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# EC Agricultural Policy and International Trade

by Eckart Guth, Brussels\*

**The world markets for agricultural products are in a state of crisis. This is manifested in phenomena such as record surpluses, falling incomes for farmers and constantly increasing agricultural expenditure in a number of industrial countries while, at the same time, people go hungry in many developing regions. What are the factors which have brought this situation about? What can be done to solve these problems?**

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For decades, the European Community's Common Agricultural Policy has largely been moulded by material and political compulsion within the Community. In the initial stages, priority was given to expanding common market organisations, the development of EC agricultural structural policy only following after some delay. On top of that, before it proved possible to fully consolidate what had already been achieved, especially in the case of agricultural policy, the Community had to cope with its enlargement from six member countries to twelve. At the end of the 1970's it became increasingly apparent that the Community had reached the limits of its ability to finance its agricultural policy. Undreamed-of technical progress together with agricultural pricing policy facilitated an expansion in EC farm production which, for a long period of time, could be disposed of either on the domestic market or, with the aid of export refunds, on the world market. Thus, during the early 1980's the Community changed from being a net importer to being a net exporter of almost all its major agricultural products, taking up a dominant position in world agricultural trade behind the USA.

Now that the conditions have changed – including declining demand, increasing self-sufficiency among what were previously important purchasers such as India and China, and the worldwide trend for agricultural exporting countries to develop structural surpluses – with the result that world agricultural markets have been plunged into serious crisis, agricultural policy has become a focal point in international discussions.

Former US Agriculture Minister Block posed the question: "What went wrong in the early 1980's?" If one looks at the industrial countries' record surpluses, the

farmers' falling incomes, continual increases in agricultural expenditure in several industrial countries yet, at the same time, hunger in a large number of developing regions, this is a justified question indeed.

## Causes and Symptoms of the Crisis

The situation which has been coming to a head since the beginning of the 1980's is attributable to the interplay of a number of factors. The first point which can be ascertained is that the increase in the supply of agricultural produce in all industrial countries has been outstripping changes in demand for some time now. While the substantial progress on the technical side allows increases in agricultural production which had previously been inconceivable, demand in the industrial countries is now only increasing to a slight extent, as consumers are largely satiated and populations are stagnating if not even declining.

The potential demand which certainly exists in numerous developing countries, manifesting itself as famine in extreme cases, frequently goes hand in hand with a lack of purchasing power, with the result that this potential demand can often only be satisfied by means of food aid (emergency aid) or by making substantial price concessions (extremely favourable supplier credit or other special terms). In addition to this the decline in the price of oil has made many petroleum exporting countries – which for years were the industrial countries' best agricultural customers – rather more reticent in buying food.

Other buyers of agricultural surpluses which had long been considered guaranteed customers disappeared from the market because some major developing countries managed to substantially increase their own production during the early 1980's. As part of this development, China and India actually became net

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\* Commission of the European Communities. – The views expressed in the article do not represent the official position of the EC Commission, but are the personal opinion of the author.

exporters of wheat – an achievement which would have been considered impossible even in the early 1970's. A further example showing what can be achieved using technical progress, especially when enough money is available, is provided by Saudi Arabia, another country to join the ranks of the wheat exporters.

To add to the pronounced tensions already bearing upon world agricultural markets, they were subjected to further disruption by the fact that some countries made their willingness to supply produce into a political weapon (US grain embargo against the USSR) while the USSR for its own part, the world's largest grain importer, also coupled its purchasing behaviour to political considerations.

One of the reasons that the shifts in worldwide food demand which were becoming ever more apparent during the early 1980's did not produce any reaction on the supply side is that virtually all industrial countries – albeit to differing extents – shield their agricultural sector from the risks of the world market.

Mainly in order to provide income support for domestic agriculture, but also for the sake of security of supply, maintaining employment and preservation of the cultivated landscape, domestic producer prices for agricultural commodities are supported using government funds. As time has gone on, a whole arsenal of different instruments has been developed (state intervention buying, marketing boards, deficiency payments, export subsidies, import restrictions), all of which to a greater or lesser extent share the unpleasant characteristic that they off-load domestic agricultural problems on to the world market at the cost of third parties. Especially if the countries concerned have a high export dependency together with an internal support price lying well above the world market price – as is the case in the USA and the European Community – this process of off-loading problems onto the world market is also associated with budgetary burdens which are difficult to hold in check. For the latter reason alone the EC has a vital interest, in its current position as a net

exporter, in seeing that the international trading rules are improved.

Even though one would occasionally gain such an impression from the international press, the European Community is not in fact the only offender in world agricultural trade. The reality of the matter is that practically all industrial countries pursue agricultural policies leading, to a greater or lesser degree, to distortions and disruptions in world trade.

Primarily at the insistence of the European Community, the above situation came to be reflected in the declaration to mark the opening of the new GATT round in Punta del Este. Contrary to the original desire of devoting attention primarily to the matter of direct export subsidies, all other forms of agricultural support are now meant to be subjected to critical examination, too, regardless of whether they occur in the domestic market, in connection with imports or with exports.

### **Conflicting Interests**

One of the reasons that the current agricultural crisis is so difficult to deal with is that worldwide interests or, to put it another way, the advantages and disadvantages flowing from any change of course, are very different from country to country.

By far the greatest beneficiary from the confused situation on the world agricultural market is the USSR, the world's largest purchaser of grain, milk products and sugar, which must therefore have an interest in low agricultural prices on the world market. Furthermore, the USSR makes appropriate use of its monopsonistic position when purchasing produce.

The developing countries' interests, on the other hand, must be seen in rather more subtle terms. In view of the extremely low world market prices, some developing countries succumb all too easily to the temptation of neglecting their own agriculture. One reason for this is undoubtedly that cheap food imports

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make it easier to finance ambitious industrial projects. This, however, is a strategy which can prove to be a political timebomb, as has been shown by the rioting which followed increases in the price of bread in Morocco, Tunisia and Egypt. It would serve the developing countries' interests better if they were to develop their own food production within a stable economic and political framework. China and India have successfully followed this track, to the extent that they have even become occasional net exporters of wheat. Food aid, then, ought to be confined to genuine emergency aid and not to become a means used by the industrialised countries to dispose of their surpluses.

On the other hand, though, a large number of developing countries are in a position to export foods and kindred products or indeed are compelled to do so in order to earn the foreign exchange they need to purchase vital imports. Despite the efforts to assist which the industrial countries have indisputably made, these developing countries naturally suffer to a great extent from the low level of world market prices. Among the measures taken by the EC in this regard, one which deserves its own mention is the ACP Agreement and the sugar protocol which forms part of it and allows African, Caribbean and Pacific countries the opportunity to market 1.3 million tonnes of sugar within the Community at EC market prices. Unfortunately, however, in this particular case the Community's efforts are being frustrated by the fact that the USA has steadily cut back its sugar imports in recent years.

Among the hardest hit are the farm sectors in thinly populated industrial and agricultural countries where domestic demand is low and the dependence on exports accordingly high. Australia may serve as an example here: it exports 60 % of its wheat, 50 % of its beef, and 90 % of its sugar output. Although countries such as Australia, New Zealand, Canada and Argentina also do not entirely renounce the provision of state support, the farmers in these countries do have to rely on their own competitiveness as regards the major export products, which they have to be able to offer at prices approaching world market levels. It will therefore be immediately apparent that both farmers and governments in these countries have a prime interest in a liberal system of international agricultural trade and in stable world market prices.

To ensure that they would not forfeit any chance for themselves right from the outset in the dispute between the giants in agricultural trade – the USA and the EC – 14 agricultural countries, including Australia, New Zealand, Argentina and Brazil, but also others such as Thailand and Hungary, recently joined together to form what is

known as the Cairns Group. Despite the group's heterogeneity, it is held together, for the time being, by the overriding common interest in a liberalisation of agricultural trade. The Cairns Group first began to play a part at the opening of the new round of GATT negotiations in Punta del Este, Uruguay.

In contrast to this, industrial countries such as Sweden, Norway, Austria, Switzerland and Japan are pursuing quite different interests. Although in some cases the level of support they provide is higher than in the USA or the European Community, they do not export their produce, or at least not to any significant extent, and therefore believe their responsibility for the problems in world agricultural trade is only a very limited one. They place special emphasis in international negotiations on the part their agriculture plays in safeguarding food supplies and preserving the environment, and therefore put the case for agriculture being given strictly separate treatment under the GATT.

### **EC and US Dominance**

For some years now, the European Community's large agricultural surpluses have increasingly made it the main target for criticism from the classical agricultural exporting countries. Nevertheless, this criticism has recently also been directed against the USA which, to a growing extent, is seeking to regain its former share of world markets with the aid of export subsidies.

The EC and the USA stand accused of competing unfairly against countries such as New Zealand, Australia, Argentina and Canada by means of subsidised exports, of depriving those countries of market share, and of failing to comply with the international rules (as laid down in the GATT). In practice, however, none of the agricultural exporting countries has completely clean hands when it comes to trade policy. On the other hand, there are few exporting countries which have such a formidable involvement in the world markets as do the EC and the USA. Whereas other countries do generally concentrate on those products where they have a competitive advantage (e.g. New Zealand on butter and mutton, Argentina on wheat and beef), the EC exports everything that could be found on a good quality menu, and does so "competitively" thanks to the export refunds involved.

The Community did its best to comply with the rules of the GATT code on subsidies – which admittedly are not very precise or operable – as regards undercutting world market prices and maintaining an "appropriate share of the world market". However, since the USA, with the aid

of its export promotion programme, began quite candidly underbidding current world market prices, the only way of describing the situation on the market is as one of "catch as catch can". Given the tenseness of the situation in agricultural trade, one should not underestimate the danger of such a conflict spreading into general economic and political relations between the USA and the European Community. Both sides have a vital interest in avoiding developments of this kind.

There are a number of products where the USA and the Community occupy such a dominant market position that any further increase in export volumes would only exacerbate the fall in world market prices and hence ruin their own export markets. The Community, for example, has learned to its cost that extremely high market shares are difficult to maintain when world market demand is in decline – this is borne out by the EC's market shares in skimmed milk powder (58 % in 1980, 26 % in 1986), butter and butter oil (63 % in 1980, 46 % in 1986), and full-fat milk powder (73 % in 1980, 62 % in 1986).

In the post-war period and on into the 1970's, the USA played such a dominant part on the world's agricultural markets, particularly in key products such as grain, flour and animal feed, that the domestic American price level and the world market price level were identical. In the late 1970's and early 1980's, however, the USA had to relinquish part of its predominant position on the world market. The high value of the dollar in conjunction with prices within the USA which were pegged too high meant that US exports became less and less competitive. When this effect was added to by political decisions (the US grain embargo against the USSR) and by growing competition from other exporting countries (Argentina, Australia, Canada and the EC), the USA eventually lost world market share to a painful extent (US share of world wheat exports in 1975/76 approx. 50 %, in 1985/86 approx. 30 %).

In view of the USA's record trade deficit at present, this is a trend which must inevitably cause alarm. With its latest agricultural legislation, the USA has attempted to halt the trend and to regain world market shares. With this aim, it has reduced the support level, largely compensating for farmers' income losses by way of deficiency payments. In extreme cases, this allows US farmers to receive payments of up to \$ 250,000. In parallel to this, the USA is taking recourse to export subsidies, some of which are aimed deliberately and on a large scale against European Community exports.

In addition to those areas where the USA is trying to regain its competitiveness on the world market, there are other markets such as those for sugar, beef and

dairy produce where the USA is practically delinking itself completely from the world market and thus maintaining high domestic prices.

For its own part, the Community has evolved from being a net importer to a net exporter in all important agricultural product areas. After the USA, it is now the world's second largest food exporter. At the same time, the EC remains the largest food importer. One of the main import fields concerns products the Community is unable to produce itself, such as tea, cocoa, coffee and bananas. However, the EC also imports commodities which, although it does not produce them itself, at least not on a large scale, are nevertheless in close competition with EC products. This category primarily includes vegetable oils and fats – the raw material for margarine which competes with butter – and grain substitutes such as manioc and corn gluten feed, which displace domestic grain in the feed market. The question therefore arises as to why suitable measures are not taken to curb these imports to create more room for domestic produce.

A case in point which shows clearly that this is no simple solution is the import of grain substitutes the price of which is substantially below EC market prices for forage grain. During GATT negotiations in the 1960's the Community had declared itself willing to bind the customs duties applicable to proteins and grain substitutes at a relatively low level or at zero, due to the high import demand then existing for protein-bearers such as soya. In return for this the Community was granted the opportunity to provide external protection for what were considered important traditional EC agricultural products such as milk, beef, sugar and grain, in the form both of refunds and of variable levies. It ought to be immediately apparent that any increase in external protection today, in the case of grain substitutes for example, could again only be introduced on the basis of negotiations with the other GATT signatories. It is self-evident that whatever increased protection is achieved in one product area must be compensated for by concessions in other product areas.

### **An International Approach**

The paradoxical situation in which abundance in the industrial countries can go hand in hand with hunger in a number of developing countries is undoubtedly another spur to critical reflection on the future of world agricultural trade. For example, it cannot be taken as a sign that the system of agricultural trade is functioning well if a developing country like the Sudan exports the greater part of its millet harvest to the EC, and then

imports subsidised wheat from the USA to replenish the shortfall.

The new GATT round which got under way last autumn will provide the opportunity to tackle the most burning issues in international agriculture and the trade in its products. Immediate priority will need to be given to an orderly reduction in structural surpluses. The reforms already introduced in various industrial countries will have to be continued more intensively. In this regard, joint efforts on an international level can help prevent the sale of surpluses on the world market from occurring to the one-sided disadvantage of individual third countries. A positive example of such a process is the EC's cooperation with the most important exporters of dairy produce in the international milk agreement.

Following a long period during which a number of third countries had tried to place the sole responsibility for all problems at the European Community's door, a more sensible political and economic line has been asserting itself on an international level for several months now. Thanks to the preliminary work done by the OECD, to the coordinated efforts discussed at two world economic summits (Tokyo, Venice) and to the initiation of the new GATT round, the industrial countries are now generally agreed amongst themselves that they all carry a share of the responsibility for allowing the current problems to develop, and that all should therefore join together in seeking solutions to the present difficulties. In view of their importance on the world agricultural market, the USA and the EC have a special responsibility in this respect.

The degree of success achieved in the sphere of agricultural trade during the new GATT round will have to be measured in terms of the objectives formulated in the final declaration at Punta del Este. The stated aims are

- ☐ to improve access to the agricultural markets,
- ☐ to improve discipline in the use of direct and indirect subsidies affecting agricultural trade and
- ☐ to reduce the disadvantageous effects of sanitary and phyto-sanitary measures to a minimum.

With its most recent proposal, that all support and assistance measures having any effect on production levels should be eliminated over a period of ten years, the USA has reached out far beyond the objectives laid down in the Punta del Este declaration. How far the USA will succeed in making these aspirations a reality is a matter which will have to be left for the future to show.

Hopefully the political will which was expressed in the Punta del Este final declaration will be sufficient to

create a healthier basis for agricultural trade in the future. Over the years, the European Community has come to occupy such a dominant position in the world's agricultural markets that it simply must have an interest in improving the system of world agricultural trade, even on the strength of intra-Community farm policy considerations alone. This is quite apart from the superordinate interest the EC has in a properly functioning system of world trade.

### **Rethink Essential**

The crisis in the world agricultural markets demands that the industrial countries rethink their agricultural policies. More than ever before, the situation on the international market prohibits the misuse of agricultural exports as a safety valve for the industrial countries' domestic agricultural problems. The world markets for agricultural products will continue to be subject to pronounced fluctuations in the future, both in price and in quantity, so to orient agricultural policy to these markets is invariably associated with high financial risks. If, on top of this, the domestic price level is far removed from the world market price and the export volume is high, then the use of public funds to fully absorb export risks – e.g. by way of export subsidies – is subject to unpredictable fluctuations, and it therefore becomes ever more difficult to reconcile such a policy with the objectives of orderly budgeting and achieving healthier levels of public spending. This problem, which primarily faces the EC and the USA, can be alleviated either by raising a levy from producers and/or consumers to fund the expenditure involved in supporting exports (as in the case of sugar) or by narrowing the gap between the domestic price level and the world market price. Since a reduction in the level of support will have some effect on production trends and hence on exports themselves, this also reduces the pressure on world market prices.

Obviously, the upward shift in the world market price level will be all the stronger, and hence the burden of adjustment for individual countries all the lighter, the more countries are prepared to take such a step simultaneously. It is therefore well understood that it is in the Community's interest, but also that of the other agricultural exporters, that international cooperation should be intensified.

Via the reform of EC agricultural policy which is already under way and will undoubtedly be continued, the changes which have occurred in external economic conditions will inevitably have a direct effect on farming in the Community. How those in the agricultural sector will be able to respond to this challenge depends to a

large extent on the initial economic, natural and structural conditions.

In European agriculture, which continues to be very heterogeneous, the compulsion to make structural adjustments can be expected to generate noticeable shifts in production. The burden of adjustment will be felt especially keenly in those locations, and those member countries, where the natural and economic preconditions are relatively unfavourable. Both agriculture and trade will have to be prepared for the fact that, as more limits are placed on the struggle for world market shares by the Community's budgetary situation and the tightening of international rules, the struggle for market shares within the Community will break out all the more strongly.

When it comes to the question of the extent to which agriculture should then also be maintained in less favoured locations, purely economic considerations will become less significant. Regional, social and environmental considerations will have to be accorded a

greater priority than they received in the past. The discussions now taking place on an international level do give express recognition to these special tasks which fall to the farming community in many industrial countries. Equally, however, a very clear demand is being made that whatever support the farming sector receives for the fulfilment of such goals must be granted in a form which has as little effect as possible on production and trade in the agricultural sphere. Agricultural policy therefore faces the task of re-examining those instruments which have so far been primarily oriented towards market policy goals, and of supplementing these with appropriate instruments in the fields of regional, social and environmental policy.

In its agricultural policy reform proposals, the European Community is taking account of the changed working conditions for trade and agricultural policy. What matters now is that the remaining parties involved refrain from just sitting back and waiting for the effects of the EC reforms to materialise. The problems are too great to be overcome by one party alone.

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