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The Chances for a Thorough Reform of the Common Agricultural Policy

by Ulrich Koester, Kiel*

That the Common Agricultural Policy of the European Community is in need of reform is by now commonly accepted. But all moves for a reform on the political level have been postponed until after the French elections in the spring, a fact which highlights the political problems. Is there a real chance of a thorough reform of the CAP?

There is no chance of a thorough reform of the EC's agricultural policy without universal recognition of the need for reform. The first point to be settled therefore is whether such a need for reform does exist. In the analysis of this question it is assumed that the politicians will only contemplate a change of policy if its officially affirmed objectives cannot be achieved by a continuation of the status quo and/or if negative side-effects produced by the realization of these objectives are politically unacceptable. A reform will stand a better chance of consummation if those liable to feel its negative effects appreciate the need for change or find it relatively easy to hold off the pressure for adjustments brought on by the reform.

The objectives of the EC's agricultural policy set out in Articles 39 and 110 of the EEC Treaty are used here for an appraisal of its success hitherto. We do not imply that the objectives as stated in these Articles are in fact desirable from an overall economic point of view but merely assume that in the practice of agricultural policy a difference between the real situation and the officially announced objectives may touch off political activities.

The market and price policy pursued hitherto as the most important element of European agricultural policy

was targeted mainly on the farmers' incomes. Art. 39 of the EEC Treaty stated only that the agricultural population were to be assured of a fair standard of living through increased productivity in agriculture. In practice however this aim was evidently interpreted as an instruction to bring the average incomes of those engaged in agriculture into line with the incomes of comparable occupational groups.

A Missed Target

The statistics show that

- the policy has failed to assist an even development of incomes in the agricultural sectors of the individual member countries, and that
- the individual countries have succeeded to varying degrees in bringing the sectoral income trend into line with the general income trends in their economies.

In the Federal Republic of Germany the average incomes in agriculture have been lagging behind the general trend, especially in the last three years.

The empirical findings reflect the fact that the resource deployment was not consistent with the objective: In as heterogeneous an economic area as the EC with differentiated agricultural structures to start

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with and, above all, highly divergent monetary trends, it is probably impossible to serve the income objective equally well in all countries by means of a common price level as intended under the common market and price policy. It may be argued that the instruments of price policy will prove even less suitable for the intended objective when the EC has been enlarged further.

Increased Productivity?

The EEC Treaty mentioned "increase of productivity" explicitly as an objective of agricultural policy. A measurement of productivity by the percentage change of labour productivity in agriculture shows that the increase exceeded the average for the whole economy. But it would be hasty to infer from this that the objective was achieved in the best way. Crucial for an assessment under agricultural and economic policy aspects is not the development of the target variable, but the true criterion is the resource input by means of which this development was achieved and what the development might have been with an alternative resource input.

Following this line, it may be argued that the price policy in particular militated against a labour exodus from agriculture and thus acted as a curb on productivity. In addition to its other effects, it kept the structural change in agriculture below what could have been achieved by a different resource deployment. A comparison of the changes in actual unit sizes with the technical optimum in the agriculture of the Federal Republic of Germany shows that while farm units became on average larger, the actual increase in size did not match the technical optimum. This is especially true of dairy farming: The annual increase in the last ten years averaged about one cow per herd while the technical optimum rose much more. It has therefore to be noted that the "increase of productivity in agriculture" is another aim which has not been achieved.

Reasonable Consumer Prices?

The EEC Treaty postulated as an aim of agricultural policy that the consumers should obtain supplies at reasonable prices. It must be conceded that the "reasonableness" of consumer prices cannot be established by simply comparing internal and world market prices at a given point in time; but it can certainly be said that further rises of consumer prices which widen the gap between internal and world market prices contravene the objective. Following this train of thought through, it may be stated that further

Table 1
Self-Sufficiency of the EC in Agricultural Products¹
(in %)

	1967-1971 ²	1973	1976	1977	1978
Sugar	82	93	105	104	125
Butter	91	104	107	107	118
Milk fat ³	100	103	106	108	112
Barley	103	107	103	94	112
Rye	100	100	92	95	108
Milk protein ³	113	109	107	110	108
Wine	97	89	97	102	107
Poultry	101	104	104	105	103
Soft wheat	—	100	101	105	102
Potatoes	100	102	98	96	101
Eggs	99	99	100	100	101
Meat of swine	100	101	99	100	100
Oats	96	96	95	91	97
Beef	90	86	99	97	95
Vegetables	98	94	95	92	92
Fresh fruit	80	77	79	78	73
Meat of sheep and goat	56	59	64	64	65

¹ Included in the internal consumption are the product quantities disposed of by the aid of subsidies; ² partly estimated; ³ as constituents of the aggregate milk product consumption.

Source: Statistical Office of the European Communities.

price increases also mean failure to achieve the objective of "supplying consumers at reasonable prices", especially since we have been producing surpluses in almost all markets (see Table 1). As a continuation of the present policy is bound to aggravate the surplus situation, further price increases can no longer be justified by the argument that the food supply has to be safeguarded.

Art. 110 of the EEC Treaty states that the EC is to contribute to the harmonious development of world trade. This objective precludes a further increase of nominal protection rates. To solve the so-called substitution problem by imposing levies also on grain substitutes (especially tapioca) and vegetable oils (soya oil in particular) which have hitherto been imported almost duty-free, for instance, would be a clear violation of this objective.

The first enlargement of the EC, from six to nine member countries, has probably militated further against the objective, and the second extension, to include 12 countries, will make matters worse. The EC is already the dominant world market supplier for a few agricultural products (the EC's butter and dried skim milk exports for instance accounted for 47.5 and 44.9 % respectively of the total world trade in 1978), so that the EC's agricultural price policy has wide repercussions in the world markets and on third countries.

According to the basic concept of the EEC Treaty the EC is intended to be, at the very least, a customs union with duty-free intra-Community trade and common external tariff rates. Monetary Compensatory Amounts in the agricultural markets which act as internal customs duties are thus contrary to the basic concept of the EEC Treaty.

Considering that the Monetary Compensatory Amounts were introduced in consequence of divergent monetary developments and of therefrom ensuing exchange rate variations, it may be argued that the spread of national inflation rates is likely to widen as a result of the EC enlargement. Adherence to the policy pursued hitherto will therefore necessitate continuation of the Monetary Compensatory Amounts.

Rising Costs

The practical agricultural policy seems to focus mainly on those effects of the resource deployment which arouse public criticism. Politicians and public opinion alike attach relatively great importance to the course of the expenditure on market organizations when they appraise the present agricultural policy.

Table 2 shows the changes in EAGGF (European Agricultural Guidance and Guarantee Fund) spending. Steep increases were recorded year after year during the seventies. If the present policy is continued, the EC's financial resources – its own revenue from levies and duties plus one per cent of the harmonized national value-added tax receipts – will certainly be exhausted shortly. The possibility of opening up new sources of finance need not be ruled out but such action would surely attract increased public interest and possibly provoke political opposition.

It has already been pointed out that the foreign trade conditions for the EC's agricultural policy have changed. This is due, on the one hand, to the enlarged size of the EC and the consequent need to take counteraction by foreign trade partners in the face of agricultural policy measures by the EC into account

and, on the other, to what is known as the "open flank" of the EC's agricultural market organizations. It was stated earlier that grain substitutes and vegetable oils and fats can be imported almost duty-free as a result of GATT regulations. Users inside the EC are therefore making increasing use of imported substitutes in the place of indigenous feed grains, and the grain substitutes are expected to become even more important. The imports have been curbed temporarily by a voluntary export restraint agreement with Thailand, the main supplier of tapioca, but the relatively favourable world market price trend for tapioca suggests that other potential suppliers, like Brazil in particular, will place larger quantities in the world market. In the circumstances further grain price increases in the EC will swell the surpluses, and the removal of these surpluses will put a heavier burden on the EC budget.

Misallocation of resources is a major drawback of the present price support policy from an overall economic point of view. It amounts in effect to acceptance of a national product shortfall. It has to be realized that, quite generally, as the agricultural structure becomes increasingly heterogeneous in consequence of the enlargement of the EC, the allocation costs connected with a certain degree of income objective accomplishment are bound to rise.

Undesirable Distributive Effects

Undesirable effects on income distribution are another negative aspect of the price support policy pursued hitherto. Three different effects should be pointed out:

- ☐ Price increases tend to make the income distribution in agriculture more uneven. High income earners gain more in absolute terms from every price increase than low income earners. The price policy thus widens the existing differentials in the agricultural sector.
- ☐ It must also be remembered that price increases bear particularly heavily on those consumers who

Table 2
European Agricultural Guidance and Guarantee Fund Disbursements since 1974
(DM mn)

	1974	1975	1976	1977	1978	1979	1980
Total	8,005.74 100.0	11,411.14 142.5	13,364.66 166.9	14,936.48 186.6	19,847.06 247.9	23,964.01 299.3	26,523.29 ¹ 331.3

¹ Budget appropriations.

Source: The State of Agriculture in the Community. Report 1979.

spend a relatively large part of their income on food – i. e., on the socially weak members of society.

□ Furthermore, the price policy contributes, especially through further price increases, to intra-Community income transfer flows. Higher prices bear, in principle, on all consumers in the EC, but the income effects benefit only the farmers and thus mostly the countries which export agricultural products: Income is transferred from the importing countries, especially from Great Britain and Italy, to the major exporting countries, in particular France.

To sum up, the negative side-effects of using the instruments of price policy for the realization of objectives of agricultural policy tend to gain in weight. A more cautious (more restrictive) price policy appears to have been adopted of late because of this fact. A shortfall of agricultural policy objective realization has had to be accepted at the same time however. In the light of this diagnosis there are indeed good grounds for a reform of the EC's agricultural policy.

Reform Proposals

A reorientation of the EC's agricultural policy could be based on a reinterpretation of its objectives or on a modification of the resource input. The reform proposals may be sub-divided

- according to the intensity of the proposed changes as indicated by the relinquishment of individual objectives pursued hitherto, or
- according to their bearing on the economic order.

There is much evidence to suggest that the income objective will in future be interpreted in other ways than in the past. With the relatively high income level reached by now, the social status of agriculturalists cannot be gauged simply from the income trend. Other variables – wealth, job security, independence, etc. – have to be taken into account. It has also to be borne in mind that if there are wide differences in incomes, the average sector income says nothing about social need among the people in that sector. In fact the intrasectoral income disparity has increased in recent years, in the Federal Republic at least. If the authorities are to intervene in the determination of prices in the agricultural sector on social grounds, it would not be the average sector income but the income level of marginal social groups in the agricultural sector which would have to be used as the indicator triggering intervention. Accordingly, the focus should be on the minimum income in agriculture rather than on the average income.

The price policy as a global instrument of agricultural policy could be divested of its income function by such a reinterpretation of the income objective; it could then be used chiefly for production guidance. It has to be admitted however that the chances for such a – relatively radical – reorientation of policy seem to be fairly slight, and this for the following reasons:

- It would probably require additional public expenditure, at least if the minimum incomes are related to the social assistance rates.
- A political consensus would have to be reached on the EC level about national or supranational finance for such a policy. Against a background of intra-EC conflicts of national interests it is not easy to see how a compromise that would be acceptable to all could be reached.
- Opposition must also be expected from among those affected. Some farmers would obviously bear the stigma of drawing social assistance benefits, and farmers as a body may understandably object to this.

The EC Commission has demanded to pursue at least a restrictive price policy in the future. Implied in the suggestion of such a policy is a modified interpretation of the income objective: Restrictive price policy is often interpreted in the sense that the price policy is to be used to prevent a further accumulation of surpluses. In the present situation in the agricultural markets when technological progress and structural changes are expected to induce 1.5-2 % rises in supplies to most agricultural markets while the demand for agricultural products will be growing only slightly – by about 0.3 % – in the next few years, the real prices would have to be cut by some 4-6 % over a number of years in order to prevent a further rise of the surpluses¹. In the Federal Republic a policy of this kind would entail annual nominal price reductions of 0-2 %. The real incomes in the agricultural sector would fall by about 8-12 % per annum.

Little Chance of Realization

These figures give an idea of the intensity of the reform: It would entail acceptance of an abrupt cutback of the income guarantees offered to those employed in agriculture so as to give more weight to market-economy features in agricultural policy. In the present and prospective situation in the labour markets of all EC countries, such a policy might well have little effect on the efflux of workers from agriculture. Its main effect would probably be a steeper decline of farmers'

¹ These figures emerge from a rough calculation on the assumption of a short-term price elasticity of 0.2 for supply and -0.1 for demand.

incomes. Such a measure would therefore be politically unacceptable unless the objective of "bringing the social situation of the people engaged in agriculture into line" were thought to be of little relevance in the future. Such a *volte-face* in the interpretation of the objective of agricultural policy is, however, unlikely. It follows that a restrictive price policy stands little chance of being adopted in the absence of a further increase of the surpluses and without flanking measures.

It would be possible to divest the price policy of its dual function of production guidance and realization of the income objective by extending the range of deployed instruments. Production guidance could continue to be provided through the price policy while the income objective might be achieved by direct income transfers to the intended recipients. This kind of reform would be less radical than the proposals discussed above.

However rational such a policy may be, there is little chance of its being put into effect at the present juncture. With the income objective being interpreted as hitherto, it would probably entail larger government expenditures. The farmers' organizations would resist it as much as a minimum income policy, and it would seem difficult to settle the problem of fixing and financing the resource inputs on the EC level.

The Farmers' Union's Ideas

Even the German Farmers' Association and the European Confederation of Agriculture appreciate the difficulties in the way of a continuation of the present policy and are therefore also suggesting reforms. They advocate in particular that a scheme like that for the European sugar market, with its quota-based price differentiation, should be applied to the milk market. Under such a scheme an unchanged price would apply to the present production volume; a price cut would affect only the incremental output of individual

producers. A scheme of this kind offers the following advantages:

- ☐ The status quo can be perpetuated insofar as an unchanged price is paid for the current volume of production.
- ☐ Any further growth of production and consequent surpluses can be scaled down.
- ☐ Future investment decisions in agriculture would be based on the lower price. The prices would be a better guide for production decisions, with the result that the cost and profit calculations of individual producers would be more consistent with overall economic considerations.

The drawbacks of such a scheme seem however to outweigh these advantages:

- ☐ Most important, as the experience with the sugar market organization has shown, is that a quota-based system of differentiated prices which does not involve large surpluses and expenditures is politically hardly attainable. Fixing a reference quantity depends on a political compromise. This is especially difficult to achieve if the individual countries do not agree to the reference quantity being simply based on past production, as will always happen when the production and earnings potentials in the individual countries have so far been utilized to differing degrees and there are countries which do not want their production growth potential to be curtailed by a tie with such a reference quantity. To give an example for the EC: The milk output-per-cow amounts in Ireland and Italy to 3,300 kilograms a year but is over 5,000 kilograms in the Netherlands. Countries with an unexploited production potential are unlikely to agree to being tied down to a past level. It is more likely that a similar situation will arise as at the launching of the European sugar market organization when it was also impossible to fix a quota aggregate within the limits set by the internal demand. A European consensus cannot be expected under these circumstances for such a system unless an

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increase in production is programmed at the same time.

□ Even if agreement could be reached on a reference quantity below the normal production volume with a guaranteed price, this kind of scheme could not be expected to work in other markets than that for sugar to which the bottleneck principle applies in an extreme form: There are many producers of the raw product sugar beet and also numerous consumers of the commodity sugar but the production passes through a very small number of processing enterprises (beet sugar factories) so that the production volume can be ascertained with precision and supplies can be channelled and prices differentiated on this basis. In all other markets – including the milk market – the bottleneck principle applies only to a limited extent. The producers of the unprocessed agricultural product are normally able to supply it to the final consumer direct. Only by establishing a tight network of controls could the quantities produced in particular units be measured accurately, especially because the individual operator will hardly be interested in reporting his deliveries directly to the administration. All sales channels and purchase contracts would therefore have to be strictly controlled.

□ As the limited control facilities would make it in any case impossible to apply this system to more than a few markets – including possibly the milk market – the surplus problem would only be shifted to other markets. The basic problem cannot be solved in this way.

□ A great drawback of the price differentiation by quota is its effect on productivity and structural change. Less efficient units could hold out longer beside their more efficient counterparts than they could with uniform prices.

□ Finally, a system of this kind would mean more dirigiste intervention. To go by the experience in other countries, governments find it almost impossible in such cases to extricate themselves later.

To sum up, there is little likelihood of avoiding an accumulation of larger surpluses by quota-based price differentiation. Under overall economic aspects a negative view would in any case have to be taken of such a change of system.

The need for a reform of the EC's agricultural policy is slightly less acute at present, not least because the world market situation is marked by fairly high prices for grain, sugar, tapioca and soya, and is thus rather favourable from the EC's point of view. It is therefore

reasonable to expect that the agriculture ministers will at their next round of meetings decide on a general price rise for agricultural products unaccompanied by a significant reorientation of agricultural policy, even though the co-responsibility levy on the milk market is likely to be raised. In the situation as it is the problem can be held over.

It has to be noted however that this gain of time is not conducive to a solution of the problem. When enlarged further, the Community will be even more heterogeneous, the conflicts of interest will be more marked, and there will probably be less chance of a fundamental reform. Besides, the southward enlargement of the EC will make a homogenization of the existing heterogeneous agricultural protectionism imperative since it was designed chiefly for northern and less for Mediterranean products. If the existing system for northern products is extended to Mediterranean products, it will burst its financial confines. The only way of avoiding this is an alignment in the form of reduced agricultural protectionism for northern products. It is difficult to see how an enlarged EC could possibly achieve general consensus on this point, which means that the real test of the Common Agricultural Policy is still to come. The odds are that uncontrolled national interests will exercise even more influence on the EC's agricultural policy in the future than they did in the past.

CAP Collapse an Acute Possibility

If one subscribes to the view that the present conflicts between national interests rule out a fundamental reform of the Common Agricultural Policy and further that adherence to the agricultural policy pursued hitherto will either burst the existing financial framework wide open or necessitate substantial retrenchments in the pursuit of agricultural policy objectives, a collapse of the Common Agricultural Policy must be considered an acute possibility. Under these circumstances it would be a realistic strategy not to aim at a fundamental reform come what may, but to consider as a second best solution the preservation of the Common Agricultural Policy by permitting national measures to be taken under control at the EC level. Under an umbrella of common agricultural prices the member countries might be allowed to take differentiated social measures in the agricultural sphere after previous authorization by the EC. Stricter control over the observance of the common regulations on competition already in force could help to obviate any distortions of the competitive conditions inside the Community.