

Tangermann, Stefan

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# European Agricultural Policy at the Crossroads

## Dirigistic Pseudo-Solutions or Genuine Reforms?

by Stefan Tangermann, Göttingen\*

**It is now widely acknowledged that the agricultural policy course followed by the EC in the past cannot continue unchanged. Intensive negotiations on modifications to the Common Agricultural Policy have taken place, but have not yet led to agreement among the member countries. Professor Tangermann analyses the ideas for reform that are currently under discussion and presents possible alternatives.**

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It is a truism that the agricultural policy of the European Community has been in a state of permanent crisis ever since its inception. It is also self-evident that hitherto the response to this long-running crisis has not been fundamental reform but crisis management. All attempts to save the EC agricultural policy from collapse have concentrated not on thoroughly reviewing the course steered but on containing individual problems, not on curing the patient but on treating the symptoms. That could be tolerated as long as the Common Agricultural Policy did not jeopardise Europe as a whole and as long as policy mistakes were marginal and could in principle be corrected at any time. Neither of these provisos now applies, however.

A situation has now arisen in which it is no longer Europe that is upsetting agricultural policy but the reverse. At the same time, decisions on the future of the CAP have been initiated that will prove to be not simply cosmetic solutions and ways of deferring problems but irreversible steps towards expanding dirigisme in agricultural policy. These two serious charges must be explained before dealing with the ideas for reform that are currently under discussion and possible alternatives.

The failure of the Athens summit has illustrated more clearly than any other recent event how heavy a burden the CAP has become for the European Community. All the participants have hastened to stress that it is not agricultural policy that has brought Europe to the brink of

collapse, but on closer inspection it can be seen that almost all of the various issues on which the Heads of State and Government disagreed are directly linked with EC agricultural policy. This is self-evident in the case of the monetary compensatory amounts for farm products and the milk quotas that were on the agenda in Athens, but it is also true of the equally contentious questions of the EC budgetary ceiling, the distribution of financial burdens among member countries and the southward enlargement of the Community.

An increase in the one-percent limit for the transfer of VAT to the Community as own resources was proposed by the Commission and certain member states because the current level of EC expenditure could not be financed within the present budgetary ceiling. As about two-thirds of this expenditure is caused by agricultural policy, the CAP bears a very large share of the blame for the Community's financial mess and hence for the political row about a possible increase in the budgetary ceiling. This also ties in very closely with the dispute about the relative contributions of the various member countries, which is further connected with agricultural policy in another way. The United Kingdom, which is vehemently seeking budgetary relief since it is a large net contributor but has a comparatively low gross national product, bears not only the visible burden of cash payments; because of its heavy dependence on agricultural imports, it also makes substantial invisible transfers of income to agricultural exporting countries in the EC (such as France) owing to the EC's farm prices being set well above world market levels. This circumstance, of which the British are well aware,

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\* University of Göttingen.

makes them particularly tenacious in fighting for a reduction in budgetary contributions, even to the extent of endangering the political cohesion of the Community.

Finally, the southward enlargement of the Community, which has been protracted to an extent that is barely tolerable for all parties concerned but especially for Spain and Portugal, is not apparently being held up by doubts on foreign policy or general economic policy grounds. The real stumbling block now seems to be simply the concern of certain existing member states, in particular France, that allowing agricultural products from the Iberian peninsula unhindered access to the Common Market might cause difficulties for their own producers of competing goods. Here too, therefore, agricultural policy stands in the way of further political progress.

Besides this, consider the inefficiency and the waste of political capital when the summit conferences of Heads of State and Government have to attend to technical details of truly minor importance, such as the monetary compensatory amounts, simply because a clutch of agriculture ministers who are vying with one another to appear as the unyielding defenders of their countries' agricultural interests have proved incapable of taking the decisions that fall within their domain. Quite apart from the fact that the Heads of State and Government must necessarily lack the knowledge to deal with such technical questions, it is lamentable that the precious time of the highest-ranking politicians in Europe, not to mention the no doubt limited potential for consensus in European politics, are squandered on disputes of no great significance instead of being available to solve the many important political and economic issues in Europe today.

Must it really go so far, that Europe founders because of its agricultural policy? Can it be that partisan policies in favour of one profession which has limited importance in the economy as a whole can jeopardise the process of European unification, a phenomenon unique in history and of worldwide political significance? Fortunately, that day has not yet arrived. However, there seems little doubt that Europe is ailing because of its agricultural policy and that this malaise must be cured quickly before irreparable damage occurs.

#### **EC on the Brink of Irreversible Mistakes**

It is not yet generally recognised that the European integration process is no longer being promoted but obstructed by the Common Agricultural Policy. Too often the CAP is seen as an isolated problem. Nonetheless, it has had to be widely acknowledged that

the agricultural policy course followed in the past cannot continue unchanged. Hence the intensive negotiations on modifications. In accordance with a mandate handed down at the Stuttgart summit, the EC Commission submitted its outline proposals for reform at the end of July 1983 and since then has revealed its ideas on the details in various draft regulations. The Council of Ministers and the Athens summit negotiated on the basis of these proposals and essentially took the same line. Agreement has not yet been reached among the member countries, but it is already clear where the decisions might lead. The courage to introduce fundamental reform is conspicuously lacking. Instead, cosmetic solutions of a dirigistic nature are being sought, some of which lead irrevocably into blind alleys. The reason for this false turning is easy to identify; the stimulus and impetus behind the present "reform" efforts is not the realisation that the design and operation of the CAP display fundamental economic and political defects but merely unease at an external symptom, the heavy burden of the EC budget. Accordingly, the proposals for change are only designed to suppress this symptom, not to eradicate the problems themselves.

What has gone wrong with the EC agricultural policy can be described in a few words. Farm prices in the Community have been pushed well above the world

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market level by a sophisticated market intervention system for both internal and external agricultural trade. The misallocation of resources and the burden on the consumer that ensue have been chronicled and analysed often enough by economists.<sup>1</sup> The visible and invisible transfers between EC member states to which this gives rise have also been clearly demonstrated.<sup>2</sup> Finally, attention has been drawn repeatedly to the adverse effects the CAP has on the operation of world agricultural markets and on other countries.<sup>3</sup> These false turns, which are not entirely apparent from the political viewpoint, have not induced EC agriculture ministers to change their minds, however. As long as politically effective restrictions did not yield any advantage, the excessive support of farm prices continued unchecked. In concrete terms this means that the Council of Ministers of Agriculture could help themselves to an increase in prices every year, provided expenditure on regulation of the market in agricultural products did not reach the financial ceiling of the Community budget.

That point has now been reached, however. Since the beginning of the seventies the agricultural expenditure of the Community has grown at rates far in excess of the rate of growth of the available budgetary resources, and in 1983 for the first time the budget limit was finally reached. The outward reason for this development is the dramatic increase in EC farm production, which in view of the stagnation in consumption can increasingly be sold on the world market only with the help of large export subsidies. It is barely an exaggeration to say that consideration is now being given to changes in the CAP solely on account of the visible and politically embarrassing financial consequences, not because of the policy's fundamental economic shortcomings. Hence it is no surprise that those concerned with agricultural policy are concentrating solely on finding ways in which the budgetary burden can be held in check, not ways in which the CAP could be made economically more rational. As, at the same time, there is to be no change in the prime orientation of agricultural policy to serving the interests of farmers, efforts are

being directed towards maintaining or even intensifying the price support mechanism, in other words not towards remedying the central error of excessively high farm prices.

As far as policy measures are concerned, the envisaged solutions go primarily in three directions: further restrictions on competing imports, the creation of new sources of revenue and administrative limitations on the growth in production. It is patently obvious that these are but cosmetic solutions that do not resolve the problems, only patch them up. More serious, however, and unfortunately less discernible, is the fact that these are the first steps towards increasing dirigisme which for political reasons will not be reversible, because they will create positions that the beneficiaries will not wish to relinquish. This can be demonstrated clearly in the case of the Commission's proposals in the fields of grain policy, fats tax and milk quotas, which will be discussed here as being representative of the entire catalogue of policy adjustments currently under discussion.

### **Grain Policy – No Courage for the Straight Course**

The Commission's proposals for the future grain market policy no doubt contain sensible elements. It has again suggested that the price policy objective should be rapidly to reduce the gulf between prices in the Community and those in its main competitors. In concrete terms this would mean moving towards US grain prices, in other words a gradual (real) reduction of 20-30 % in the level of EC grain prices. An important instrument in the attainment of this aim is to be the "guarantee threshold", a defined ceiling for overall EC grain production which, if exceeded, would trigger a reduction in intervention prices. This sounds good, for it appears to tackle the cause of grain surpluses, the excessive degree of price support. On closer inspection, however, doubts set in, for it is far from certain that the Commission's proposals will actually lead to this result. The notion of a guarantee threshold may prove to be a complete optical illusion and the other measures concerning so-called grain substitutes may destroy the very basis of the intended price policy.

The guarantee threshold concept, which in a similar form is also intended to apply to products other than grain, does not relate to a predetermined development of (real) guarantee prices but merely provides that the increases in intervention prices in the annual price rounds will be smaller than "normal" if the guarantee threshold is exceeded. Unless a firm market-related basis for "normal" price increases is laid down, there is no guarantee that the grain prices actually set (and the other prices determined in the same way) will lead in the

<sup>1</sup> See for example A. E. Buckwell, B. R. Harvey, K. J. Thompson, K. A. Parton: *The Cost of the Common Agricultural Policy*, London, Canberra 1982, and the literature mentioned therein

<sup>2</sup> See for example U. Koester: *The Redistributive Effects of the Common Agricultural Financial System*, in: *European Review of Agricultural Economics*, Vol. 4 (1977), pp. 321-345

<sup>3</sup> See for example S. Tangermann: *Agricultural Trade Relations between the EC and Temperate Food Exporting Countries*, in: *European Review of Agricultural Economics*, Vol. 5 (1978), pp. 201-219, S. Tangermann: *EC Policies and Agricultural Trade with Developing Countries*, in: G. Johnson (ed.): *Rural Change. The Challenge for Agricultural Economists*, Oxford 1981

intended direction. In other words, as the "normal" price increase is an arbitrary (political) number, the grain price increase derived from it via a guarantee threshold mechanism is also no more than an arbitrary number.

A clear solution would be to use the target reduction in real grain prices over a given period as a guideline. For example, the Commission could have announced that a 20 % reduction in the real level of support was to be achieved within five or six years. This would entail reducing real grain prices by between 3 and 4 % a year. Such a solution would leave no room for arbitrary decisions from year to year, and would give farmers a clear basis on which to make their plans, a particularly important aspect. The Commission evidently lacked the courage to adopt such a clear line. However, more important than this objection is the concern that must be felt about the plans for further impediments to imports of grain substitutes. Under the euphemistic motto of "extending the system of Community preferences", the Community is well on the way to entangling itself in ever greater protectionism in this field. This development has to be viewed through the eyes of an impartial observer to see how wrong-headed the agricultural policy world of the EC has already become.

#### **Burden Shifted to the Consumer**

The Common Agricultural Policy established a high price policy for grain. Grain substitutes such as tapioca and corn gluten feed, which could fortunately still be imported into the Community at reasonably low rates of duty and were therefore cheap, understandably displaced grain in animal feeds, and increasingly so the more grain prices were raised. Any observer who was not yet infected by the Community's agricultural philosophy would say that the only correct reaction in this situation can be to rectify the original mistake, in other words reduce the grain price support and thus make grain competitive again. However, such normal thinking is long past where the CAP is concerned.

Instead, a cosmetic solution is to be found that does not eradicate the problem but only masks it. Imports of grain substitutes are to be impeded in order to make them more expensive and hence to drive them out of animal feeds in favour of grain. This certainly eases the financial strain on the Community budget, but ultimately it merely shifts the burden from the EC coffers to the consumer, for the higher feed prices will be passed on to the prices of meat and dairy produce. Viewed in this light, impeding the import of substitutes can be seen to be an attempt at deception. The overall burden resulting from a mistaken policy is not reduced but only concealed in that it is transferred from visible

government expenditure to unseen consumer spending.

Numerous other criticisms could be made. New import curbs would further strain the Community's already troubled relations with many of its trading partners. It is also difficult to understand why a deliberate increase in the cost of European farmers' inputs and hence a further reduction in their competitiveness should be a sensible instrument of policy. However, there is one point above all else that remains to be emphasised: if the further obstruction of imports of substitutes becomes reality, the basis for the cautious grain price policy the Commission hopes to establish in the future disintegrates. All experience to date indicates that the Council of Ministers of Agriculture can only be checked in its pricing policy if increases in expenditure are disproportionately large. If the grain surpluses are reduced by driving substitutes from the market, room is created for further increases in grain prices. There is therefore a serious danger that in the end the old – and mistaken – grain price policy will continue to be pursued. Nothing would have changed, except that a new protectionist element (obstacles to the import of substitutes) would have been added. It would be practically impossible ever to remove this new element, not only because all economic policy instruments take on a life of their own once they have been introduced, but also because this instrument will be declared an indispensable safeguard of the Community's grain price policy.

#### **Fats Tax – a Way of Shelving the Problem**

The EC Commission has proposed that a tax be levied in the Community on the consumption of all edible fats, with the exception of butter. The arguments advanced in favour of such a tax are similar to those put forward to justify impeding imports of grain substitutes. Imports of oilseeds, the raw material for vegetable fats, do not attract duty in the EC. Edible vegetable fats, in particular margarine, are therefore cheaper than butter. Raising their price by imposing a tax on consumption is therefore intended to reduce their competitive advantage in the eyes of the consumer, increase butter sales and hence help reduce the butter surplus and the subsidies that have to be paid from the Community budget in order that the surplus can be exported. At the same time, the fats tax is to have a second positive effect; it is to bring new budgetary resources into the EC coffers that are intended to contribute towards financing agricultural expenditure. Many arguments can be raised in opposition to this dual-purpose instrument, which many of those responsible for agricultural policy in the

Community regard as a neat solution. New taxes on consumption introduced on purely fiscal grounds run completely counter to all fundamental notions of a rational fiscal policy. Consumer taxes on foods are a particularly antisocial tool. The overseas suppliers of oilseeds – in particular the USA, the major exporter of soya – regard the introduction of the fats tax as an attack on their export opportunities and understandably threaten retaliatory action. Nor will they be restrained by the legalistic argument that as it is a domestic consumer tax, the fats tax (possibly) does not contravene the letter of the GATT.

More important for the line of reasoning expounded here, however, is the fact that the fats tax is also a typical example of the Community's prevalent tendency in the agricultural field not to resolve underlying problems but only to mask their external manifestation. If the prices of milk and dairy products in the Community are so high that intolerable surpluses are produced, the straight course of action is (gradually) to reduce the (real) level of support. The fats tax merely shifts the problem; it transfers the burden from the Community budget to the consumer and requires not the EC milk producers but foreign oilseed producers to adjust their production.

The introduction of the fats tax would also be a step towards fresh state intervention that would be difficult to reverse. Indeed, in all probability it would sow the seed for more widespread interventionism. "Established taxes, good taxes" – this by-word of fiscal policy would undoubtedly also prove valid where the fats tax was concerned. Moreover, the comparatively low tax rate that the Commission has proposed so far would certainly not last long. There is already a growing body of opinion that the rate of tax will have to be raised substantially if the measure is to achieve its intended effect of increasing butter sales. Moreover, once a new source of revenue has been created which the agriculture ministers can control on their own authority, there will be a great temptation to increase the flow. After all, the tax provides better safeguards for the continuation of the high spending agricultural policy pursued to date. It will be almost impossible to break out of this wrong-footed agricultural policy loop.

### **Milk Quotas – the Direct Path to Dirigisme**

The implications that may emerge only at second glance in the grain substitutes question and the fats tax issue are immediately apparent in the Commission's proposals on milk market policy. The planned individual farm quotas for milk production tackle only the symptom and do not touch the cause of the milk surpluses, namely excessive price support. The quotas proposal is

solely motivated by fiscal considerations, even more than the measures aimed against grain substitutes and the fats tax. All overriding considerations, long-term aspects, macro-economic reservations and consumer interests have been swept aside.

This is not the place for a wide-ranging critique of administrative volume restrictions; the Advisory Council to the Federal German Ministry of Agriculture expressed very firm criticism along these lines in its latest report and indicated workable alternatives.<sup>4</sup> Only one point calls for constant re-affirmation, as it still seems to be insufficiently well known among the general public.

Quotas are not only a cosmetic solution that mask the underlying issue rather than tackling it, they are an irrevocable step into agricultural dirigisme. Other countries have already experimented with milk quotas; their experience, which the EC agriculturalists have apparently not taken to heart (perhaps because they have not analysed it), is anything but encouraging. They have demonstrated one thing above all else – you can never get rid of milk quotas. Once quotas have really become established, they can only be removed if prices were drastically cut at the same time. As such a price reduction is politically unacceptable, the quota mechanism asserts its independence and becomes a permanent fixture. What is worse, the method tends to spread. Capacity that can no longer be accommodated in milk production is put to use in other sectors, where it generates growing surpluses. The call for quotas is then heard in these sectors too and dirigisme spreads by stealth. Quotas therefore lead into a blind alley, with no room to turn at the end of it. Economic efficiency and the consumer suffer in any case, but in the long run the farmers cannot feel at ease in the straitjacket of a planned economy either. In German eyes it is completely incomprehensible why a Federal Government that came to power to strengthen the influence of market forces is advocating the direct path towards dirigisme.

### **Are Alternatives Conceivable?**

The direction in which a genuine and, in the long run, tolerable road towards reform of the Common Agricultural Policy would lead is already clear from this criticism of some of the solutions currently under discussion in the agricultural policy field. It would consist in a return to free market principles instead of recourse

<sup>4</sup> Wissenschaftlicher Beirat beim Bundesministerium für Ernährung, Landwirtschaft und Forsten (Advisory Council to the Federal Ministry of Food, Agriculture and Forestry): *Milchmarktpolitik: Kontingentierung oder marktorientierte Preispolitik*, published in the series: *Angewandte Wissenschaft*, No. 286, Landwirtschaftsverlag, Münster-Hiltrup 1983.

to dirigistic pseudo-solutions. In concrete terms, this means that EC farm price support should be brought back to a sensible level.

Of course this could not and need not take the form of an abrupt reduction in the level of agricultural prices. The long-enduring support of farm prices at a high level and the many and varied ancillary measures, including not least the substantial subsidies for farm investment, have placed the Community in a position of responsibility from which it cannot withdraw overnight. Policy adjustment should probably be achieved by reducing farm prices gradually in real terms, perhaps at a rate of 3-4 % a year.<sup>5</sup> If this price policy line were laid down convincingly in advance for a fairly long period, there would be a good chance that the growth in agricultural production in the EC and consequently the rise in expenditure on regulation of the market in agricultural products might soon be noticeably curbed.<sup>6</sup> It would therefore be quite possible to avoid the abrupt price collapse that Community politicians like to portray as the only alternative to their dirigistic proposals and which they paint in lurid colours, to great political effect.

Much could be written about such a policy alternative. However, two aspects must be mentioned even in this brief exposé – the effects on farm incomes and the necessary political safeguards for the reform of agricultural policy at Community level.

The main argument put forward by opponents of fairly large real price reductions is that they would put pressure on farm incomes. Naturally, such pressure cannot be avoided altogether; it is the belated consequence of an earlier mistaken policy that must now be corrected. However, the scale of the income effect should not be overestimated. Adjustments within agriculture itself will ease the pressure,<sup>7</sup> even at a time when opportunities to leave agriculture are restricted owing to the difficult situation in the labour market as a whole. Moreover, there are many possibilities of direct financial compensation that could cushion the social effects of the transition to a more market-oriented agricultural policy.<sup>8</sup>

Price restraint in the CAP cannot be achieved by persuasion alone; what are needed are political safeguards. Not to put too fine a point on it, this should be so arranged that the Council of Ministers of Agriculture are denied the opportunity to behave as if they were in a self-service store with no pay desk. This requires that a firm financial lid continue to be kept on EC agricultural policy and that no scope be allowed for an expansion of farm price support by raising the budgetary limits and creating new sources of revenue.

However, it also requires greater accountability at national level for the financial burden of farm production in individual member states. At present it is relatively painless for each Minister of Agriculture to push for concessions for farming in his own country. "Financial solidarity" under the CAP means that the resulting burdens are borne by the Community and not by the national budget. This system is tantamount to a challenge to conduct agricultural policy at the expense of the other member countries. The fact that the overall burden must then be borne jointly by all members is easily overlooked.

### Need for a Fundamentally Different Attitude

A new system of Community finance which would establish at least a tenuous link between national farm production and the national budgetary contribution – as foreseen in a number of proposals currently under discussion – might lead to a change of thinking in this regard. However, all these technical details will not bring the CAP onto a better course unless a fundamentally different attitude towards the role of agricultural policy takes hold. Agricultural policy can no longer be seen as an isolated protected zone in which interest-serving ministers of agriculture can make free with dirigistic instruments that conflict with all the principles of economic policy accepted in market economies. And the CAP can no longer be allowed to block the process of European unification.

The Heads of State and Government are therefore called upon to rethink their role. At present they are allowing themselves to be saddled with the unfinished business of the Council of Ministers of Agriculture and, moreover, harnessing themselves to the interests of their respective ministers. They must take back the reins, reverse the roles, make agricultural policy subordinate to the more important issues, set bounds for their agriculture ministers and force them to be ready to compromise. Europe must no longer ail on account of its agricultural policy, for Europe is the more important of the two.

<sup>5</sup> See also the following report, generally worth reading, of the Advisory Council: Wissenschaftlicher Beirat beim Bundesministerium für Ernährung, Landwirtschaft und Forsten: Landwirtschaftliche Einkommenspolitik, Angewandte Wissenschaft, No. 267, Munster-Hiltrup 1982.

<sup>6</sup> See in this connection the report of the Advisory Council referred to in footnote 4, which also includes further concrete suggestions on formulating an alternative policy.

<sup>7</sup> See G. Schmitt, S. Tangermann: Die zukünftige Rolle der Agrarpreispolitik der EG, Institut für Agrarökonomie der Universität Göttingen, Göttinger Schriften zur Agrarökonomie, No. 56, Göttingen 1982.

<sup>8</sup> With regard to concrete proposals see also the report of the Advisory Council referred to in footnote 4.