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Monika Hartmann*

Old Wine in New Bottles: Agricultural Protectionism in the EC

Intensified efforts have been made in the EC in recent years to close the open flanks of its agricultural trade policy. The advocates of this not only believe that an import substitution policy will solve the problem of surpluses, the budget crisis and the grave income problems in the agricultural sector, but also see it as an opportunity to reduce the widespread price and trade distortions. Are these hopes justified?

Agricultural protectionism has been at the centre of international political discussions during the Uruguay Round. The objective of these negotiations is to reduce the massive distortions prevailing on the world's agricultural markets. Especially the USA and the Cairns Group, composed mainly of developing countries, have been pressing for a far-reaching liberalization of those markets. On the other hand, the European Community is only prepared to accept a relatively moderate reduction in the high level of protection afforded to the core commodities of the Common Agricultural Policy (CAP). Moreover, it has linked this "concession" to the demand that external protection should be increased for a number of products where the EC has a trade deficit. Increasing problems with surpluses and the Community budget in the last few years had already been strengthening the tendency to close the open flanks of agricultural trade policy in order to be able to substitute EC products for imports. Up to now, however, the consolidation of tariffs in the GATT severely restricted the leeway available to the Community for trade policy interventions. The EC has now been demanding during the Uruguay Round a removal of these GATT bindings. However, the traditional agricultural exporters are not in the least inclined to yield to that demand. This issue played no small part in the fact that negotiations collapsed "for the time being" in December 1990.

However, the import substitution strategy is a matter for controversial debate not only in the international arena but also within the EC itself. Its advocates not only believe that an import substitution policy will solve the problem of surpluses, the budget crisis and the grave agricultural income problems but also see it as an opportunity to reduce the widespread price and trade distortions in the agricultural sector. The critics do not share such optimism. They suspect that the policy will serve only to shift the EC's

pressing internal problems elsewhere, possibly concealing them in the short term but not truly solving them. Beyond that, they realize that this reform proposal implies a new wave of protectionism, distortions and welfare losses, warning that the strategy could bear serious consequences for the Community and world trade.

Given these conflicting views, it is appropriate to examine the import substitution approach more closely. This article will therefore sketch out the historical background to the renewed policy of import substitution for agriculture in the EC, illustrate the complexity of the problem using in particular the EC feedstuff market as an example, and finally give an economic assessment of this approach which is favoured among politicians.

Historical Background

The strategy of import substitution is not new to the agricultural sphere in the EC. Ever since its foundation, the Community has made use of variable levies and other protective measures to impede third countries' access to the EC market while simultaneously encouraging domestic farmers by means of excessively high and also generally stabilized domestic prices. As a result of this policy, the Community has progressed from being a net importer to become a significant net exporter of the most important temperate agricultural products. This *old* strategy, originally conceived of as an import substitution policy, but which later became a very costly policy of export promotion, is the real underlying cause of the *new* import substitution efforts in the EC's agricultural sector. The reason for this is that the agricultural protective wall erected at the time the Community was founded contained a small number of loopholes which were regarded as insignificant at the time. The Community's variable levy system, for example, did not apply to starch- or protein-rich grain substitutes and to oilseeds, as such products were either regarded as insignificant (in the case of starch-rich

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Table 1
Displacement of Forage Grain in the EC "Twelve"

	Forage grain consumption ¹ in 1000 tonnes	Grain subst. imports in 1000 tonnes	Share of grain in mixed feed (%)
1984	90,677	13,613 ²	39.0
1985	88,670	14,655 ²	38.3
1986	84,862	15,042	35.4
1987	81,722	18,258	32.7
1988 ³	82,100	18,300	31.0

¹ Figures are for each financial year. ² EC "ten" only. ³ Estimate.

Sources: EG-Einfuhren an Substituten stagnieren, in: *Agra-Europe*, Vol. 30 (1989), No. 17, pp. 18-20 (Markt und Meinung); Bundesministerium für Ernährung, Landwirtschaft und Forsten: *Statistisches Jahrbuch über Ernährung, Landwirtschaft und Forsten der Bundesrepublik Deutschland*, Münster-Hiltrup, various years.

grain substitutes) or else could only be produced at a very high cost by international standards (oilseeds and protein-rich feedstuffs).¹ The consolidation of tariffs at very low levels for these agricultural products thus seemed an acceptable *quid pro quo* for the toleration of the EC's system of variable levies and price support during the Dillon Round of GATT negotiations.²

The high and in some cases increasing level of protection for the so-called core commodities in the Common Agricultural Policy (CAP) on one side of the picture and the low or indeed zero tariff rates applying to grain substitutes and oilseeds on the other inevitably imply that the price ratios between the two types of produce are seriously distorted. In a sector with such a wide variety of horizontal and vertical interdependencies as agriculture, such distorted price differentials also lead to major distortions in both demand and supply.³ These distortions, the true cause of which lies in the old import substitution policy, have generated demands for import substitution efforts. This connection will be examined in more detail below, with reference to the EC's animal feed market. Following that, the most important measures of the new EC import substitution policy will be described one instrument at a time for other agricultural products.

Renewed Import Substitution in Feedstuffs

During the past decade, grain has increasingly been displaced on the EC feedstuff market by imported products

¹ Cf. H. E. Buchholz: Feed Imports as a Problem of the CAP, in: K. J. Thomson and R. M. Warren (eds.): *Price and Market Policies in European Agriculture*, Newcastle-upon-Tyne 1984, p. 101; H. von Witzke and J. P. Houck: Economic Effects of Possible European Community Market Intervention in Soybeans and their Products, Department of Agricultural and Applied Economics, Staff Papers Series 87-6, St. Paul 1987, p. 1.

² Cf. H. E. Buchholz, *op. cit.*, p. 101.

³ On this, cf. Bundesministerium für Ernährung, Landwirtschaft und Forsten: *Getreidesubstitute*, Schriftenreihe des Bundesministers für Ernährung, Landwirtschaft und Forsten, Reihe A: *Angewandte Wissenschaft*, Issue 307, Münster-Hiltrup 1985, pp. 4 ff.; H. E. Buchholz, *op. cit.*, pp. 101 ff.

such as tapioca, maize gluten feed, citrus pellets and oilseeds. The trend is hardly surprising if one considers that grain receives a relatively high level of protection within the Community whereas protein- or starch-rich substitutes have hardly any. Although these substitutes would not generally be competitive under world market conditions, the politically induced price distortions have allowed them increasingly to push grain, a core CAP commodity, out of Europe's feeding troughs.⁴ This was a trend that only exacerbated the surpluses on the grain market which were already raising serious financial and trade-policy problems, making imported grain substitutes an increasingly sensitive subject in agricultural policy debates. Since the early 1980s, there have been many demands that this "loophole" in EC agricultural trade policy should be closed.⁵ The current GATT round, then, was not the first time the Community had sought to increase trade protection against oilseeds and grain substitutes. However, the EC's room for manoeuvre to intervene in these markets is limited as a consequence of earlier tariff consolidation and there is no prospect at present that the Community's trading partners might be prepared to agree to its "rebalancing" proposals.

The Community thought it had found a way out of this situation by concluding so-called "voluntary" export restraint agreements for manioc, the most important grain substitute in the EC. An agreement with Thailand, the world's largest exporter of manioc, was signed as early as 1982. Similar agreements were later entered into with Indonesia and China. It was just recently that the agreement with Thailand was renewed for a further four years up to 31st December 1994. Nevertheless, the reduction in manioc imports which occurred as a result of "voluntary" self-restraint agreements did not lead to more grain being used for feed as had been hoped (cf. Table 1). Instead, the policy led only to an increase in imports of other grain substitutes which had not had restrictions

⁴ The development has been especially distinct in Germany, the Netherlands and Belgium. The first reason for this lies in the low transport costs for imported feed due to the proximity of major ports, while the second is that the existing monetary compensatory system within the EC leads to a greater implicit price advantage for imported grain substitutes in member countries with strong currencies. Cf. also H. J. Winterling and S. Tangermann: *Economic Implications of Restricting Manioc Trade between Thailand and the EEC*, Kiel 1987, pp. 12 ff.

⁵ On this, cf. also Australian Bureau of Agricultural and Resource Economics: *Some Implications of Rebalancing EC Agricultural Protection*, Discussion Paper 90.5, Canberra 1990, pp. 6 ff.; M. Hartmann and P. M. Schmitz: *EC Agricultural Reform Policy—The Beginning of a New Form of Protectionism*, in: *INTERECONOMICS*, Vol. 23 (1988), No. 4, pp. 157 ff.

⁶ On this, cf. H. J. Winterling: *Eine LP-gestützte Analyse der Tapiokanachfrage der Mischfutterindustrie der BR Deutschland*, in: *Agrarwirtschaft*, Vol. 37 (1988), No. 3, pp. 61-68; A. M. Hillberg: *Limiting EC Grain Substitute Imports: A Simulation Model of the West German Manufacturer Feed Economy*, in: *European Review of Agricultural Economics*, Vol. 13 (1986), No. 1, pp. 43-56.

placed upon them.⁶ Especially imports of maize gluten feed, a by-product of ethanol and isoglucose production in the USA, increased by more than 65% during the period from 1981 to 1988 (cf. Table 2).

However, voluntary export restraint agreements were not the only aspect of the import substitution policy pursued in the EC feed markets. Other past elements of the policy have included substantial grants for the production and/or processing of forage pulses and oilseeds, as well as for the use of skimmed milk powder as animal feed.⁷ The latter measure was simultaneously intended as a convenient way of disposing of the policy-induced dairy surpluses since it was inconspicuous from a trade policy point of view. Yet again, though, the increased use of all these products for feed in the EC produced a boomerang effect, for the measures taken not only led to a relative decrease in imports of protein-rich feedstuffs but also further accelerated the displacement of domestically produced grain from the feeding troughs.⁸

The Community is now understandably carrying out a feverish search for alternatives which would be capable of bringing this displacement process between grain and its imported substitutes to a halt, and if possible reversing it. An idea of this kind which has taken on increasing significance in recent years is the introduction of a premium for the use of grain in the feeding trough. Two such proposals had been put forward by the EC Commission in 1988. Although the Council of Ministers had rejected these at the time because of the large amount of administrative and supervisory work involved,⁹ it asked

the Commission a few months ago to draw up a new proposal on feedgrain which would enable it to reach a decision for the 1991/92 financial year.¹⁰

There has also been a renewed increase in attention given to the fats tax as a possible instrument in recent agricultural policy discussions.¹¹ By imposing a tax on the consumption of margarine and vegetable fats other than olive oil, the European Community would achieve import substitution on two levels at once. On the one hand, it would be hoped that the move would increase butter and olive oil consumption at the expense of demand for imported vegetable fats. Apart from that, the more important expected result would be an increase in the world market price of oilmeal, thus also increasing the competitiveness of grain within the Community.¹²

Current Measures in Other Markets

The above import substitution efforts, which have so far only reached the discussion stage, have triggered off fierce controversies in politics, business and the academic world. In contrast to that, however, there are a number of other measures which seemed less spectacular at the time but which have long since been implemented. These will be discussed below, not according to the markets affected as in the earlier part of this article, but according to the type of measure.

Among the recent trade policy decisions was a further

⁷ Cf. A. Basler: Auswirkungen einer möglichen EG-Importsubstitution bei Futtermitteln auf die Entwicklungsländer, in: *Landbauforschung Völkenrode*, Vol. 37 (1987), p. 164.

⁸ Cf. Getreide verliert weitere Marktanteile an Substitute, in: *Agra-Europe*, Vol. 29 (1988), No. 20, p. 1 (Markt und Meinung).

⁹ Cf. Bundesregierung der Bundesrepublik Deutschland: *Agrarbericht 1990*, Bonn 1990, p. 95.

¹⁰ Cf. Preispaket durch flankierende Maßnahmen etwas entschärft, in: *Agra-Europe*, Vol. 31 (1990), No. 18, p. 22 (Europa-Nachrichten).

¹¹ Cf. A. S. Friedeberg: Protectionist Re-balancing or Market-Oriented Reform? EC Oils and Fats Policy, in: *Food Policy*, Vol. 14 (1989), No. 4, p. 305; H. von Witzke and J. P. Houck, op. cit., p. 1.

¹² Cf. T. Hanriotis and G. C. W. Ames: The 'Oilseed Tax' and U.S. Soyabean Exports to the Enlarged European Community, in: *European Review of Agricultural Economics*, Vol. 15 (1988), No. 1, pp. 40 ff.; U. Koester and A. Valdés: Reform of the CAP: Impact on the Third World, in: *Food Policy*, Vol. 9 (1984), No. 2, p. 97.

Table 2
Imports of Grain Substitutes¹ into the European Community

Product	EC-9		EC-10					EC-12		
	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988 ²
Tapioca (and sim. roots)	5,375	4,866	6,678	8,101	4,505	5,257	6,336	5,823	6,986	7,000
Bran	2,014	1,950	1,994	1,963	1,958	1,196	972	682	230	174
Maize gluten feed	2,021	2,596	2,837	2,842	3,566	3,734	3,542	4,097	4,707	4,737
Corn meal	1,037	1,058	1,032	1,063	1,302	1,036	958	1,440	2,392	2,462
Citrus pellets	1,205	1,571	1,352	1,265	1,430	1,322	1,467	1,237	1,652	1,554
Brewer's tailings	204	290	365	377	498	416	436	633	853	833
Sugarbeet peelings	224	190	284	390	529	417	488	322	483	835
Waste fruit (grape marc)	186	195	160	165	199	133	114	207	347	508
Yams	81	324	88	55	142	101	351	602	607	532
Total	12,347	13,039	14,790	16,220	14,128	13,610	14,664	15,042	18,257	18,635

¹ Substitutes as defined in Appendix D of the Basic Regulation on Grain. ² Excludes Greece.

Source: Bundesregierung der Bundesrepublik Deutschland: *Agrarbericht 1990*, Bonn 1990, p. 141.

reduction in quotas granted to imports of New Zealand butter and cheese to the United Kingdom at special rates,¹³ and also the quota reduction for sheepmeat imports from New Zealand, Australia, Argentina and Uruguay under a renegotiated voluntary export restraint agreement.¹⁴ Furthermore, imports are often impeded on the EC's part because its import regulations are so complex. There is now such a plethora of complicated rules governing processed fruit and vegetables imports, for instance, that they act as an effective non-tariff barrier.¹⁵

The domestic economic instrument most frequently used in the EC's new import substitution policy is undoubtedly that of paying out grants. In addition to the substantial grants mentioned above for the production and processing of oilseeds and pulses, acreage grants for durum wheat have also risen in recent years. Over the space of just 10 years, these payments rose by 116% from ECU 79.24 per hectare in 1980/81 to ECU 171.43 per hectare in 1990/91. In roughly the same period, the Community developed from being self-sufficient in the product (100% self-sufficiency in 1980/81) to acting as a significant net exporter with 139.4% self-sufficiency in 1987/88.¹⁶ Acreage grants for buckwheat, canary seed and millet were introduced for the first time with effect from the 1990/91 financial year. These measures are intended to encourage the planting of grain in which the EC has a net deficit, as a "workable alternative to the surplus production of wheat, barley and maize".¹⁷ Encouragement is *only* intended to be given to the extent which "... is necessary to

satisfy the genuine needs of the Community market"¹⁸ or, in other words, to substitute completely for current imports. Similar objectives also underlie the producer grants for seed-growing, the special assistance for sheep and goat-rearing in certain less favoured regions,¹⁹ and the acreage grants for grain, olive oil and oilseed production for industrial uses, all three of which were brought into operation in 1990/91.

The Community's subsidy policy not only covers support for the cultivation of deficit crops but also substantial subsidies on the consumption of domestically produced agricultural items. Among these measures are:

- marketing grants for butter fat and olive oil;
- grants for the use of skimmed milk powder as animal feed, which only recently were raised because of increased intervention stocks, from ECU 60 per 100 kg to ECU 70 per 100 kg;²⁰
- measures intended to increase sales of products from within the EC market, such as the sales promotion measures implemented in 1990/91 for citrus fruits and apples;²¹
- grants to support the use of domestic agricultural products for industrial purposes as well as for ethanol production.

The last of these policies, which comes under the heading of promoting renewable raw materials, can be

¹³ Cf. Kommissionsbericht zur Einfuhr neuseeländischer Butter, in: Agra-Europe, Vol. 29 (1988), No. 46, pp. 1-12 (Sonderbeilage).

¹⁴ Cf. Neue Selbstbeschränkungsabkommen für Schaffleisch ausgehandelt, in: Agra-Europe, Vol. 31 (1990), No. 12, p. 15 (Europa-Nachrichten).

¹⁵ Cf. Europäische Gemeinschaft behindert Drittlandsimporte, in: Agra-Europe, Vol. 31 (1990), No. 21, p. 15 (Europa-Nachrichten).

¹⁶ Cf. Commission of the European Communities: Die Lage der Landwirtschaft in der Gemeinschaft, Brussels 1985, p. 319, and 1990, p. T/164.

¹⁷ Cf. The European Communities: Regulations of the Council of the European Communities, Brussels, Regulation (EEC) No. 1340/90 of the Council, 14th May 1990 (translated from German version).

¹⁸ Cf. *ibid* (translated from German version).

¹⁹ Cf. The European Communities, *op. cit.*, Regulation (EEC) No. 1240/89 of the Council, 3rd May 1989 and No. 1323/90 of the Council, 14th May 1990.

²⁰ Cf. Höhere Beihilfen für Magermilchpulver, in: Agra-Europe, Vol. 31 (1990), No. 41, p. 1 (Kurzmeldungen).

²¹ Cf. The European Communities, *op. cit.*, Regulation (EEC) Nos. 1201/90 and 1195/90 of the Council, 14th May 1990.

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expected to gain in significance in future. Even though the primary aim of this approach is to substitute for imports of *non-agricultural* raw materials by using *domestically* produced crops, it is still perfectly possible that import substitution of agricultural products may arise as a desired side-effect. Ethanol production from oilseeds, for example, would also generate a substantial increase in domestic oilcake production for use as feed thus reducing protein feed imports.²²

Finally, the failed attempt in a number of EC countries to prohibit certain imitation products which do not pose any undue health risk was also nothing but a form of import substitution. The measures were not so much intended to protect consumers as to drive cheaper substitutes out of the EC's internal market.

The above remarks demonstrate that a policy of import substitution is currently being pursued across a broad front in the EC's agricultural sector. The variety of forms and the complexity of many of these measures frequently conceal the massive protectionism inherent in this strategy. One thing about which there can be no uncertainty, though, is that any closing of tariff loopholes would be a flagrant contradiction of both the spirit of the GATT and the present worldwide efforts to liberalize trade. Despite all that, the approach has a lot of support in the political camp within the Community. The import substitution policy is felt to

²² Cf. C. Spelman: Assessing the Future Importance of Industrial Markets for Agricultural Products. Plenary Session Paper presented at the 6th European Congress of Agricultural Economists on "European Agriculture in Search of New Strategies" in The Hague, 3rd-7th September 1990, p. 71.

promise a solution to urgent internal problems. Whether such hopes are justified will be examined below.

Economic Assessment

Academic findings on the implications of current policy generally tend to fall upon deaf ears among practical policy-makers in agriculture. They reject welfare-economic analyses and the policy recommendations derived from them on the grounds that they do not provide an adequate reflection of the political and economic realities of the agricultural sector. Their attitude changes, however, when it comes to the theory of second-best solutions. This theory states that:

In the event that political reasons make it impossible to reduce a high level of market protection for one of two similar goods, the *second-best* policy is to harmonize the treatment of the highly protected good with that of its close substitute by raising the tariff level in the substitute market. A strategy of this kind allows price and trade distortions involving these goods to be reduced, thus increasing overall economic welfare.

This is a piece of theory which is happily adopted by agricultural policy practitioners, as it also seems to provide a justification from an economic welfare perspective for a strategy of import substitution in agriculture. The response is hardly surprising if one recalls that a policy of import substitution implies an increase in protectionism, and one more step down the dead-end street of interventionism favoured by the practical policy-makers. They do not seriously examine whether or not the assumptions on

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Transmigration between poverty, economics and ecology

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which second-best theory is based are actually valid for the European agricultural sector. The question we must therefore ask is: "Does a policy of import substitution in the EC's agricultural sector really represent a second-best solution?"

The first point which must be remembered is that an import substitution policy in its strictest sense is also a policy of self-sufficiency. From a welfare-economic point of view, however, closing an import loophole cannot be regarded as an objective in itself, and can certainly not be justified by referring to the theory of second-best.²³

Apart from that, the second-best argument was developed with a *two-product* model. In reality though, the EC's agricultural sector in particular has a variety of *multi-faceted* interrelationships. Furthermore, the agricultural sector is becoming more and more closely interlinked with processing industries, and with non-food industries, which as a rule are more strongly free-trade oriented. If one assumes that there are also close substitutive relationships between the one market which is newly protected and another which has no such protection, even in the final situation, there is a much lower probability that an import substitution strategy really will be the second-best policy. In this case, new distortions would be created between the two markets concerned. As a general rule, one can say that the more significant the potential for substitution is between the newly protected market and others which are more free-trade oriented, the greater is the likelihood that an import substitution policy will have negative consequences.

There are still other economic and political realities of the EC's agricultural sector which are not taken into account by the second-best argument, among which some of the most important are as follows:²⁴

- The introduction of a tariff policy in a market which has previously had free trade is not always possible due to earlier tariff consolidation; the use of alternative protectionist instruments, however, may yield completely different results.
- The European Community represents a "large" economic zone. Terms-of-trade effects therefore need to be included in the analysis.
- Any import substitution policy inevitably harbours the danger of overkill. The Community oilseed market, for

example, has at times been more strongly protected than the grain market, resulting in additional distortions and runaway expenditure.²⁵

- Any new political intervention in markets automatically induces additional, unproductive "rent-seeking" activities within society.²⁶
- A number of import substitution measures are generally introduced simultaneously, which further increases the complexity of the effects under consideration, rendering it impossible to make general statements regarding the welfare effects of an import substitution strategy.

The above remarks suggest that a policy of import substitution for agriculture in the European Community by no means guarantees that welfare will be increased. The many, varied interdependencies which exist mean that the reduction of distortions in one area can simply induce new misallocations elsewhere. That in turn gives interested parties reason to call for renewed political intervention. Thus a policy which at first sight appears to represent a second-best solution turns out to be an impediment in its own right, and a third-best solution has to be sought. It is a well-known fact that subsidies and protectionist elements are easy to introduce but that it is almost impossible to abolish them again. A second-best policy, then, carries with it the danger of being sucked into a vicious circle of growing inefficiency.

Yet the most telling criticism of all is that the basic assumption on which second-best theory is based simply does not apply to the agricultural field. That assumption is that the economic distortions involved are exogenously given. Only if this is the case is it economically rational to intervene in the market in order to balance out the original distortion as far as possible. However, the level of protection applied to CAP core commodities is not in the least an exogenously given factor: it is the consequence of political decision-making processes within the EC, and needs to be alleviated by precisely those processes.²⁷ Against that background, it is evidently inadmissible to justify new protectionist elements by maintaining that they are a second-best strategy. The wish to relieve price and trade distortions between individual products demands that there should be less regulation, not more. The better strategy is therefore one of reducing protectionism rather than of import substitution.

²³ Cf. M. Hartmann: Die neue Importsubstitutionspolitik im EG-Agrarbereich – Analyse und Bewertung, in: P. M. Schmitz and H. Weindlmaier (eds.): Land- und Ernährungswirtschaft im Europäischen Binnenmarkt und in der internationalen Arbeitsteilung, Schriften der Gesellschaft für Wirtschafts- und Sozialwissenschaften des Landbaues e. V., Vol. 27, Münster-Hiltrup 1991.

²⁴ Cf. *ibid.*

²⁵ L. P. Mahé and C. Tavera: Harmonization of EC and U.S. Agricultural Policies, in: European Review of Agricultural Economics, Vol. 15 (1988), No. 4, p. 331.

²⁶ A. O. Krueger: The Political Economy of the Rent-Seeking Society, in: American Economic Review, Vol. 64 (1974), No. 3, pp. 291-303.

²⁷ H. J. Winterling and S. Tangermann, *op. cit.*, pp. 56 ff.