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**Fourth Minnesota Padova Conference on
Food, Agriculture, and the Environment**

Proceedings of a Conference Sponsored by
University of Minnesota
Center for International Food and Agricultural Policy

Universita degli Studi di Padova
Dipartimento Territorio e Sistemi Agro-forestali

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Ente di Sviluppo Agricolo

**SESSION I: RECONNAISSANCE OF AGRICULTURAL AND
ENVIRONMENTAL POLICY DEVELOPMENTS:
U.S. AND E.U., NAFTA, AND GATT**

**PAPER 2: AGRICULTURAL POLICY DEVELOPMENTS IN
THE EUROPEAN UNION**

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AGRICULTURAL POLICY DEVELOPMENTS IN THE EUROPEAN UNION

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1. INTRODUCTION¹

The reform of the Common Agricultural Policy (CAP) adopted on 21 May 1992, to be implemented by 1996, anticipates some essential features of the 1994 Uruguay GATT Agreement to be implemented between 1995 and 2000.

Together these two events will change substantially, and sometimes reverse, the past trends in the EU agricultural policy, and generate unprecedented changes in production, trade, as well as in producers' and consumers' welfare, creating conditions for a more timely structural adjustment.

This paper will first outline the new scenario of agricultural policy in the EU in order to better devise its likely impact on the economy, namely on income distribution, on resource allocation and on the natural and social environment.

A third part of the paper will focus on the perspective developments of the CAP before the beginning of the next round of multilateral negotiations in 1999, examining the possibility of a further progress of CAP reform triggered by the implementation of the GATT agreement and by a better information among European citizens of the effects of existing agricultural policies.

2. GATT AGREEMENT AND CAP REFORM

The 1994 agreements have brought agricultural policy into GATT, clearly classifying existing policies in two categories.

A first group of policies which generate trade distortions, or effects on production, or involve transfers from consumers, or provide price support to producers may be considered socially undesirable in principle, and commitments have been taken in order to gradually reduce them in the future. These policy measures are implicitly considered 'unfair' to other social groups at domestic level, or to other countries at global level.

A second group of policies, which do not generate perceivable trade distortions or effects on production, do not involve transfers from consumers and do not provide price support to producers, are exempted from reduction commitments. These policies may be considered 'fair' as *per se* they are not likely to damage other social groups and, if well implemented, could result in increased national and/or global welfare.

¹ Useful suggestions by E. Croci-Angelini, improving the first draft are gratefully acknowledged. Some paragraphs of this paper are taken from: S. Tarditi, Agricultural policies in CEECs countries: oriented to CAP or to global integration?, XXII IAAE Conference, Harare 1994.

2.1. MEASURES UNDER REDUCTION COMMITMENTS

In principle the most important policy measures under reduction commitments are export subsidies, whose budget outlays in industrial countries, according to the GATT agreement, will be cut by 36% in value terms, while the volume of subsidised exports for each commodity will be cut by 21% from the base period (average 1986-90), over the next six years.

Non-tariff trade barriers will be converted to bound tariffs based on the 1986-88 tariff equivalent and will be reduced by 36% as unweighted average (each item will be reduced by at least 15%). Sanitary and phytosanitary import barriers claimed on health and safety grounds will have to be scientifically based.

Domestic support as indicated by the Aggregate Measure of Support (AMS) will be reduced on average by 20% from the 1986-88 average.

A number of loopholes and wide room for dispute on the definition of the actual reductions of these policy measures are still present in the GATT agreement (Anderson 1994), however the principles and the pace for dismantling these policies are clearly agreed.

2.2. PARALLEL FEATURES OF THE CAP REFORM

The 1992 CAP reform had anticipated some of these changes with reference to all products subject to market organisation with the exceptions of sugar, wine, fruit and vegetables, pigmeat, poultrymeat and eggs.

Price support is eliminated for oilseed and protein crops, while the intervention price for cereals will be cut by 30% over three years.

Milk prices will be reduced by 2.5% while eliminating the co-responsibility levy (1% of target price), the intervention price for butter is reduced by 5% and the milk production quota will be reduced by 1%.

Intervention price for beef will be reduced by 15% and ceilings will be put to buying into intervention from 750.000 t in 1993 to 350.000 t in 1997. Premiums for suckler cows and male bovine animals are raised but are paid only to producers who respect a stocking rate per ha of forage area. Individual limits on sheep and goat premiums are established for producers.

2.3. MEASURES EXEMPTED FROM REDUCTION COMMITMENTS

Annex 2 of the GATT agreement defines the basis for exemption from reduction commitments and lists in detail various examples of policy measures which can be implemented. Frame 1 provides a synthesis of the major groups of these allowed policies.

Stabilisation of the domestic market, of farm incomes, assistance to structural adjustment and environmental protection are all objectives that could be reached through an appropriate use of these policy measures, without creating side problems on the domestic or on international markets.

2.4. PARALLEL FEATURES OF THE CAP REFORM

Measures accompanying the reform of the CAP that may be classified at large as exempted by reduction commitments in the GATT can be subdivided in three groups:

- agri-environmental measures provided in order to protect environment and the countryside,
- early retirement schemes to encourage retirement of elderly farmers and use their land to facilitate structural adjustment,
- reforestation schemes to find other uses for agricultural land as forestry and leisure activities.

In order to compensate farmers for the fall in support price of cereals, oilseeds and protein crops, per-hectare payments are granted, conditional on setting aside at least 15% of the area for which the producer applies for aid. Reference is made to the regional base area (average of years 1989-1991). Small producers (92 t of cereals, approximately 20 ha) are exempted from set-aside requirements.

These direct payments under production limiting programs, in the GATT agreement are not considered support for producers and consequently are not included in the calculation of the AMS and are not under reduction commitments. However these payments are only partially decoupled from farm production and their impact on farm supply and trade distortions is apparent.

3. LIKELY EFFECTS OF RECENT POLICY CHANGES

The future impact of GATT agreements on the actual dismantling of unfair policy measures will largely depend on the attitude of national governments, which is largely a result of the political power of existing pressure groups.

Actually farmers interest groups have largely contributed to shape the outcomes of the Uruguay Round and CAP Reform. Liberalisation has been wider in commodities where producer groups in various countries had diverging interests (cereals, oilseeds) while has been much more modest when the stronger producer groups had converging interests (sugar, dairy products).

The future reduction in actual domestic support by the end of the century, is likely to be rather limited. (Anderson 1994). Agricultural export subsidies are still tolerated and the impact of their agreed reductions by the year 2000 on domestic production will be limited by expected rise in world prices.

The impact of tariffication and tariff reduction is likely to be modest as well, by the agreed computation of 'unweighted average' tariff cuts and by the high level of claimed tariff equivalents in the depressed base period 1986-88. Allowed tariff variability in order to stabilise domestic markets will still increase fluctuations on world food markets, while elements of quantitative trade management, including

scope for discriminatory limitations on trade, reduce the adjustment to changing market circumstances.

The 20% reduction of the aggregate level of domestic support has already occurred in large part, and some important support measures, as direct payments under production limiting programs, are not included in the aggregate measure of support.

For the EU-12 it will be easier to meet the GATT targets by year 2000 thanks to the accession of EFTA countries which used to have more protectionist agricultural policies than the CAP. A substantial part of the adjustment required to the enlarged EU will be born by farmers of the new member states.

Notwithstanding the existing loopholes and room for manoeuvre, some likely effects of the GATT agreement and CAP reform can be foreseen.

3.1.ALLOCATIVE EFFECTS

In the short term the negative effects on resource allocation widely recognised in the pre-reformed CAP will be partially reduced. According to numerous estimates, about 30% of the income transfers flowing from households to producers is likely to be lost in inefficient allocation of resources. These estimates usually do not account for the administrative costs of implementing policy programs, when born by national and local governments in the EC, and for the allocative and transaction costs of raising taxes in order to finance budget outlays.

Lower price support should improve the allocation especially of labour and capital both at intersectoral and at intrasectoral (inter commodity) level. Non agricultural industries will increase their international competitiveness as lower food prices will reduce real wages. The development of non-farm related sectors in the economy will probably be fostered.

These allocative benefits will be partly offset by the increased amount in transaction costs necessary to implement and control the direct producer payments, and set-aside obligations.

In the longer term reduced price support are likely to stimulate intersectoral and intrasectoral structural adjustment generating further economic benefits, notwithstanding the negative impact of persisting production quotas in the sugar and dairy subsectors.

3.2.REDISTRIBUTIVE EFFECTS

The redistributive effects generated by lower price support in the EU will favour a better **interpersonal** income distribution in the society. Lower food prices will favour in larger proportion worse-off consumers and benefit less the better-off producers.

Regions will loose in proportion of the reduction in support granted to their farm products and gain in proportion of their demographic size, consequently. **interregional** income distribution will probably change in the right direction. As

an example, poor Mediterranean regions are likely to be advantaged as compared to continental regions where the reduction in price support is larger.

However the administrative costs of implementing producer payments and set-aside will be larger in the poorer member states and regions, where usually the administrative apparatus is less efficient. Improved opportunities for better structural adjustment will probably reduce the disparities existing between member countries and between farm and non-farm incomes. (Frame 2)

Extra profits generated by production quotas and land-based compensatory payments will be still incorporated in asset values, privileging the remuneration of capital as compared to labour and offsetting the positive impact of reduced price support on the **functional** income distribution.

3.3. ENVIRONMENTAL EFFECTS

As far as **natural environment** is concerned, the use of polluting inputs is likely to be reduced as a consequence of lower output prices. These benefits will be more apparent in continental member states and regions, where the present pollution is more diffused. (Frame 3)

In some environmentally sensitive areas, the reduction in positive externalities related to lower price support could be obtained through targeted local programmes, at a lower cost for society.

Effects on the **social environment** are less debated in the literature.

In the short term, the increase of public intervention, detailed regulations and bureaucracy at local level are likely to reduce the existing entrepreneurial capacities and increase the propensity to frauds. Especially in regions where the public administration is less efficient, opportunities for frauds and reduced transparency on market transactions have obviously a negative impact on social welfare.

At international level, reduced distortion on world market prices and lower losses in global welfare will probably improve the diplomatic relations of the EU with many trade partners.

In the longer term, the reduced possibility for farmers of getting extra profits by influencing price support policies will probably weaken the existing network of pressure groups.

4. PERSPECTIVE DEVELOPMENTS

External pressures for CAP reform have been displayed in the GATT negotiations, but for further achievements in the next years, it would be necessary a domestic willingness to reform CAP according to GATT principles

On equity grounds, the benefits generated by CAP and still concentrated in relatively few better-off farmers do not justify the higher cost for consumers and taxpayers and for society as a whole, unless we admit a bias of the policy maker in favour of farmers as frequently assumed in the literature.

However if such a bias in favour of farmers existed, without any other justification on allocative, distributive or environmental grounds, I doubt it could be admissible in many developed countries where their constitutions state that all citizens must be treated on equal grounds.

In fact this assumed preference of the policy maker in favour of farmers is just an abstraction which does not exist in practice, or in any case could not generate such strongly biased policy measures. The actual outcome in terms of agricultural policies is much more the result of a well organised strategy of farmers interest groups, who are in a quasi-monopolistic position on the domestic political market, given the almost non-existent strength of countervailing pressure groups from the consumer side in most EU member countries.

4.1. CORRECT INFORMATION: AN ESSENTIAL PUBLIC GOOD

One of the basic issues in the long term strategy of these interest groups is the manipulation of information, particularly in Southern member countries of the EU, where mass media are probably more easily influenced.

As consumers are usually less interested in the technicalities and effects of agricultural policies, while farmers are the most interested readers and user of news related to their direct interests, much frequently information at national and regional level is distorted in a number of ways, e.g. by identifying the member-country interests with its farmers interests. In the press dealing with agricultural policy problems the impact of price support measures on consumer welfare is rarely mentioned while producer benefits are widely publicised. The result is a wide lack of information or even a very distorted information on the actual impact of policy measures among farmers and the general public.

Frame 4 presents some answers given in the last special survey on CAP accomplished by Eurobarometer (1988) ¹ on a representative sample of EC12 citizens (11651 interviews on people over 15 years old). A large share of people interviewed declared their complete ignorance of the CAP (answers "do not know" vary between 9% to 34% among general people and between 7% and 29% among farmers)², however opinions of people who answered the questions are quite interesting.

As indicated in Frame 4, although the CAP in the UK increased agricultural support and changed the deficiency payment scheme to market price support, shifting the burden from taxpayers to consumers, the majority of interviewed British farmers think that consumers have benefited from CAP. The same opinion is shared by over one fourth of consumers. In Ireland such percentages are equally alarming.

These opinions are quite far away the OECD research work where the transfers generated agricultural policies are costing over 1300 Ecu/year per

¹ Eurobarometer performs a monthly opinion survey on EU citizens on general political, economic and social issues, complemented by some surveys on special topics such as the CAP.

² This share is not published per every question, consequently the full interpretation of results is less strait forward.

household, and benefiting over 13000 Ecu per full time farmer equivalent or over 800 Ecu per ha¹.

A large majority of EC12 population and of farmers believe that the EC should defend its position as the second world agricultural exporter, while a slightly smaller majority think they should not pay for CAP as consumer and as taxpayers, not realising the inconsistency of this opinion with the defence of export leadership.

Concerning public expenditure in agriculture, among the 75% who answered there is not a clear majority among general people, while among farmers 59% (70% of answers) think EC budget expenditure is insufficient.

This glimpse of how distorted is information among EU farmers and consumers on CAP is quite surprising. Probably a more correct information does not reach the general public also because it is per se too complicated or it is presented in a poorly appealing way. However a correct information is a prerequisite for a strategy towards agricultural policies that could be more beneficial to society as a whole.

4.2. CLEARLY STATED OBJECTIVES

Setting clear and widely accepted objectives is the obvious starting point of policy-making.

In market oriented economies the private sector is the centre of the economic activity and self-interest behaviour is the core of economic development. As Adam Smith clearly pointed out, private entrepreneurs produce essentially for themselves, yet increasing in the same time the wealth of the whole society. However, the interests of society as a whole are protected by laws formulated by policy makers and enforced by public servants, against the possible abuses of private-oriented behaviours of individuals. Economic policies in particular are supposed to aim at increasing social welfare by preventing the formation of monopolies and oligopolies, as well as by fostering economic efficiency, improving interpersonal income distribution, providing public goods, reducing negative externalities and favouring positive externalities generated by private firms or individuals.

The concept that policy makers behaviour should aim at maximising the 'common good' when in contrast with the 'private interest' is as old as western civilisation. In the fourth century B.C. Aristotle was already classifying governments in two categories, according to their attainment of the common good. (Aristotle p. 207)

Forms of government aiming at increasing the welfare of society as a whole are classified as 'perfect', while governments aiming at private interests of individuals or social groups are classified as 'degenerate'. Monarchy for example may degenerate into tyranny if it is pursuing the personal interest of the king,

¹OECD (1993) *Agricultural Policies, Markets and Trade, Monitoring and Outlook 1993*, Paris

aristocracy may degenerate in oligarchy if pursuing the personal interest of the few people ruling the country, even democracy may degenerate if it pursues only the private interests of poorest people at the damage of the whole society.

Although preferences of individuals are assumed to be selfish to a large extent, philosophers and religions most diffused in western countries consider giving the same weight to everybody interests a fundamental of moral behaviour for individuals. *A fortiori* the policy maker, in attaining the highest social welfare, should give the same weight to all individuals, without discrimination. Actually in numerous countries, when ministers take office, they must swear that they will pursue only the supreme interests of the nation and not private interests of any type.

4.3. COUNTERVAILING INTEREST GROUPS

If these broad objectives of economic policy are accepted, information should not be distorted in favour of particular interest groups when their behaviour leads to policy decisions contrary to social welfare.

A possible means of avoiding a quasi-monopolistic position of producers' lobbies, could be increasing public support for consumers' and possibly for other organisations which could constitute a countervailing power, capable to guarantee a non distorted information on agricultural policy issues.

A second institutional step could be to avoid all possible interference between the public and the private sector which could be noxious to a feasible maximisation of social welfare through agricultural policies.

Too often policy makers involved in agricultural policy have strong direct personal interests in agriculture. In some countries, for example, it is commonly accepted that it is much better for a minister of agriculture to be a farmer or to hold a long experience in farmers unions, in order to better understand and solve the complicated and highly specific problems of agricultural policy.

Unfortunately these personal characteristics, consciously or unconsciously, are likely to bias his behaviour when he chooses between private, sectoral or public interests. As a matter of fact, in some more civilised countries when these conflict of interest arise the policy maker must temporarily alienate his property to a 'blind trust' in order to avoid noxious interference between personal and public interests.

4.4. FAIR VS. UNFAIR AGRICULTURAL POLICIES

The broad guidelines to agricultural policies leading to a global economic integration are set by the recent GATT agreement, where the agricultural policy measures exempted from reduction commitments are listed in Annex 2. These measures should have no or at most minimal trade distorting effects, should be financed by public funds not involving transfers from consumers and should not provide price support for producers.

In principle at least, these policies, widely applied also in the EU, are not the main responsible of the negative effects of the CAP summarised in the previous

sections of this paper, consequently they could be implemented wherever deemed useful in order to meet efficiency, redistributive or environmental goals.

On the other hand bilateral and multilateral pressures on EU policy makers to complete the CAP reform on the remaining sectors, especially dairy and sugar, and to dismantle gradually the existing policy measures under reduction commitments could ease the European integration process in coming years.

As a common goal of European integration for 2010, the major price support measures still existing in the EU could be decoupled, and compensations to farmers could be jointly financed by EU, national and regional governments. This strategy would be consistent with existing GATT commitments and along the line of further liberalisation in the next round of multilateral trade negotiations initiating in 1999.

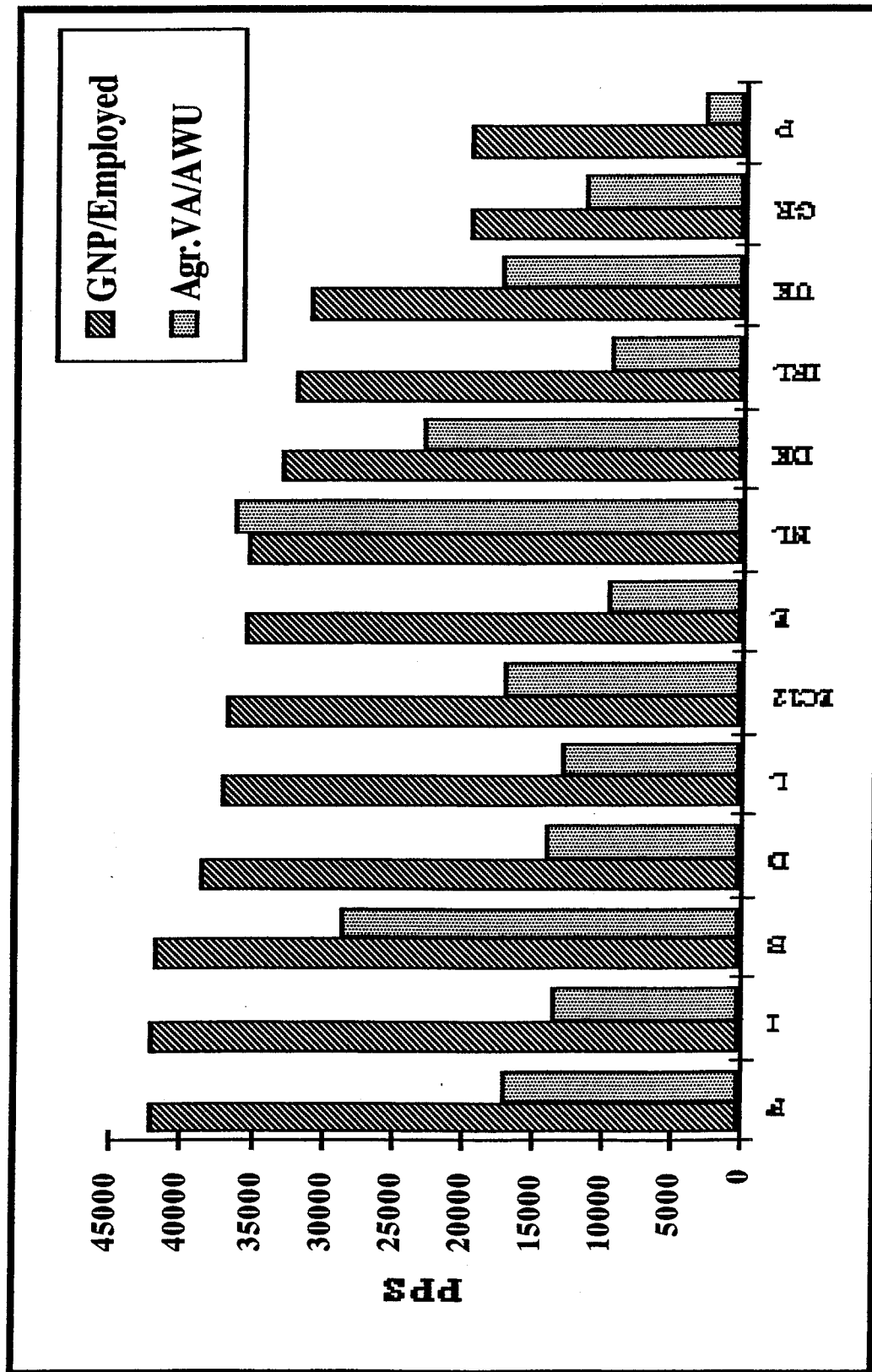
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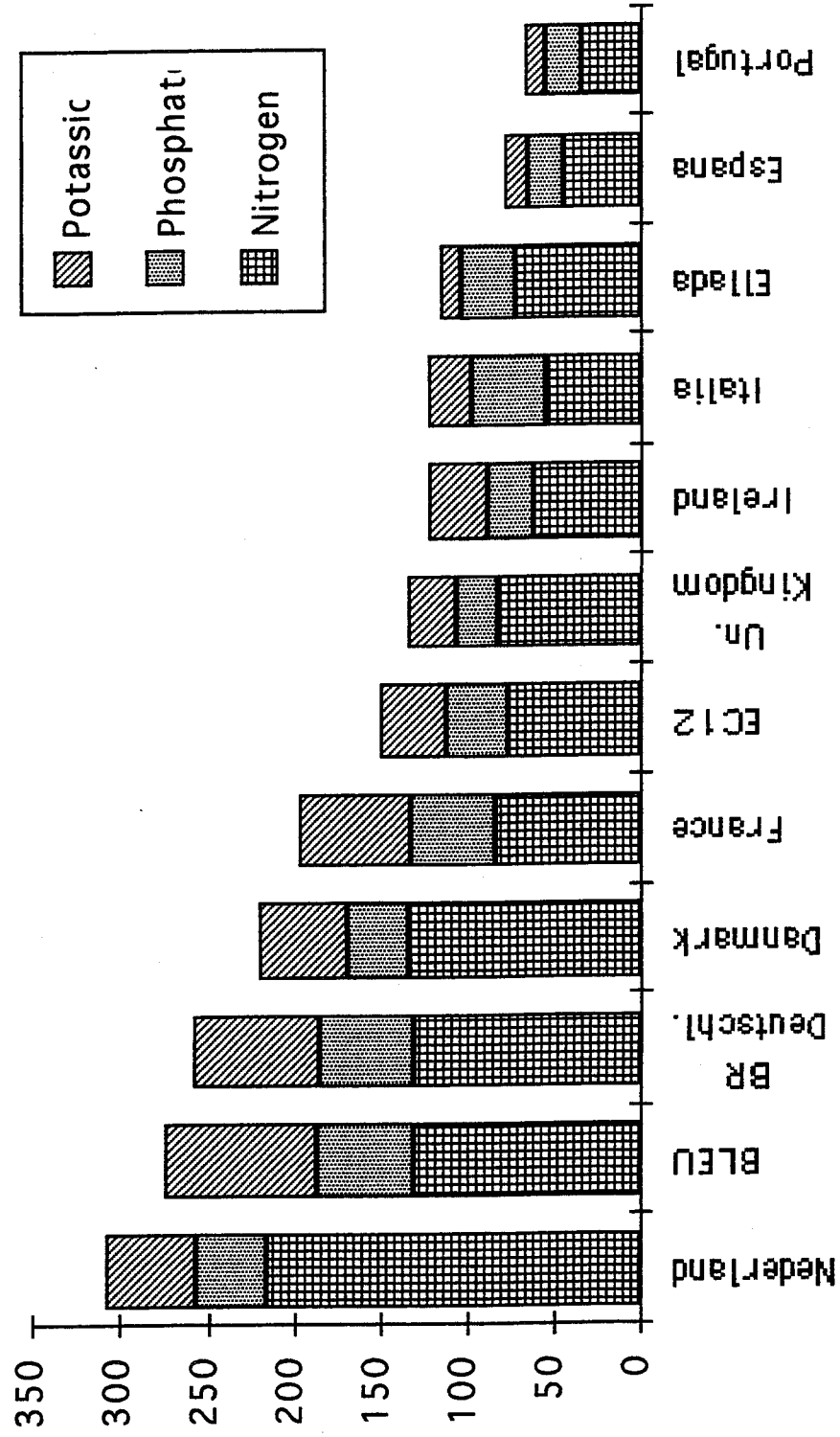
Frame 1 Policies exempted from reduction commitments

- **Agricultural measures exempted from reduction commitments**
 - have no, or at most minimal, trade distorting effects
 - financed by public funds, not involving transfers from consumers
 - not providing price support for producers
- **1) General services (research, training, extension, marketing & promotion, infrastructures**
- **2) Public stockholding for food security**
- **3) Domestic food aid**
- **4) Direct payments to producers**
- **5) Decoupled income support**
- **6) Government participation in insurance programmes**
- **7) Payments for relief from natural disasters**
- **8) Structural adjustment assistance: producer retirement programs**
- **9) Structural adjustment assistance: resource retirement programs**
- **10) Structural adjustment assistance: investment aids**
- **11) Payments under environmental programmes**
- **12) Payments under regional assistance programmes**

Frame 2 GDP per employed in agriculture and in the economy



Frame 3 Use of chemical fertilizers (Kg/ha UAA)



Frame 4 Europeans' opinion on CAP (Eurobarometer)

| | CE | I | B | DK | D | GR | E | F | IRL | I | L | NL | P | UK |
|---|----|----|----|----|----|----|----|----|-----|----|----|----|----|----|
| CAP benefited consumers | | | | | | | | | | | | | | |
| answers from general public | % | 37 | 44 | 44 | 51 | 41 | 14 | 40 | 35 | 38 | 41 | 44 | 40 | 28 |
| answers from farmers | % | 47 | 57 | 76 | 63 | 50 | 17 | 49 | 58 | 49 | 60 | 72 | 40 | 63 |
| CAP benefited farmers | | | | | | | | | | | | | | |
| answers from general public | % | 34 | 43 | 58 | 30 | 56 | 9 | 38 | 66 | 40 | 48 | 44 | 43 | 34 |
| answers from farmers | % | 36 | 48 | 81 | 11 | 59 | 7 | 29 | 78 | 36 | 55 | 84 | 41 | 59 |
| CAP budget as a whole is positive | | | | | | | | | | | | | | |
| answers from general public | % | 46 | 43 | 52 | 48 | 45 | 35 | 50 | 55 | 45 | 47 | 49 | 40 | 48 |
| answers from farmers | % | 50 | 55 | 82 | 37 | 57 | 45 | 44 | 69 | 50 | 57 | 71 | 45 | 72 |
| The influence of farm organizations is excessive | | | | | | | | | | | | | | |
| answers from general public | % | 34 | 41 | 32 | 40 | 44 | 25 | 40 | 53 | 28 | 53 | 38 | 36 | 30 |
| EC should defend its position as second exporter on world markets | | | | | | | | | | | | | | |
| answers from general public | % | 71 | 65 | 56 | 67 | 65 | 61 | 84 | 70 | 74 | 69 | 71 | 50 | 72 |
| answers from farmers | % | 80 | 84 | 80 | 80 | 77 | 70 | 85 | 83 | 88 | 80 | 90 | 61 | 92 |
| EC citizens should not pay as consumers and as taxpayers | | | | | | | | | | | | | | |
| answers from general public | % | 62 | 59 | 42 | 70 | 61 | 52 | 71 | 68 | 62 | 57 | 49 | 44 | 60 |
| answers from farmers | % | 69 | 40 | 33 | 41 | 55 | 42 | 55 | 46 | 56 | 41 | 51 | 38 | 41 |
| Public expenditure in agriculture | | | | | | | | | | | | | | |
| General public | | | | | | | | | | | | | | |
| Too high | % | 22 | 20 | 18 | 36 | 13 | 6 | 26 | 27 | 12 | 25 | 29 | 6 | 26 |
| Insufficient | % | 27 | 19 | 13 | 16 | 49 | 45 | 19 | 22 | 42 | 12 | 17 | 45 | 18 |
| Equitable | % | 26 | 34 | 37 | 32 | 20 | 10 | 30 | 25 | 20 | 43 | 29 | 9 | 33 |
| Farmers | | | | | | | | | | | | | | |
| Too high | % | 8 | 10 | 12 | 6 | 6 | 5 | 7 | 6 | 10 | 9 | 26 | 3 | 21 |
| Insufficient | % | 59 | 48 | 27 | 52 | 70 | 72 | 48 | 69 | 70 | 45 | 20 | 57 | 22 |
| Equitable | % | 18 | 32 | 46 | 30 | 15 | 7 | 25 | 21 | 13 | 37 | 36 | 9 | 49 |

Source: Eurobarometro 2-1988. Translated from the Italian edition