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# The Common Agricultural Policy – Where Now?

by Nick Butler, London\*

**The outcome of the Athens and Brussels summits was a cruel disappointment for all European optimists. The brunt of the consequences of this diplomatic failure will be borne by the Common Agricultural Policy. Is it now time to write its obituary?**

For a brief moment at the beginning of December 1983 it appeared that the European Community had finally found the political will to solve the problems which have beset its progress since the turn of the decade. After six months of detailed negotiations, involving eleven meetings of the foreign and finance ministers, France had tabled a proposal which it seemed could resolve at least one of the problems. A strengthening of budget discipline, designed to set limits to spending, offered the chance that a log jam of reforms could be broken. With clear controls on Community spending an increase in the resources provided by every member state might be agreed and with such an increase could come a new method of calculating contributions. If not the method proposed by Britain itself – a ceiling of 0.1 per cent of Gross National Product as an absolute limit on payments to the Community budget – then at least a carefully formulated change which could have ended years of squabbling and insistent demands for rebates.

With expectations raised, the outcome of the Athens summit was a cruel disappointment for all European optimists. After two days of rancour it was clear that the French proposal was not the Holy Grail sought for so long by politicians and officials but simply one more addition to the European paper mountain. The ten government leaders failed to agree even on the sequence of reform, let alone the much more critical issues of substance. For France it seemed budget discipline could only be set in the context of an increasing budget, specifically with more money and not less for the farm sector. There were matching and equally unresolved differences of perception on the linkage of contributions and additional resources.

Three months later the cruel cycle of expectation and disappointment was repeated. After extensive

preparation, involving personal diplomatic missions by President Mitterand and other French ministers, the EEC Heads of Government met in Brussels to deal with three interrelated issues: the Community budget for the future; the agricultural price settlement for 1984 and the longer term future of the CAP; and the existing and prospective problem of British contributions. On the first two, according to a host of press reports, and post summit disclosures, broad agreement was reached. A figure of 1.4 % of VAT revenues was mooted, with further possible increases in the later 1980s not ruled out. On agriculture, although the farm ministers had failed to reach agreement before the summit, consensus emerged around a package of small price cuts and a production constraint on milk, with only the details of the national quotas left unresolved.

The construction, however, was a house of cards, which could not stand without agreement on the third issue – the British budget contribution. After two days of argument the hope of an agreement was blown away by Chancellor Kohl's declaration that Germany was unwilling to add to her own already substantial contribution to alleviate the whole of Britain's problem. As British agreement on the other two issues was conditional on general acceptance of a permanent reduction in the UK's net contribution, "a matter of vital national importance" in Mrs. Thatcher's words, the summit ended in failure with nothing resolved.

## Effects on Community Budget

For the moment, the forward march of the Community is halted by the failure of the two summits. Talks on the third enlargement, to bring in Spain and Portugal, can make no real progress. Discussions on new common policies, including the projected, and potentially crucial, common industrial research and development policy, will take place only in the corridors. The campaign for the second set of direct elections to the European Parliament has begun without any clear vision of where

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Europe is going, or even of where it will be in June when the votes are cast. For the agricultural sector, the one part of the economy which depends for its livelihood and income on European decisions, the crisis is more immediate. Agricultural spending, taking over sixty per cent of the Community's budget, has been the root cause of the Community's problems and was central to the disputes over contributions and resources at Athens and in the run up to the Brussels summit. As the main common policy, the CAP will take the brunt of the consequences which diplomatic failure will impose. As well as examining those immediate consequences the purpose of this article is to assess whether the obituaries of the CAP, written with such pleasure by its opponents, are any less premature now than they have been in each of the last half dozen years.

In the short term the Community's financial position is undisputed. The budget signed just before Christmas by the President of the European Parliament, Piet Dankert, allows for total expenditure of just over 25 billion ecu (some £ 14 billion). The balance of income to sustain that expenditure will come from the levy on VAT revenues in member states and with a clear limit to monies accruing from customs duties and agricultural levies the best estimate is that between 0.95 and 0.99 of the one per cent limit on the VAT contribution will be required to meet the budget.

The budget itself is probably an underestimation of the Community's outgoings. In 1983 spending on agriculture rose by 28 per cent. In the Parliament's budget it will rise in 1984 by no more than 4 per cent – more a fond hope than a realistic assessment. World market conditions for the two key sectors – dairy and grain – are if anything set to worsen in 1984. The American "payment in kind" scheme, which took land out of production in 1983, cost the US Treasury over 20 billion dollars. The scheme for 1984 is slimmer, and less effective. Any rise in US grain output (the most recent official forecast is for an increase in volume of 20 %) will soften prices, and add to the burden of export restitutions which in total consume almost half of all Europe's farm spending. In a highly competitive environment a cut in the restitutions which compensate the farmer for the difference between guaranteed Community price levels and the much lower world market price, would leave European grain in the silos. In the dairy sector prospects are no better. In 1983 production in the Community grew by 3½ per cent while consumption remained flat. Total stocks of butter alone are now at the level of six months' consumption – an overhang which clouds the whole world market. The continuing growth of production could create a stockpile

of butter of as much as one million tons by the middle of this year – a considerable physical as well as economic burden. Butter is not unique, and its problems are spread across the dairy sector as a whole.

### Ad hoc Measures

With costs rising inexorably, and possibly rapidly towards the ceiling, first of the agreed budget, and then very quickly to the real ceiling of available resources, the outlook in the next few months of the year is for a series of ad hoc measures to limit costs. Proposals to tax consumption of all oils and fats except butter in order to shift the pattern of demand, and to suspend intervention buying of skimmed milk have all been floated by the Commission, in addition to the quotas on milk production finally agreed by the post Summit meeting of the farm ministers in Brussels on March 30th. On grain, the proposals have centred around the limitation of imports of cereal substitutes. Tapioca and cereal brans have already been subjected to volume limits. Proposed restraints on citrus pellets and corn gluten feed would, in theory, re-open additional domestic markets to home-produced grain and animal feed.

These ad hoc measures, even with what appears to be a general strategy of delaying payments across a range of programmes, would still fall a long way short of the changes necessary to avert a financial crisis. In practice they are very unlikely to be implemented in full, and certainly not in a time period as short as six months. The strength of particular lobbies, and in the case of cereal substitutes the obstacles of GATT agreements and vocal foreign producers, will delay if not defeat even the best laid plans.

Quotas plus super levies would limit the cost to the budget of additional milk production but would do nothing to relieve the costs of disposing of current stocks. A thorough system, with quotas for individual producers, would impose a considerable cost on the bureaucracy. The suspension of intervention purchasing (which buys all unsold output from the producer) would be more effective, as would a straight cut in guaranteed prices, but the political pressures on farm ministers and their governments to maintain incomes are so strong that no effective system is even within sight.

In the grain market cereal substitutes are a symptom of the problem, and not the problem itself. The high cost of European produced grain has led farmers and feed suppliers to switch into substitutes, the range of which is potentially so considerable that quotas on one particular product would simply lead to consumption of another.

Only penal general levies, with all the adverse consequences for trade relations with the major supplier, the United States, that that could imply, would have a real effect. The Community would then find itself forcing up meat prices because of the high cost of cereal feed inputs, alienating both the livestock sector and the consumer. Dealing with the symptom in this way does nothing to alter the underlying problem caused by high cereal prices as set by the CAP.

The assumption must be that these or similar measures will be tried over the next few months, and will be found wanting, both because of the weaknesses described and the fact that they fail to make a significant impact on costs. Even the decision to lower support prices by one per cent, taken at the farm minister's meeting, will not avert the day of reckoning, since the impetus of technological progress and productivity advance is still pushing production upwards into even greater surplus. The state of the world market will determine the cost of export restitutions or storage for that surplus but the chances of market conditions saving the Community from the financial crunch look slim indeed.

The near inevitability of the crunch has encouraged many British observers who desire a fundamental reform of both the CAP and the Community's budgetary mechanisms to anticipate with optimism the cathartic effect of crisis. Reform, though, is not the only possible outcome nor, if one considers the deal which was almost agreed in Brussels, even the most likely.

### **National Aids to Agriculture**

If the house of cards cannot be reconstructed quickly the Community's funds will reach the point of exhaustion in a matter of months. The first response to that exhaustion will be a re-assumption of national responsibility for agricultural support. The CAP as it stands will continue to be applied in principle as far as funds allow, but its workings will be subject to national control and modification. National aids to agriculture are already considerable, and though no European government is yet prepared to discuss its contingency plans, a number of possible developments are easily discerned. Green currency rates may be fixed by national or bilateral decision, rather than common agreement. Particular producers may benefit from additional national support and some governments might see a corresponding advantage or political logic in subsidizing consumers as well. Indirect support mechanisms for the agricultural sector, through marketing boards and tax concessions, might be extended in those countries where the agricultural lobby

is most effective. Such lobbies and their national governments will wish without question to place their agriculture in the strongest possible position prior to any later recreation of the CAP. Particular measures of support and subsidy now excluded by the provisions of the CAP will be secured much more easily if they are once in place. Though the degree of enthusiasm will certainly vary, it is difficult to imagine any European government abandoning responsibility for its farm sector while neighbouring farmers are given additional protection and subsidy. National support after all would have a greater political appeal than the channelling of funds to the Community.

Perhaps the most dramatic effect of even a gradual renationalization of agricultural support would be on trade. Within the Community, non-tariff barriers such as health and hygiene regulations could be more stringently enforced by governments determined to protect national farm sectors at minimum financial cost. Extra subsidies and the restriction of internal trade will add to the surpluses and place on national governments the onus to support exports. Direct subsidies both to solve immediate problems and with an eye to securing trade markets before future negotiations would be highly likely. Equally likely would be schemes more extensive than anything currently planned by the Community to encourage the use of home grown crops such as cereals, and to exclude substitutes.

### **Increase in Community Resources**

The second, and much more likely alternative in the light of what occurred before talks broke down in Brussels, is that agreement will be reached and confirmed on an increase in the Community's resources. The emerging consensus among the heads of government did not involve a fundamental change in the CAP, nor even a limit on the growth of agriculture as an expenditure item in the Community's budget.

The terms of the farm ministers' agreement reached on March 30th were for a very modest price cut, leaving grain producers for instance with an effective protection level of 40 % against the world market price, and for production limits on only one product – milk. The growing surpluses in wine, beef and a number of other products went untouched. More important still, the farm ministers accepted a farm budget which will, even in official estimates, exceed the resources available to the Community. Unless extra resources are made available (the agricultural ministers' assumption was clearly that they would be) a significant cut in the EEC's other expenditure on regional and social programmes will be necessary.

What caused the failure in Brussels was not agriculture but rather the issue of net national contributions. By the end of the summit the gap for negotiation between the British demand and the final offer from the nine was reported to have been as little as £150 million.

The summit failure has fostered acrimony and distrust, with threats to withhold previously agreed British rebates and retaliatory threats to withhold British contributions. A new settlement may take some months to achieve and a sense of common purpose even longer. In the end, however, the odds must be strongly on the issue being resolved, if only by an entrenched guaranteed version of the annual rebate accorded to Britain in the last three years. Whatever the degree of dissent on national interests and particular figures, the support for the Community as a political entity is still strong and not one of the ten member governments would be happy to see the enterprise collapse.

An increase in available resources would relieve the financial pressure on the Community for at least the rest of the decade. For agriculture, a budget of this sort would have two significant consequences. First, it would remove the ceiling which for the last three years has given the Community the last card in negotiations on price increases. The continuing weakness of farm incomes relative to those in many other sectors of the European economy, the need for financial assistance to producers whose livelihoods are damaged by the high cost of inputs under other CAP regimes and, from the French in particular, the desirability of a Common Export Policy to sell or dispose of whatever Europe can produce will all be reasserted.

Secondly, the focus of agricultural policy debate will shift to the accession of Spain and Portugal and the problems of incorporating into a common policy two countries whose main economic activity, employing 50 per cent of the working population, is farming. New policies, under the principles of common benefit, will require new funding if Mediterranean products are to be

given comparable treatment to that accorded to grain and the produce of northern Europe. Though Spain and Portugal may provide some markets for existing Euro-surpluses, relative income levels in northern and southern Europe will, on balance, ensure that the new regimes will impose a net cost on the CAP, not offset by the reduction in the burden of export restitutions. The arrangements offered to the Spanish by European negotiators on 21st February were immediately declared inadequate by Madrid and further concessions seem inevitable given the political pressure for enlargement.

As can be seen, neither creeping renationalization nor an increase in resources represent reforms of the Common Agricultural Policy. Either could entrench still further many of the worst aspects of the Policy as it now exists.

### **Inadequacies of the CAP**

The economic inadequacies of the CAP scarcely need to be spelt out here. They have become familiar reading in the twenty-five years since the policy was inaugurated at the Stresa conference and were summarized again in Dr. Stefan Tangermann's article in the February issue of *INTERECONOMICS*.<sup>1</sup> By its system of price supports and the levels at which those supports are set, the Community encourages production regardless of demand. For products covered by the CAP this has meant a trend running beyond self-sufficiency into chronic surplus. Much of the cost of the CAP goes to pay for the disposal of that surplus – an excess of supply over demand which is neither transitory nor yet stable.

Though the CAP unquestionably assists the rural areas of Europe its distributional effects are negative, and regressive. The greatest benefits of a guaranteed price system go to the most efficient producers who are usually the largest scale, technology and capital

<sup>1</sup> Stefan Tangermann European Agricultural Policy at the Crossroads – Dirigistic Pseudo-Solutions or Genuine Reforms? in: *INTERECONOMICS*, Jan./Feb. 1984, pp. 10 ff

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intensive farmers. The incomes of the less wealthy and less efficient farmers are protected but the real transfer of resources in the European economy as a result of the CAP is from the taxpayer and the consumer to the more efficient farm owners. As the British pressure group, the Low Pay Unit, has shown in detailed research work, farm workers as opposed to owners have fared badly and farm wages are still at the bottom of the income scale in Britain and most other European countries.<sup>2</sup>

In economic terms the CAP represents a serious misallocation of resources. Food costs are higher than they need to be and capital is devoted to the production of goods for which there is no demand. In world-wide terms, a number of the major products covered by the CAP can be produced more cheaply in regions outside the EEC, and it is the developing country producers, as well as the traditional suppliers such as Canada, Australia and the United States which suffer. The developing countries which are net importers of commodities such as grain benefit from the depressant effect on the world market price of subsidized European production, but the disincentive to the modernization of the Third World's own agricultural sector is probably a greater net cost in the long run.<sup>3</sup>

It is also becoming increasingly obvious that there is a political cost to be counted in with the economic cost. As the CAP has shifted a number of key products into surplus, the consequences of Community policy have spread from the internal to the external environment. Non-European producers who have seen their trade with the EEC decline as European self-sufficiency ratios advanced are now finding their trade with third markets jeopardized. The CAP's system of export restitutions which compensates producers for the gap between prices on the world market and prices as guaranteed by the Community offers a degree of open-ended trade subsidy which few other countries can match.

The prospect of a subsidy war – the ultimate in economic futility – has soured US-European relations and only the American decision to take farmland out of production during the last year has forestalled an open outbreak of hostilities.<sup>4</sup> With almost every other exporter of agricultural produce the EEC finds itself in dispute and although those remote from the agricultural sector may dismiss the specific issues as trivial or minor the cumulative effect on relations between Europe and the rest of the world is negative.

To cope with these problems the CAP needs not only to avoid the adverse consequences of renationalization or an uncontrolled increase in resources but also to go beyond the present series of cost-cutting measures.

## Future Principles

Two new principles must be established as the basis of the CAP for the future.

First agricultural policies, and in particular prices, must be related to the interaction of supply and demand. High support prices exist to raise farm incomes but as a means of supporting earnings the price regime is a clumsy and ineffective tool. The incomes of farmers, and of the rural community as a whole, would be much more efficiently protected by a system of direct income supplements (coupled ideally with a serious structural policy to remove what remains of farm poverty).

The choice of the price mechanism as the key instrument of the CAP reflected a conscious desire, evident in national policies well before the formal construction of a common regime, to stimulate production as well as to redistribute resources. The target of self-sufficiency and security of supply which became enshrined at that stage is now outdated and should be the object of the second shift of principle.

The world market, whether in grains or dairy products, no longer provides any justification for the fears of shortage which contributed to the original aim of self-sufficiency. With consumption levels high (and therefore susceptible to reduction or modification without trauma in times of particular shortage) 100 per cent self-sufficiency (let alone 120 per cent) is not justified if world production costs are lower than those in the EEC, and if world supply is as consistently secure as it has been in the last decade. A limited reserve stock, or participation in a wider international stock-holding scheme, is a more economically efficient means of ensuring security of supply than the present policy. The single most effective means of implementing such a shift of policy would be the modification or removal of the system of variable levies insulating the Community from the world market. No political realist would argue for an agricultural sector without a substantial degree of intervention and public support. Support, though, cannot be open-ended and must take its place in an order of priority with all the other claims on public funds.

The effect of a shift in current policies on self-sufficiency and pricing would be considerable. Burdens of storage, export restitution and direct payments would be lifted from the Community budget. To the extent that

<sup>2</sup> Low Pay Unit. *A Poor Harvester*, London 1982

<sup>3</sup> Timothy Josling: *The European Common Agricultural Policy and the interests of the developing countries*, ODI Review, London 1979.

<sup>4</sup> Nick Butler: *The Ploughshares War*, in: *Foreign Affairs*, Fall 1983.

production levels fell, world market prices might rise, and a number of the most acrimonious trade disputes would evaporate, establishing a new atmosphere before the next GATT initiative on trade liberalisation. Agriculture would still be a well protected sector and if, as part of a second phase of reform, national aids to farmers were brought under Community jurisdiction, a more genuinely common policy would have been established.

This is not the place for an elaboration of every guaranteed price level, or the mechanics of every single product regime. They can be worked out, but as with the overall objective – the achievement of a realistic, economic and internationally orientated policy – progress will depend upon the willingness of a number of European governments (by no means just the French) to sacrifice particular sacred cows by the acceptance of the fact that the pattern of production established by the CAP can and should be altered.

### Obstacles to Reform

Will the reformers prevail? In two or three years' time will we look back on the summits at Athens and Brussels and the six months of the French presidency as the turning point when an overblown agricultural system was reformed and when the renaissance of the Community began?

After the Brussels summit and the meeting of agriculture ministers on March 30th there are good reasons for caution in the face of such optimism. The calm rationality of the arguments of Dr. Tangermann and so many other economists is no guarantee that constructive change will now begin. First, all the proposals offered by the Community and the farm ministers so far have been ameliorative rather than substantive and if implemented would leave the basic structure of the Common Agricultural Policy unchanged. Fundamental reform of the principles of the policy has as yet received no published support from Brussels nor, it must be said, from any national government, Britain included.

Secondly, the farm lobby remains strong in sufficient regions and countries to make the necessary unity for reform look unattainable. To date, the strength of the lobby coupled with the conclusion of politicians and diplomats that European harmony and co-operation is worth the cost of the CAP – it accounts after all for barely one per cent of European GDP – has kept the unreformed agricultural structure in being. It is barely conceivable, for instance, that a French government will wish to alienate the farmers' lobby, which is already

sensitive to perceived iniquities in green currency rates and unhappy at falling farm incomes.

On top of those factors is the dynamic impetus of the policy itself on national agricultural circumstances. Britain is perhaps the most appropriate example. Ten years ago one might reasonably have predicted that Britain with its very distinct agricultural history, and very different system of agricultural support to that entrenched in continental Europe (based on payments to meet deficiencies in income rather than on a guaranteed price regardless of output) would have forced a radical change in the CAP. As a large-scale importer, with an efficient but limited domestic agricultural sector, British interests appeared to be sharply at odds with the protectionist and high-price continental tradition.

Experience has given the lie to those expectations. Britain has to an extent been seduced by the CAP. High guaranteed prices have stimulated production. Britain is now 76 per cent self-sufficient in those products produced here. As recently as 1970 self-sufficiency was no more than 60 per cent.<sup>5</sup> Some of the intervening budget imbalance has been offset by the series of special rebates, reducing the level of critical decibels and permitting agricultural progress to continue without let or hindrance. Now, ten years on, British farming is still efficient but its level and pattern of output and income reflect the integration with the CAP on Europe's terms. Farming on the basis of output, profits and property values is one of the country's most successful economic sectors making a growing contribution to the balance of payments. With the recent establishment of new institutions to assist the export of farm products it is clear that the Ministry of Agriculture has no plans for a reversion to a pre-1973 regime. The CAP, it seems, has come to stay.

As time passes, with the flows of funds to support agriculture off-setting the burden of net contributions and the trade advantages becoming more evident as the balance of payments problems now concealed by North Sea oil come to the forefront of economic policy concerns, the strength of the will to change the CAP will diminish. Reform is far from being the automatic consequence of the current crisis, and though the coming months may indeed witness successive budget crises and exercises in brinkmanship the odds are that when the dust has settled the CAP will have survived, shaken but not stirred and still in much the same form that we have come to know and love.

<sup>5</sup> Ministry of Agriculture: Annual Review of Agriculture, London 1984, Cmnd. 9137.