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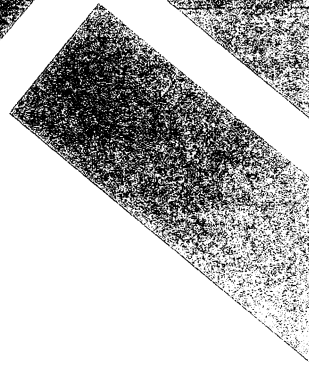
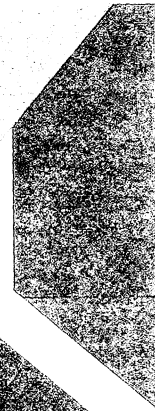
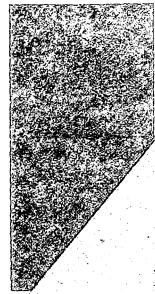
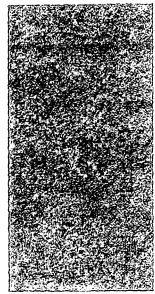
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The world market for agricultural products is comprised of many trading nations—some importers, some exporters. Each has a set of governmental policies to meet internal goals including protecting farm incomes, supporting farm prices and stabilizing consumer food prices. Policies of any one major trading nation affect the others.

Thus, the U.S., as a major exporting nation, has a vital interest in policies pursued by other nations. The May 1979 *Minnesota Agricultural Economist* presented policies of Canada, Australia, and Brazil—major competitors of the U.S. in world grain and soybean markets. Their efforts to seek markets for their farm goods and their internal policy goals were presented.

This and the next issue highlight policies of three major importers—the European Community, Japan, and the Soviet Union. Their importance to the U.S. can be seen in the chart. They represent three distinct economic and political systems with diverse agricultures. Self sufficiency and protection of domestic farmers are emphasized in Europe and Japan. Soviet policies concentrate on production instability and growing demand.

Where U.S. Ships Its Agricultural Exports

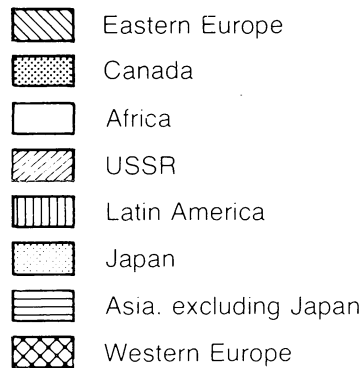
\$ bil.

30 —

20 —

10 —

0 —



1970

72

74

76

78

Fiscal Year

Adjusted for transshipments.

Source: USDA

Food and Agricultural Policy in the European Community

Carol M. Harvey*

The European Community (EC) is the largest foreign market for U.S. agricultural products. Despite policies dampening imports to protect European farmers, agricultural imports from the U.S. during 1979 exceeded \$7 billion. This article traces the origins of those policies, describes key features, and outlines the accompanying monetary problems in a system involving several nations.

The EC, founded in 1957, fosters free trade of goods and free movement of workers among members¹ and a common policy for trade with other nations. The eventual goal is to align economic policies of its very diverse member-states. Agriculture is the major area of common policy. The Common Agricultural Policy, CAP, is the only major common policy yet effected. It is the basis for most judgments about the EC's success and its behavior towards third (non EC member) countries.

There were considerable problems in developing an agricultural policy to satisfy even its six original members. Agricultures differed considerably and diverse agricultural policies reflected different needs and constituencies. France was a relatively low cost producer with high production potential and an interest in expanding markets, particularly to food deficit areas within the EC. The French situation led to the principle of preference for EC production in member states. Belgium, Germany, and Italy were high cost grain producers and feared that lowering prices would severely injure domestic producers. The Netherlands was heavily engaged in livestock production for which it imported feed grains; the Dutch did not wish to see these input prices rise drastically. Not only were

farm structures and incomes different among the six members, but there were differences within each country.

When the EC was formed, the following CAP goals were mandated: to increase overall productivity, to insure a fair standard of living for those on the farms through increased earnings, to stabilize markets, and to guarantee regular and ample agricultural supplies at reasonable prices to consumers. Routes toward achieving these goals can easily conflict with one another. The policy which resulted was based heavily on income support through high minimum prices in the marketplace, not on supply control, structural reform, or income payments. High prices also play a role in stemming rural migration to the cities.

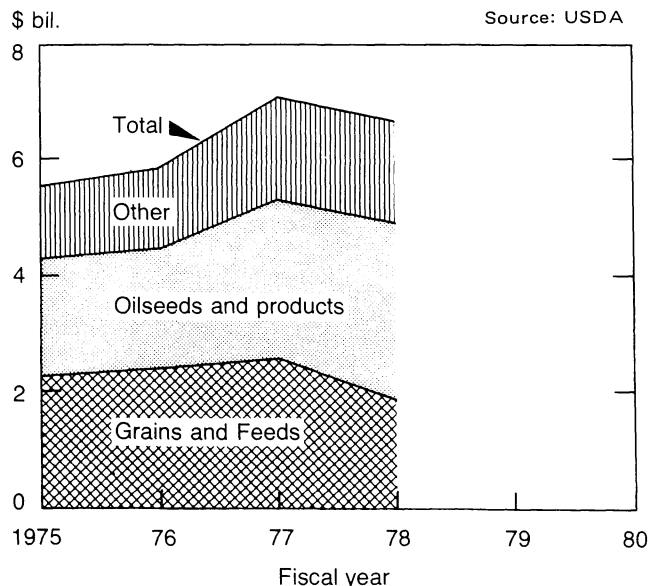
The EC chose three basic principles to achieve CAP goals: common pricing, EC preference, and common financing. Under common pricing the support price for a particular commodity would be roughly the same throughout the EC after an initial adjustment period.

The purpose was to encourage agricultural trade across regions and borders within the EC. Ideally the system would promote specialization by those producers and in those regions best suited to production of a particular commodity. Yet, the political problem of trying to reconcile the needs of high- and low-cost producers constrain the EC's price decisions so that the compromise price may not encourage specialization.

Common pricing continues to exist in name only. With today's floating currencies, the system is disrupted. Internal member state support prices do not fluctuate with the currency of the country, instead they are converted at fixed exchange rates from the "common" price. The result is a different price in each member state maintained through a system of border taxes (see the section on Monetary Problems).

EC preference simply means that domestic production is to be favored over third country supplies. This has resulted in the protective system that

U.S. Agricultural Exports to the European Community



European Community includes Belgium, Denmark, France, Germany, Italy, Ireland, Luxembourg, Netherlands, and the United Kingdom. The data are not adjusted for transshipments.

*Carol M. Harvey was a graduate student in the Department of Agricultural and Applied Economics, University of Minnesota.

¹Original members were Belgium, France, West Germany, Italy, Luxembourg, and the Netherlands. Denmark, Great Britain, and Ireland joined in 1973. Greece will join in 1983.

is the source of third country discontent with the CAP. Its object is to make production from outside the EC more expensive than domestic production. Usually the EC keeps the prices of imports at or above internal prices by charging an import tax (or levy) equal to the difference between the world and internal prices. If the EC has surplus production, exports are subsidized to compete on world markets.

Common financing means that the cost of the CAP operations—EC purchases of surplus production, storage costs, export subsidies among others—is shared by members. It is the major part of the EC budget.

HOW THE CAP WORKS

Grains

The EC sets a floor under the price of grains (feed wheat, bread wheat, barley, rye, corn). Intervention Agencies, in each member state, buy as much grain as is offered at the support price the EC sets annually. There is an increase in this price each month to encourage farmers to store their grains. When the system began in 1967, prices were highest at the most deficit consuming area and lowest at the most surplus area. Now there is a single valid intervention price for each EC grain. With wheat, the intervention price is the floor for feed quality wheat. A special, higher reference price has been set for bread quality wheat. This system was intended to make surplus feed quality wheat more competitive with other feed grains.

The intervention price and storage system puts a floor under producers' prices. But producers actually expect to obtain a higher price. The EC sets a *target* wholesale price for the greatest grain deficit area (Duisburg, Germany). The target price is protected by a minimum import price. The minimum import price or *threshold price* is calculated as the target price less transportation costs from Duisburg to Rotterdam, a main import point. A *variable levy* is calculated daily as the difference between the lowest cost, insurance, freight (cif) Rotterdam price (adjusted to EC standards), and the threshold price. This means imported grain cannot be cheaper at Duisburg than EC grain.

The target prices have historically been much above the world price for



Carol M. Harvey

grains.² To sell EC surpluses outside the EC, export subsidies are needed. These subsidies vary depending upon the market where the shipment is to be sold. One effect of the system has been to make the EC a net exporter of wheat for most of the last 5 years, although some bread quality wheat still is imported. However, the EC is not self-sufficient in corn despite recurring large increases in French production during the sixties and seventies.

Another effect of the high price of feed grains has induced some EC livestock producers to seek cheaper alternative imported feeds, such as manioc or corn gluten feeds, which are mixed with oilseed meals—primarily soybean meal. These alternatives have either no or low levies. The soybeans used by European crushers are levy and duty-free.

Livestock

Beef and veal prices are supported internally through intervention purchases when market prices fall below 90 percent of a guide price set each year. EC production is protected from imports by duties and a variable levy which bridges the gap between the im-

²The only exception occurred during 1973-74 when world prices actually exceeded EC prices and export taxes were imposed to dampen exports and keep internal prices relatively stable.

port offer price (plus duties) and the guide price. The heavy use of intervention in the beef market began with the glut in European production in 1974. Previously import control was the major means of supporting the internal price. With the glut in production, imports were severely restricted for 3 years. Direct payments also are made to support bovine animal producers' incomes.

While an intervention system exists for pork, private storage aids are the primary means of supporting internal prices. Import protection is identical to the following description for poultry.

Poultry

Poultry has no intervention system for internal support. Internal prices are maintained solely through import controls. Protection has two parts: 1) a basic levy which is supposed to compensate for the higher grain costs the EC poultry producer faces plus an extra margin of protection; and 2) a supplemental levy charged when a third country's price is below the minimum import price. This changes as frequently as necessary and is based on the lowest offers. The EC also grants export subsidies for poultry—again according to market need where the poultry is to be sold. The introduction of this system in the early sixties fostered rapid increases in production and has turned the EC into a net exporter of poultry, competing heavily with the U.S. in the last decade.

Oilseeds

The EC is a net importer of oilseeds. Domestic production is small. Nonetheless it has an intervention system and designates a target price for producers which it maintains through deficiency payments (direct payments to producers) if the world price is below the target level. This is one of the few instances of the EC using such a system. It cannot erect a variable levy to force the domestic price up to the target level because most oilseeds and products have a duty-free binding under the General Agreement on Tariffs and Trade (GATT).

Dairy

Producer prices are supported through unlimited intervention purchases for butter and nonfat dry milk, at levels designed to maintain a target price for whole milk indirectly. Protection from imports occurs through vari-

able levies based on threshold prices for the intervention products and some additional pilot products (for example, whey powder, evaporated milk, some cheeses). Adjustments are then made to fit the threshold price and the levy to the imported product. Current support levels follow:

Target price for milk	\$ 13.66/cwt.*
Intervention price for Butter	\$181.84/cwt.
Nonfat dry milk	\$ 73.89/cwt.

*Equivalent U.S. dollar converted via Danish kroner per hundredweight.

These support levels contributed to severe surplus problems (stocks of 1.2 billion metric tons of nonfat dry milk at their peak in 1976; 570 thousand metric tons of butter in early 1979), only partially solved by export subsidies, herd conversion or elimination premiums, compulsory producer check-off funds for dairy product promotion, school lunch milk subsidies, and various subsidy programs to encourage milk use for feed purposes.

Dairy revenues remain important to many small farmers in Europe, especially in mountainous areas where there are few alternatives to dairy production except to quit farming. The support level of dairy products is an extremely sensitive political issue: the EC is caught between producers who feel support prices should be raised more than the average 1.8 percent (annual increase over the last 3 years) and angry consumers who must pay more than consumers in third countries who buy subsidized EC butter.

MONETARY PROBLEMS

The support programs described here were designed for uniform prices throughout the EC. Prices are fixed each marketing year in Units of Accounting (UA) and converted via fixed exchange rates, the Green Rates, into the national currencies of each member state. So long as the Green Rates corresponded to the nearly fixed exchange rates set up after World War II, support prices in national currencies were equal in market terms.

The international currency crises of 1971 led to floating exchange rates—creating the policy problem of changing internal EC price levels. To keep the market value of support prices equal among member states it would

have been necessary to let the Green Rates float too, allowing support prices in each country to change with currency alignments. The German farmer would have received less for a bushel of wheat as the mark was revalued while the French farmer would have received more as the franc was devalued. This would have led to some painful adjustments. Politically, these adjustments were unacceptable, so Green Rates were held fixed (they are periodically adjusted) and a border tax system was instituted to maintain stable prices within each country.

To illustrate, suppose 1 Unit of Account (UA) is equal to 5 French francs (FF) and also to 4 German marks (DM), and that those are the respective support prices for a bushel of wheat. Then FF 5 buys DM 4 or 1 bushel of wheat. But if the franc is devalued so that it now takes FF 6 to buy DM 4 then FF 5 buys only DM 3.33. If the Green exchange rates remain 1 UA = FF 5 and 1 UA = DM 4, the wheat support price is still FF 5 in France and DM 4 in Germany. Germans could buy French wheat for DM 3.33 while German wheat would be DM 4. The French farmer still gets FF 5 for a bushel of wheat but can sell it in Germany for less than his German counterpart. To avoid such a situation, border taxes were imposed to make up the difference.

The border taxes (Monetary Compensatory Amounts or MCA's) are now an elaborate system costing the EC more than \$1 billion annually. They subsidize producers and cost consumers in countries with strong (revaluing)³ currencies such as Germany, Belgium, and the Netherlands. (Without the MCA's the German wheat price would fall towards DM 3.33 in this example.) In the countries with weak (devaluing) currencies, for example, Great Britain, France, Italy, MCA's subsidize consumers, to the disadvantage of domestic producers whose prices are held down. (The wheat price would rise toward FF 6 in France without MCA's in this example.)

The border tax system contains a hidden subsidy, too. Producers in strong currency countries can buy im-

ported inputs, not subject to variable levies, more cheaply than producers in weak currency countries. For instance a German livestock feeder obtains imported oilseed meal at prices that are lower relative to CAP support prices than does a French or British counterpart. Suppose that \$1.00 once bought FF 5 or DM 4. If it devalues with the French franc against the German mark, DM 4 now buy \$1.20. U.S. soybean meal worth \$1.00 still costs the French farmer FF 5, but costs the German farmer DM 3.33 instead of DM 4 as before.

Early in 1979 the EC agreed on a new monetary system which links the member state currencies more closely than before—except for those of Great Britain and Italy.⁴ The others will not permit their currencies to fluctuate more than 2.25 percent in either direction from each other or from a new EC unit. This should stabilize market rates over time, but for the short run the new system will have virtually no effect on Green Rates, MCA's, or internal EC farm prices.

CONCLUDING COMMENTS

The price support policies of the EC have contributed to surplus production of several commodities causing the EC to become a major exporter of some at subsidized prices. These products compete with shipments from the U.S. and other major exporters. The U.S. competition is mainly in grains, poultry, and certain kinds of fruits. Nonetheless, the EC remains a net importer of agricultural products, with a net agricultural trade deficit of \$25.2 billion in 1978 for the agricultural sector. It depends heavily on imports of oilseeds, of certain kinds of produce, tobacco, cotton, and depends somewhat on imports of food and feed grains, sugar, and many specialty products ranging from specialty meats to almonds. As the EC enlarges to include Greece and very likely Spain and Portugal, it will grow more self-sufficient, particularly in fresh and processed fruits and vegetables. Some changes in policies may be forced if further surpluses are to be avoided. The changes remain to be seen.

³Revaluing and devaluing are now relative terms—the British Pound Sterling has recently been appreciating against the dollar and the mark—but its market exchange is still far from equal to its Green Rate.

⁴Italy's currency may fluctuate in wider bands. Previously there were no constraints on Italy.

Value of Minnesota's Agricultural Exports

Commodity	Fiscal years (year ending Sept. 30)		
	1977	1978	1979
	-----million dollars-----		
Wheat & products	121.1	197.2	220.9
Feedgrain & products	232.3	464.4	538.3
Soybeans & products	290.9	487.0	579.6
Sunflower seed	35.1	66.1	103.5
Fruits & preparations2	.4	.5
Vegetables & preparations	15.0	16.9	20.9
Dairy products	35.2	34.2	19.7
Meats & products (excluding poultry)	30.6	33.2	36.2
Hides and skins	49.6	46.9	74.5
Poultry products	8.5	9.1	9.8
Lard and tallow (edible & inedible)	21.4	19.1	21.5
Other	<u>63.8</u>	<u>100.2</u>	<u>118.8</u>
All commodities	\$903.7	\$1,474.7	\$1,744.2
Total U.S. agricultural exports	\$23,973.9	\$27,306.2	\$31,982.8

Source: USDA

Jerome W. Hammond Editor
 Prepared by the Agricultural Extension Service and the Department of Agricultural and Applied Economics. Views expressed are those of the authors, not necessarily those of the sponsoring institutions. Address comments or suggestions to Professor Jerome W. Hammond, Department of Agricultural and Applied Economics, 1994 Buford Avenue, University of Minnesota, St. Paul, MN 55108.

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