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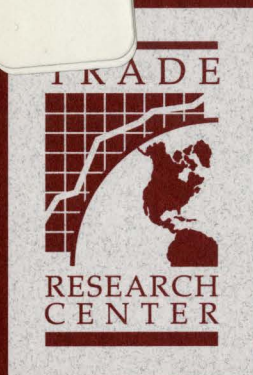
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# **The Economics of World Wheat Markets: Implications for North America**

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## The European Union Common Agricultural Policy under the GATT

*Anthony Rayner, Robert Hine, Timothy Lloyd,  
Vincent H. Smith and Robert Ackrill*

**The European Union should be able to meet its required reductions in domestic support. However, the EU's exportable wheat surplus will almost certainly exceed the ceiling by 2000.**

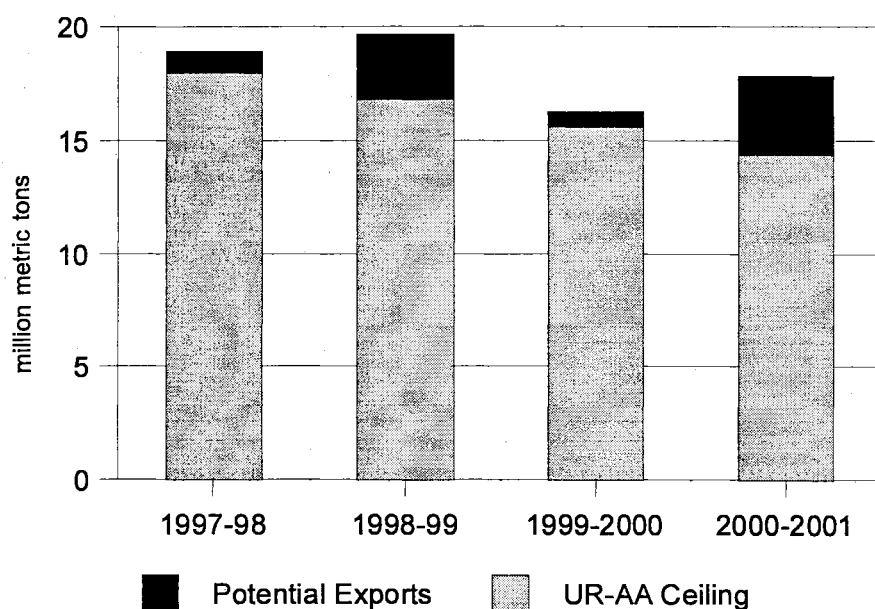
The European Union (EU) became a significant exporter of wheat in the 1980s and by the end of that decade it was responsible for some 20 percent of world wheat export trade. The growth of exports was characterized by a general expansion of sales to all markets and was supported by heavy subsidization of EU producers. The expansion and consolidation of the EU's wheat export position in the 1980s took place against the background of increasing world wheat production and stagnant consumption. World prices fell and stocks increased. Other important commodity markets exhibited similar characteristics and the export earnings of the traditional agricultural exporting nations declined quite severely. The deteriorating trade environment led to tensions between the agricultural trading nations and an escalation of trade disputes. The crisis in agricultural trade provided a major incentive for nations to give a priority to reducing agricultural subsidies and liberalizing farm product trade in the Uruguay Round of the GATT which was launched in 1986.

At the outset of the Round, the European Union in conjunction with Japan, attempted to limit the scope of the agricultural negotiations to the modification of existing policies whereas the United States, supported by the Cairns Group of agricultural exporters, pressed for the dismantling of trade-distorting farm support and protection. The agricultural negotiations were drawn out and a resolution was not reached until the European Union reformed the Common Agricultural Policy (CAP) in a manner which reduced its trade-distorting impacts. The 1992 reform of the CAP provided for a phased reduction in support prices for cereals and other arable crops, coupled with set-asides and the supplementation of farm incomes by direct payments from the EU budget. The Uruguay Round was completed in December 1993 and signed off in April 1994. The signatories committed themselves to reducing agricultural support and protection relative to a 1986-1988 base over the six-year period 1995 to 2000. These provisions fall under three headings: domestic support, market access, and export subsidies.

The European Union should not experience any difficulty in meeting its domestic support commitment for a number of reasons. First, base-period support was at a high level when world prices, denominated in

European Currency Units (ECU), were historically low. Second, support prices for cereals, oilseeds, and protein crops were cut by around one-third and the intervention price for beef by 15 percent under the 1992 reform and associated arrangements. Third, compensation payments introduced as part of the reform and now accounting for some two-thirds of the EU guarantee agricultural budget are exempt from the commitment. Fourth, the larger cuts in support of some products (e.g., cereals) can be offset by the smaller cuts in other sectors (e.g., sugar). The price cut for cereals which accounted for nearly 30 per cent of base-period support, and the exclusion of compen-

**Figure 10. European Union -15 Wheat Export Projections  
(excluding durum)**



sation payments are sufficient for the European Union to deliver on its commitment. The European Union will also meet its market access commitments in terms of increasing import access and converting nontariff barriers to bound tariffs.

Potentially, the ceiling commitments on the quantities of subsidized exports could be the most binding elements of the Uruguay Round Agricultural Agreement (UR-AA) for the EU cereals sector and may require an adjustment to policy. However, this is an area of considerable uncertainty and disagreement. There are uncertainties as to the extent to which the 1992 reform will result in supply and consumption adjustments sufficient to meet the export obligations. There are also uncertainties regarding world price developments and the \$/ECU exchange rate and hence the future requirement for the subsidization of EU exports. Initial assessments by the EU Commission in the early 1990s were optimistic that the exportable cereals surplus would remain

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within the limits authorized by the UR-AA and be compatible with the 1992 reform. However, more recent analyses by the EU Commission, in 1995 and 1997, have been pessimistic and foresee the UR-AA constraining EU cereals exports, especially of wheat, leading to a substantial rise in EU intervention stocks unless there is a further reform of the CAP.

Projections made by the authors also suggest that the EU exportable wheat surplus will almost certainly exceed the UR-AA ceiling on subsidized exports by 2000 (Fig. 10). However, what is less clear from the authors' projections is whether the EU export price in 2000 will be below the relevant world price in ECU so that EU exports will require a subsidy in order to be sold on the world market. Projections of world wheat prices, the quality premiums earned by other wheat exporters, and the \$/ECU exchange rate suggest that although subsidization is still likely it is not inevitable. This situation would be in marked contrast to the 1980s when European Union subsidization of wheat exports was the norm; the reduction in support price introduced by the 1992 CAP reform would appear to be a critical factor in bringing about this change. However, as noted elsewhere in the papers presented at this conference, the likely future path of the world price of wheat is a controversial issue and judgment must be reserved on the possibility that the world market will be strong enough in 2000 for the European Union to export without subsidy.

There are strong pressures for continued reform of the CAP. Political and economic realities will require the development of and adjustment to the 1992 policy reform. There are many factors imposing on the policy process: the existence of the UR-AA disciplines, the prospect of the 1999 World Trade Organization "mini-round" of agricultural negotiations, rising production, the prospect of lower budgetary spending on the CAP, and enlargement of the European Union after the turn of the century to incorporate new members from Eastern Europe. Currently, the EU Commission is examining the market outlook for cereals and other commodities with a view to making recommendations for further reform of the CAP. Recent pronouncements by the EU Commission have stressed that cereal support prices need to be reduced substantially if the European Union is to remain a major exporter of grains.