AgEcon SEARCH
RESEARCH IN AGRICULTURAL & APPLIED ECONOMICS

The World's Largest Open Access Agricultural & Applied Economics Digital Library

This document is discoverable and free to researchers across the globe due to the work of AgEcon Search.

Help ensure our sustainability.

Give to AgEcon Search

AgEcon Search
http://ageconsearch.umn.edu
aesearch@umn.edu

*Papers downloaded from **AgEcon Search** may be used for non-commercial purposes and personal study only. No other use, including posting to another Internet site, is permitted without permission from the copyright owner (not AgEcon Search), or as allowed under the provisions of Fair Use, U.S. Copyright Act, Title 17 U.S.C.*

NEWT DP8

University of Newcastle upon Tyne

GIANNINI FOUNDATION OF
AGRICULTURAL ECONOMICS
LIBRARY
WITHDRAWN
APR 16 1984

DISCUSSION PAPER

Department of Agricultural Economics
and
Department of Agricultural Marketing

UNIVERSITY OF NEWCASTLE UPON TYNE

Department of Agricultural Economics
Department of Agricultural Marketing

DP 8 March 1984

The 1984/85 CAP Debate: An Evaluation and Some Observations

David R. Harvey and Kenneth J. Thomson
Department of Agricultural Economics

THE 1984/85 CAP PRICE PROPOSALS : AN EVALAUTION AND SOME OBSERVATIONS[1]

David R. Harvey and Kenneth J. Thomson
Department of Agricultural Economics
University of Newcastle upon Tyne

I INTRODUCTION

The 1984/85 price fixing discussions take place against a more uncertain and complicated background than in previous years, resulting from the imminent exhaustion of European budgetary resources and the consequent discussions and negotiations about increasing those resources. These negotiations inevitably involve consideration of two major and related European problems, namely the growth and control of expenditure on the CAP, and the distribution of the budgetary costs and benefits between the European member states (in particular, the British net financial contribution). In turn, the first problem generates discussion of the merits of the current CAP against possible alternatives and the possibility or desirability of reform; while the second gives rise to questions over the financial mechanisms of the EC budget, and ultimately about the scope, spirit and intent of the Community itself. 1984 is thus a crucial watershed in the development of the Community, with the re-election of the European Parliament heightening the political and electoral interest in the Community and its activities.

One short paper cannot address all of these issues in detail, but it would be foolish to concentrate purely on the CAP price-fixing without recognition of the wider aspects of the current negotiations. We return to some of these aspects in the final sections of this paper, but first examine the background to the present situation and then consider the Commission proposals themselves. It might have been more prudent to await the final outcome of the Council of Ministers meetings during 1984, and to analyse the effects of the actual decisions rather than discuss the effects of some options prior to these decisions. However, we feel that some independent observations on the issues involved in these discussions may be useful to commentators and policy makers alike and offer this paper in that spirit.

II BACKGROUND

The 1984/85 CAP price-fixing negotiations of the Council of Ministers come at a time when the policy itself is threatened as never before with lack of sufficient funds to meet the support bill. The long-predicted exhaustion of the European budget is now, apparently, actually about to occur. It should be remembered, however, that this event has been previously expected with almost equal conviction, especially in 1980/81, yet poor European harvests and production levels coupled with fortuitous world price levels and exchange rates, and "planned" marketing of European surpluses, especially butter, have conspired to postpone the bankruptcy proceedings. Such events may occur again, though the probability of their occurrence in sufficient measure is undoubtedly very low. Alternatively, the European Community leaders may agree to increase budgetary funds, thus alleviating the immediate problems for the CAP. It seems likely that any such agreement will involve some concommitant agreement to limit agricultural expenditure. It is certainly possible that with a sufficiently generous budgetary reimbursement scheme for the major financial net contributors (the UK and Germany), objections to increasing the VAT may be overcome. Much hinges on the negotiating strategy adopted by the British Government, which has the options either of demanding satisfactory recompense for its European net budgetary contribution through some financial "safety net", or of requiring an effective curb on CAP expenditure as the price of agreement to increasing the budgetary limit. While both may be pursued, the emphasis has been very much on the budgetary settlement option. Nevertheless, it would be foolish to suppose that all talk of CAP reform is necessarily empty since it is clear that, in spite of the policy's strong defences, concern about the excesses and maldistribution stemming from the policy is growing.

The European Commission has made it very clear that it, at least, believes that the economic and political conditions are such that some adjustment of the policy is both necessary and politically feasible. It spelled out its proposals in July 1983,[2] and subsequently refined these for consideration at the European Council meeting in Athens in December 1983. In brief, the Commission propose guarantee thresholds

on production, a 'restrictive' price policy, more discretionary market management by the Commission, special schemes to protect small or less favoured farmers, modification of production and consumption subsidies, an oil and fats tax intended to improve the competitive position of butter on a the domestic market, and a more active external trade policy for both imports and exports. Many of these suggestions have been hardened into definite proposals, of which the milk 'super' levy[3] and the oils and fats tax have provoked most discussion. The Commission has made it clear that it regards these proposals as part of the price package as a whole, and initially threatened a more severe set of proposals in April 1984 if agreement on this total package could not be reached. However, the Council of Ministers in its initial discussions of the price proposals has tended to leave the other "reform" measures on one side for resolution with the wider budgetary questions.

Meanwhile, the Commission, as of October 1983, already introduced means of delaying certain payments and ending some export tender invitations as a first step in response to immediate budgetary limits. From now on, therefore, all EC agricultural production and trade will have to be conducted in the knowledge that CAP instruments may be suspended with minimal warning. Economic theory predicts that risk-avoiding producers will reduce their activities - a direct if medium-term budgetary benefit - but says less about the effect on traders and consumers. However, it seems likely that market instability will increase, and thus compound the loss of certainty which has to date been a major rationale of the CAP.[4] In addition, delays in payments to intervention boards are expected to have some depressing effect on support and market prices, especially for cereals.

The current state of play, therefore, is that the Community is faced with its most serious financial crisis ever, at two levels: the question of the overall EC budget, and the CAP measures necessary to keep within the approved 1984 expenditure levels. Opinion seems to be hardening in favour of quantitative restrictions on the volume of output eligible for full community support. Specific and effective implementation of these controls in the timescale necessary to avoid financial

breakdown is however questionable, and in any case formidable political, legal and international obstacles have to be overcome. Attention should therefore be devoted equally to price measures which could have more immediate effect. But even in the longer term, it could be unfortunate if the CAP becomes locked into a new framework of quantitative measures. As Professor S. Tangermann has warned,[5] these could represent a new and qualitatively different type of bureaucratic intervention in agriculture which many farmers (not to mention economists) would regard as prejudicial to competitive and efficient use of resources.

III EVALUATION OF 1984/85 PROPOSALS

The main elements of the European Commission's price proposals of January 1984 for the 1984/85 agricultural year appear to fall into five main groups:

a) No changes in intervention and other support prices for cereals, except a 1.5% rise for durum wheat, and a 1% nominal fall for oilseed rape;

b) Rises of 1.5% in the guide and basic price of meats, along with limits on the variable premium mechanisms in this sector;

c) A 10% fall in the intervention price for butter, offset by a similar rise in that for skimmed milk powder, leaving the intervention milk price equivalent virtually unchanged;

d) Rises of 1% in the basic price for sugar and up to 3.5% in those for Mediterranean-type products;

e) Changes in green exchange rates sufficient to substantially reduce the MCA tax/subsidies on intra- and extra-EC trade.

In the cereals sector, the production threshold system is designed to reduce price rises according to the extent to which previous Community average production exceeds a pre-defined quantity. This has been rendered useless in 1984/85 by the persistence of the relatively poor 1981

harvest in the production average used, and the extra allowance for high cereal inputs of "substitutes". The other weapon of the Commission, the strategy of reducing EC cereal support prices to those in the (domestic) markets of its main competitors, has been blunted by the strong US dollar, and the temporary effectiveness of that country's PIK programme for wheat in controlling supplies, thus maintaining domestic and world prices. However, these factors should not be allowed to obscure the continuing need for longer-term reform. In this sense, the Commission's proposals are disappointing. The opportunity has not been taken to put forward significant reductions in the support given to the cereals market as the fundamental sector of European agriculture. For example, the threat of a co-responsibility levy on cereals has not been brought forward again, while a proposal for a nominal fall in the cereal intervention price, however small, might well have had a salutory psychological effect.

In the light of the recent difficult market conditions experienced by many Community livestock producers, some move towards supporting this sector might have been expected, particularly for pigs. However, against frozen cereal prices and continuing productivity growth, price rises of over 1% appear relatively generous. Greater (though selective and temporary) use of storage subsidies could have been sufficient to improve these markets without adding a further twist to the price spiral. Attempts to limit the variable premium system for beef and sheepmeat in the UK and Ireland are probably worth trying in markets which have become accustomed to the hitherto unlimited extent of these subsidies. Although the implications for consumer prices may lead to some political embarrassment, in the UK especially, it is doubtful if this will be sufficient to generate much political resistance.

It is in the dairy sector that the major decisions must be taken, and hence on which most interest centres. The Commission has proposed a farm-level levy of 75% of the target price on any deliveries over a base of 1981 levels plus 1%. The effectiveness of this measure, if adopted at all, will depend on the speed with which it is implemented, and the determination with which it is applied to individual producers

through national governments and dairies. It seems unlikely that the necessary agreement on the quota base and the level of the super levy, as well as the adminsitrative preparation, can be completed by July 1984, so that individual producers will not find their returns altered, at least in the fashion intended by the Commission, until 1985. This will greatly weaken the short term effect. Moreover, next year's round of farm negotiations will probably include further discussion of at least the detailed exemptions and alleviations attaching to the super-levy scheme, and possibly reallocation of quota between member states and reconsideration of the level of the levy, further weakening the longer term effects of the programme. Meanwhile, evasive action will be taken by those in a position to do so, e.g. splitting herds, creating 'new' herds, or exploring difficult-to-monitor direct sales.

On the agri-monetary proposals, marked reduction of positive MCAs may be worthy but is probably unattainable, particularly since reducing positive MCAs with no increase in common support prices means that nominal support prices would be reduced in the UK, Germany and the Netherlands. This has not happened before and is very unlikely to be acceptable now. The elimination of negative MCAs is of course a different matter and seems likely to be a necessary price to pay for any agreement. However, this year, after a relatively long period when no special green rate changes have been implemented, there are worrying signs of a change in the underlying situation, quite apart from the present proposals. The possibility of a 'green' ECU tied effectively to the Deutschmark would mean a return to the pre-1978 situation of built-in upward drift in agricultural support, with several national governments able to exploit the system to electoral advantage by devaluing their green exchange rates after foreign exchange market shifts. In time of exchange rate stability and in the absence of budget constraints, this may not matter, since these devaluations could be tied into the annual Council decisions, and hence be fully taken into account in Community decisions on common prices. But European economic recovery, if it progresses any faster, is likely to bring pressure to bear on intra-European market exchange rates through unequal rates of expansion. While these may or may not be controllable under the European Monetary System, there is likely to

be increased scope for opportunistic green rate adjustments, which would be inimical to effective price control.

As with all economic evaluations, consideration of the 1984/85 proposals must entail one or more feasible alternative situation so that the comparative costs and benefits may be calculated. Roughly symmetric alternatives are: (a) continuation in real terms of the previous year's policy, i.e. (notional) adjustment of CAP prices and exchange rates so as to compensate producers for the effects of cost rises over the year in question, and (b) a complete price "freeze", involving constant nominal support price levels, and hence the deterioration of producers' incomes (but the amelioration of consumers' and taxpayers' costs) through the effects of inflation and the associated differential depreciation of the various Community currencies. The Commission proposals for 1983/84, as first put forward in December 1982, would have meant a 1983/84 outcome roughly halfway between these two extremes. As anticipated, however, the Council did not agree to the Commission's monetary proposals, so that an extra 1-1½% was added to the package in May 1983. The alternation in French economic policy during the year, coupled with hesitant German recovery and the stability of sterling against othe European currencies, avoided further upward drift in effective support through MCA changes. For 1984/85, the alternative policy of constant real support prices is even less realistic than it was in 1983/84, in spite of the fact that it is roughly consistent with the trend in real support prices in national currency terms over the past ten years or so. However, evaluation of the current package against this alternative does allow estimation of the income consequences of policies in real terms.

The option of a complete price freeze, however, is a realistic alternative for 1984/85. Indeed, some commentators have treated the proposals as more or less equivalent to this, and it is the defacto outcome of a failure by the Council of Ministers to agree a price package. In real terms, average support prices would decline by about 5.9 per cent compared to 6.5 per cent for the full set of Commission proposals. Against a complete freeze, a possible outcome considered here is a set of "amended proposals" which ignore the proposed reductions in the positive MCAs for Germany, the Netherlands, and the United Kingdom. This

would result in an average real price fall of around 4.3 per cent. It may be that some token reduction will be agreed by the relevant Minsiters, especially if this is part of the price for an overall package, but past experience shows reluctance to give in on these specifically national aspects of the proposals. Another possibility, not examined here, would be a more severe set of changes, designed (as the Commission proposals are not) to contain the Community budget to within the current financial limits.[6]

The effects of the Commission proposals against these policies of constant real prices, a price freeze, and the amended proposals are set out in Table I. World prices have been assumed rather closer to normal (i.e. lower) levels than has been the case in 1983. Two ways of looking at the consequences are presented - one assuming that production and consumption levels remain unchanged at their trend 1984/85 levels (the 'impact' effects), and the other assuming full adjustment of production and consumption quantities to the different levels of real prices under each policy. The latter would only occur in fact if no further policy changes (in real terms) took place over the period (the long run) during which adjustments could be made in production systems and investment programmes. Not only is that unrealistic, but further technological and behavioural shifts will occur beyond those already taken into account. Nevertheless, the 'full adjustment' effects give a better indication of the underlying implications of the current proposals in terms of economic welfare and the future direction given to the agricultural industry than the short-term 'impact' figures.

The results in Table I show, firstly, that unchanged policy (i.e. constant real prices) is estimated to result in gross FEOGA expenditure of about £10.1 billion in 1984/85, or about £1.5 billion above the currently budgeted limit, as compared to the short-term outcome under a complete agricultural price freeze of just over £9.7 billion. Against these two 'extremes' the Commission package of price and green rate proposals (but ignoring the milk super-levy) is estimated to involve 1984/85 expenditure at almost exactly the same level as a freeze. In the longer run, however, it is slightly more successful in containing expenditure

than the freeze, largely because the MCA changes result in lower real prices. If the changes in positive MCAs are ignored, as in the amended package, the short-term impact creeps up towards the constant-real-price base. Even after economic adjustment, gross FEOGA expenditure approaches £9.2 billion. The conclusion must be that while the proposed package is reasonably strict in price terms, especially if levels of production are reduced in response to its continued application in future years, it is highly dependent on the MCA proposals. Past experience would imply that much of the budgetary impact would be lost if countries with strong currencies refuse to allow exchange rate pressures to affect their farming sectors.

The lower part of Table I shows the alternative outcomes of the various policy situations at the level of the individual worker or farm holding. The effects on the agricultural industry are measured as real changes in value added or net product for the agricultural industry as a whole. These changes would be distributed through to factor markets to returns to land, labour, and capital employed by the industry, and should not be taken as indications of the final effect of the policy changes on farm incomes per se, although the consequences may show up initially as changes in farm incomes. To make these figures more understandable, they have been expressed both per farm and per head of the agricultural working population. Similarly, the consumer/user and taxpayer effects are expressed per head of the working population. Thus the EC agricultural industry stands to lose annually around £470 per head under a price freeze, £520 per head under the package as a whole, but 'only' £340 per head if the package is amended by leaving positive MCAs unchanged. Figures are also given for farms of various sizes, and show that reductions in real value added would vary between £1300 and £2200 per 'large' holding. Set against these effects, annual gains to the general population through lower real food prices and reduced calls on tax revenue amount to between £40 and £60 per head, except for the smaller gain of £28 in the short term under the amended package without any green currency revaluations. The effect of the amendment would be to bring the longer-run per capita losses and gains rather closer together than the alternatives.

TABLE I

Outcomes of Alternative 1984/85 Price Policies

	Constant Real Prices	Price Freeze		Commission Proposals		Amended Proposals[a]	
		Impact	Adjustment	Impact	Adjustment	Impact	Adjustment
Self-Supply Ratio	108.5	108.5	103.4	108.5	103.2	108.5	104.8
Average Real Price Change from 1983/84 (%)[b]	0.0	-5.9	-5.8	-6.5	-6.4	-4.3	-4.2
FEOGA Expenditure (£m)							
- export refunds	4381	3755	2998	3905	3134	3905	4329
- intervention	2450	2293	2206	2291	2183	2352	2271
- gross[c]	10105	9731	8551	9733	8462	9731	9183
Real Value Added and Income Effects (£)							
Value Added							
- per agric. worker	-	-478	-472	-521	-519	-341	-341
- per farm: small	-	-118	-116	-107	-106	-93	-92
: medium	-	-462	-456	-469	-466	-336	-336
: large	-	-1854	-1834	-2158	-2158	-1282	-1290
Real Income							
- per consumer/taxpayer	-	+40	+58	+44	+63	+28	+40

Notes: (a) Excluding proposals to reduce positive MCAs.
(b) Averaged over 16 commodities (cereals excl. rice, livestock products, milk and olive oil).
(c) Including net MCA expenditure and expenditure on commodities not explicitly modelled (see note (b)).

Source: Newcastle CAP Model, January 1984.

Table II shows some of the consequences for each country in the Community. The effect of some of the more specifically national measures such as accessionary arrangements for Greece and removal of butter subsidies in the UK are not included, so these results should be taken as indicating the effect of the basic backage rather than a complete calculation. The effect of amending the proposals by dropping the positive MCA reductions is clearly seen in the cases of Germany, the Netherlands, and the United Kingdom. The table also shows estimates of the net effect on each country's position vis-a-vis the Community budget. CAP expenditure on export refunds, intervention and MCAs has been set against member states' payments in terms of import and producer levies and VAT-based financial contributions to the overall net cost of the CAP (and before any rebates). It can be seen that the balance of the proposals as compared to a straight price freeze has the greatest effect on Germany, France and the Netherlands, in that the reduction in Germany's positive MCA converts a potential gain under a freeze arising from Community-wide downward pressure on farming into a further budgetary loss of over £90 million. France, on the other hand, would be severely treated under a freeze, but under the proposals is much more gently treated. The Netherlands stand to lose considerably in terms of export refunds under the unamended proposals. Not surprisingly, the United Kingdom benefits from any reduction in the overall cost of CAP. On a per head basis, a freeze has the greatest impact in terms of agricultural value added on Belgium (on account of high inflation) and the United Kingdom (with a relatively small farming workforce). The unamended proposals would almost double the loss per UK agricultural worker from a price freeze, but more than treble the equivalent loss in Germany and the Netherlands. These losses amount to 23.3% of net value added at factor cost (1982) in the United Kingdom, 9.3% in the Netherlands and 22.7% in Germany. Most other countries would experience losses in real income of £200-£400 per agricultural worker under the proposals, while the average loss for the EC amounts to 11.7% of net value added in the Community. Under the amended proposals, these farm-level effects are greatly reduced, and indeed improve the position for some as compared with a price freeze. The effect as a percentage of net value added over the whole Community falls to 7.7%, to 6.3% for Germany, and 11.7% for the United Kingdom.

TABLE II — Full Adjustment Effects of Commission Price Proposals, by Country[a]

	G	F	I	Ne	B/L	UK	Ir	Dk	Gr	EC10
Average % Real Price Change from Base										
Price freeze	-2.7	-7.0	-10.7	-2.4	-6.1	-5.2	-7.4	-4.8	-15.3	-5.8
Proposals	-7.3	-3.4	-9.5	-5.4	-5.2	-9.3	-5.2	-4.3	-12.7	-6.4
Amended Proposals	-2.1	-3.4	-9.3	-1.7	-5.2	-4.6	-5.2	-4.3	-12.7	-4.2
CAP Net Expenditure (£m)[b]										
Price freeze	+222	-431	+309	-62	-41	+91	-115	-16	-18	0
Proposals	-94	-51	+296	-141	-32	+35	-43	-3	-69	0
Amended Proposals	+109	-131	+169	+25	-57	+29	-44	-15	-84	0
Real Changes in Value Added in Agriculture (£/head if agric.working population)										
Price freeze	-277	-671	-388	-504	-1422	-820	-556	-569	-257	-472
Proposals	-770	-320	-325	-1053	-1402	-1519	-365	-465	-207	-519
Amended Proposals	-214	-321	-324	-264	-1402	-763	-365	-465	-207	-341
Real Income Changes for Users, Consumers & Taxpayers										
Price freeze	+38	+67	+85	+41	+56	+41	+78	+35	+121	+59
Proposals	+71	+39	+72	+62	+62	+68	+55	+34	+101	+63
Amended Proposals	+26	+32	+67	+25	+53	+35	+51	+31	+99	+40

Notes:
(a) See notes to Table I.
(b) Changes due to policy alternative in: FEOGA guarantee expenditure on country production/utilisation basis, less VAT contributions to net EC FEOGA expenditure. These changes in intra-EC financial flows naturally sum to zero for the EEC as a whole.

Source: Newcastle CAP Model, January 1984.

Finally, the consumer/taxpayer effect of the unamended proposals as compared to a freeze is focussed on Germany and the United Kingdom (the Community paymasters), while the amendments would reduce the potential gains to their populations at large to below those in most other memebr states. As order of magnitude, the Commission's proposals would improve consumers' and taxpayers' welfare in real terms by about 4.5% of total food expenditure for the EC as a whole, with a range of 2.3% for France and 6.5% for the United Kingdom.

IV THE FUTURE OUTLOOK

The Commission's 1984/85 price fixing proposals and the meetings of the Council of Ministers to decide support price levels are almost certain to be the last of their type. Future meetings and proposals will need to be increasingly concerned with quantitative limits, production thresholds, quotas and super-levies as well as support price levels and MCAs. In fact, discussion of the levels of the base dairy quota, the associated super levy and the definition of any exemptions are likely to make even the 1984/85 meetings rather different than previously. The effect of these complications, to say nothing of the effect of the simultaneous budgetary negotiations, on this year's outcome from the Council of Ministers is uncertain. However, it need not make agreement more difficult, since there will be more options and possible trade-offs for member states to choose from in coming to a mutually acceptable package.

A possible outcome, however, is that no overall agreement will be reached in time to affect this year's agricultural price decisions, these being reached in default, or in anticipation of later budgetary accords. From the strictly Community point of view, the financial flows involved by the operation of the CAP will then be constrained to the recently-passed budget ceilings, however national governments may choose to supplement these to their own farmers in the short term. Of course, we have to assume that severe disruption to production, consumption and (especially) intra-Community trade does not develop over the year, though the likelihood that this can be avoided in any longer period of crisis

is small. The additional uncertainty generated through, for example, non-payment of specific EC funded grants and subsidies, as well as prolonged uncertainty over the future of the policy itself, may turn out to be as effective a limit on production as any specific measure agreed this spring. Thus it will be considerably more uncomfortable for farmers and those industries relying on agriculture than a more certain and consistent plan of adjustment and reform. The relative certainties of the past have come at a very high price.

A budgetary and CAP crisis could also be precipitated by world events, even if the whole of the Commission's package, including the adjustment proposals, is adopted by the Council of Ministers. A fall in the US dollar versus the ECU, or increased world supply in the rest of the world as Australian production recovers from the drought and as US grain stocks are sold off, could occur relatively quickly, far more quickly than the medium term adjustment proposals of the Commission can take effect. The US, in particular, may become impatient with simple sabre-rattling and actually draw the sword of the threatened trade war. If such a situation occurs while changes in the CAP or budget are still not agreed by the Council of Ministers, then clearly the pressure for hard bargaining will become almost intolerable. Although the Ministers and their advisors must be very well aware of the dangers, there is little sign as to what, if any, member state is prepared to give away in the direction of CAP adjustment or reform.

Public statements from most member states seem to support the idea of an overall limit or constraint on CAP spending, but such general agreement on the principle is not at all the same thing as agreeing on the practice. Possible methods of enforcing such an overall ceiling vary from a budgetary cash-limit approach as proposed by the UK, to farm level transferable quotas and super-levies as suggested by the Commission for milk. The debate over the appropriate mechanism centres on two major questions: a) the effectiveness of the method in controlling "overspending" for the Community as a whole; and b) the differential impact of the measures on each member state. The familiar argument between

member states over the appropriate distribution of pain, and the determination of member states to minimise the damage done to their own farmers and citizens, do not favour eventual agreement on an effective package to limit expenditure. A distinct possibility is that member states will take over at least some of the financial responsibility for agricultural support within their own frontiers, either de facto or even by agreement. The consequences of this development for free trade within the Common Market and for European integration in general are serious, but whether serious enough to prevent member states from following this road remains to be seen.

Given a continuation of the current policy, the CAP will cause a breach in the European Community's budgetary ceiling very soon. Something has to be done to limit production, increase consumption or increase the financial resources to cover the growing cost of surplus disposal. Estimates of the future of the CAP budget are shown in Table III, assuming a continuation of historic trends, at current world market conditions. Any bearish tendencies in world markets, including a depreciation of the US dollar, would increase these figures for 1988, at the rate of approximately a 1% increase in expenditure for every 1% fall in effective world prices in ECU terms.[7]

It is the response to this budgetary pressure which will determine the future of the CAP over the foreseeable future. In essence the options open to the Community are to:

a) reduce gross expenditure on the CAP, by reducing real prices or introducing quotas or quantitative restrictions on production;
b) reduce net budgetary expenditure on the CAP by means of co-responsibility levies; or greatly stimulating European consumption;
c) increase European budgetary resources by raising the VAT limit or by introducing some new revenue source.

TABLE III   CAP Budget Expenditure and Income Projections (£m at constant prices)

	1982[1]	1983[1]	1983[2]	1983[2] (Lower World Prices)	1988[2]
1. Total FEOGA Guarantee Expenditure	7071	9123	10020	11400	12600
2. Total Agricultural Own Resources	1270	1466	1300	1480	1250
3. Net CAP Expenditure (1-2)	5801	7657	8720	9920	11350
4. Total Own Resources with VAT at 1% (assumed 2% growth)	12681	13894	14080	14080	15550
5. Total Non-Agricultural Own Resources (4-2)	11411	12428	12780	12600	14300
6. Net CAP Expenditure as % of Own Resources	50.8	61.8	68.0	77.3	79.4

Sources: 1. European Commission: Bulletin of the European Communities, Supplement 4/83 - Adjustment of the Common Agricultural Policy.

2. Newcastle CAP Project, January 1984 estimates.

The economist's answer to the CAP problem has traditionally been to reduce real prices and supplement needy farmers' incomes through direct income support. Although this option is ritually paraded, there is little evidence of any substantial political will in support of the approach in other than marginal cases. In the past, prudent price increases have only been acceptable in ECU terms given national flexibility practically to cancel out real price cuts through changes in green rates. Quantitative restrictions on output qualifying for support, by means of a super levy on over-quota production, seems likely to be much more acceptable to most member states than realistic and effective price reductions. The key elements in determining the effectiveness of this policy are the base quota level, the size of the super levy, the exclusions or exemptions from the scheme, the effectiveness of the policing mechanism, and the means by which quota entitlements are transferred or re-allocated between producers, regions and memebr states. At worst, such a system will simply add yet another layer of costly bureaucracy over the industry, doing little to stem the growth in production or cost and generating yet another political quarrel within the Council of Ministers. At best, the system does offer a means of progressively reducing the level of support, and thus improving the real international comeptitiveness of the European industry, while at the same time providing adequate and acceptable compensation to producrs for giving up the right to support. This can be done if the Commission progressively buys in quota at the going market price for tradeable, farm level, quotas, thus compensating producers who give up the right to support.

Given the strength of the CAP defences, and the demands for additional Community policies, an increase in budgetary funds seems a very likely outcome, albeit coupled with some attempts to curb gross and net CAP expenditure. However, the latter are not likely to be agreed in a form which is particularly effective, which will leave the underlying pressures on the policy towards increasing production surpluses and expenditure largely unresolved. The vested interests in the European agricultural industry might regard such an outcome as satisfactory. But this will do nothing to alleviate the current uncertainty and dissatisfaction with the policy and its levels, and in the longer term may do the industry and its members more harm than good.

V THE COSTS AND BENEFITS OF THE CAP[8]

The current European debate over the budgetary problems of the Community has once again raised the whole question of the costs and benefits of the CAP, both in terms of who gains and who loses and by how much, and in terms of whether the policy represents value for money. Many of the arguments about the appropriate direction for reform or adjustment of both the CAP and of the European budgetary mechanism are bound up with judgements on the costs and benefits of the policy without these being made explicit. This section presents some current estimates of these costs and benefits in an attempt to enlighten the argument.

The costs and benefits of the CAP and their distribution between member states is a subject which continues to cause considerable disagreement and misunderstanding. The European Commission itself has not improved matters by re-calculating the member states "share" in the total budgetary expenditure on the basis of agricultural production shares rather than on the basis of the location of actual expenditure.[9] There is no theoretical justification for this procedure, although in a sense it does recognise that budgetary expenditure under the CAP supports markets throughout the Community, rather than simply in those countries where the money is spent in the first instance. Another point of view has recently been expressed through the columns of the Financial Times (and in evidence to the House of Lords) by the Institute of Fiscal Studies.[10] According to their figures, the costs of the policy are properly identified by comparing the effects of the current policy with a situation in which there existed no policy of agricultural support at all. This approach has some textbook merit, but falls short of useful policy information since it is clear that unfettered free trade is not an acceptable alternative to the current policy without some other means of supporting the agricultural and rural population. Since specification of these other means of support constitutes a new agricultural policy, the proper measurement of the current policy's opportunity cost should be with respect to that "next best alternative".

To sort out the wheat from the chaff, Tables IV and V show current estimates of the major components of the costs and benefits of the current policy with its current level of support. The two tables show the costs and benefits associated with two separate and distinct alternative policies: nationalisation of the CAP and free trade at world prices.

A Nationalisation of the CAP (Table IV)[11]

An alternative to the current CAP is for each member state to finance its own agricultural policy separately. To keep things simple, suppose that each country chooses to keep the same system and level of support as currently applies under the CAP. As a result, all budgetary expenditure received under the policy in any member state now becomes the sole responsibility of that country, while there are no VAT contributions to the Community budget from any member state to finance the CAP. Each member state would retain import levies and would be solely responsible for financing any export refunds or intervention arising in its own territory, the levies and refunds would now apply on trade with the rest of the Community as well as on trade with the rest of the world, instead of intra-Community trade taking place at common preferential prices as now. In other words, nationalisation of the CAP involves abandoning the principles of free trade at common preferential prices and of common financing, while retaining current levels of support and using exactly the same instruments and intervention buying to remove surpluses. Export refunds and import levies would continue to insulate domestic agricultures from world trading conditions and there would be no change in production and consumption levels, and thus in export surpluses and import requirements. Nor would there be any effect on world prices, at least in principle, since trade volumes would not change.

The differences between the current CAP and the nationalised version are shown in Table IV. Line 1 shows the current expenditure under the CAP (roughly the FEOGA guarantee section of the budget) estimated for 1983 on the basis of trend production and consumption levels for each commodity in each country and the historical pattern of trade. As such, the total does not correspond precisely with the European Commission's figures for 1983 actual expenditure (which are some 3.8%

higher). Against this gross expenditure, the CAP raises revenue through import levies, which are estimated as above and are subtracted from the gross expenditure (to give net expenditure in each country) in line 2. (It is this expenditure, rather than a share of the total EC budget, which each member state would have to finance from internal tax sources under a nationalised version of the CAP.) Line 3 shows each member state's VAT-based contributions to the current total CAP budget. Line 4 shows the net budgetary cost to each member state of the common elements of the CAP. These of course balance out across the Community as a whole, and show that West Germany and the United Kingdom are net contributors to the CAP budget while all other member states are net beneficiaries. The figure of £1 billion for the United Kingdom makes up most, if not all, of the United Kingdom's net budgetary deficit with the EEC budget, since expenditure and contributions for other European programmes more or less balance out for the United Kingdom. There is, however, a further effect of the CAP on inter-country transfers. The principle of free trade at common (preferential) prices means that importing countries are paying higher prices than world prices to exporting members of the Community. Under a nationalised policy, import levies would be raised and export refunds spent on this intra-Community trade, as the difference between domestic price levels and the current world price. Line 5, the preferential trade effect, provides an estimate of this, showing net importers (e.g. West Germany, Italy and the United Kingdom) losing and net exporters gaining. The combined loss or gain to each member state is thus the budget and the trade effect, line 6, also shown as a percentage of Gross Domestic Product and on a per head basis for each member state.

Three major points should be noted in connection with Table IV. First, world price levels in European currencies were high in 1983. In 1984, a 20% reduction in world prices is not unlikely and would increase gross and net FEOGA expenditure by about 20%, confortably breaking the current overall European budget limit (based on the 1% VAT ceiling). Second, projections of production and consumption levels over the next five years suggest that net FEOGA expenditure under unchanged policies will rise by about 8.5% per year in real terms, increasing the CAP share

TABLE IV — Costs and Benefits of the Common Elements of the CAP

1983 (£m)

	WG	F	I	Ne	Be/L	UK	Ir	Dk	Gr	EEC[1]
1. Gross FEOGA Guarantee Expenditure	1700	2110	1610	1020	450	860	310	360	400	8820
2. Net FEOGA Guarantee Expenditure	1490	1935	1480	900	380	565	295	335	340	7720
3. VAT Share of Net Expenditure	2210	1800	1065	410	285	1600	75	155	120	7720
4. Member State CAP Budget Balance (2-3)	-720	135	415	490	95	-1035	330	180	220	0
5. Preferential Trade Effect	-160	195	-1235	620	-45	-270	375	550	-30	0
6. Budget and Trade Effect (4+5)	-880	330	-820	1110	50	-1305	595	730	190	0
7. (6) as % of GDP	-0.2	+0.1	-0.5	+1.4	+0.1	-0.5	+6.8	+2.4	+1.0	0
8. (6) as £ per head of working population	-35	+16	-40	+226	+13	-57	+518	+300	+57	0

Notes: 1. EEC totals may not equal the cross country sums exactly, due to rounding.

of total available European budgetary funds from its current level of 62% to 80%, again effectively breaking the Community budget. These projections also show that budget and trade effects on each member state become more pronounced, the annual United Kingdom figure increasing to a loss of £1.8 billion from £1.3 billion in constant price terms. Third, if any member state increases its share of agricultural production under the current CAP, for example, by using national aids or devaluing its green currency, it will gain the full effect of this increase in self-sufficiency in terms of FEOGA net expenditure and the preferential trade effect, but will only contribute a part share of the cost in terms of VAT-based contributions. The "free-rider" feature of the costs of the CAP is an important element in the development of the CAP, through its influence on member state responses to the CAP both nationally and within the Council of Ministers.

B The Free Trade Alternative (Table V)

A different alternative policy against which the costs and benefits of the CAP may be measured involves the Community abandoning all market price protection of European agriculture, eliminating export refunds, intervention buying, import levies and other instruments of market support, and accepting the resulting world prices as being the appropriate levels for domestic European market prices. This is, apparently, viewed as the appropriate alternative by the Institute of Fiscal Studies. Prices would generally fall in the Community and total farm output would also decrease (although some individual farmers would be encouraged to become more efficient and may, as a result, increase their output levels). Consumption would increase and self-sufficiency levels would fall in each member state and in the Community as a whole. Exports would be reduced, while imports would increase. As a result, world prices would increase from current levels. It is estimated, rather roughly, that prices for agricultural commodities in the EC under the CAP are on average about 27% higher than they would be under free trade. This figure may be interpreted as the approximate level of protection currently given to EC agricultural markets. This protection improves agriculture's value added from what it would otherwise be, and means higher prices and thus

income or purchasing power losses to consumers and users. It also, of course, involves EC budgetary flows on CAP which would be eliminated under a free trade option. The gains and losses to these groups are shown in Table V.

The gain in value added in agriculture in the Community as a whole and in all but three member states is smaller than the combined losses suffered by consumers and taxpayers as a result of the CAP compared with free trade. Increased production requires additional inputs which have to be bribed out of other uses to produce agricultural output. In addition, higher consumer prices mean that some consumption at lower prices is foregone, while the remaining consumption is only possible at higher prices and greater expenditure. Taxpayer losses represent lower public or private purchasing power, depending on the fiscal response to ending the VAT contributions from national exchequers. It is these "efficiency" losses for the Community which are shown in sub section III of the Table. Overall, the Community cost of the CAP is about 0.5% of GDP, or about half the projected rate of economic growth in 1984 (O.E.C.D.). Whether or not this is a satisfactory state of affairs depends on the value placed on other agriculturally-related objectives such as secure and stable food supplies; rural employment, population stability and rural development; and on whether there exist acceptable alternative policies which would achieve these objectives at lower economic cost than market intervention, while providing sufficient protection of existing producer interests to be economically acceptable. The effective cost of the CAP can only be measured against such an alternative policy.

The operation of the CAP results in very different cost burdens on each member state, which may not correspond to their national evaluation of the value of supporting domestic agriculture, perhaps particularly in the United Kingdom. As a result, there are likely to be widely different national evaluations of the value for money which the CAP represents.[12] However, the potential income gains to the agricultural industry are substantial. Removal of this protection without any form of compensation, at least to smaller producers, would be politically and socially unacceptable, even in the United Kingdom. While in the longer run the

TABLE V   Effects of Agricultural Market Price Support under the CAP versus Free Trade

		WG	F	I	Ne	Be/L	UK	Ir	Dk	Gr	EEC
I	Gain in Agriculture's Value Added										
	a) £m	5775	4740	3005	1685	865	3250	520	750	655	21245
	b) £ per holding	7240	4170	1370	13070	9000	13060	2320	6484	892	3741
	c) as % of Agricultural Gross Product	98.1	48.7	28.7	73.8	82.2	83.3	69.8	73.1	28.1	56.7
II	Users & Taxpayers Income Loss: (£m)										
	a) users	6070	3640	3330	1100	690	4310	235	270	575	20220
	taxpayers	2210	1800	1065	410	285	1600	75	155	120	7720
	total	8280	5440	4395	1510	975	5910	310	425	695	27940
	b) £ per household	330	260	210	310	255	255	270	175	205	265
	c) as % of GDP	2.4	1.9	2.4	2.1	1.9	2.3	3.6	1.4	3.7	2.2
III	Net Effect of European Agricultural Support:										
	a) £m	-2505	-700	-1390	+175	-110	-2660	+210	+325	-40	-6695
	b) £ per household	-100	-35	-65	+35	-30	-115	+185	+245	-15	-65
	c) as % of GDP	-0.7	-0.2	-0.8	+0.2	-0.2	-1.0	+2.5	+1.1	-0.2	-0.5

industry as a whole would adjust to lower prices through more extensive production practices and lower input use, this adjustment would clearly be painful for those currently in the indsutry. Particularly, one would expect land values and other asset values to fall, thus reducing the wealth, savings, and effective pension funds of those currently owning these assets. Such a reduction in prices and incomes would certainly bankrupt numbers of existing farmers. On the other hand, consumers and taxpayers as a whole gain sufficiently from free trade to be able to compensate farmers for their losses and, in principle at least, still be better off. However, on a per head basis, the consumer and taxpayer losses are far less significant than the per head or per farm gains of farmers. The political weights attached to these conflicting interests are unlikely to correspond to economic weights of £1 for £1 in each group, whatever the political system. Even if they did, the economic prescription in favour of free trade requires that the losers are actually compensated for any losses in order that free trade can be considered superior policy alternative. The form of the compensation package thus becomes a new agricultural policy which must be specified before a firm conclusion on the net benefits of free trade can be firmly established.

VI CONCLUSIONS

There is no agricultural policy or policy change available to the European Community which will simultaneously (i) maintain farming incomes and wealth, (ii) eliminate surpluses, (iii) reduce budgetary spending, (iv) satisfy consumer interests in lower food prices, and (v) harmonise differing national interests. Until now, the policy process has concentrated on the first and last objectives, although it has had only very limited success in achieving a satisfactory level of farm incomes throughout the Community. Exhaustion of the European budget, however, clearly redirects public and political attention to the appropriate ranking and weighting of these conflicting objectives. The "budget problem" of the United Kingdom (and Germany) compounds the political re-evaluation. It is clear that any solution to the budget or surplus problems is likely to involve losses to producers or consumers or both, while full protection of farmer interests will mean an increased burden

on taxpayers and/or consumers. Similarly improvement of any one member state's financial balance with its partners will involve a worsening of others balances. These are obvious points, perhaps, but ones which are often forgotten in the heat of debate. The fact that the budgetary problem now requires a Community decision means that the annual CAP price decision cannot be taken in isolation from this budgetary consequences, as it has been largely in the past. This alone makes this year's Council of Ministers meetings different from previous ones. It is possible that the outcome of the budgetary negotiations is simply to raise the budgetary ceiling, in which case future price fixing meetings would be likely to revert to their previous form. It seems more likely, however, that the budgetary decision will carry with it some specific adjustments to the way in which the CAP operates, in terms of total spending allocated to FEOGA and/or of emphasis on quantitative limits on individual commodity support levels, such as the dairy quota. These adjustments will then inevitably form part of the CAP package to be re-negotiated in the future. Thus, the 1984/85 price fixing meetings can be seen as the last of the old and the first of the new. The outcome is important not just to the agricultural industry, but to all concerned with the future of the European Community and its policies.

NOTES AND REFERENCES

1. The calculations for this paper were carried out in late January 1984, and the text finalised in March. In that period, little movement was perceptible in the negotiating stances of EC member states. This is unlikely to remain true much longer, however, and the paper should be read with the above timetable in mind.

The authors would like to thank their colleagues Allan Buckwell, Lionel Hubbard and Phil Dawson for their helpful comments. This paper was written on the basis of research currently supported by the Ministry of Agriculture, Fisheries and Food but does not necessarily represent any official views whatsoever.

For earlier examples of price proposal evaluation see: Thomson and Hubbard; Evaluation of the 1982/83 Price Proposals for the

CAP. March 1982, No. 1 of this series; and Thomson and Harvey: Evaluation of the 1983/84 Price Proposals. Agra Europe Special Report No.17. Outlook '83 Proceedings, April 1983.

A shorter version of the present paper was presented to the Agra Europe Outlook '84 Conference, London. February 8/9th 1984.

2. European Commission: Adjustment of the Common Agricultural Policy. (Report and proposals to the European Council, 29th July 1983.) Bulletin of the European Communities, supplement 4/83.

3. The question of milk quotas and super levies is to be examined in detail by L. Hubbard in a forthcoming discussion paper in this series.

4. Villain, C. The Political and Economic Influences Affecting the Common Agricultural Policy. Paper to 'Outlook '83 Conference, published as EC Green Europe Newsletter in Brief, No. 22, February 1983.

5. Tangermann, S. Financial Times. November 2, 1983.

6. Sheehy, S.J. Implications for an Exporting Member State of Alternative Reforms of the CAP Dairy market. Paper to EAAE Symposium, September 1983, to be published in Proceedings by Departments of Agricultural Economics and Agricultural marketing, University of Newcastle upon Tyne.

7. See Thomson, K.J. CAP Budget Projections to 1988. DP4, Departments of Agricultural Economics and Agricultural Marketing, University of Newcastle upon Tyne. Other estimates of budgetary trends, e.g. Agra Europe, November 25, 1983, are even more pessimistic.

8. This question is addressed much more comprehensively in The Costs of the Common Agricultural Policy, Croom Helm. 1981. By A. Buckwell D. Harvey, K. Thomson and K. Parton.

9. See, e.g. Agra Europe, November 11, 1983, pp. 12 and 13.

10 Financial Times, December 8, 1983, and IFS, Evidence to House of Lords Select Committee on the European Communities, Future Financing of the Community. Session 1983-84. 12th Report.

11 The costs and benefits under this alternative have been measured previously by Buckwell et al, op. cit., and by Rollo and Warwick, Government Economic Service Working Paper No. 27, London, November 1979. The CAP and Resource Flows among Member States; and Godley: The System of Financial Transfers in the EC, in Whitby, M. (ed). The Net Cost and Benefit of EEC Membership, Wye College, CEAS, 1979, among others.

12 This point is elaborated at some length by Harvey: National Interests and the CAP. Food Policy, Vol. 7, No. 3. August 1982, pp174-190.

The Department of Agricultural Economics and the Department of Agricultural Marketing launched a new series of Discussion Papers in the Spring of 1982. The titles available are:

DP 1 Evaluation of 1982/83 Price Proposal for the CAP
Kenneth Thomson and Lionel Hubbard

DP 2 Forecasting EEC Support Prices
Christopher Ritson

DP 3 Cereals and the CAP
Kenneth Thomson

DP 4 CAP Budget Projections to 1988
Kenneth Thomson

DP 5 Herd Size and the Impact of Reducing EEC Dairy Support Prices
Lionel Hubbard

DP 6 The CAP for Fruit and Vegetables: Its Impact on Third Countries
Christopher Ritson and Alan Swinbank

DP 7 The Urban-Rural Income Gradient and the Pressure of Demand for Labour
Martin Whitby and Lionel Hubbard

DP 8 The 1984/85 CAP Price Proposals: An Evaluation and Some Observations
David R. Harvey and Kenneth J. Thomson

Forthcoming:

DP 9 UK Agricultural Trade Since Entry into the European Community
Allan Buckwell

These papers are priced at £2.00 each (including postage and packing in the UK and Eire) and are available from the Department of Agricultural Marketing, The University, Newcastle upon Tyne, NE1 7RU, or by telephone on Newcastle (0632) 328511, extension 2932 (Agricultural Marketing) or extension 2900 (Agricultural Economics). Please make cheques payable to The University of Newcastle upon Tyne and send to the Department of Agricultural Marketing.