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# Manchester Discussion Papers in Development Studies

AGRICULTURE IN CONFLICT WITH TRADE

AND DEVELOPMENT

David Colman

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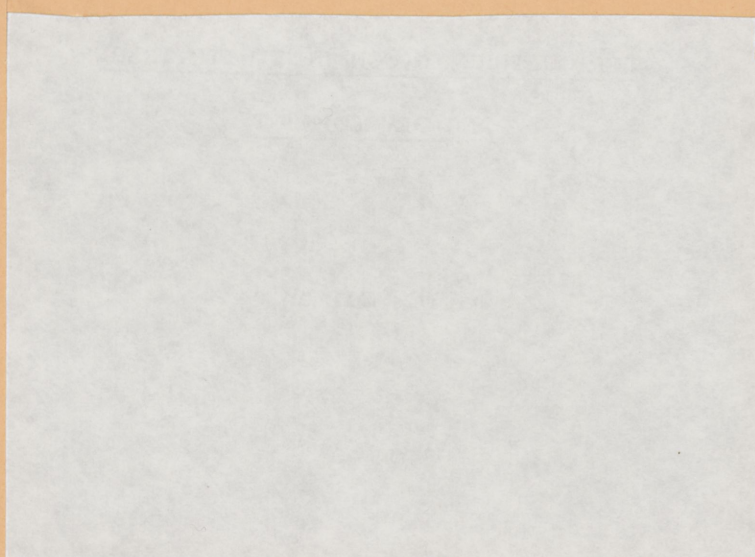


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## AGRICULTURE IN CONFLICT WITH TRADE AND DEVELOPMENT

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Of all the conflicts under discussion at this Conference, that between protectionist EEC agriculture and the trade and development interests of other countries is the least controversial. There is no doubt that the expansion of EEC agriculture has had adverse effects upon the agricultural exports of other developed and developing country exporters, and that the trade effects are reasonably clear. The consequences of this for the development of poor countries is less clear, but is generally assumed to be harmful. As always, however, given the complexities of the world economy, the effects are not universally bad and there are groups within LDCs and LDCs as wholes which may actually benefit from the trade effects of EEC agricultural growth. Thus in order to obtain a balanced view it is worth exploring the mosaic of external effects attributable to current CAP policy.

### Some Basic Facts

In order to raise prices paid to European farmers above levels determined by international produce markets, the CAP employs systems of variable import levies and variable export subsidies, coupled with intervention buying and subsidies for diversion of produce into lower valued uses than the produce is suited to (e.g. incorporation into animal feed, distillation into alcohol). The import levies have a dual function: For commodities of which the Community is a net importer they set a minimum price below which imports cannot enter, and thus they help fix high minimum prices to European farmers. For commodities of which the Community is a net exporter they serve to make it unprofitable to import produce with the intention of selling it into intervention.

Variable import levies are calculated as the gap between threshold prices (minimum import prices) and (c.i.f.) international market prices.

Inevitably this gap varies substantially through time as world market conditions change, but it has tended to be large. Certainly this was so at the time when the European Commission last published figures (shown in Table 1) for the excess of EEC threshold prices over "world" prices. As can be seen from Table 1 EC threshold prices for most major commodities have generally been at least 50 per cent higher than "world" prices, and in the case of butter and skimmed milk powder have been around 300 per cent higher.

Table 1 : Percentage by which EC Entry Price\* Exceeds Third Country Offer Price, by Commodity

	<u>1975/76</u>	<u>1977/78</u>	<u>1979/80</u>
Butter	220	288	311
Skimmed Milk Powder	166	394	279
White Sugar	9	155	31
Durum Wheat	45	118	59
Common Wheat	24	116	63
Barley	17	106	61
Maize	28	103	90
Beef and Veal (Live)	58	96	104
Olive Oil	117	111	93

Source: EC Commission Report 1980.

\* The Entry Price is the Threshold Price for Cereals or its equivalent for other commodities. The prices actually paid by wholesalers and processors for produce from within the Community are in most cases somewhat below the entry price and may be much closer to intervention prices for most commodities for which there is an intervention scheme.

While farm prices in Europe do not typically get pulled up to threshold price levels, the policy has maintained them at substantially higher levels than would otherwise have been the case. The consequences of this have been inevitable and are well-known. The main effect of the policy has been to stimulate a rapid growth of production. This is well illustrated by the data in Table 2 showing the extent to which UK self-sufficiency ratios have risen

for a number of selected products. Of particular note are the extent to which the UK has doubled wheat production since 1971 to become a net cereal

Table 2 : UK Percentage Self-Sufficiency in Agricultural Production

	<u>Wheat</u>	<u>Barley</u>	<u>Cheese</u>	<u>Butter</u>	<u>Total Meat</u>	<u>Sugar</u>	<u>Beef &amp; Veal</u>
1971*	56	89	50	17	73	39	81
1972*	52	96	56	22	75	34	78
1973*	62	95	66	22	80	37	83
1974*	66	100	65	11	82	22	85
1975	57	107	67	9	83	26	92
1976	56	94	60	20	83	29	89
1977	59	96	67	32	83	37	86
1978	71	121	72	40	81	40	85
1979	75	106	65	47	82	47	86
1980	88	116	70	57	84	47	91
1981	97	141	67	56	86	50	93
1982†	106	128	71	64	85	54	90

\* Harvest years, not calendar years.

† Forecast

Source: Annual Review of Agriculture

exporter by 1981, and the substantial increases in self-sufficiency in dairy products and sugar which have reduced its dependence upon imports. Since similar rates of output growth have been recorded in the other member countries of the EEC the agricultural trade flows between the Community and the rest of the world have undergone major changes.

That the EEC should have become a major sugar exporter and seized over 20 per cent of the world market as a consequence of its highly protective policies can only be seen as being highly anomalous. So too can the emergence of the UK as a major wheat exporter. From the standpoint of traditional sugar

and wheat exporting countries which do not offer comparable rates of protection to their farmers subsidised EEC exports of this type and scale are unsurprisingly viewed with disfavour. However, it is not simply EEC incursions into export markets which are a source of tension. So too are the reduced EEC import markets for traditional suppliers as a consequence of increased Community self-sufficiency, but these are issues which will be taken up more fully in the next section.

The growth of EEC agricultural self-sufficiency and the emergence of large exportable surpluses of some commodities has had major budgetary implications for the CAP. Reduced imports have meant a corresponding fall in the share of total income raised from import levies, while the need to dispose of ever increasing surpluses has required a substantial rise in (1) budgetary expenditure on export refunds and (2) withdrawal and denaturing payments, storage aids, and other intervention costs. Quite how rapid the growth of these surplus disposal payments has been is revealed in Table 3. It can be seen that from 1977 to 1983 export refunds rose by 249 per cent from 2287 to 5700 million e.c.u.'s, and expenditure on the various headings classed as intervention rose by no less than 322 per cent of the 1977 level, from 3,050 to 9,845 million e.c.u.'s. This has been almost entirely financed by increases in the VAT contributions of member states; these have risen quickly enough to enable some expansion of the non-agricultural regimes of the EEC.

#### The Trade Effects

In trying to assess the trade impacts of current agricultural protection policies by the EEC and other industrialised countries, the question posed by

**Table 3 : Community Revenue and Agricultural Expenditure 1977 to 1983**  
(million ECUs)

	1977	1978	1979	1980	1981	1982	1983
<b>REVENUE</b>							
Customs Duties	4,459	4,391	5,189	5,906	6,392	6,939	7,235
Import & Sugar Levies	2,137	2,279	2,144	2,002	1,747	2,685	2,434
VAT - Contribution	-	-	4,738	7,259	9,188	11,998	13,691
(VAT - rate)			(0.79)	(0.73)	(0.79)	(0.92)	(0.99)
Financial Contributions	2,495	5,330	2,302	-	151	198	217
Total Own Resources	9,091	12,000	14,373	15,167	17,478	21,820	23,577
<b>AGRICULTURAL EXPENDITURE</b>							
Guarantee Section- Export Refunds	2,765	4,278	5,721	5,452	4,939	4,764	5,700
Intervention Costs	3,687	5,226	6,044	5,564	5,962	7,328	9,845
Guidance	297	324	403	603	576	650	621
Total Agricultural	6,749	9,828	12,168	11,619	11,477	12,742	16,166
(Agric. as % Total Expenditure)	(74)	(71)	(76)	(73)	(65)	(63)	(66)

Source: Agricultural Situation in the Community.

1. Figures from Draft Budget.

economists is "what would be the situation if the policies were wholly or partly removed?" Because of the complexities of the world trading system, detailed answers to this can only be obtained by employing a large economic model. Fortunately there have been a number of recent exercises of this type which provide mutually reinforcing answers.

Before turning to the results of these analysis it may be helpful to distinguish between the following (not mutually exclusive) groups of commodities.

1. Temperate zone commodities, which are the object of a major CAP support regime, and which are exported by other OECD countries such as Australia, Canada, New Zealand and the USA. This group

includes such major commodities as wheat, dairy products and sheep meat.

2. Products, subject to a CAP support regime, which are exported by both Less-Developed Countries (LDCs) and other OECD countries. Examples here are beef, oilseeds, rice and wine.
3. Products subject to a CAP support regime, which are major exports of LDCs. This group includes sugar, tobacco, cotton, olive oil, and fruit and vegetables.
4. There are products like soyabeans and manioc which substitute for EEC-produced feedstuffs, but for which the EEC does not impose substantial import barriers.
5. There is a vast range of tropical commodities not produced in the EEC which are subject to common external tariffs. Under the EEC Generalised System of Preferences (GSP) and the Lome Convention poorer countries obtain preferential access for most of these commodities, in many cases tariffs are waived entirely. Thus for the beverages, unroasted coffee enters duty-free under the GSP but roasted and otherwise processed coffee incurs duties of up to 14 per cent. Various categories of fruit, fish, spices, vegetables and the whole range of processed food products attract some import duties.

EEC barriers to imports of all of these groups, other than 4, reduce the export earning of various countries. In the case of group 1 commodities it is the export earnings of our traditionally closest political allies which come under pressure. European markets for Australian and New Zealand beef, sheepmeat and dairy products have been greatly curtailed since the UK joined the Community. This has created political friction and forced these countries to develop alternative export outlets. Even the concessions which were

negotiated to allow New Zealand restricted access to its traditional dairy product and sheepmeat markets in this country have been continuously whittled down and are the focus of continuing scrutiny for those searching for ways of reducing CAP costs which do not require reducing support for Community producers. Similarly North American wheat and maize exports to the EEC have steadily declined, and as competition has spilled over into world markets, as the EEC strives to find outlets for surplus wheat and dairy products, trade negotiations between the countries have become increasingly acrimonious. Thus EEC price-supported expansion of production of group 1 products, particularly cereals and dairy products, has had adverse impacts upon the exporting interests of our traditional allies.

There is, however, another side to this particular coin; one which receives much less attention. This is that many LDCs are substantial importers of grain and dairy products, and that these imports are cheaper as a result of the greater export surpluses (or reduced import demands) of EEC and other OECD countries. Moreover, the existence of grain and skimmed milk surpluses in those countries has been the major spur to the development food-aid programmes intended to help alleviate malnutrition in LDCs.\* Thus the increased exportable surpluses, of cereals in particular, has kept world market prices down, which has been of appreciable benefit to the food consumers in poor countries. Van Dijk et.al. (1983) cite an estimate of the MOIRA model, which is that the number of "hungry" people in LDCs is reduced by around 25 per cent as a result of the developed countries' protection of agriculture. These results are supported by other analyses. For example recent preliminary runs of the International Institute of Applied Systems Analysis' (IIASA) huge global Food and Agricultural Project (FAP) model indicated that the/food price rises which

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\* The question of whether food-aid is a beneficial or effective means of helping eradicate malnutrition is a hotly debated one, which will not be explored here.

would be caused by trade liberalisation would result in net welfare losses for (amongst others) Egypt, Nigeria, Indonesia and Turkey all of which are heavily reliant upon cereal imports. Other losers in net welfare terms are estimated to be Brazil, Mexico and Pakistan, where consumer losses due to higher food prices appear likely to outweigh the benefits to producers. In a similar vein Valdes and Zeitz (1980) have used a relatively simple model to compute the effects of a trade-liberalising 50 per cent reduction in agricultural protection by the OECD countries. According to their results, reproduced in Table 4, the higher prices resulting from trade liberalisation are likely to cause net welfare losses to low income LDCs. This is because in the North Africa/Middle East area the gains from increased exports (of all agricultural products) are estimated to be outweighed by losses of consumer due to the increased food prices.

The overall picture presented by Valdes and Zeitz' results in Table 4 is however very much what is to be expected. It can be seen that taking the LDCs as a group, the opening up of OECD agricultural markets would, it is estimated, produce a once-for-all gain in welfare, because the gains to producers would exceed the losses to consumers. Note that this is the obverse of the situation which exists within the EEC. All the estimates of the costs of the CAP (e.g. by Morris (1980), and Buckwell et al. (1982)) show that the cost to consumers exceeds the benefits to producers. From this it follows that within the Community trade liberalisation would cause consumers to benefit by a greater amount than producers would lose. Thus rather unsurprisingly the external effects of the CAP upon consumers and producers are exactly the opposite. The CAP operates to the disadvantage of Community consumers but to the advantage of foreign ones; it benefits EEC farmers but harms the interests of those in other countries.

One point underlined by the results in Table 4 is that, in connection with agricultural policy, national welfare cannot be equated with the size

Table 4 : Potential Welfare Effects of Trade Liberalisation and Changes in the Agricultural Trade Balance of Selected LDCs by Income Group and Region (US \$ million 1977)

<u>Income Group/Region</u>	<u>Change in Agric.Trade Balances</u>			<u>Changes in Welfare</u> <sup>1</sup>		
	<u>Increased Export Revenues</u>	<u>Reduced Import Expend- ture</u>	<u>Net Change in Trade Balance</u>	<u>Gain from Increased Exports</u>	<u>Loss from Reduced Imports</u>	<u>Net Change in Welfare</u>
Total LDCs	3,008	704	3,712	1,056	583	473
Income group:						
Low Income	512	350	862	174	176	-2
Middle and Higher Income	2,496	354	2,850	882	407	475
Region:						
Sub-Saharan Africa	253	23	276	146	59	87
Asia	681	290	971	260	184	76
N.Africa/ Middle East	270	260	530	92	224	-136
Latin America	1,804	131	1,935	558	116	442

Source: Valdes and Zeitz (1980) Tables 2 and 3.

1. Welfare changes are measured in terms of changes in producer and consumer surplus.

of the trade balance on the agricultural account. Note that North Africa/Middle East is estimated to suffer a net welfare loss from OECD trade liberalisation of \$132m, (224-92), despite increasing exports by \$270m and decreasing imports by £260m, i.e. an improvement in the balance of payments of £530m. In a similar way, increased agricultural exports from the EEC and reduced imports may cause an improvement in the agricultural balance of payments, but they also result in a loss in social welfare.

Turning now to the main sources of damage to the economic interests of LDCs arising from EEC policy, the principal problems result from CAP protection of group 3 commodities. Less substantial, but nonetheless significant export earning reductions arise from action against products in groups 2 and 5 the latter of which is only loosely associated with the CAP and which may be construed as being primarily concerned with protection of food processing industries. The importance of EEC import barriers for group 3 products is again strongly underlined by the work of Valdes and Zeitz, although their analysis is based on 50 per cent trade liberalisation by the OECD countries as a whole. An extract of their results is presented in Table 5. These indicate that the major gains to LDCs from trade liberalisation would arise from sugar and tobacco (group 3), beef plus veal, and wine (group 2), and from green coffee (group 5). In this assessment the potential export revenue gains to LDCs for raw and refined sugar dominate the list, and they account for 35 per cent of the estimated total gains of \$3 billion from a total of 47 commodities. The LDC countries which would be major gainers from this expansion of sugar exports are Mozambique, India, Philippines, Thailand, Bolivia, Brazil, the Dominican Republic, Guatemala and El Salvador. That Valdes and Zeitz should estimate that such a large displacement of LDC exports is attributable to sugar, serves to confirm that this regime is the most damaging to LDCs of all EEC commodity policies. However the LDCs stand to make appreciable export revenue gains from reductions in EEC (and other OECD) protection for other commodities. According to the estimates in Table 5, a 50 per cent trade liberalisation could increase LDC beef export revenues by as much as 75 per cent, with Kenya and Tanzania among the principal gainers; and smaller proportional gains would be made by countries such as Malawi, Zambia, Bangladesh, Sri Lanka and Algeria from liberalisation of trade in tobacco. In fact the only one of the seven commodities listed in Table 5 for which there is no CAP regime is coffee. Hence it is clear that the CAP is

Table 5 : Potential absolute and percent increases in exports of selected LDCs after trade liberalisation by OECD countries, main commodities<sup>1</sup>

Commodity	Increase in LDC export revenues (US \$m) <sup>3</sup>	LDC increase as percentage of initial export revenues (%)	LDC share of total increase in world exports (%)	LDC share of total world exports	
				Initial (%)	Post-libera- lisation (%)
Raw Sugar	683	25.2	42.9	38.0	38.9
Refined Sugar	334	46.1	*2	34.8	51.4
Beef and Veal	243	74.9	42.7	19.2	25.1
Green Coffee	210	3.1	88.8	88.8	98.8
Wine	161	46.3	29.0	28.0	28.3
Tobacco	140	11.8	43.3	53.0	51.8
Maize	83	7.7	14.9	14.9	14.9
Wheat	79	13.2	8.5	8.5	6.9

Source: Valdes and Zeitz (1980) p.34.

1. Calculations use the base period 1975-77.
2. Total world exports of this commodity would decrease.
3. 1970 US dollar values.

exercising a major constraint upon the agricultural export earnings of LDCs.

A chink in the protective armour of the EEC exists with respect to the group 4 commodities, manioc and soyabeans, for which there are no major import barriers. This chink has become something more akin to a gaping hole as manioc and soyabean imports have rapidly increased to be incorporated into animal feedstuffs in place of high priced EEC produced cereals. It is an opportunity which has afforded considerable benefit to Thailand as the main manioc supplier and to a lesser extent to Brazilian soyabean exporters. However, precisely because these imports compete with home-grown cereals, (and with EEC butter and oilseeds), there is intense pressure from some producer interests within the EEC to block them off to help staunch the budgetary haemorrhage. It is only the threat of USA trade reprisals which prevents curbs being put on soyabean imports, and in the case of manioc, Thailand has been forced to accept a "voluntary" export quota.

However, the opportunities afforded to LDCs to increase some exports (because the EEC has not erected barriers to entry of all agricultural commodities) must be seen as insignificant in the context of the total trade restriction effect which the CAP has upon the exports of both LDCs and other developed countries. As the estimates recorded show there is an undoubted conflict between the CAP and other countries efforts to expand their exports. This conflict is one of the major factors which had led to loud protests from LDCs and other countries, and to calls for agricultural trade liberalisation.

#### The Development Effects

While identification of the adverse effects of the CAP on the agricultural exports of other countries is relatively easy to achieve, assessment of any adverse effects upon LDC development are much more difficult to gauge. As already noted, it is a mistake to assume that an increase in the agricultural balance of payments is equivalent to an increase in national welfare.

The comparative static analysis reported in Table 4 showed that it is possible (North Africa/Middle East) for a net welfare loss to accompany a balance of payments gain. More typically however net welfare gains do increase with balance of payments, but to a lower degree because there are real resource costs in producing the exports. Thus for example from Table 4, LDCs as a whole were estimated to have a potential agricultural balance of payments gain of \$3,712m but a net welfare of only \$473m arising from OECD trade liberalisation.

This impression, that relatively small benefits would accrue to the LDCs from the reduction of agricultural trade barriers, is reinforced by the outcome of recent preliminary runs of IIASA's large global FAP model. Initial estimates are that elimination of all agricultural trade barriers would increase world trade by around 39 per cent, but that this would increase the poorest countries' gross value of output by only two per cent, and that the effect on world gross value of output would be negligible. Similarly it was estimated that elimination of EEC agricultural protection would increase world agricultural trade by 8.3 per cent and would have only very small effects on the output and welfare of LDCs. While the preliminary nature of these results raises questions about the calibration of the FAP model, the content of the model does provide plausible reasons for believing that reducing or removing EEC agricultural trade barriers would not have a major impact upon the welfare or GNP of LDCs.

In stating that the benefits poor countries would obtain from reducing EEC agricultural trade barriers appear to be low, it is important to note that in relation to the volume of development aid they are equivalent to large increases in aid. Thus they can be seen as valuable, but not in any way decisive. Of course it may well be that the modelling exercises referred to are unable to take full account of the dynamic benefits which might accrue to the LDCs in the long-run. Certainly they do not take into account any benefits which might result from the reduction in world commodity price

instability which should result from reducing trade barriers - it is generally accepted that agricultural policies such as the CAP force price instability into world markets with all the problems that this entails for LDCs heavily dependent upon agricultural markets. Here again however it may well be that the development benefits due to reduced price instability may not be large, and that the overall adverse effects of the CAP on LDCs may be comparatively small.

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