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The International Repercussions of EC Agricultural Policy

by Peter Michael Schmitz, Giessen*

The importance of the EC in international agricultural markets has grown steadily since the establishment of the Community and will receive another boost following its southward enlargement. Nevertheless, agricultural policy has been inward-looking and has paid little heed to the external effects it engenders. Prof. Schmitz shows that EC agricultural policy has tended to depress world market prices, has increased their volatility and artificially distorted the price structure in the world market.

With growing agricultural protectionism and the expansion in its membership as a result of the southward enlargement, the European Community is playing an increasingly important role in international agricultural markets. The outward signs of this are the switch from importer to exporter status in many agricultural markets and the Community's substantial share of world exports of farm products. Up to now, this situation has applied mainly to the Community's northern products, such as cereals, sugar, meat and dairy produce, but Mediterranean products can be expected to be similarly affected after the accession of Spain and Portugal on 1st January 1986.

The common agricultural policy continues to be inward-looking, despite the change in the Community's position in the world market. The instruments of market organisation are used primarily to meet incomes and fiscal policy requirements. Policy-makers pay relatively little heed to the international repercussions of the common agricultural policy, with the result that this essentially inward-oriented policy is coming under growing criticism from many non-member countries. The Community of Ten is not only accused of contributing to a decline in world market prices for agricultural raw materials but it is also blamed for the lasting destabilisation of the world agricultural markets. This is affecting primarily the poorer developing countries, who are denied access to the EC market and are also losing world market shares to Community countries. In recent years, stronger resistance has also come from certain industrialised countries (such as the

USA, Australia, New Zealand and Canada) which are traditional exporters of farm produce but have seen their market shares squeezed by the EC.

To counter these charges, apologists of the EC's agricultural policy frequently point out that the Community is still the world's largest importer of agricultural products, that imports of many farm products are still growing at a rapid rate, that developing countries in particular enjoy a series of preferential trade arrangements and finally that the Community's food aid helps combat hunger in the world.

This controversial assessment of EC agricultural policy constitutes the starting point for the article that follows, which analyses the effects that the Community's foreign trade arrangements and internal market organisation have on the world agricultural markets and on non-member countries. It largely disregards the policy's effects on non-agricultural markets and the political reactions of trading partners.

Reference System

The EC is indeed the world's largest importer of farm products and the Community's imports of a number of products are still growing at a rapid rate.¹ However, it would be premature and logically untenable to conclude from this that the Community's agricultural policy is not protectionistic and would, on the contrary, encourage the opening of its markets to non-member countries. To identify the effects of a policy, it is not generally sufficient to examine changes over time in just one variable of

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¹ In this regard, see I. K i e c h l e : . . . und grün bleibt unsere Zukunft, Stuttgart and Herford 1985, pp. 254 ff.

interest. For example, foreign trade is influenced not only by policy but also by such things as technical progress, factor prices, incomes and preferences. Hence it is quite possible for imports to rise in spite of a protectionistic import policy, because other factors have outweighed its restraining effect. It is impossible to determine whether a particular development has occurred because of or despite the agricultural policy without knowing precisely the direction and intensity of the effect of the other factors.

A comparison of foreign trade flows both with and without the agricultural policy could not be faulted from the point of view of logic. As experimentation is not an option in the field of economics, the agricultural economist must confine himself either to simulating the "no policy" situation by using a model of reality or comparing this sector with others where the policy in question did not apply but where the other influences nevertheless developed a similar effect. An example of the latter approach is a study by von Urff and Weinmüller, who based their examination of the Community's foreign trade in farm products on a differentiation between those that are subject to import levies and those that are not.² The study found that net EC imports from non-member countries consisted only of non-dutiable agricultural products not produced in the Community or which are produced only in small quantities or in certain seasons. These included in particular fruit and vegetables, coffee, tea, cocoa, spices and oil seeds. In the case of "hard" market organisation products, on the other hand, by 1981 the Community was already recording net exports

of more than ECU 6.3 billion, compared with net imports of around ECU 2.5 billion as recently as 1975. The authors of the study blame this dramatic reversal in trade flows in dutiable agricultural products primarily on the system of import levies and export subsidies under the EC's agricultural policy.³

In analysing the external effects of the common agricultural policy, the alternative approach is often chosen, namely modelling. The situation with the policy is then compared with that without it and conclusions are drawn as to the direction and intensity of the effects generated by official intervention. The remarks that follow focus in particular on studies of this type.

Effects of Levies and Subsidies on Price Levels

If a country imposes levies on agricultural imports and pays subsidies on agricultural exports, the products involved become more scarce in the internal market and as a rule the price will rise. As a result, domestic demand is dampened, domestic supply stimulated, imports curbed and exports expanded. The more elastic the reaction of supply and demand to the policy intervention, the more pronounced will be the volume effects. If a trade policy of this kind is applied by a small country, it has no impact on the level of prices in the world market. In the case of a large country or group of countries such as the EC, by contrast, a change in the volume of trade also induces an adjustment in the world market price. Import levies and export subsidies depress world market prices, because the artificial distortion of trade flows makes the goods less scarce outside the EC. This price reduction effect is all the greater the more elastic are supply and demand in the EC, the more inelastic are supply and demand outside the Community and the higher the levies and subsidies in relation to the world market price. Empirical studies have been made of this aspect with regard to a number of products,⁴ although in many cases they have approached from the opposite direction by calculating the rise in world market prices that would result from partial or complete liberalisation of the Community's system of agricultural protection. For example, Koester calculates an increase of 9.6 % in the world market price of wheat, while Koester and Schmitz obtain an average increase of 12 % in a comparable model for the sugar market.⁵ Particularly large increases in the prices of dairy products could be expected, such as an increase of about 28 % for butter.⁶

It is not solely agricultural protection within the EC that is depressing the world market prices of many agricultural products; they are also being affected by the trade policies of other industrial countries,⁷ some of

² W. von Urff, E. Weinmüller: Außenwirtschaftliche Aspekte der EG – Agrarpolitik, in: H. Priebe, W. Scheper, W. von Urff: Agrarpolitik in der EG – Probleme und Perspektiven, Baden-Baden 1984, pp. 125 ff.

³ Ibid., p. 129.

⁴ Cf. A. Valdés, J. Zietz: Agricultural Protection in OECD Countries: Its Cost to Less-Developed Countries, Research Report 21, International Food Policy Research Institute, Washington 1980, p. 46; T. E. Josling: Developed-Country Agricultural Policies and Developing-Country Supplies: The Case of Wheat, Research Report 14, International Food Policy Research Institute, Washington 1980, pp. 25 ff.; S. Tangermann, W. Krostitz: Protectionism in the Livestock Sector with particular Reference to the International Beef Trade, in: Göttinger Schriften zur Agrarökonomie, No. 53, Göttingen 1982, pp. 19 ff.; U. Koester: Policy Options for the Grain Economy of the European Community: Implications for Developing Countries, Research Report 35, International Food Policy Research Institute, Washington 1982, pp. 27 ff.; U. Koester, P. M. Schmitz: The EC Sugar Market Policy and Developing Countries, in: European Review of Agricultural Economics, Vol. 9 (1982), pp. 185 ff.

⁵ U. Koester, op. cit., p. 28; U. Koester, P. M. Schmitz, op. cit., p. 190.

⁶ See also U. Koester: Internationale Aspekte der EG-Agrarpolitik, in: Agrarwirtschaft, Vol. 33 (1984), p. 237.

⁷ Examples for the beef market are to be found in P. M. Schmitz: Instability Effects of Non-Tariff Trade Barriers on World Beef Markets, in: Quarterly Journal of International Agriculture, Vol. 23 (1984), No. 2, pp. 119 ff.

which use similar instruments (such as Scandinavia) and some of which adopt a different approach (such as export credits and countercyclical import quotas in North America). Nevertheless, there can be absolutely no doubt that the EC has built up the highest average level of protection in the world, measured in terms of nominal protection rates, and therefore bears a substantial part of the blame for the depression of prices on the world market. However, any assessment from the point of view of non-member countries would be incomplete without first examining a further aspect.

Price Stability Effects

The establishment of variable import levies and export subsidies considerably narrows the scope for price fluctuations within the EC itself. Internal prices can only move in the narrow band between intervention prices and threshold prices, with the result that changes in scarcity on the world market do not lead to price adjustments within the Community. This artificial price stability in Community markets in turn triggers reactions on the part of market participants. In particular, the cost of the risk borne by suppliers decreases, as there is less need to spread the risk by diversifying production. The intensity and specialisation of production therefore increase and the stabilisation of internal prices generates a further incentive to raise production in addition to the stimulus provided by price support. This dual effect has undoubtedly contributed greatly towards the production of surpluses in the EC.

Like price support, price stabilisation in the EC naturally also has repercussions on international markets in agricultural goods, although the link between trade restrictions and price uncertainty in the world market is not as simple⁸ and clearcut as in the case of the price level. Despite this, literature on the subject has long relied exclusively on the elasticity argument, whereby the price-stabilising delinking of one part of the market leads to a reduction in the elasticity of demand and supply in the remainder of the market, so that autonomous fluctuations in supply and demand cause

sharper price movements in this remnant than they would in integrated markets. According to this argument, the world market price is therefore undoubtedly destabilised as a result of the Community's foreign trade policy. In reality, however, it is not solely the level of elasticities or changes in them that determine the result of such a policy of delinking but also a series of other factors which influence the outcome in widely differing ways:⁹

- ☐ the choice of the instrument of protection,
- ☐ the level of protection,
- ☐ the protectionist country's shares of production and demand,
- ☐ the nature of stochastic disturbances (additive, multiplicative),
- ☐ the origin, scale and distribution of stochastic disturbances,
- ☐ the correlation of disturbances,
- ☐ substitution effects on the supply and demand sides,
- ☐ the way in which price expectations are formed,
- ☐ differences in the level of information of market participants,
- ☐ adjustments in the behaviour of private holders of stocks,
- ☐ the form in which public stockpiles are held.

Hence, in theory at least it is not possible to make a clear pronouncement about the influence of EC agricultural policy on stability on the world market, but empirical studies suggest¹⁰ that its destabilising effects outweigh its stabilising effects. Apart from the elasticity argument, two aspects in particular militate towards that conclusion:

- ☐ First, delinking the EC market through the stabilisation of internal prices destroys the incentives for the private sector to hold stocks and engage in futures transactions within the EC. Possible additional stockpiling by foreign stockholders, particularly in developing countries, cannot as a rule fully offset the loss of domestic stockpiling because of the higher

⁸ Cf. D. M. G. Newbery, J. E. Stiglitz: *The Theory of Commodity Price Stabilization – A Study in the Economics of Risk*, Oxford 1981, p. 274.

⁹ Regarding the steps towards these conclusions and their impact, see P. M. Schmitz: *Handelsbeschränkungen und Instabilität auf Weltagrarmärkten* (Weltwirtschaftliche Studien des Instituts für Europäische Wirtschaftspolitik der Universität Hamburg, No. 21), Göttingen 1984, pp. 29-81; cf. also M. D. Bale, E. Lutz: *The Effects of Trade Interventions on International Price Instability*, in: *American Journal of Agricultural Economics*, Vol. 61 (1979), No. 3, pp. 512-516; S. J. Turnovsky: *The Distribution of Welfare Gains from Price Stabilization: A Survey of some Theoretical Issues*, in: F. G. Adams, S. A. Klein (eds.): *Stabilizing World Commodity Markets*, Toronto 1978, pp. 126 ff.

¹⁰ P. M. Schmitz, U. Koester: *The Sugar Market Policy of the European Community and the Stability of World Market Prices for Sugar*, in: A. H. Sarris, A. Schmitz, G. G. Storey (eds.): *International Agricultural Trade – Advanced Readings in Price Formation, Market Structure and Price Instability*, Boulder 1984, pp. 243-259, and P. M. Schmitz: *The Common Agricultural Policy and Instability on World Food Markets*, in: K. J. Thomson, R. M. Warren (eds.): *Price and Market Policies in European Agriculture*, Proceedings of the 6th Symposium of the European Association of Agricultural Economists, 14-16th September 1983, Newcastle upon Tyne 1984, pp. 323-331.

marginal costs involved. For that reason and on account of the narrowing of the futures markets, the realised carry-over volumes in the world market diminish and trade restrictions in the form of variable import levies and export subsidies destabilise the world market. This aspect lends powerful support to the traditional view.

□ Secondly, an analysis of the EC cereals market¹¹ has shown that stockpiling by state agencies in the EC has also had a destabilising effect, because fluctuations in Community production have been partly externalised and the official agencies' carry-over policy has not been geared towards the cereal futures market and to price differentials on the world market. It is not improbable that such a state stockpile policy will be applied to other EC products in surplus, so that this too has a destabilising effect on the world market.

A study of the beef market¹² that takes the most important of these arguments into consideration comes to the conclusion that liberalisation of the EC beef policy would reduce the degree of price instability on the world market by between 14 and 22 %.

Effects on the Structure of Prices

Widely differing values are obtained if one calculates and compares the nominal protection rates afforded to EC farm products, that is to say the difference between internal and world market prices in relation to the world market price. A comparatively high level of protection has been built up for dairy products, sugar, beef and cereals, whereas relatively low rates apply to fruit and vegetables, vegetable fats and animal feed high in protein and carbohydrates, for example. This distortion of the internal price structure has diverted factors of production to the highly protected parts of agriculture,

where they have caused surpluses; less protected sectors show deficits that must be offset by increased imports from non-member countries.

The counterpart to this price distortion is to be found in the world market, though with the signs reversed. Here the prices of dairy products, sugar, beef and cereals fall in relative terms while those for other products with low Community protection rates rise. For example, cereals production becomes less advantageous for the poorer developing countries, whereas the export of animal feed increases in importance. In extreme cases, entirely new markets may develop, such as the world market in tapioca, which consists almost exclusively of Thailand's exports to the EC. On the other hand, regional markets may disappear altogether as a result of a protectionist policy. For example, this would be the case if the exporting country's transport, marketing and insurance costs were no longer covered owing to artificially low world market prices. This appears to apply to many countries in Africa. Hence, the impact of the Community's agricultural policy on the structure as well as on the level and stability of prices is to blame for the distortion of world trade flows and the fact that as a consequence the advantages of the international division of labour cannot be fully exploited.

Evaluation through the Eyes of Non-members

An evaluation of the common agricultural policy from the point of view of non-member countries must be based on all three price effects. However, it is the effect on the level of prices that is often given prominence; within the framework of applied welfare economics, policy-induced price reductions on the world market mean losses in producer surpluses and increases in consumer surpluses, provided corrections in world market prices are also allowed to apply in the internal market. A country that exports goods both before and

¹¹ Cf. U. Koester: Policy Options..., op. cit., pp. 53 ff.

¹² Cf. P.M. Schmitz: Handelsbeschränkungen..., op. cit., p. 125.

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after the introduction of EC protection therefore suffers a welfare loss as a result of the artificially low world market prices. By contrast, a country that was already importing goods before the introduction of external protection by the EC will reap a welfare gain. This supposed advantage for importing countries is not unqualified if one assumes, as is in fact the case, that many countries that are now importers were themselves traditionally exporters before the introduction of farm protection by the EC and many other industrialised countries. In these circumstances, it is highly probable that the loss in producer surpluses outweighs the gain in consumer surpluses, so that even countries that are now importers have suffered a net welfare loss as a result of the Community's policy.

This line of argument is strengthened if one also considers the effect on price stability. If it is assumed that price risks on the world market adversely affect the welfare of the trading nations owing to risk aversion and the danger of the misallocation of resources, both exporting and importing countries must be expected to suffer a welfare loss as a result of the policy's impact on price stability. This effect is far from insignificant,¹³ and if it is ignored it can distort the evaluation, especially as far as importing countries are concerned.

Finally, account must also be taken of the effect on the price structure, which distorts the patterns of production and consumption in the non-member country in question. As can be demonstrated easily in the two-product case with the aid of production possibility curves and indifference curves, a change in world market price ratios induced by the EC leads to an overall welfare loss for the country, irrespective of whether the goods in question are imports or exports if only this effect is considered. Hence, when all three price effects are taken into consideration, the frequent assertion that importing countries would automatically benefit from an EC price support policy needs to be modified. There are even grounds for holding that both exporting and importing countries are among the losers.

In reply, it is occasionally argued that non-member countries, and especially developing countries, are unaffected by changes in the world market induced by EC policies, since their own trading policies shield their

internal markets. This is indeed true, to a greater or lesser extent. For example, many developing countries hold domestic prices below the world market level by levying export taxes and the marketing boards often pass only part of any price fluctuations on to producers, if at all. Price level, stability and structure effects in the world market do not therefore necessarily affect producers and consumers. However, these effects do not simply disappear; on the contrary, they are fully reflected in the country's government budget or balance of payments, so that they are merely transferred to other market participants. It may be that the cost of market adjustment (such as the cost of hedging risks) works out less than if the domestic market were fully integrated, but in principle the above statement continues to apply: agricultural protection by the rich industrial countries, with the EC in the van, reduces the welfare of the rest of the world. With this alternative view, there are changes in export earnings, import expenditures, export duties and import subsidies instead of changes in producers' and consumers' surpluses.

A final counterargument is that the EC has concluded a series of preferential trade agreements with developing countries and hence contributes to increasing their welfare. Indeed, evidence of such gains can be found for individual countries, one example being the sugar and beef protocol¹⁴ under the Third Lomé Convention with the countries of Africa, the Caribbean and the Pacific (the ACP countries). Nevertheless, the EC's perfect export subsidy system ensures that additional, preferentially treated imports from ACP countries are re-exported, so that roundabout transactions arise and the potential downward pressure on prices is diverted from the EC market to that of the rest of the world. First, this needlessly ties up valuable transport resources and secondly all countries that do not enjoy preference suffer discrimination to the benefit of those that do.

In addition, most EC preferential trade agreements are subject to time limits and volume quotas, so that a true opening of markets does not occur at all, or the preferential margin is so small that exporting to the EC is often not worthwhile for the developing countries. Besides that, potential exporting countries are also rather hesitant because the political risk is considered to be too high. Who will guarantee the developing countries that the Community will not suddenly close a particular export market altogether by invoking the so-called safeguard clauses? Long experience with the behaviour of the EC in international agricultural trade has taught many trading partners caution, in particular the poorer developing countries. Furthermore, there are

¹³ On the significance of the so-called risk benefits, cf. *ibid.*, pp. 130 ff.

¹⁴ Cf. U. Koester, P. M. Schmitz: The EC Sugar Market Policy . . . , *op. cit.*, p. 199; and P. M. Schmitz: European Community Trade Preferences for Sugar and Beef, in: Deutsche Forschungsgemeinschaft and Institut für wissenschaftliche Zusammenarbeit mit Entwicklungsländern (eds.): Recent German Research in International Economics – Special Research Program 86, Hamburg/Kiel, Chairman: H. Giersch, Bonn and Tübingen 1984, pp. 108 ff.

historical factors behind most preferential trade agreements and analysis of their transfer effects shows that the richer countries in the recipient group are often given privileged treatment. In some cases, therefore, EC preferential trade agreements may indeed produce welfare gains,¹⁵ but overall they cannot offset the disadvantage for non-member countries created by EC protection. Preferential trade agreements are also problematic from the point of view of resource allocation, as they discriminate not only between recipients and non-recipients but also between countries within the recipient group.

External Effects of Internal Market Organisation

Less attention is often paid to the external effects of purely internal system of market organisation than to foreign trade arrangements, even though internal market arrangements established by a large country undoubtedly also impinge upon the world market and hence on other countries. Let us briefly examine three examples of this.

The reform of the EC's agrimonetary system at the beginning of the 1984-85 financial year passed largely unnoticed by the Community's international trading partners. As a result of the reform, positive monetary compensatory amounts will no longer be built up within the Community; only negative amounts for countries devaluing their currency will be allowed. This will be achieved by adjusting the central rates of all member currencies upwards in line with the rate of appreciation of the strongest currency and declaring these to be the so-called green central rates. The harmonisation of prices within the Community, which continues to be a desired objective, will therefore necessarily take place at this higher level. In effect, this means setting common prices in Deutsche Mark instead of ECUs. Every revaluation of the DM within the EMS therefore provides all other member countries with potential scope to raise their prices, an opportunity which experience suggests will not be missed. This mechanism remains effective even if common prices in ECUs are frozen or even slightly reduced. Non-member countries should therefore pay greater heed to the Community's agrimonetary system than hitherto.

The following quantification on the basis of a two-stage econometric model of the world sugar market¹⁶

¹⁵ On the identification of the conditions necessary for a welfare gain as a result of preferential trade agreements, see *ibid.*, p. 125.

¹⁶ A detailed treatment of the model is to be found in R. Hermann, P. M. Schmitz: *Stabilizing Producers' Revenue by fixing Agricultural Prices within the EC?* in: *European Review of Agricultural Economics*, Vol. 11 (1984), No. 4, pp. 395-414.

Table 1
Internal and External Effects of Different Agrimonetary Systems following Exchange Rate Changes within the European Monetary System: the Example of the Sugar Market
(percentages)¹

	Old system ²	New system ³
EC supply ⁴	1.8	6.4
EC demand ⁴	-0.1	- 4.2
EC surplus ⁴	7.2	28.8
EC price ⁵	4.5	16.1
Burden on EC budget ⁶	9.6	40.3
World market price ⁷	-3.6	-14.3
Export earnings of developing countries ⁸	-4.2	-16.4

¹ Measured as the percentage deviation from reference date (1982-83) before exchange rate changes. ² Old agrimonetary system without taking account of MCAs. ³ New agrimonetary system without taking account of MCAs. ⁴ Calculated from actual exchange rate changes between 1980 and 1983 and on the basis of uniform supply elasticities of 0.4 and demand elasticities of -0.3, using volumes for the 1982-83 sugar year as initial data. ⁵ Average price rise without raising common prices in ECUs, weighted in accordance with national production shares. ⁶ On the basis of 1982 price differentials: EC intervention price \$480 per tonne, world market price \$185 per tonne, calculated in both cases in white sugar equivalents and taking terms of trade effects into account. ⁷ Calculated on the basis of a two-stage econometric model of the world market (see footnote 16 in the text). ⁸ Calculated from data contained in the FAO Trade Yearbook and on the basis of the price effect on the world market.

Source: Calculations by the author on the basis of data from FAO: Trade Yearbook 1982, Rome 1983; Statistical Office of the European Communities: Crop Production, No. 3, Luxembourg 1984; Deutsche Bundesbank: Die Währungen der Welt, Series 5, No. 4, Frankfurt 1984.

may underline the point (see Table 1). With the same exchange rate adjustments, the new system would have raised internal prices by about 16 %, compared with 4.5 % under the old system, in each case excluding monetary compensatory amounts. This would have led not only to larger Community surpluses, but also higher associated budget costs. The corresponding external effects are therefore already clear. World market prices and developing countries' export earnings would both have fallen much more sharply under the new agrimonetary system. If it is assumed that similar exchange rate adjustments within the European Monetary System will also be made in future, this external effect should on no account be ignored.

This is particularly important in the light of the supposed alleviation of the world market through the introduction of guarantee thresholds for certain surplus products (e.g. cereals) and production quotas for milk. Advocates of the Community's agricultural policy like to interpret both innovations as the first steps towards dismantling protectionism and hence as a contribution

¹⁷ For an assessment of guarantee thresholds, see S. Tagermann: *Guarantee Thresholds: A Device for Solving the CAP Surplus Problems?*, in: *European Review of Agricultural Economics*, Vol. 11 (1984), No. 2, pp. 159-168.

to the balanced development of world trade. However, closer scrutiny of the two instruments shows that there are grounds for doubting this assessment.¹⁷

Under the guarantee threshold arrangement, the "normal" rate of price increase is automatically cut, in most cases by a maximum of 5 percentage points, when production exceeds a given level. However, the "normal" rate of price increase is decided by the Council of Ministers, which will fix it such that the desired result is achieved after taking the cut into consideration. Moreover, the latest price negotiations for the 1985-86 budget year have demonstrated clearly that this supposed regulatory mechanism has no real binding force. It is also defective in that it applies only to products in surplus and is based on the wrong criterion. If the aim is to involve foreign trading partners in a process of market adjustment, steps must be taken to ensure that the price differential between internal prices and world market prices in both import and export markets does not widen and is narrowed if possible. It is this price differential alone that determines the loss in total welfare as a result of the Community's agricultural policy.

The Community also claims that milk production quotas will ease the world market. Here too, however, expectations should not be set too high. Experience with the organisation of the sugar market, which has included quotas from the outset, shows that production quotas cannot prevent the creation of unsaleable surpluses, heavy budget commitments and the disposal of sugar surpluses on the world market by paying massive export subsidies. The restrictive effect of production quotas and their beneficial impact on the world market are overestimated, for four main reasons. First, experience has shown that such systems become increasingly riddled with exceptions for cases of hardship. Secondly, there is invariably an increase in the willingness of politicians to offset the income effects of volume constraints by pursuing an active price policy. This accelerated rise in prices under a system of quotas further dampens demand and therefore exacerbates the problem of the surplus. Thirdly, farmers switch to other forms of agriculture, thereby shifting the problem of surpluses to other markets. Fourthly, in accordance with the internal logic of production quotas, limits are often extended to foreign supplies as well, in other words imports from non-member countries; the sugar market provides a clear example in this respect too.

Import restrictions then cancel out any easing of world market conditions that might result from restricting internal supply, in that trade is diverted away from the Community. Non-member countries should therefore

not set too great store by the supposedly positive external effects of guarantee thresholds and production quotas.

The importance of the EC in international agricultural markets has grown steadily since the establishment of the Community. Nevertheless, agricultural policy is essentially inward-looking and pays little heed to the external effects it engenders. This article attempts to show that the use of import levies and export subsidies as instruments of foreign trade policy tends to depress world market prices, increases their volatility and artificially distorts the price structure in the world market. Barring a few exceptions, this tends to reduce the welfare of non-member countries. Countries that have traditionally been importers of agricultural products may be regarded as the exception, although it has been shown that if account is taken of all three effects on world market prices (level, stability and structure), it is perfectly possible for these countries to suffer a welfare loss as well.

Granting preferences to developing countries makes no fundamental difference to this adverse assessment. In individual cases there may be a short-term welfare gain, but the terms of these preferential trade agreements prevent a true opening of markets over the long term and also have a discriminatory effect.

Systems of internal market organisation are often paid too little heed by non-member countries. The reform of the agrimonetary system is an example in this regard. In fact, it is having inflationary effects on the internal EC market and protection is being increased permanently, to the detriment of non-member countries. This mechanism continues to operate even if common prices in ECUs are frozen or reduced. Expectations that guarantee thresholds and production quotas will alleviate problems in the world market appear to be exaggerated.

The Community's agricultural policy therefore conflicts with Article 110 of the Treaty establishing the European Economic Community, which calls for the Community to make a contribution to the smooth growth of world trade and to the gradual removal of trade restrictions. Continued pursuit of this policy means foregoing the advantages of the international division of labour, may encourage others in their attempts to gain protection and hence hasten moves towards worldwide agricultural protectionism and may ultimately jeopardise the Community's crucial exports of high-value industrial goods and services. Agricultural policy should also take this into account and should therefore accord with overall economic policy.