agrarian reform be quantified in advance? In the following the authors consider some of these problems; their conclusions are based on a report they have prepared for the Federal Ministry of Food, Agriculture and Forests.¹

Increasing Need for Reform

The following trends give rise to expectations that the difficulties which the price policy has had to contend with hitherto may increase in the future, thus making a change in agricultural policy ever more necessary:

□ To judge by the many forecasts about the future development of supply and demand on the agricultural markets of the EC, the tendency towards self-sufficiency will grow stronger for most products. This will make it more difficult to pursue a price policy which aims at the same time at keeping the market in equilibrium and securing the farmers a steady income. Calculations we have carried out on our model show that if the present agricultural price policy is continued — a policy which guarantees the farming community an income in step with that of the rest of the population — Germany's agricultural output is likely to rise twice as fast as consumption.

□ The widely expected slow-down of economic growth and the stagnation, if not actual decrease, of the population figures act as dampers on the already sluggish rise in demand for farm produce, thus jeopardizing still further the market equilibrium. The one potentially positive effect of a deceleration in the rate of income claims on the part of the farming sector should be more than offset by the high general level of unemployed which — it is to be feared — may result in fewer country-people migrating to the towns. In these circumstances it would seem appropriate to formulate an agricultural policy which furthers the continuation of the present structural change without exercising an undue social pressure on the farmers.

□ Particularly through the enlargement of the EC to nine — and in future possibly more — countries the Community's agriculture has become increasingly heterogeneous. Heterogeneity will increase also in future by a rising importance of part-time

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¹ U. Koester, S. Tangermann, Alternativen der Agrarpolitik (Alternative Agricultural Policies). A cost-benefit inquiry undertaken on behalf of the Federal Ministry of Food, Agriculture and Forests, Hilstrup 1976.

farming within individual countries. It will therefore be less possible to pursue a price policy which would guarantee all farmers working in different regions and farm systems a steady income while at the same time leaving sufficient forces work to effect a structural change into larger and more efficient units.

To correct the consequences of excessively high level of guaranteed prices for farm produce constantly requires more and more money and administrative personnel and leads to ever greater absurdities (see the new legal obligation to use skimmed milk powder as an admixture). With this kind of nonsense it won't be long before the non-farming sections of the population will revolt. A social policy aimed at providing farmers with a secure living by reasonable means would probably be tolerated, but for the undesirable consequences of such a policy for the product markets there will be no understanding.

Marginal Conditions for an Agricultural Reform

Previous attempts at introducing agricultural reforms have failed mainly for two reasons: One was that the proposals were for a price policy which was more restrictive than that in force. In this way it was hoped to reduce surpluses. But, if such a course were adopted, the aim felt to be of political priority, i.e. to secure an adequate income for the farming community, would be more difficult to achieve. It is therefore understandable that the decision-making authorities in matters of agricultural policy showed great reserve vis-à-vis such proposals particularly in view of the common price agreements made in Brussels. In other reform proposals, for instance those put forward by the Atlantic Institute in 1971, the advice was that the farmers should be compensated by direct income transfers for the short-fall in earnings they would suffer in consequence of a more restrictive price policy. These proposals omitted to show, however, how the budgetary problem of financing these transfer payments was to be solved. But only such a proposal can be regarded as a genuine alternative to the present agricultural policy that also demonstrates how the problem of finance and also the problems of administrative feasibility are to be solved. In addition, there are still some more marginal conditions of agricultural policy which will have to be fulfilled.

In our inquiry into the possibilities of re-shaping agricultural policy we therefore had to proceed from the following assumptions:

A certain level of food supplies must be assured. What this level is to be is a political decision. At the same time surpluses must be prevented from growing.

For political and social reasons the pressure exercised on the farming population to adapt themselves to changed conditions and move from the country to the towns must not be heavier than it was in the past. If the strength of the pressure is measured in terms of disparity of incomes, this norm means that a change of system must not lead to an increased disparity of incomes.

Agricultural policy must not be changed abruptly. Imperative is to provide guide-lines, especially for novices taking up a profession.

The new agricultural policy must not create an additional budgetary burden. It must at least indicate possible ways of financing additional public expenditures.

Any proposed alternative must contribute more to the country's social product than does the existing policy.

Among the various possibilities of shaping an agricultural policy which fulfils these conditions – theoretically these aims are attainable also by way of a quantitative control of the total agricultural output – the following proposal strikes us as particularly worthy of discussion.

Elements of an Alternative Agrarian Policy

Henceforth the officially supported farm prices are to rise by 2 p.c. less than the average price level of the entire economy. (Hitherto agricultural prices have fallen by scarcely 1 p.c. per annum in real terms).

The farmers should be compensated for the loss suffered on this account by direct income transfers tied up with specific individuals. These transfer payments should be made in principle only to the present generation of farmers – but during a transitional period exceptions should be allowed – and their amount should be fixed independently of current output. These income transfers should be fixed at levels high enough to give the farming community overall parity as far as income development is concerned.

As an added incentive for farmers wishing to leave the land it should be possible to allow the recipients of income transfer payments to capitalize these payments when changing over to another – non-agricultural – activity.

The funding of direct income transfers should ideally be made out of direct taxes. As this is presumably impossible, it is recommended that a "structural levy" on farm produce is imposed to finance these transfers. The amount of the levy should roughly equal the difference between the cost of maintaining the necessary price trend under the present policy and the trend of producer prices under the reformed system.

The proposal to replace the price-support system by direct income transfers is in principle not new as such, although some of the essential details in the suggested form have not yet been discussed. New is the suggestion not to bring down internal prices for farm products to the world market level "at a stroke" but to reduce the support level gradually. In this manner it should be possible to allay political misgivings which jerky price changes would certainly arouse. Besides, a gentle "glide" down to a lower output level makes it possible to retain the existing instruments of market and price policy. In this way the possibility always exists to go into reverse if for reasons of assuring adequate supplies a higher level of selfsufficiency seems necessary. In view of the present high degree of selfsufficiency, however, the problem is not how to guard against a crisis arising in the food sector but how to limit the accumulation of further surpluses.

The structural changes of the present system may possibly be helped along in the desired direction by confining income transfers to the present generation and also by giving the recipients of such transfers on leaving their farm the option of capitalizing future instalments. The burden of adjustment is thus transferred, to a large extent, to the future generation which makes the burden less onerous without impeding the structural changes of existing farms.

New is further the suggestion to finance the income transfers out of a structural levy on the consumption of farm produce — a levy which in a way would act like an indirect tax. Because of the regressive effect of this kind of levy on income distribution, the authors would however personally prefer to see these payments be made out of direct tax revenue. On the other hand, it must not be forgotten that up to now every suggestion to introduce direct income transfers has been instantly rejected on the grounds that there was no means of financing such payments, whereas the ability of the consumer to assume additional burdens were apparently thought to be wellnigh limitless. Even in regard to the practicability of such transfers from the administrative point of view the proposal contains concrete suggestions which should dispel most of the misgivings felt on that account.

New is finally that assessments have been made and submitted of the effects of such a change in agricultural policy on the national economy and finances and that these calculations cover not only one year but a longer period.

Quantitative Effects of a Reform

The calculations which confine themselves to the effects on the Federal Republic of Germany, are

based on an econometric model of German agriculture. With the help of this model it is possible to study different price trends insofar as they are relevant and to erect pointers marking the way in which output is likely to develop and to show how much factor input will be required and what the income of the agricultural sector will be. By evaluating the individual quantity series, applying different prices or shadow prices, the costs and benefits to the national economy of the present agricultural policy can be assessed and compared with the alternative solution. Additional calculations can be made about the size of the income transfers, the structural levy and the expenditures to finance the market organizations and these make it possible to make statements about the effects of the proposed reforms on the national budget.

For the cost-benefit analysis it is necessary to price the production factors entering into the agrarian sector of the national economy, the prices used being either ruling market prices or — as for instance in the case of the workforce — national alternative incomes. The evaluation of the output volume must however be based on world market prices. In view of the fact that forecasting world market prices for agricultural products is a very uncertain undertaking, our model assumed a number of different price trends.

According to our calculations, a more cautious farm price policy, that is a decrease of prices by 2 p.c. in real terms instead of 1 p.c. per annum as hitherto, could — assuming average world market prices — lead within the next 15 years to a total increase in the German GNP by about DM 17 bn (in 1972 prices). Per annum the gain would be after five (ten; fifteen) years: 0.1 p.c. (0.2 p.c.; 0.3 p.c.) of the German national income.

After five years already the cost for Germany alone of financing the agricultural market organizations could be reduced by nearly DM 1 bn. The revenue from the structural levy would more than suffice to finance the income transfers so that the burden on consumers could be reduced by lower prices.

Counter-arguments by the Critics

Changes of the kind proposed have already been variously discussed; the defenders of the *status quo* have therefore got their counter-arguments ready. They should however pause to consider whether their arguments also hold good against the special change of policy suggested by us. There are first of all objections to the effect that the envisaged change is administratively and financially impossible; these we have already dealt with earlier on. But, these apart, there are some

often quoted standard arguments which are advanced again and again; here is a summary of them:

There will be no reduction of surpluses because when prices drop supplies do not. If, in addition, the farmers are compensated by direct payments for their loss of income, the supply situation would in no way be different from what it is with the present agricultural policy.

But our proposal does not envisage price reductions, but — small — price increases. Whoever admits that price rises bring about increases in supplies must also admit that smaller price rises lead to smaller increases in supplies. To think that payments which are made independently of output lead to the same increases in supply as price rises, is to assume that farmers are incapable of economic reasoning and that they make their output and investment decisions dependent on their liquidity rather than on profitability. Even if some of the farmers acted like that, it could be expected that on the whole supply expansion and surplus creation would not remain unchanged. Besides, if unlimited increases in the expenditures on market organizations are not to be tolerated, what other alternative is there to reducing the prices for farm products without compensation?

Direct income transfers — so the argument goes — obstruct structural changes because they discriminate against efficient production units and in favour of weak farms by guaranteeing the latter a regular supplementary income which eases the pressure on them to give up.

This objection would be valid, if the direct income transfer payments were made *additionally* to an unchanged price policy. If, on the other hand, the payments are made in lieu of price increases that have not occurred, the situation is different. More slowly rising land prices and incentives to leave the land in the form of capitalization should help rather than hinder the structural changes.

Through direct income transfers — it is contended — the farmers would be turned into recipients of public welfare whereas before they earned their living via the market.

It should by now be widely known that the markets for farm produce inside the EC are not really "markets" in the sense that markets are places where prices are usually allowed to find their own level. Transactions have been undertaken for the sole purpose of keeping the present system alive. A case in point is what recently happened on the market for milk products. Operations of this kind tend further to strengthen the view that agricultural prices have little to do with "fair" prices freely arrived at and that, on the contrary, their function is to a large extent one of welfare policy. In this

respect, the impression is that in a certain sense farmers are already "social welfare beneficiaries", which does not necessarily mean that this is in itself something derogatory. On the contrary, it is an essential feature of the "social market economy" that it does not allow the forces of the market unhindered play but that it helps social considerations to have an influence on events. Besides, farmers fulfil functions such as preserving the countryside in a cultivated state — functions which appear to deserve monetary recognition by the state. True, it is certainly easier from a political point of view to introduce some kind of invisible payments than visible ones. But, having said this, there are still two points to be considered:

Firstly the transfers paid to the farming sector at present have long since become plainly visible because of the high administrative costs involved and the absurd consequences of the present market policy.

Secondly, if "invisible" payments can be replaced by very much lower visible ones, the political pressure in the direction of making such a replacement is sure sooner or later to achieve its objective.

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European Concerns

Within the EC agricultural price policies are no longer the concern of national governments; they are fixed jointly after consultation. A proposal such as ours, discussed and calculated in German terms would appear therefore to be a little too far removed from reality. And yet, there are two reasons which make us believe that such is not the case:

□ Firstly, a system as proposed by us, combining as it does direct income transfers with price policy may be able to help overcome on the European plane a good many of the obstacles to integration. Today, the fact that conditions vary so greatly as between one member country and another make the pursuit of a common agricultural policy very difficult and at times wellnigh impossible. Now, under our scheme, such differences could be taken into account in that it allows communal agricultural price levels to go hand in hand with different direct payments. It would be a matter for the national authorities to decide how they wished to finance these direct payments. Of course, fixed direct international transfers out of Common Market funds would have to replace the international income re-distribution which is today effected invisibly via price subsidies, if the new scheme is to be attractive also to the favoured countries of the present system. One point in favour of the new scheme would be that it would do away with the compensation deals which result from the "common" price fixing — transactions which are one of the political causes for the excessively high price guarantees. The first objective of the EC — the free movement of goods — would thus be achieved without any need to make a hopeless attempt to influence via a uniform agricultural price level, incomes from Scotland to Sicily to the satisfaction of all areas concerned.

□ There is a second reason why our proposal seen from a European perspective is not unrealistic: it is that Germany would have the possibility to dismantle the border equalization levy and introduce direct compensation payments instead. In this manner Germany, even if it went ahead alone, could make sure of reaping part of the possible benefits of the proposed scheme.

Theory and Political Practice

Critics have already been loud in condemning our scheme, and it will doubtless be the target of still more criticism in future. We are sure to be told that these proposed reforms are pure scientific theory and that as such they make insufficient allowance for what is politically realizable.

Criticism of this kind is being expressed not only by the representatives of farming interests but also by a good many fellow scientists and by politicians themselves.

The representatives of agricultural pressure groups would have to have an answer to the following question: is it wise to rely on the present policy of "invisible" income transfers via price subsidies continuing indefinitely? Would it not be more far-sighted to reckon with the possibility that the time will come when the cost to the national economy of such an agricultural price policy will become politically intolerable? And would it not be better to work out alternative forms of income subsidies in order not to be found with nothing to offer when the present price policy has reached deadlock?

And the representatives of science, who for a long time have been calling for price-political moderation and who regularly wash their hands off the whole affair whenever their warning calls die away unheard, these scientists too should ask themselves whether they have really done enough to indicate politically viable alternatives. As long as, for want of other instruments, agricultural policy can support the incomes of farming communities only via prices, it is, in view of the high political priority clearly given to the income objective, scarcely promising to demand emphatically that the price policy be brought into line with market conditions. Nor is the objection tenable that after careful consideration science has come to the conclusion that alternative means of securing agricultural incomes are politically impracticable. The politicians cannot be relieved of their duty to decide what is and what is not politically realizable. Besides, there is considerable danger that those politically responsible will not even look carefully into an alternative which science has rejected in advance.

Of the politicians themselves it can hardly be expected that they welcome a proposal for basic reforms with open arms for this would be tantamount to an implied admission that the previous policy was unsuccessful. They are more likely to take small steps and, rather than turn the whole system inside out, they will want to try out individual new elements in individual regions on individual products. The introduction of a revaluation compensation in relation to the area farmed, the creation of an aid programme for hill farmers and the constantly expanding welfare policy show that people are becoming increasingly doubtful as to whether price policy can achieve everything and are drawing obvious conclusions. If we were to hazard a prognosis we would be inclined to think that tendencies in this direction are likely to become more pronounced.