Articles and Notes

This opening article in this section is the second in a series of agricultural policy reviews newly commissioned for the *Review.* In 1987 published reviews will be for Australia (April issue), the European Community (this issue) and the U.S.A. (December). It is anticipated that these reviews will be updated in 1988, and augmented by reviews of some or all of the U.S.S.R., Japan and ASEAN. Whenever possible, these reviews will be commissioned from nationals of the country or countries involved to add their domestic perspective to our external perceptions of their countries' agricultural policies. In the case of the present review of the European Community's agricultural policy, a continental European view was sought on the Common Agricultural Policy specifically to balance the otherwise readily available perceptions of the CAP from Australian, U.K. or U.S. sources. It is anticipated that, in general, future reviews of the CAP will also be written from varying continental perspectives. To expedite publication of this policy-oriented material, these reviews will not be formally refereed.

Aspects of Agricultural Policy in the European Community 1986/87 †

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The article reviews recent developments in and under the Common Agricultural Policy of the European Community. It shows the complicated systems of market regulations, points to the performance of markets and informs on the latest proposals and decisions (prior to 1 April, 1987). The main features and effects of the agri-monetary regime are explained as well as the new proposals for its modification. Finally, the budgetary constraints are considered. The main conclusions are that the CAP is going to change although a thorough reform is not in sight. At present, the most urgent task is to cut down useless intervention stocks and to prevent their immediate resurgence.

1. Introductory Comments

From its very beginnings, the Common Agricultural Policy (CAP) has evoked many objections from inside and outside the European Community (EC) as being over-protectionistic, inefficient and bureaucratic. This criticism has intensified over the years and, since the early 1980s, has not only been confined to academic circles. The reasons are twofold: first, by the maintenance of badly inefficient production capacities through a predominantly income oriented policy of high and stable producer prices, the resulting oversupply in almost every kind of agricultural produce and the immense wastage of resources have reached tremendous dimensions. These inefficiences have made the underlying protection of the agricultural sector (its principle, means, level, and the distribution of profit and loss) less and less acceptable for those who have to pay for it, as well as for those who no longer profit from it as much or as easily as they were told. Second, there is a growing opposition from exporting countries competing with the EC in world agricultural markets, where the Community due to its artificially stimulated production, its particular system of export subsidies and its financial backing has reached and has been able to defend high market shares successfully.

As long as the budgetary means required for

† Editor's footnote. This review presupposes knowledge of the EC's structure and administrative mechanisms. There is a burgeoning English language literature on these aspects; for an introduction, see for example, S. Harris, A. Swinbank and G. Wilkinson (1983), *The Food and Farm Policies of the European Community,* Wiley, Chichester.

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financing the support of agricultural prices[1] levelled well below the volume of total funds available for that purpose such criticism, however justified it was economically, was not taken too seriously by politicians. It was only under the threat of acute financial difficulties and on the explicit mandate (thereupon) given by the heads of state (30 May, 1980) that CAP reform became a high-ranking topic on the agendas of both the Commission and the Council. The broadening discussion which followed the publication of the Commission's first reform proposals[2] showed a remarkable degree of consent with regard to the situation analysis but a similarly remarkable degree of divergence in the views concerning recommended actions. It made clear that the Community would not be able to quickly convert to a policy totally different from the existing CAP (*e.g.* by applying direct payments instead of price support). Obviously, policy reform will not consist of a bold endeavour but rather be a long and painful (costly) evolution. It will be hard enough for the Commission again and again to overcome the persistent opposition of those governments who, in changing coalitions, fiercely fight any step towards reduced protection and more balanced markets.

The following review is not intended to give a thorough analysis of the CAP, its foundations, history and aims. It is more directed to concisely inform on recent economic and political developments in EC agriculture. In doing so, stress is laid on a few agricultural markets (cereals, oilseeds, sugar, milk, beef and pork), on changes in the agri-monetary sphere and on the budgetary constraints. Social, structural and environmental aspects as well as foreign trade relations have not been dealt with, due to space limitations.

2. Agricultural Markets and Related Policy Measures

The natural and structural, social and economic diversity of EC agriculture is well known and in this context needs no broader documentation. But this diversity should be kept in mind when the actual problems are reviewed which the Community — admittedly to a large extent by its own fault — is facing now in its agricultural markets and finance.

At present, roughly 92 per cent of total agricultural production (EC-10, 160,000 million ECU in 1985)[3] is in some way or the other under a common market regulation. The more elaborate ones, equipped with some kind of intervention regime[4], protect about 60 per cent out of the same total. Milk, beef and cereals belong to this group. They hold the biggest shares in total production (19, 14, and 12 per cent, respectively). Sugar and oilseeds sharing some 2.5 and 1.6 per cent, respectively, are hardly less protected but fall under different types of administrative regime. Production quotas and differentiated price levels characterize the sugar policy while oilseeds are supported through producer subsidies which leave market prices to fluctuate at much lower levels. Pork, poultry and eggs with an overall production share of almost 19 per cent are, on the other hand, the most prominent examples of less strictly regulated markets. Here, minimum import prices give EC producers a certain advantage over foreign competitors, while on domestic markets prices, supply and demand are more or less left to themselves. Accordingly, these three products have always received much lower (effective) protection than most other products under common market regulation —

1. For CAP purposes the Community runs the European Agricultural Guarantee and Guidance Fund (EAGGF) which is part of the Community's total budget (*cf.* section 4).

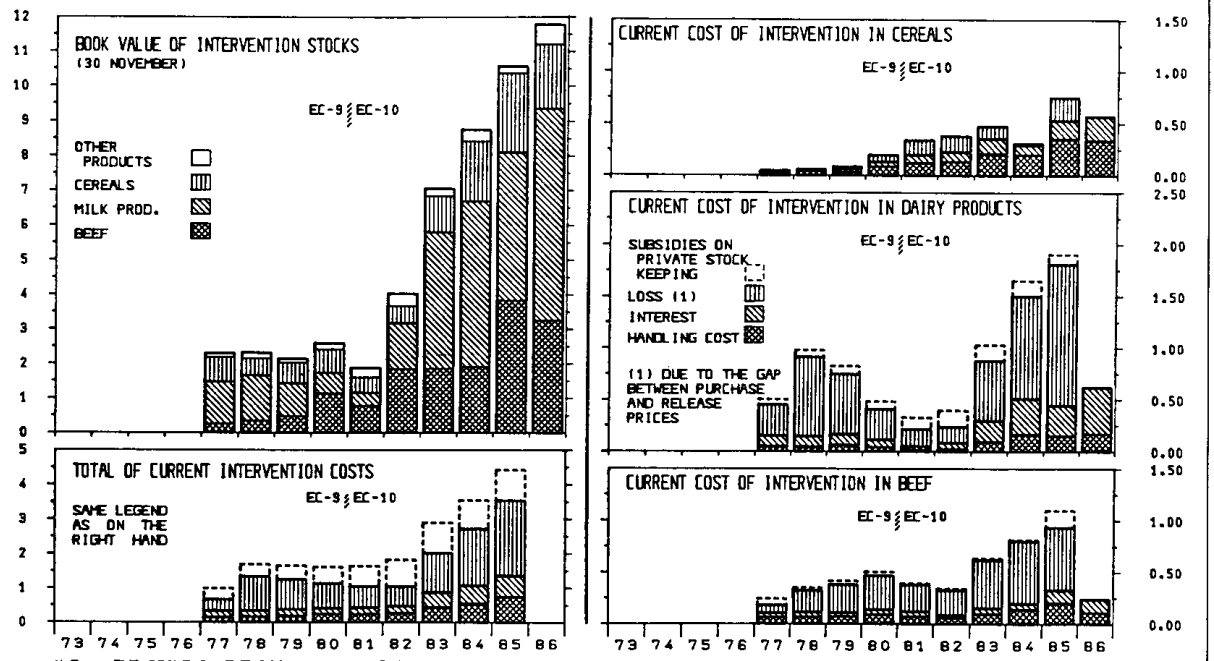
2. These proposals are published in a series of documents listed at the end of this review under the authorship of the EC Commission. Since the English titles indicated below are translations from available German sources, they may slightly differ from the official English titles. All other specifications however are valid irrespective of the language chosen.

3. The following average exchange rates may be used for conversion of the ECU prices and monetary amounts mentioned in this article (units of national currency per ECU):

	AUS$	U.S.$	DM
1980	n.a.	1.39	2.52
1981	n.a.	1.12	2.51
1982	0.96	0.98	2.38
1983	1.00	0.89	2.27
1984	0.90	0.79	2.24
1985	1.06	0.76	2.23
1986	1.47	0.98	2.13
1987 (1st quarter)	1.66	1.12	2.07

4. For a detailed explanation of all CAP-related technical terms see the *CAP Monitor,* a continuously up-dated, loose-leaf compendium on Common Agricultural Policy matters published by Agra Europe (London) Ltd.

Figure 1: BOOK VALUE OF INTERVENTION STOCKS AND ANNUAL COST OF INTERVENTION (MILLIARD ECU)



and their markets are often seen to have performed better.

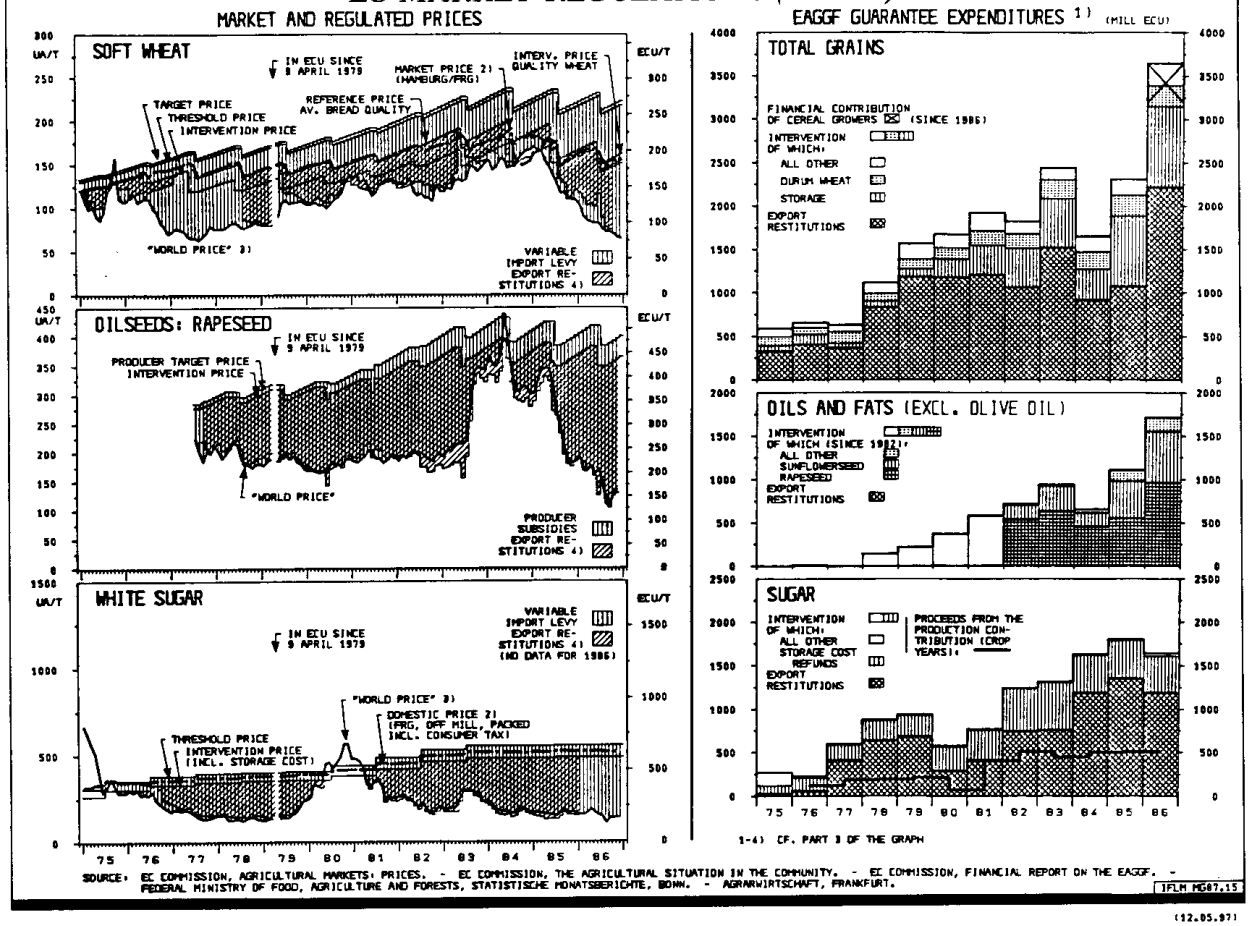
Regardless of the differences in the organization of the various markets, there is no product among those mentioned above, except of course oilseeds, in which the Community has not reached and now regularly exceeds full self-sufficiency. The structural surpluses which the CAP has enabled the farmers to produce are, however, the most serious impediment to its unchanged continuation. It is in the cost of stockpiling and surplus disposal that the wastage of resources has been most clearly recognized by the public (*cf.* Figure 1). Cutting these costs has, therefore, at present the highest priority for the Commission, who in this respect follow a two-tier approach: getting rid of unnecessary stocks and avoiding their later resurgence. The proposals made by the Commission since December 1986 are part of this strategy.

2.1 Cereals

Production increases of about 2.5 to 3 per cent annually, and a stagnating or even depressed domestic use, can be taken as the long-term results of a policy combining absolute price security with excessive price levels in the EC cereal markets (*cf.* Figures 2 and 3). This approach used to be the cornerstone of an income oriented price policy considered as indispensable for the existence of so many small-scale family farms. But the over-protected market reacted predictably; it first became less dependent on grain imports and by about 1980 turned to increasing surplus. High imports of non-grain feeds and reduced world demand for cereals made the situation even worse. EC intervention stocks in cereals tripled within only four years and reached some 18 million tonnes (with more than 10 million tonnes of wheat) at the end of 1985/86. Intervention costs soared correspondingly. Moreover, falling world grain prices sharply widened the gap which the Community, due to its inflexible guarantee price system, was forced to bridge whenever exports were to be made. Persistent domestic surplus, high budgetary costs and growing political tensions encumbering the relations with other exporting countries meanwhile forced the Community to adopt a policy which the farmers soon realized was less responsive to their pressures for higher prices and incomes.

The new policy course began to materialize in 1984/85, when the Council of farm ministers agreed on a general decrease of cereal intervention prices by 1 per cent, which in fact was the first general grain price reduction

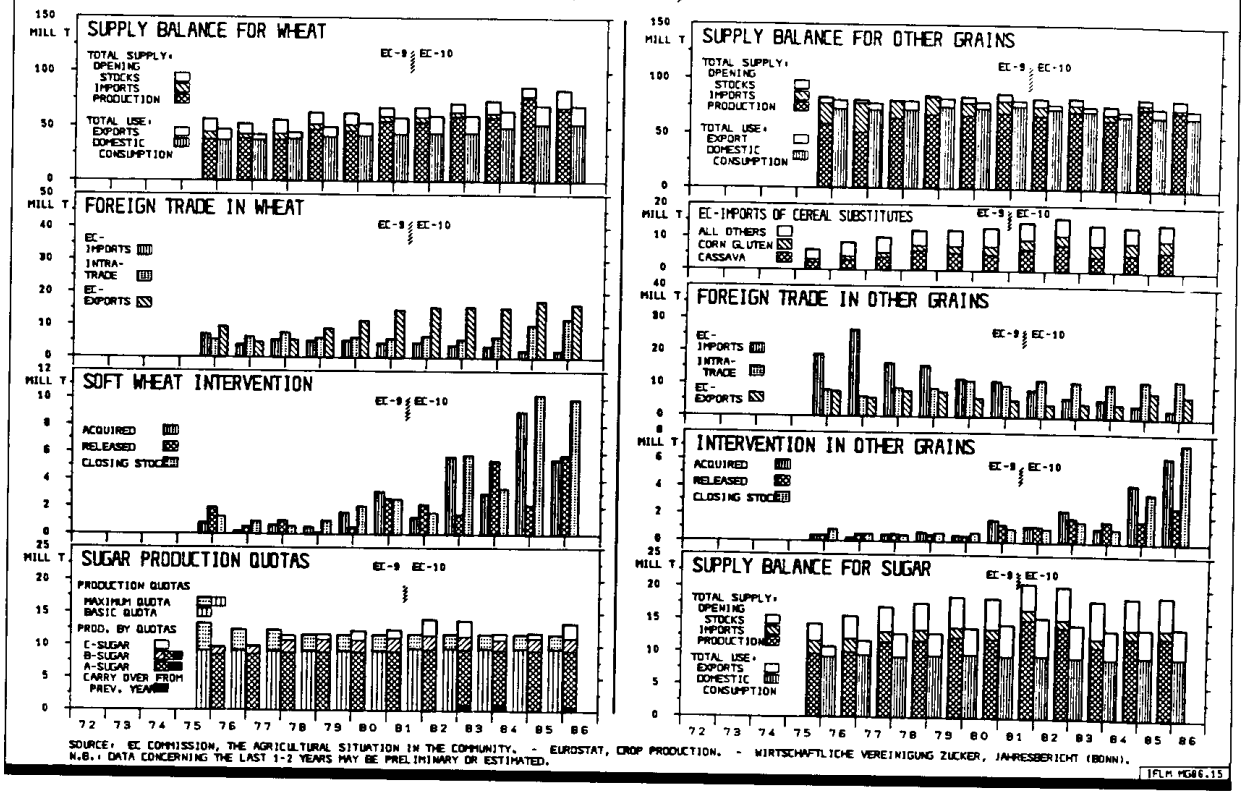
Figure 2: COMMODITY PRICES AND BUDGET EXPENDITURE UNDER EC MARKET REGULATIONS (PART 1)



(nominal, in ECU terms) in the history of the Community. In the following year, the German farm minister opposed a further price cut and prevented a formal price decision from being taken. However, the Commission decided to carry out its own compromise proposal, aiming at a price decrease of 1.8 per cent in the cereals sector (originally, minus 3.6 per cent was planned). For the next year, 1986/87, the Commission proposed a nominal price freeze but, surprisingly, the Council got through with a price reduction in spite of the strong opposition from the German side. Overall, the 1986 price package contained much more than that. Unwrapped, there were three parts: the price setting proper, the imposition of a co-responsibility levy, and new terms of intervention.

With regard to cereal prices, the Commission originally proposed mainly to exert pressure through stricter quality criteria for the entry of grains into intervention, but obviously most member countries deemed straight price cuts to be necessary. So it turned out that the feed grain prices were directly reduced by 5 per cent except for the maize price which remained unchanged. Common (soft) wheat of breadmaking quality was given a 5 per cent premium on the feed grain price with an additional 2 per cent price premium in the case of still higher quality (*e.g.* 14 per cent of protein or more). If the breadmaking criteria (machineability test, Hagberg falling number, Zelny index, and protein content) were not satisfied, common wheat was subject to progressive price reductions and thereby finally classified as a feed grain. The former reference price for breadmaking wheat, which was already suspended in 1985/86, was abolished and the monthly price increment (thought to cover storage cost) was set at 2.45 ECU/tonne, 4.7 per cent below the previous year's level. To allow for changes in the marketing pattern following the new membership of Spain and Portugal, the beginning of the cereal marketing year was brought forward from 1 August to 1 July. To cope with the dephased maize and sorghum

Figure 3: PRODUCTION AND UTILIZATION OF AGRICULTURAL COMMODITIES UNDER THE EC AGRICULTURAL MARKET REGULATIONS (PART 1)



seasons, the threshold prices for these two crops valid in June (the end of the previous seasons) are to be applied until 30 September. Contrary to the fall of intervention prices, there was a slight increase in the target and threshold prices reflecting a certain increase of transportation and handling costs within the Community (Uhlmann 1986).

All grains sold to domestic processors, to intervention agencies or for export were subject to a new co-responsibility levy of around 3 per cent (5.38 ECU/tonne for all types and qualities of grain from the 1986 crop). Exempt from the levy were grain imports from non-EC countries, unprocessed grain purchases by farmers and grain processing on farms. The original intention of the Commission to exempt on social grounds grain deliveries from small-sized farms (up to 25 tonnes of grain marketing) was actually only followed in Italy and Spain. All other member countries preferred to reimburse small farms at a maximum rate of 134.50 ECU/farm with the total amount not surpassing 69.99 million ECU for these other nine countries (in Portugal the levy is not applied).

New terms for cereal intervention were set in various ways. No grains harvested in EC member countries and meeting the minimum quality requirements can be refused by state intervention agencies. Quantitative restrictions which were applied on breadmaking wheat during two preceding years (1984/85 and 1985/86) no longer hold. But the general obligation to intervene is binding only from 1 October through 30 April. Contracts made during this period must not be paid earlier than three months after delivery; if grain is signed in earlier, a four months' delay has to be kept. Tighter standards on moisture content (15 per cent in 1986/87 and 14 per cent thereafter), on impurities and specific weight were imposed to further restrict the quantity of grains sold into intervention.

The special attention which the Council of farm ministers has paid to high quality wheat by separately defining an additional intervention price was not the best solution. Price premiums of only 2 per cent could have been achieved by a simple price bonus system — if an administrative arrangement was deemed necessary at all. But this was hardly the case because the market itself is well aware of different grain qualities, and both traders

and processors are used to paying at least similar price increments. Moreover, the wider gap between intervention and threshold prices tended to make EC grains more competitive on domestic markets and, therefore, to reinforce the quality aspect, too. On the other hand, one has to recognize that, when the German farm minister had asked for a special intervention price for high quality wheat, he obviously thought of a much bigger margin than was finally conceded. Such a marked price differentiation would have favoured the more quality oriented producers (*e.g.* in West-Germany) relative to those preferring the higher yielding wheat varieties (*e.g.* in the United Kingdom) but obviously only at the risk of higher wheat intervention purchases.

By setting the intervention prices for feed grains (except for maize and sorghum) at a uniform, somewhat reduced, level the Council certainly made a step in the right direction but with some less desirable side-effects to be expected. First, the decrease in the support prices of cereals indirectly strengthened the relative profitability of oil- and protein-rich crops (rapeseed, sunflowerseed, dry beans, peas *etc.*) since their prices were kept unchanged (*cf.* section 2.2). Second, the cereal price reduction, however justified and necessary it was from the market point of view, was still unlikely to produce some measurable demand effects. On the one hand, it fell short of decisively improving the competitiveness of EC feed grains relative to low-priced "cereal substitutes" (*e.g.* cassava, corn gluten feed, various by-products of the food processing industry which, under the CAP system, may enter the Community almost tax- and levy-free although some of them have quantitative restrictions). Consequently, it could hardly stimulate domestic use of feed grains. On the other hand, even the chance of producing a slightly greater demand effect was foregone, when a co-responsibility levy was chosen instead of an additional direct price reduction. The levy may have favoured on-farm use of grains but to the detriment of purchased compound feed. Traders in and processors of cereals bitterly complained about being charged with additional administrative work. Third, in the light of almost no immediate overall demand and/or supply effects to be expected from the price reduction, it was nevertheless certain, that offering equal intervention prices for wheat and barley would only shift some imbalances from one crop to the other. Wheat could be expected to replace cereals of lower nutritive value in feed rations thereby forcing more barley into intervention. (Anticipating this side effect, some quality criteria applicable to barley intervention were also tightened). Moreover, from the EAGGF budget point of view the exchange of wheat for barley was even risky, because barley usually needs still higher export restitutions to compete at world market prices although it may find its outlet more easily than wheat.

In the price proposals for 1987/88, the Commission indicated once again its determination to continue further the restrictive cereals policy. In view of the steady productivity increase and a threatening annual excess production of about 26 million tonnes of grains it was said to be the main task to prevent a situation which could easily result in an accumulated stock of 100 million tonnes by 1993 (Agra Europe 20.2.87).

The Commission proposed to cut the intervention prices for all feed grains by 2.6 per cent but to maintain the intervention prices for breadmaking wheat and for high quality wheat unchanged. However, additional price reductions would be brought about by a reduction and deferred application of the monthly price increments. Their amount was proposed to be 2 ECU/tonne (compared with 2.45 ECU/tonne in 1986/87) and they would be applicable to the intervention prices only from March through May while the right of cereal producers to sell to intervention should be limited to the four months from February through May. But on the target and threshold prices, the monthly increments would still apply according to the old schedule (first increment in August, the last one in May). The co-responsibility levy should remain in place unchanged despite its admitted shortcomings[5]. Combined with the direct price reductions, the changes proposed in the monthly increments would — according to estimations made by the Commission — amount to an effective price cut of about 11.5 per cent compared to 1986/87.

The proposed new reduction of the cereals prices was heavily objected to by the West

5. Obviously, the commission thought of the administrative weaknesses rather than the systematic defects of the instrument as they were analyzed by Hubbard (1982).

German government which argued that these measures were not suited to solving problems but would rather create new ones with regard to farm incomes and regional poverty. Other member countries like for example France, the Netherlands and the United Kingdom seemed prepared to accept the proposals.

2.2 Oilseeds

Since the early 1980s, oilseeds production has expanded rapidly in several EC member countries. Stimulated by favourable prices, improved seeds (hybrids) and a receptive domestic market, the production of rapeseed, sunflowerseed and soybeans more than tripled within only six years to reach 6.5 million tonnes in 1986 (EC-10). Most of this increase was due to extended plantings which partly resulted from the restrictions imposed on cereals under the CAP. Current year prospects are for another big acreage expansion (*e.g.* + 25 per cent for rapeseed). Thus, 8 million tonnes of oilseeds are likely to be harvested in 1987 (EC-10) plus another one million tonnes of sunflowerseed produced in Spain and Portugal (Toepfer International Market Report 19.3.87).

Assuming appropriate growing conditions (especially with regard to temperature and humidity), there is considerable potential for substituting oilseeds for cereals, and the similarity in input requirements makes such an exchange highly responsive to price and yield differentials. Judging from intervention prices only (although producer returns for oilseeds usually ranged above and for cereals below their respective intervention levels), the rapeseed/feed grains price ratio changed from almost 2:1 in 1979 to 2.5:1 in 1986. There has therefore been a clear political incentive in favour of increased oilseed production. But this stimulation is not very likely to persist since, from the EAGGF budget point of view, the substitution turns out to be very costly: in 1985/86, the price subsidy for rapeseed amounted to 760 ECU/hectare while the export subsidy for barley was about 380 ECU/hectare (always on the basis of average yields). By the end of 1986 this gap was even wider since, in compensation for decreasing world oilseed prices, the subsidy then made up almost 70 per cent of the intervention price. The growth of total EAGGF expenditures on oilseeds is reflecting both the expansion of production and the fluctuations in the rate of subsidy (*cf.* Figure 2).

In order to limit the further expansion of production, annual guarantee thresholds were set up for the first time in 1982 beyond which there is a progressive reduction of the price subsidies payable. In 1986/87, this mechanism triggered off a cut in the sunflower subsidy by 29.18 ECU/tonne (equal to the maximum admissible reduction of 5 per cent of the target price) because the harvest was 0.23 million tonnes above the threshold of 1.7 million tonnes. Preliminary estimates of the rapeseed crop just fell short of the threshold (3.5 million tonnes, EC-10) so that its subsidy was applied unabated although the final crop figure subsequently indicated a small surplus. For 1987/88, the Commission proposed to maintain target and intervention prices unchanged, as well as the guarantee thresholds, but to remove the present price cut limitation of 5 per cent (rendering bigger price cuts possible).

However, the most important change which the Commission proposed to make in the EC's edible oil and fat policy is the imposition of a general consumption tax on all vegetable and marine oils. The proceeds from this tax will be used to (co-) finance the burgeoning cost of oilseeds support and are also said to be required in view of the big increase in EAGGF expenditure on olive oil to be expected as a belated consequence of the last EC enlargement. For the first period of application (1 July, 1987, to 31 December, 1988) the tax is planned to be 330 ECU/tonne which is said to represent the maximum level ever (Agra Europe, 13.2.87). At this rate and 1985 consumption assumed, the tax would yield at least 2000 million ECU (EC-10).

Obviously, the Commission considers the tax to be compatible with GATT rules as it would apply on all vegetable and marine oils and in the same manner to Community products as to imported ones. Critics however retort that in fact the tax is discriminatory if its proceeds are fed back into support of domestic producers and if butter (as well as all slaughter fat) is exempt from the tax. Indeed, the competitiveness of butter would be considerably strengthened on domestic markets if a tax amounting to around 10 per cent of its retail price is imposed on competing products. Standard quality margarine would lose much of its price advantage. Moreover, such a big price increase would be intolerable

on social grounds. Member state governments still seem to be divided over the oil tax issue. On the one hand, they hesitate to impose a new tax on consumers while on the other they certainly welcome the idea to alleviate the financial burden of the EC without touching national finance. At least some member states also seem worried about the prospects of getting involved in a new trade conflict with the U.S.A. and other interested countries which may hurt their interests in other fields and must further compromise their position in international trade negotiations.

2.3 Sugar

EC sugar production is almost exclusively based on sugar beet (some sugar cane is grown in the French overseas departments and in Portugal). Around 1.7 million hectares (equivalent to 6 per cent of the cereals area) are devoted to this crop (EC-10) and the average production of 12.5 million tonnes (white sugar equivalent, 1982-86) makes up 133 per cent of domestic use (128 per cent in EC-12).

In recent years, excess production could not be totally disposed of at depressed world markets and consequently resulted in growing carry-over stocks. Closing stocks (31 August) increased from about 30 per cent of consumption in the late 1970s to more than 45 per cent in the mid-1980s. By the end of the current crop year, at least 6.7 million tonnes are expected to be in EC-12 stocks (200,000 tonnes more than in 1985/86).

The obvious disequilibrium in the EC sugar market and the high storage and export subsidies payable have so far not caused the Commission and the Council fundamentally to revise their policy. The general impression was rather that everybody tried to avoid an in-depth study of the problems related to the EC sugar market for fear of stimulating a new struggle among all member countries for higher shares in the overall quota. Hence restrictive proposals were never made public. On the contrary, guarantee prices were still raised regularly in the early 1980s (1980-83), and since then have been maintained unchanged (with the exception of a negligible increase in 1985) despite depressed cereal prices (*cf.* Figure 2).

The lack of any effort to better adjust the EC sugar policy to domestic and international markets has repeatedly been explained as a consequence of the so-called self-financing system imposed on this section of the CAP. But this excuse has to be rejected totally. First, it is true that sugar produced in excess of a quota has in principle to be exported unsubsidized. However, quota prices are high enough to allow the sugar mills to cover total fixed costs within the quotas only and to enable them to produce excess sugar profitably as long as receipts from exports cover the variable costs only. In order to secure a higher use of capacity, the sugar mills apply various types of production contracts or pay blended prices to the beet growers to encourage or even require them to extend their production beyond their quotas. Second, the regulation is that subsidies on export of quota sugar are paid from the EAGGF budget on the condition that the whole amount is reimbursed from the proceeds of a special production contribution. But when it turned out that the money collected from the industry (both the farmers and the mills) no longer covered total expenditures, it was extremely difficult for the Commission to institute a surcharge aiming at a cutback of the deficit (some 400 million ECU in 1986) within five years. This "(deficit) elimination levy" was imposed on the sugar and isoglucose producers in all member countries apart from Spain and Portugal (whose governments had refused responsibility for a deficit accumulated before their membership) but at different national rates. The differential national surcharges (ranging from 0.63 to 1.63 per cent of the white sugar intervention price) are to reflect each country's proportional contribution to the deficit — and its willingness to clear it. Third, in 1981 the sugar industry obtained an amendment of the basic regulation on the common organization of the market in sugar (COMS) which made EC consumers directly liable to pay the total storage cost (originally consumers had to pay storage cost of quota sugar only). Together with a more generous carry-over regulation, this change gave the industry much more flexibility in its export dispositions (Manegold and Sommer 1986). Finally, it should be clearly understood that the whole system of price support is "self-financing" only in so far as the EC consumer bears the cost. The taxpayer is affected only as far as the subsidies for exporting 1.3 million tonnes of white sugar are concerned (a quantity equivalent to the so-called ACP sugar being imported on

preferential terms from some former French or British colonies and territories in Africa, the Caribbean or in the Pacific, hence ACP).

As could be expected *a priori,* it was a mere ritual to sanction the existing order for another five years term when the Council met on 24 March, 1986 to review the functioning of the COMS. But astonishingly enough, there must have been doubts over the proper level and distribution of quotas since it was specifically agreed to reconsider this matter before 1 January, 1988. Thus, the present conduct of the sugar industry has to be seen in view of this new conference. In France and West Germany the industry is recommending its members not to exploit fully all opportunities for excess production in order to avoid any quota cuts (beet acreages in 1986 were reduced by 11 and 4 per cent, respectively, and there will be a further decrease this year). But at the same time the opposite strategy is being followed in Italy, Greece and Spain, who are all trying better to fulfil their national quotas and whose governments are offering subsidies from their own budgets to prevent unused quota shares from being eventually seized.

Moreover, it is hoped that, when the perspectives of the EC sugar market are reviewed at the aforesaid conference, the Commission will present more realistic production and consumption figures than it has obviously provided on former occasions (Sommer 1986, p. 408). With regard to domestic use, for instance, a larger substitution of non-caloric sweeteners for sugar has to be taken into account, and it must be considered with the failure of the chemical sugar provision to annually withdraw half a million tonnes from sugar stocks. The chemical sugar provision was completely revised in 1986 to enable EC sugar (by means of increased payments) to compete better with starch as a raw material for industrial uses and at the same time to improve the competitiveness of the EC industry to make more use of these products. With increasing world sugar prices, however, the interest in this arrangement which the chemical industry had previously demonstrated faded away completely.

Meanwhile, the Commission has for the first time in the history of the COMS proposed in 1987/88 to generally cut all EC-10 sugar prices by 2 per cent (1.8 per cent in the case of threshold prices). A drastic reduction in the monthly reimbursement of storage costs (from 0.53 to 0.43 ECU/tonne or by 18.9 per cent) will make the industry more aware of and responsive to the economic burden of uselessly high stocks. Finally, another extra levy is sought to be imposed on each sugar and isoglucose refinery payable from 15 December, 1987. According to the Commission, this levy is to balance an expected shortfall in revenue for support of the sugar market in 1986/87 — mainly resulting from exporting 1.7 million tonnes of quota sugar onto a weak world market (Agra Europe, 20.3.87).

2.4 Dairy

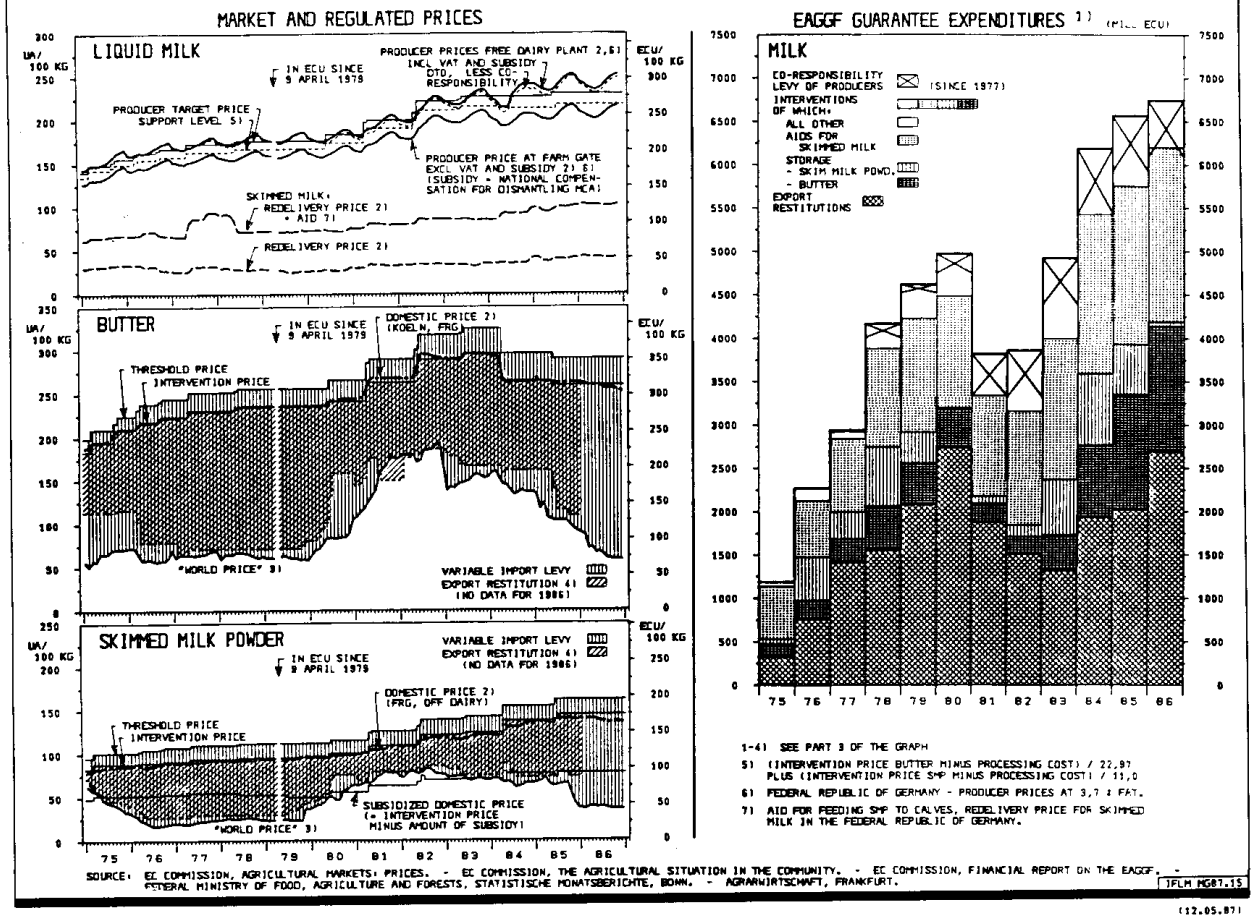
When the milk quota system was imposed on the EC dairy industry on 2 April, 1984, 900 thousand tonnes of butter and almost the same quantity of skimmed milk powder were in stocks. Total milk deliveries had reached 103.68 million tonnes in 1983 and were still expanding. Nevertheless, hopes were expressed officially that by the actions then taken, the overproduction of milk and a further accumulation of stocks could be stopped or even be reduced with relatively short delay (Reg. (EEC) No. 856/84).[6] However, such ideas proved to be over-optimistic (*cf.* Figures 4 and 5).

First, the new production rights allotted to the member countries on the basis of "milk production in 1981 plus 1 per cent" summed up to 103.7 million tonnes to be accepted in 1984/85 and, after another reduction by about 1 per cent, to 102.8 million tonnes in each of the two following years. These quantities far exceeded the 80 million tonnes of milk equivalents estimated to be saleable at market prices (Salamon 1986). Moreover, in some countries where the national quota was distributed completely according to production in the reference year, the governments later gave supplementary quotas when complaints from part of the industry about particular hardships (*e.g.* resulting from an unusual low milk production during the reference year) were found justified. Such after-care was to calm the farmers' concerns but later on necessitated a national buying-up action to bring the total amount of production rights back into line with the national quotas.

Second, the quota system itself turned out

6. Preamble to Regulation (EEC) of the Council No. 856/84, *Official Journal of the European Communities,* 27 (L90) p.10.

Figure 4: COMMODITY PRICES AND BUDGET EXPENDITURE UNDER EC MARKET REGULATIONS (PART 2)

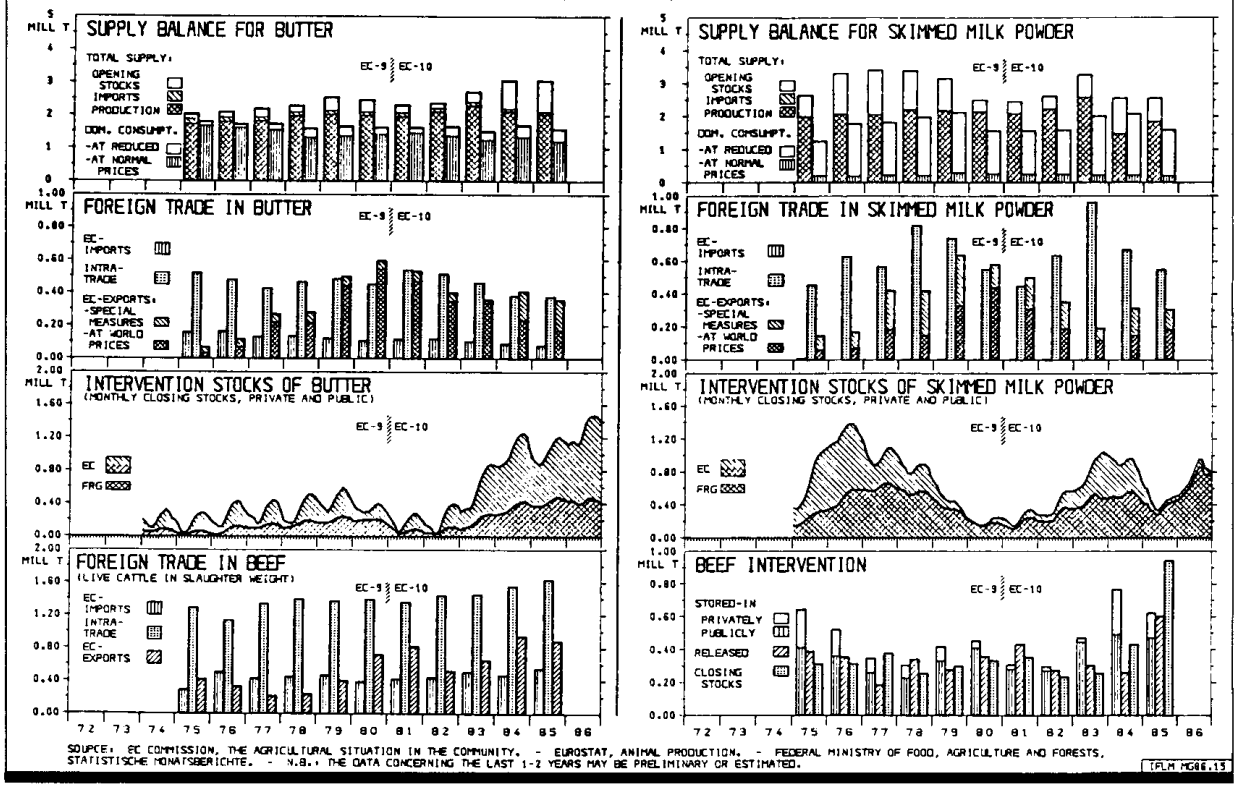


to be less restrictive than anticipated. The main reasons were (a) extensive balancing of over- and under-production; (b) dilution of penalites imposed on excess production; (c) transfer of quotas; and (d) definition of quotas by milk quantities only instead of by quantities of milk solids and fat.

(a) Originally, the opportunity of balancing over- and under-production of milk with regard to calculating the official degree of quota utilization was given only in countries having opted for dairy quotas (so-called formula B) instead of farm quotas (formula A, which are applied in West Germany, the Netherlands, Belgium, Northern Ireland). Under the regime of B-quotas, the dairies are responsible for allotting their own quotas to the farmers but they are free afterwards to balance eventual production shortfalls with excess deliveries occurring in their own milk collection districts. However, some governments had successfully claimed to consider all their milk processing plants as sharing the same collection district in order to be entitled to make use of the balancing practice on the national level. Other countries then saw themselves injured if they did not also have similar opportunities. The right of balancing over- and under-production at the national level was therefore made a general rule. The direct consequence was that all member countries were able to exploit their quotas to extremes and at the same time to minimise the penalty they eventually had to pay for excess national production.

(b) When the quota system was conceived, anyone selling milk in excess of quota was thought automatically to be fined at an amount of, respectively, 75 per cent of the target price under formula A and 100 per cent of the target price under formula B. This regulation was enacted in West Germany and the Netherlands for formula A. Consequently, in these two countries there was more money raised through producer penalties than was due under the generalised rule of balancing which the government was finally obliged to remit to the Community. In West Germany the

Figure 5: PRODUCTION AND UTILIZATION OF AGRICULTURAL COMMODITIES UNDER THE EC AGRICULTURAL MARKET REGULATIONS (PART 2)



surplus money was taken to (co-) finance a national buying-up action. Other countries (*e.g.* Belgium) preferred to lower the fine to an amount just necessary to pay the penalty on national excess production. In countries applying the B quotas, the fines were diluted even more through the balancing practice at the dairy level, which in some regions of the Community watered the original 100 per cent super-levy down to even less than 10 per cent. In Denmark, still another regulation was found: here any milk deliveries exceeding 130 per cent of the quota were subject to a 100 per cent penalty while all excess production below that level was left unpunished.

On the whole, the great variability of quota regulations clearly documented a tendency of policy re-nationalisation which the Commission later deplored and tried to reverse. Moreover, it was to be seen that almost everywhere in the Community the penalty on excess milk production (and the definition of what was to be regarded as being in excess) was too weak to be prohibitive. Surprisingly enough, it was under the farm quota (formula A) system that the member countries apparently encountered the greater difficulties in keeping production within the limits of the national quotas.

(c) Under the quota system, the general rule is that any transfer of production rights from one owner to another is bound up with a simultaneous transfer of land, be it for sale, on lease or free of charge. In West Germany any transaction, except in cases of inheritance or related to a termination of lease, is additionally levied by compulsory forfeiture of 20 per cent of the quota (an 80 per cent forfeiture planned to become effective on 1 April 1987 was finally not decreed by the government). While all these regulations had some restrictive effects, there was another which on the contrary gave new leeway to the countries concerned. On request of some member countries, a large part of the original 3.4 million tonnes quota reserved for direct sales was made convertible for use as an additional delivery quota. Whether or not in these cases over-sized direct sales quotas had been claimed — in expectation of their eventual conversion being easier to get through than any decision on additional new delivery quotas — remained an open question.

(d) Finally, when a slight increase in the

average fat content of the milk made itself felt by an accelerated intake of intervention butter, attempts were made to close this leak by a new definition of the quotas additionally referring to the quantity of milk fat. The change did not immediately influence the trend of rising fat content, but it reduced the danger that the restrictions put on milk production would effectively erode over time.

In view of the particular discretion which all governments were eager to observe in dealing with the whole quota business, it did not come as a surprise that, after total milk deliveries fell short of the overall delivery quota in the first quota year (99.59 million tonnes delivered compared with a delivery quota of 99.75 million tonnes in 1984/85), they resumed their former trend and continued to rise in spite of the intermediate reduction of the quotas. This finally resulted in more than 1.42 million tonnes of butter and 0.83 million tonnes of skimmed milk powder (SMP) being held in intervention stores (October 1986) despite considerable clearance of surplus butter from the stores under special export and internal cheap sales schemes, and massive disposal of SMP — with the help of high subsidies — in the feed sector.

The basically unbroken trend of rising milk deliveries and the excessively high budgetary costs related to the regulation of the common market in milk — more than 6,750 million ECU in the 1986 budget, with at least 1,000 million ECU caused by the difference between the intervention intake and release prices of butter — induced the Commission to work out an emergency programme for the common dairy policy. It took the Council seven days of almost uninterrupted negotiation to discuss and finally approve the package (December 1986). Combining several urgency measures to be taken during the next two milk marketing years, the programme follows two fundamental approaches: a limitation of intervention activities and a tightening-up of the quota system (Agra Europe 19.12.86).

With regard to intervention, the Commission proposed an enforced selling-out of intervention stocks (*cf.* section 4) and reduced storing-in activities. During the first three months of 1987, 281,500 tonnes of over-aged butter (more than 18 months in stock) were sold to the U.S.S.R. at around 7 per cent of the intervention price. The price difference alone (intervention price minus sales price) involved a loss of 820 million ECU, and the storage costs (18 months plus 4 months delivery term) are likely to add another 170 million ECU to the deal. Total costs have to be pre-financed by the member governments (*cf.* section 4). Intervention for SMP will be suspended during the autumn and winter months (September through February), provided that the Commission takes adequate steps to maintain the stability of the market. The ministers further agreed to authorize the Commission to adequately modify the existing intervention arrangements for both butter and SMP during the rest of the year (March through August) in order to reduce the volume of intervention purchases. For fear of uncontrolled price erosion and in view of the quota cuts becoming effective this year, however, some ministers tried to go back on this decision when the Commission presented its ideas early in 1987 on how it intended to modify the regulations. Because of this opposition (from West Germany, Luxemburg and Ireland mainly), the final Council decision fell short of the Commission's original aims. It was agreed that, between 1 March and 31 August, intervention purchases can be suspended (either throughout the Community or in part of it) as soon as 150,000 tonnes of butter and 100,000 tonnes of SMP, respectively, have newly been bought in. If butter prices in one or more member states should subsequently fall below 92 per cent of the support level, intervention buying will be reintroduced there. Should butter stocks bought in after 1 March 1987 exceed 250,000 tonnes, it is agreed that the 92 per cent floor price at which intervention buying is resumed will be lowered to 90 per cent (Agra Europe 6.3.87).

Subject to similar provisions, the Commission is authorised to modify further the existing intervention arrangements for both butter and SMP during the rest of the year in order to reduce the volume of intervention purchases. Dairies with excessive recourse to intervention may therefore in future encounter greater difficulties in simply renouncing their own marketing efforts and relying on CAP instruments.

Straight quota cuts and a tightening-up of the quota regulations in force were agreed upon in order to reduce milk production by some 9.5 million tonnes. In addition to the 2 per cent reduction in delivery quotas, which was already agreed in the 1986 price negotia-

tions to come into effect in 1987/88, there is now a further cut by 4 per cent imposed on the producers for the same year. The first 2 per cent is intended to be achieved by the existing voluntary cessation scheme. However, since participation has been low in several countries, the scheme will be made more attractive by adding 50 per cent to the present level of compensation, thus offering an annual 6 ECU/100 kg over seven years. The additional cost will be pre-financed by the member states and will be covered from the EAGGF budget in and after 1988. If the cessation scheme still falls short of taking 2 per cent of the quota out of production, mandatory linear quota cuts will become effective, while the rest of the money reserved for the buy-out may be used for restructuring programmes or direct compensation of producers.

The remaining 4 per cent reduction will be achieved by a "temporary linear suspension of quotas" (which, according to all EC experience, is very likely to become a long-term one). Producers will get compensation for the idled part of their quota. An annual payment of 10 ECU/100 kg has been agreed for two years, while member countries are free to top up this rate with an additional 2.5 ECU/100 kg (or less) from their national budgets.

From 1 April, 1988, further quota reductions will become effective. Again, 1 per cent is intended to be achieved through the older voluntary buy-out programme and 1.5 per cent through compulsory idling with a compensation payment (10 to 12.5 ECU/100 kg) or a reduction in the basic co-responsibility levy. Finally, after the agreement was settled on this part of the package, the German farm minister was entitled to draw forth all quota cuts in his country and to apply the measures from 1 April, 1987.

The increasingly criticised practice of the regional balancing of over- and under-production and the application of quotas at the dairy level instead of at the farm level, which have resulted in a decisive weakening of the production restraints, were not changed by the Council. But the penalty on excess production will be 100 per cent of the target price under both forms of the quota regulation, formula A and B. Irrespective of the formula applied, any production in excess of quota shall in future be subject to the full rate of supplementary (super-) levy, but only after taking into account a nationally uniform percentage of "excusable" overproduction to be calculated from the total amount of otherwise unused quotas.

Thus, following the Council decisions of December 1986, the levy will be less diluted than before and, at least beyond a certain margin of permitted over-production, more effectively penalise serious offenders. The introduction of this system is thought by the Commission to bring about an extra 1 per cent cut in milk marketing, in addition to the 8.5 per cent reduction aimed at by cutting the quotas themselves.

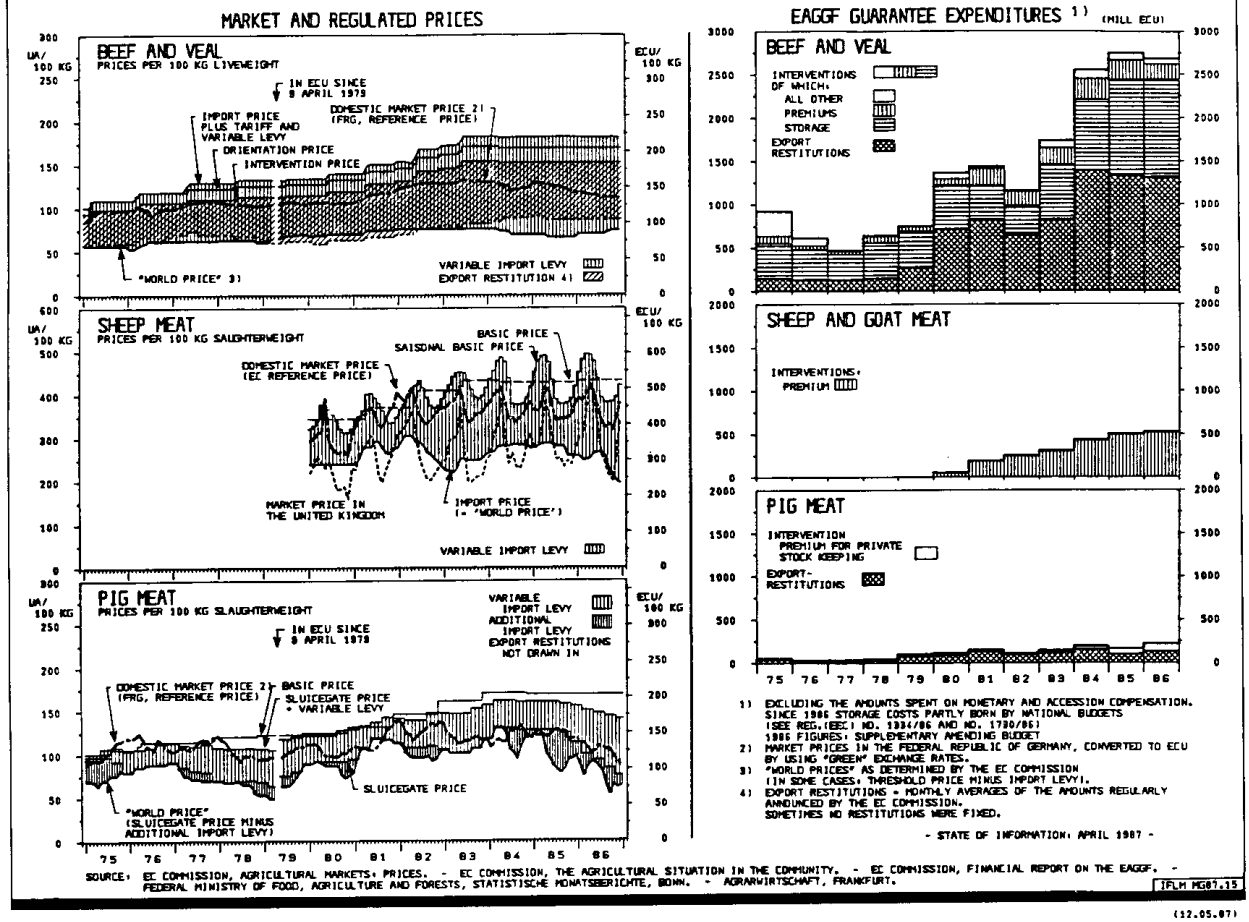
Finally, with a view to the forthcoming international trade negotiations, the Council stated in its decision that:

> ... the Community shall ensure that full credit is taken ... for the quota reductions already agreed and ... the temporary suspension of quotas ... aimed at ensuring that other exporters take equivalent action to achieve stability of the world market for dairy products (Agra Europe 19.12.1986).

2.5 Beef

EC beef and veal production mainly relies on dual-purpose breeds and therefore suffers from the restrictions presently imposed on the dairy sector: that is, that downward adjustments in milk deliveries first result in abnormal high cow culling and later on cut down calf numbers. Hence EC beef production reached an all-time high in 1984 when milk quotas became effective. Production growth (+8.6 per cent as against 1983) far outpaced demand (+1.2 per cent) and pushed up the self-sufficiency ratio to 112 percent (105 in 1983). Beef prices entered a marked trough, despite intensified intervention and subsidized exports, and EAGGF expenditure jumped up correspondingly (*cf.* Figure 6). Beef production slackened in the following years but in most countries did not fall below 1983 levels. Some countries seem to have resumed their former production growth after only a short interruption. This growth was partly due to higher slaughter weights and — following the public concern over use of hormones in calf fattening — to certain shifts in the slaughtering pattern (Probst 1986). Beef prices started to fall again in 1985 and remained below the trigger price for intervention purchases (90 per cent of the guide price). However, in view of the restricted market for frozen beef, it was clear that the increased

Figure 6: COMMODITY PRICES AND BUDGET EXPENDITURE UNDER EC MARKET REGULATIONS (PART 3)



stockpiling would only defer and multiply the (financial) burden. Early in 1986, frozen beef was sold out of German intervention stocks to the U.S.S.R. at less than 10 per cent of its original buying-in price. Under such conditions, and even without taking into account the technical and financial storage costs involved, it is evident that there was a general preference to subsidize direct exports for better clearing the domestic markets. This attitude, combined with the explicit intention to maintain an EC dominance on the world beef market (Bull. EC 12-1985, §2.1.157),[7] accompanied market developments which finally boosted EC-10 beef exports to exceed one million tonnes in 1986.

With regard to exceptionally high stocks and net exports pressing on the beef market, one should remember those days not long ago when both the EC Commission and the Council of farm ministers deemed it advisable to steeply increase the support price for beef. It was in the early 1980s that the guide price, which is the focal point for the various mechanisms in the beef and veal regime, was raised by 30 per cent within only three years (1980/81-1983/84). From the peak of 2070.90 ECU/tonne, a small one per cent was deducted in 1984, but since then the guide price has been maintained unchanged. However, notwithstanding the formal obligation of permanent intervention (since 1972) and tighter import regulations (since 1977), there was an increasing gap (of up to 25 per cent) between the guide price ("usually considered desirable for producers to obtain under normal market conditions", *cf.* CAP Monitor, § 8A.04) and the average EC market price. Due to its exaggerated high level the price support proved to be less and less effective.

In order to better adjust this ineffective but costly common market organization to present

7. *Bulletin of the European Communities,* 18 (12).

and future requirements, the Commission finally proposed a couple of amendments. Together with the dairy emergency package (*cf.* section 2.4), these proposals were discussed by the Council in December, 1986. It was agreed that, for a trial period from 6 April, 1987, to 31 December, 1988, direct payments should be extended and the intervention regime be changed from a permanent outlet into the safety net which it originally was supposed to be.

According to the December agreement, intervention purchases will continue to be released automatically without seasonal restrictions but, to limit beef intervention purchases, trigger prices and buying-in prices will be reduced. In addition, the mechanism triggering-off eventual intervention purchases will be modified. During the trial period, intervention will not take place unless the average EC market price is below 91 per cent of the intervention price (formerly 98 per cent of the guide price) and at the same time the average national market price is less than 87 per cent of the same intervention price (formerly 90 per cent of the guide price). Moreover, the buying-in price is to be made flexible. It will be the weighted average of the market prices in those member countries where intervention is operating, increased by 2.5 per cent of the intervention price. However, if from any of these countries a higher market price is reported, this higher price will apply.

On the other hand, a new premium system was added to existing ones and some of them were stepped up. First, the suckler cow premium to be paid everywhere in the Community will be financed by the EAGGF at a rate of 25 ECU per head (as against 15 ECU hitherto). Member states remain free to add another 25 ECU as before. The supplementary suckler cow premium of 20 ECU from the EAGGF plus 5 ECU from national funds applicable in Ireland and Northern Ireland will be maintained and extended to include Greece. Second, the calf premium (9 ECU per head) will continue to be paid in Italy, Ireland and Northern Ireland as well as in Greece. Italy will also continue to provide another 23 ECU per calf from national sources. Third, the U.K. variable slaughter premium will remain in place unchanged. This premium is to bridge eventual gaps between the average market price and a predetermined price target (not to exceed 85 per cent of the guide price). It may be up to 65 ECU per head and is reimbursed by the EAGGF at a rate of 40 per cent of total national expenditure. In the case of U.K. beef exports, an amount equivalent to the slaughter premium is charged to the exporter for compensation (so-called clawback). Fourth, in countries where neither the calf nor the variable slaughter premium is applied, a new headage premium is introduced. It will be paid at 25 ECU per head on the first 50 male animals of each farm. This premium will however also be paid in Ireland (normally used to share profits from the U.K. slaughter premium), but only at a rate of 18 ECU per head. Without this special arrangement, Ireland would have been left with little compensation for the tightening-up of the intervention regime, and therefore its farm minister threatened to veto the whole milk and beef package until he finally got the additional premium.

2.6 Pork

Pork production reached 12 million tonnes in EC-12 (about 10.7 million tonnes in EC-10) when in 1986 pig slaughterings approached their cyclical high. Marked production increases (+3-4 per cent) were seen in West Germany, the Netherlands and Denmark who are, respectively, the biggest pig fattener (Germany: 30 per cent of EC-10 production) and the biggest pork exporters in the Community (Netherlands: one million tonnes exported in 1985 equivalent to 175 per cent of own domestic consumption; Denmark: 0.8 million tonnes exported, 280 per cent of own consumption). The ample supply was absorbed by EC consumers at depressed prices. However, when farmers complained that pig prices were the lowest for the last 12 years, they often forgot to look at the feeding cost which, due to low-cost imports and reduced EC grain prices, ranged 12 per cent below the 1984 average. In West Germany, net receipts from pig fattening (costs of feed and piglets deducted) were only temporarily squeezed to one quarter of the preceding two years' average.

The periodic strains accompanying fluctuations in the pig cycle must not mislead to the assumption that the EC pig market was in the disarray that many other markets truly are. On the contrary, supply and demand are free to adjust without much state interference although EC pig and pork imports are kept

at lower levels than some (East European) countries would like them to be. The less regulated market does not seem to have been detrimental to the pig industry. Its generally high efficiency shows up in the following figures. In West Germany, the Netherlands and Denmark farmers experienced an annual decrease in real pig prices by 4 per cent over 22 years (1965-86) but they were still able to expand production annually by 1.6, 5.3 and 3.0 per cent, respectively (1970-86). Technical advance and structural adjustment were the leading factors behind this development which clearly was also to the consumers' benefit. However, there are also some drawbacks which increasingly make themselves felt. Public concern has been expressed about an often impaired meat quality and — perhaps even more — about the environmental effects of a progressive concentration in the pig industry. One aspect of concentration can be seen in the growing shares of total pig numbers in the largest holdings (operations with 1,000 pigs and more). In the Netherlands, this size class kept 22.0 per cent of the national herd in 1981 but 33.8 per cent in 1985 and even in West Germany (ranking at the low end of the concentration scale), these shares increased from 3.6 to 5.5 per cent during the same period. The extremely low German figures are, however, likely to be biased by existing discrimination against so-called non-agricultural ("industrial") production units (*e.g.* on grounds of a less favourable VAT regulation) and the resulting tendency to disperse certain enterprises into formally independent parts made over to different members of the farmer's family. Superimposed on the operational concentration is the regional pig density which usually is highest near the big harbours and alongside some inland waterways in the northwest of the Community. Here, the pig (and poultry) industry is already causing environmental damage (odour emission, groundwater pollution).

In 1984, the Dutch government passed an interim act banning new pig and poultry enterprises from being established in regions of already high concentration. But even under this restriction, pig numbers continued to increase and, by June 1986, they were almost 25 per cent higher than when the act came into force. The new fertilizer legislation discussed in 1986 to replace the interim law is expected to set up tighter restrictions on manure disposal but also to offer transport subsidies for displacing manure over distances of more than 20 kilometres. Since spring 1986, Dutch pig and poultry manure has been prevented by West German authorities from crossing the border because of its high heavy metal contamination (Probst 1986).

Quite another aspect of growing concentration has been put forward in the agricultural policy discussion of West Germany. The German farmers' union has repeatedly urged the government to initiate a regulation which effectively limits further growth beyond certain herd sizes. The union's aim is to reserve to its political idols, the vaguely defined family farms, a share of total animal production as big and secure as possible. It therefore recommends discrimination against the so-called industrial holdings. According to the statements issued by the farmers' union, the following size ceilings are advocated, to be applied preferably throughout the Community but even in West Germany alone if neccessary: 400 slaughter cattle, 120 milk cows, 1700 slaughter pigs, 200 sows.

The German farmers' union freely admits not being supported in this respect by its sister organizations in the other EC member countries, and that even in Germany the interests are divided. Clearly, the ceilings are too low for North German farmers but unreasonably high for the heavily fragmented South. In addition, the principle has provoked criticism within the farmers' union itself. Many of the more dynamic farmers refuse the narrow definition of the family farm, and are well aware that the restrictions may harm a sound development of their own enterprises which need to grow for better counterbalancing the adverse effects of a less favourable price policy. They also see that national restrictions are either circumvented, or self-defeating when less efficient small-scale production is protected from domestic competitors but fails to be shielded against imports. Therefore, it certainly is a better strategy to aim at tight environmental legislation for all EC member countries instead of imposing arbitrary restrictions upon the most efficient farms in only one country.

With regard to the price proposals made by the Commission for 1987/88, there is again no change envisaged for the basic price of pigmeat. If the basic price were more important for the functioning of the market, it

would have been necessary to adjust it to decreasing feeding costs. But since it is rather insignificant, the "no change" perhaps only serves to gloss over the average rate of proposed price changes which in political discussion is often used without particular reference to individual markets.

3. The Agri-Monetary Regime

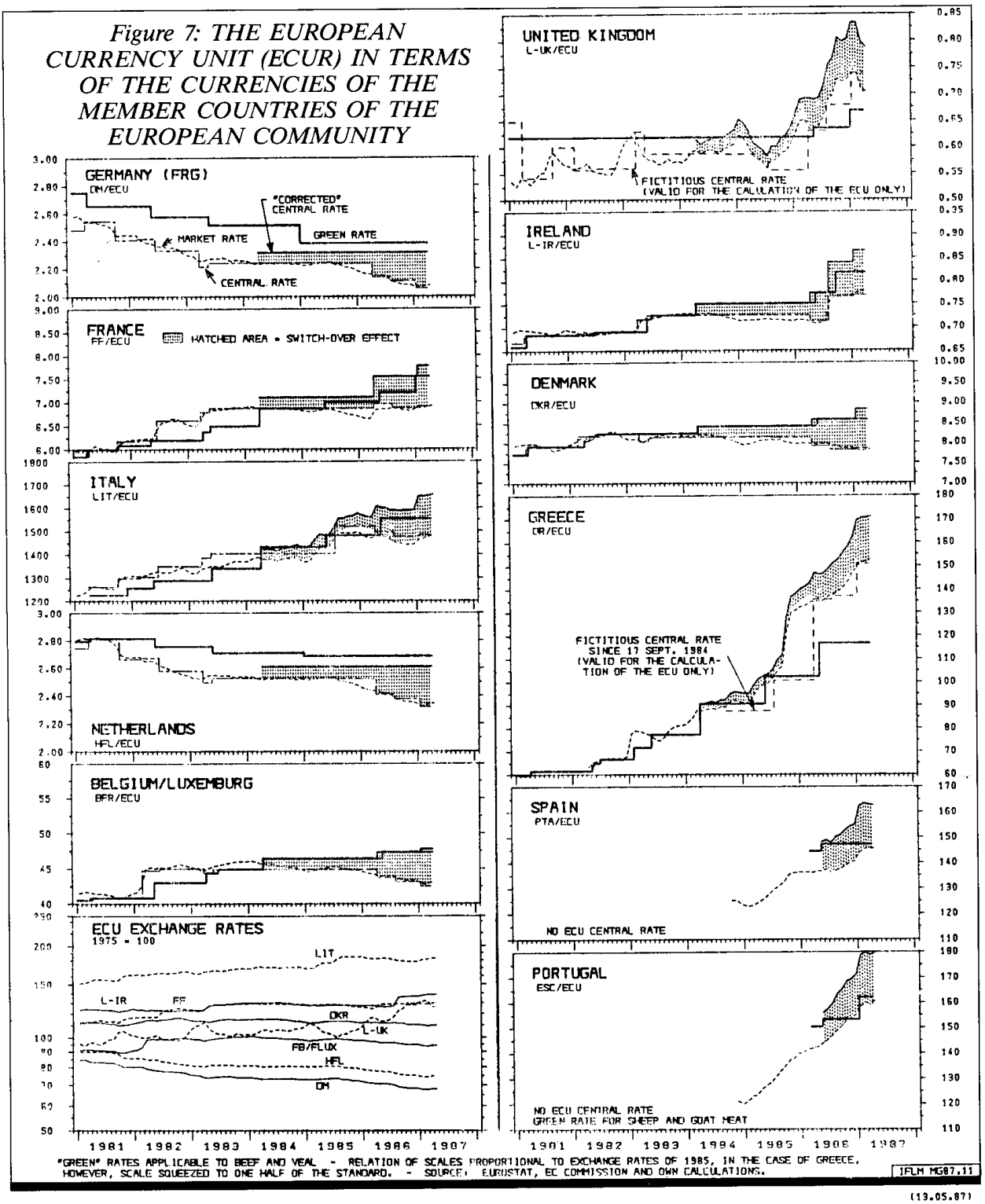
EC agricultural policy cannot be reviewed without also mentioning some monetary aspects (*cf.* Figure 7). It is well known that the central banks of the EC member states work closely together in securing greater monetary stability in their countries. Since March 1979, they have operated the European Monetary System (EMS) which is characterized by fixed, though adjustable, exchange rates and bilateral central rates tying each currency to each of the other participating currencies (Spain and Portugal are not yet members of the EMS, the United Kingdom and Greece do not participate in the exchange rate stabilization scheme). Within a fluctuation band of ± 2.25 per cent (± 6 per cent in the case of the Italian lira) around the bilateral central rates, the exchange rates are kept stable against other currencies in the system, if necessary by open market interventions and by shifting interest rate differentials. In the system a fixed composite (basket) of participating currencies is used as a numeraire in terms of which member countries' parities can be declared. The European Currency Unit (ECU) is this numeraire. After 7 years of operation the EMS was found to have served its aims remarkably well (IMF Survey, 15. 12. 1986), although there have been many periods of strain with some of them resulting in a more or less comprehensive realignment of central rates. On the whole, there have been 11 realignments from March 1979, through February 1987. Their effects accumulated, for instance, to revalue the deutsche mark by 22 per cent, and to devalue the French franc and the Italian lira by 16 and 23 per cent, respectively (always on ECU basis).

Such monetary changes are by no means negligible nor should they be looked at in isolation. It can be seen, on the contrary, that to a considerable degree they tend to counterbalance some diverging economic trends — *e.g.* inflation, interest rates, productivity, and disequilibria in government budgets or in foreign trade. However, it is also true that there often remains a varying degree of overshooting caused by speculation, political restrictions or other factors. In addition, and more often than not, there are adjustments of parities unduly delayed or complicated by issues of national prestige. These factors have made central rate realignments in the EMS more erratic than necessary.

It follows from the above that the policy of common agricultural prices, which inevitably needs a common denominator (*e.g.* the ECU) and agreed-upon exchange rates to convert fixed prices and payments into amounts of national currency, is exposed to certain disruptions whenever these parities change. Each revaluation of a currency causes fixed ECU prices to lose part of their values in terms of the revaluing currency and, as a consequence of the interdependency of all currencies in the basket, at the same time somewhat increases the equivalent amounts expressed in each of the partner currencies (and vice versa). These monetary effects were considered to endanger the political pretension of agricultural price stabilization, although the Treaty of Rome does not call for an absolute price guarantee, and the administered EC prices would still have been more stable than those in world markets even if from time to time they were exposed to influences from monetary adjustments. Unwelcome inflationary shocks as well as pressures on farm incomes were taken to justify a complicated system of special agricultural conversion rates which was to isolate agriculture and the food industry from the monetary realities that any other sector of the EC economies had to face unprotected. But the introduction of so-called "green" exchange rates also necessitated the application of "monetary compensation amounts" (MCAs). With regard to agricultural trade, the latter had to compensate for the price differences caused by divergent market and "green" rates of any member state's currency in order to avoid artificial diversions in the intra-Community trade pattern.

Originally, when the "green" rates and the MCAs were introduced, they were said to be needed only to cushion the sudden disruptions from larger exchange rate adjustments, but in practice they were maintained much longer (together with the differentiation of exchange rates). The revaluing countries always fiercely objected to any decreases in the agricultural price guarantees, especially when they saw

Figure 7: THE EUROPEAN CURRENCY UNIT (ECUR) IN TERMS OF THE CURRENCIES OF THE MEMBER COUNTRIES OF THE EUROPEAN COMMUNITY



their neighbours getting higher prices. Over the years, there was considerable political and scientific debate as to whether or not agriculture in the revaluing countries was favoured by artificially high prices (through out-dated "green" rates) and by their positive MCAs acting as an export subsidy on all products subject to intervention schemes and their derivatives. On grounds of economic theory this question certainly has to be answered in the affirmative, but empirical evidence was hard to provide — let alone the political acceptability of related argumentation.

With the political part of this debate still being open, the German farm minister in 1984 surprisingly proposed and rushed through an

amendment of the agri-monetary regime which, for a trial period of three years, simply transformed the most objected positive MCAs into usually less criticized negative ones. The new trick was to create so-called "corrected central rates" besides the official ones. The correction to be made is such as to ensure that, on the occasion of any new realignment, the corrected rate of the strongest currency must come through totally unchanged and it involves the same correction factor to be applied on all EMS currencies. However, it was clear from the beginning that this trick, the so-called switch-over mechanism, not only relieves the revaluing countries from price depressing monetary effects but at the same time gives the devaluing countries new leeway for additional price increases. To the extent that this opportunity is seized — and so far governments have seldom failed to do so — the switch-over indirectly raises the average EC farm price (*e.g.* in U.S. dollar terms) in spite of their nominal ECU amounts being unchanged. It can be seen from the increase of the central rate correction factor, which in 1984 was set at 1.033651 and since 12 January, 1987 is 1.125696, that this margin of tacit price increases is not just negligible, and it must not be omitted when EC farm prices are compared with prices in non-EC countries.

The situation is explained in Figure 7. Prior to the 1984 revision of the agricultural monetary system it was, in principle, the difference between a country's "green" rate and its (official) central rate which had to be compensated by the MCAs. Since then the corrected central rate has in this respect replaced the official one. The hatched area between the (official) central rate and its corrected counterpart is an indication of the size of the switch-over effect. Under both agricultural monetary systems, however, two exchange rates can be looked at always to represent, respectively, the same two levels of agricultural prices: the "green" rate stands for administered farm prices, the market rate represents the path which prices would have taken without agri-monetary interference (always constant ECU prices assumed).

In the context of the 1987/88 price proposals, the Commission once again attempted to modify the complicated agri-monetary system in order to overcome its built-in propensity to increase the levels of agricultural prices. This shall be achieved by automatically cutting the ECU prices on any future parity adjustment. The price reduction is to amount to half the percentage of the change in the central rate correction factor at the beginning of each of the two marketing years immediately following the realignment. For the country with the strongest currency in the realignment, the new procedure would imply automatic price cuts to the extent of the underlying parity change, while the devaluing countries may still increase their prices according to the extent of their own currency devaluation, and reserve the switch-over effect for counteracting the cuts in the ECU prices.

Thus the proposed amendment effectively turns out to restore the situation which in 1984 the German farm minister intended to eliminate, namely the accruing monetary pressure on CAP determined prices in the strong-currency countries. Therefore, he is fiercely determined to fight the Commission's proposals and he is unlikely to accept any imaginable compromise (*e.g.* on the basis of direct compensatory payments). The EC Commission, on the other hand, has good arguments for its case, namely to try to cut down newly emerged MCAs since otherwise agriculture would be increasingly isolated from national and international economic interdependencies and finally risk permanent damage and distortion. But the implementation of the proposed new arrangement of automatic ECU price cuts does not offer any opportunities which were not available under the present system. With regard to the detrimental price increasing effects of the established regime, the Commission has to be reminded of many early warnings (*e.g.* Manegold 1984) and of its own affirmation made in 1984 always to take these effects into account when the annual price changes are proposed. Supposing that all chances for reasonable price cuts were already taken, it would not make much sense to ask for a new instrument only to fail again in its use. Also, a formal decision to scrap the whole agri-monetary system by 1992 is, by all EC experience, premature at least. Any brief glance at the economic realities in the EC member countries (diversity of growth, inflation, exchange rates *etc.*) reveals that a pure policy of common agricultural prices is bound to run into difficulties which necessarily become greater the smaller is the margin for price increases. There are few indications (if any at all)

that this situation will change soon.

Even in some of its less central proposals concerning the agri-monetary regime, the Commission has provoked strong opposition. While it seems likely to be acceptable for most countries that additional products (peas, beans and lupins because of emerging subsidy differentials, and olive oil) will be included in the monetary compensation arrangements, there are opposite national interests affected when the introduction of wider MCA franchises (uncompensated exchange rate differentials or "neutral margins") is at stake. Moreover, there will hardly be a majority to follow the Commission in abandoning the practice of product-specific (multiple) green rates.

Finally, the short-term changes to the green rates which the Commission proposed are designed first to cut the negative MCAs by the amounts applying just prior to the January 1987, realignment (with reductions limited to 4 points for the United Kingdom and to 5 points for Greece) and, at some time within the 1987/88 marketing year, to dismantle the MCAs resulting from the January parity changes. A total elimination is proposed of the German and the Dutch positive MCAs.

Taking the envisaged price and agri-monetary changes together, there is again a considerable variation in the overall price effects calculated in national currencies. German and Dutch agriculture would face a negative price impact (−2.5 per cent); and Italy, Belgium, Luxemburg and Denmark were (within a margin of ± 0.5 per cent) to range near the EC-10 average (−0.5 per cent on ECU basis, +0.2 per cent in terms of national currencies). The other countries would get price increases of about 1.5 per cent (France and Ireland) or of 2.4 to 2.7 per cent (Greece and the United Kingdom). Spain and Portugal would continue to adjust to EC price levels and on average increase their prices by 5.2 and 0.3 per cent, respectively. Judging from current year inflationary expectations, there is no country where real price increases were likely to occur. Real price decreases of up to 10 per cent might result for Greek and Portugese agricultures, but both countries might be able to counteract such developments by additional green rate adjustments. Perhaps this is also true for Italy (real price decrease of about 5 per cent) but not so for Germany (with an estimated real price cut of roughly 4 per cent).

4. Budgetary Constraints

The EC budget suffers from two facts: its narrow resources and the burden of agricultural expenditures. Moreover, it is badly exposed to some institutional mechanisms which are counter-productive to any fairly rational policy serving common interests. The following example is one illustration of this exposure. In the whole decision-making process of the Council of farm ministers there is no built-in mechanism to control the budgetary consequences of the decisions taken. The decisions do not need the approval by the Council of finance ministers, the European Parliament cannot exert effective control, nor must the farm ministers observe the restrictions of any medium-term budget plan. Once the farm ministers, who always have the interests of their home constituencies in mind, have decided on a proposal made by the Commission, the Community has to take the consequences irrespective of the level and distribution of costs and benefits. The only budgetary restrictions which do apply to EC policies are the natural limitations of own resources:

> ... the price decisions of the Council are virtually dictated by those restrictions or, in other words, ministers are exploiting available resources mostly without any consideration for the internal and external consequences of these price decisions: such as surpluses and the effects of export subsidies on Third [*i.e.* non-EC] countries (Schmitt 1986, p. 338, see also Harvey 1982).

Against the background of such distortive mechanisms it seems to be a real danger, rather than a comforting precaution, that the EC Commission has recently made proposals for providing the Community with larger financial resources.

The Community's own cash resources comprise total customs duties and agricultural levies (minus a 10 per cent collection charge payable to the member countries), as well as a share in the national value added tax of up to 1.4 per cent of taxable turnover. Financial contributions collected from agricultural producers (so-called co-responsibility levies) directly fall to the budget's agricultural section, the EAGGF. In violation of the principle of double-entry accounting these financial contributions effectively reduce the volume of the EAGGF budget (by about 5 per cent in 1986).

Despite being committed to annually balanced accounts and to meeting the often unpredictable financial liabilities resulting

from common policies, the Commission is nevertheless not entitled to overspend nor to raise credit on financial markets. It has therefore from time to time resorted to exceptional measures: governments have been asked to make special contributions (in addition to or in anticipation of the regular ones), to take back part of the financial responsibility previously conferred to the Community, or to pre-finance actual expenditures on assurance of later interest and redemption payments. Even by purely administrative means (variation of terms of payment or extended stockpiling), the Commission has been able to postpone payments into the following year. Such practices have been objected by the EC Court of Auditors but usually the Commission has been politically protected by the Council of finance ministers.

The urgent reorganization of EC finance clearly needs a balanced approach on the expenditure side which includes the whole range of agricultural produce. Moreover, it has to take into consideration the pressing problem of surplus disposal. Stocks have accumulated to almost 12,000 million ECU (book value at storing-in prices, *cf.* Figure 1) and high annual costs have to be borne by the community. Costs accrue not only from handling and preserving the merchandise in stores and from the interest on outlays made on the occasion of purchase, but also from the loss incurred through price differentials (purchase minus sales prices) or through quality deterioration and decay. From the budget point of view this loss is not taken into account before the goods are sold since current loss adjustments are against the rules. But this questionable practice always tends to veil the true financial situation and allows the easing of acute budgetary pressure simply by deferring regular stock releases into a later year.

Besides the budgetary effects resulting from increased agricultural production (mainly through direct payments on production, intervention costs and the volume of net exports), there are also those linked to prices and exchange rates. It goes without saying that high support prices have contributed to inflate EAGGF expenditures. Decreasing world prices and the weakening U.S. dollar have in addition continuously worsened the financial situation since the widening gap between world and EC agricultural prices has heavily increased the preponderance of EC expenditures on export subsidies over the receipts from import levies. This mechanism was even more effective than the dollar/ECU exchange rate and statistically reported world and EC prices themselves might suggest (*cf.* section 3). The very peculiar monetary regime which the Community adopted for CAP purposes in 1984 and which relies on an increasing distortion between "real" and agricultural ECUs has also had its budgetary effects.

In a joint effort to overcome the desperate financial situation, the EC Commission and the Council of farm ministers have, in their December 1986, meeting taken steps to reduce/curb financial commitments. Beef and dairy intervention will be restricted (*cf.* the related sections above) and unconventional measures to cut down useless intervention stocks were agreed upon. In 1987 and 1988, a vigorous de-stocking programme is to affect some 700,000 tonnes of skimmed milk powder and 1 million tonnes of butter. Release of butter is envisaged not only for export and an improved social scheme but also — especially as far as over-aged butter is concerned — for livestock feeding and for industrial uses. However, before the programme will alleviate the EAGGF budget through reduced storage expenditures, it will cost the Community an estimated 3,200 million ECU (the recent butter sales to the U.S.S.R. have, perhaps, made this estimate obsolete). These high costs cannot be borne by the budget. Therefore, the member states were called upon to carry the loss until 1989 when, according to the December agreement, they will be reimbursed from the EAGGF budget in four annual installments. Meanwhile, the EC Court of Auditors has sharply criticized the obvious intention in this way to circumvent the rules of common finance. But member state governments nevertheless re-confirmed the Council's decision.

5. Conclusions

The very uncomfortable situation which the Community has run into with its Common Agricultural Policy is highlighted not only by agricultural surpluses and budgetary costs, but also by the present conflict between the EC Commission and the Government of the Federal Republic of Germany. The conflict broke out when the Commission proposed in its 1987/88 price package to reduce further the agricultural price and intervention guarantees,

to dismantle the MCAs and to translate any future parity revaluations into additional price cuts. While the restrictions decided upon in December 1986 were still supported by the German farm minister, there was determined opposition against "the stupid policy of unsocial price cuts which only damages the farmers' incomes without solving the problem of agricultural surpluses". Strongly backed by the farmers' union and some German state governments, the minister explicitly reconfirmed his strategy of "reduced production for increased prices" (see Kiechle 1986). To achieve this aim, tighter and more extended production controls (quotas, set-aside programmes, herd size limitations have been proposed as a precondition to future producer price increases. Hopes have been raised that diversified crop patterns (to include oil- and protein-rich crops, fibre plants, medicinal herbs), alternative use of bio-mass (*e.g.* for energy production) and early retirement schemes will contribute to secure the economic existence of farmers. For immediate relief, social aid programmes for farm families are to be subsidized more heavily from national funds, and the regional support offered under EC regulations was at the same time increased and considerably extended (to cover half of West Germany). Moreover, a one-state set-aside programme has been initiated on a trial basis under which farmers may get up to 1,800 deutsche marks per hectare (depending on soil fertility) for idling a maximum of one fifth of their area (on the assurance that participation will not prejudice any future production rights should a general set-aside program be enacted).

To dismiss the new official course of German agricultural polciy as lacking sound economic foundations and being bare of intersectoral and international regard would presumably be justified, but would also be too easy. In fact, many objections were raised against it on economic grounds in the national agricultural policy discussion. However, as things are, it is feared to be more than just a fleeting touch of agrarianism which will be corrected soon after the present series of federal and state elections is over.

It goes without saying that the German policy approach is not shared in the other EC member countries. France, the Netherlands, the United Kingdom and Denmark have better structured agricultures and see their relative advantages in less restricted competition. Up to now they have watched with amusement the German trend to conserve its folklore farms, but these countries are ready to intervene immediately should the German experiment entangle their own interests or affect the German contribution to EC finance. The EC Commission is meanwhile sticking to the restrictive proposals made in its price package aimed at re-establishing the function of prices in EC agricultural markets. Even if it were only on financial grounds, the Commission has no other choice. Therefore, the continuing negotiations on the 1987/88 price package will be extremely difficult. Each side has spelled out its aims clearly and thereby reduced the chances of an early compromise — which after all has to be found. The slow process of policy adjustment — not to speak of the CAP reform proper — may be retarded again.

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