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DISCUSSION PAPER

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CEREALS IN THE E.E.C.
Policy Options and Their Impact on the
U.K. Market

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I BACKGROUND TO THE CURRENT SITUATION IN THE CEREALS SECTOR

I.1 Introduction

The European Commission has recently published two discussion papers (1) (2) which examine the present and future direction of agriculture in the European Community, and set out options for the cereals sector.

At this stage the Commission has not narrowed the options down to firm policy proposals, but its most recent public statements on the subject indicate the possibility of some, or all, of the following: price restraint; a co-responsibility levy; increased quality standards for intervention grain; a delay in intervention buying.

The purpose of this paper is to examine each of these options and to assess their impact on the U.K. market. Since it seems inadvisable to attempt to predict the decisions of the Council of Ministers, we have, instead, assessed for each option in turn the extent to which it would have to be applied if used in its own right to reduce budgetary expenditure in the cereals sector. This in turn raises the question of what is the budgetary objective for the E.E.C. in the cereal's sector? Is it to make it self-financing? to reduce expenditure on the sector by some percentage? or, merely, to contain the growth in expenditure?

We have also made some tentative estimates of the consequences of an effective price freeze in the sector (whether it is imposed by an actual price freeze, or by stricter quality standards or delayed

intervention buying) together with the introduction of a 2% co-responsibility levy.

Before turning to possible solutions and their impact, however, we present a resumé of the background to the growing problems with the E.E.C. cereals sector.

I.2 E.E.C. Situation and Projections Until 1990

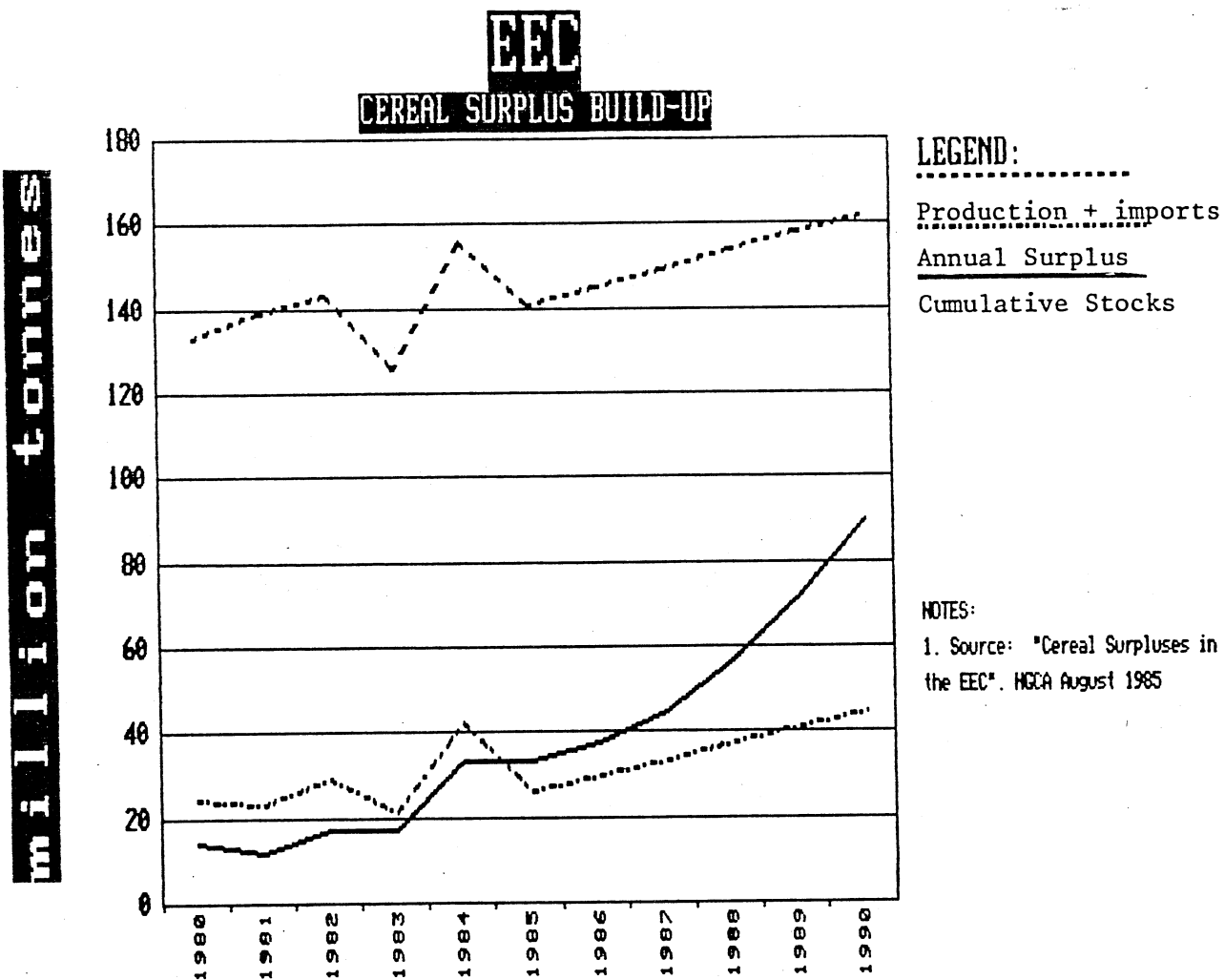
The Home-Grown Cereals Authority (H.G.C.A.) recently published estimates of E.E.C. cereal production and consumption until 1990 (3) (4), under the assumption that present trends in production and consumption would continue. (See Figure 1.)

Based on the assumptions that production would grow at approximately 3% per annum (around 4 million tonnes) and that exports, constrained by limited markets and international pressure to reduce the use of export refunds, would reach a maximum level of about 25 million tonnes per annum, the H.G.C.A. estimates that total stocks in the E.E.C. could be in the region of 89 million tonnes by 1990.

I.3 U.K. Situation and Projections Until 1990

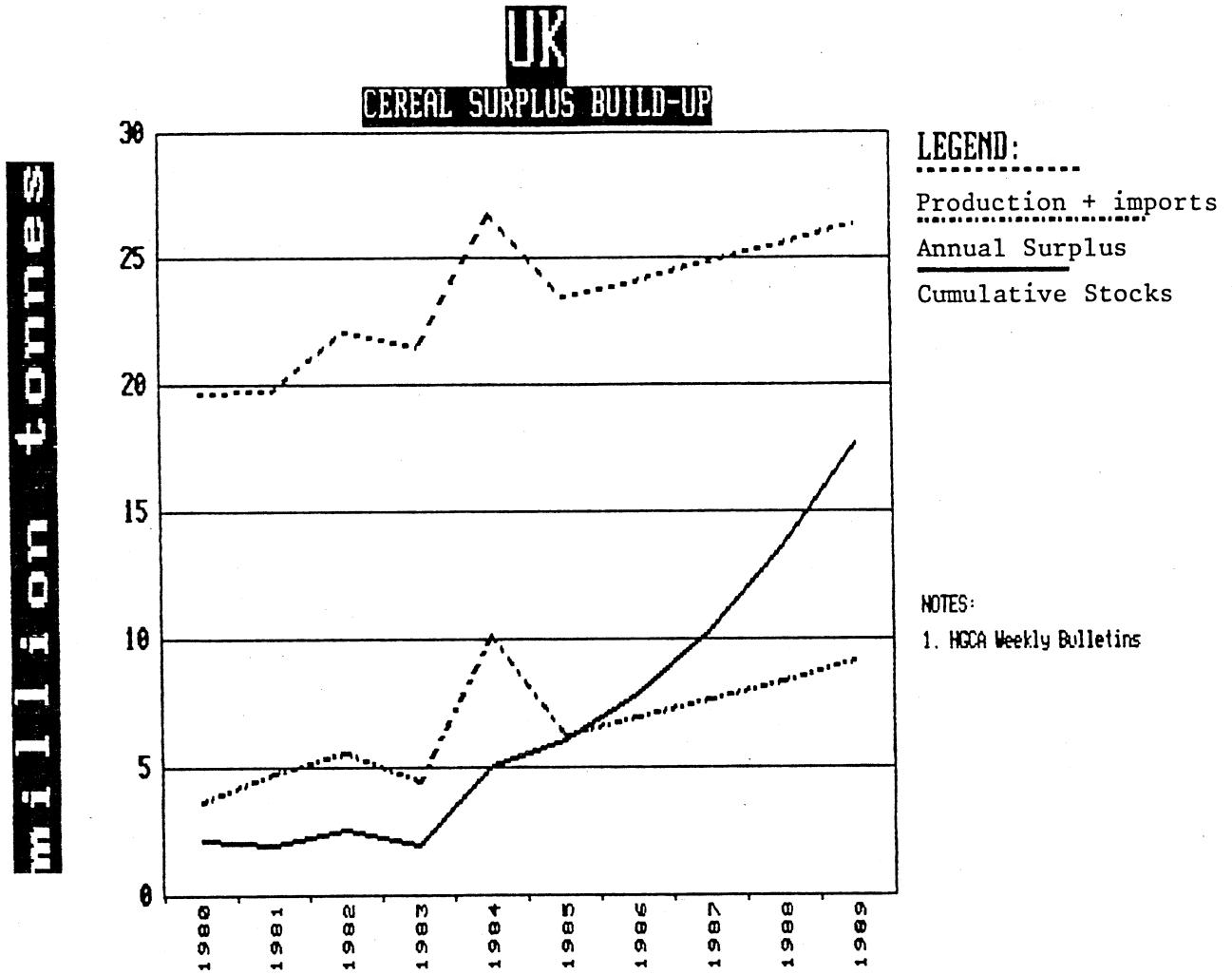
According to H.G.C.A. figures (3), the average annual increase in U.K. cereal production since 1977/78 has been 1.4 million tonnes. The average annual increase in yields has been between 0.25 and 0.35 tonnes per hectare for wheat and between 0.15 and 0.2 tonnes per hectare for barley. If these trends continue until 1990, cereal

Figure 1



production in the U.K. would be over 31 million tonnes. A recent Agra Europe Report (5) assumed a 2% extrapolation of yields, using 1983/84 as a base year, and arrived at an estimate of 27 million tonnes for cereal production in the U.K. by 1990. Using these two estimates of production as examples of high and low estimates, and assuming imports and consumption to be in the region of 3 and 21 million tonnes respectively, the annual exportable surplus (i.e. grain available for intervention and/or export) would be between 9 and 13 million tonnes by 1990. (See Figure 2.)

Figure 2



II THE MOST LIKELY OPTIONS IN THE CEREALS SECTOR AND THEIR IMPLICATIONS FOR THE MARKET

II.1 Testing a Hypothesis

The current growth in E.E.C. cereal production is unlikely to be allowed to continue. The cost of holding such vast stocks of grain would be financially and politically unacceptable.

In the past, the E.E.C. Commission has recommended price restraint as a means of containing the cost of disposing of cereal surpluses. A formula was introduced, known as the "Guarantee Threshold", in order to link the level of C.A.P. institutional prices with the level of E.E.C. cereal production.

During the 1985/86 price fixing session, the Guarantee Threshold was set to bite. The maximum allowable price cut under the formula, 5%, was to be triggered by the size of the previous year's harvest. The price-fixing discussions for 1985/86, however, revealed the weakness of the formula. Under pressure from West Germany, the Council began to consider the possibility of first increasing institutional prices for cereals and then, after the percentage increase had been agreed, reducing them by the amount dictated by the discipline of the Threshold!

Despite lengthy negotiations, there was no agreement between the ministers, and the Commission unilaterally imposed a cut of 1.8%, "in the interests of market management", until the Council could make up

its mind. This it never did, but since the Commission's decision went unchallenged, the 1.8% price cut was implemented for the 1985/86 marketing year (with flexibility over the prescribed time for delaying intervention payments to farmers, in order to give individual countries the opportunity of softening the effect of the price cut).

The irony is that when an E.E.C. measure to contain actual expenditure became effective, it was considered politically unacceptable; the Commission is now proposing the abolition of the Guarantee Threshold!

A parallel can be drawn here with the experience in the dairy sector. As dairy surpluses, and the cost of disposing of them, mounted, the E.E.C. introduced measures to limit the increase. A Co-responsibility Levy was introduced in 1977 at a level of 2%. In 1982 it was cut to 1.5% - not because the situation had improved (it had deteriorated) but because the E.E.C. was under increasing pressure from dairy producers. A "prudent pricing policy" was not having the desired effect. Anything more "prudent" was considered to be unacceptable and so a new policy was introduced for the dairy sector: quotas appeared in April 1984.

The possibility that events in the dairy sector might be repeated for cereals, leads us to examine the following hypothesis:

"that in order to be successful in cutting the costs of cereal surplus disposal, the measures suggested by the Commission would have to be so harsh as to be politically

unacceptable. The rising cost of cereal surplus disposal will therefore, eventually, lead to formal quantitative controls. Thus political expediency, rather than the law of the market will determine how the budgetary savings will be achieved."

II.2 The Measures Put Forward by the Commission in November 1985

These measures include:

- a price freeze
- a co-responsibility levy
- a delay to the start of intervention buying until nearer the end of the marketing year
- an increase in quality standards

There follows an analysis of consequences for the market if any one of these measures is adopted (on its own) to reduce budgetary expenditure on cereals.

II.3 A Price Freeze

A price freeze would mean that E.E.C. institutional price levels would be left unaltered from year to year. The impact of such a measure would depend on a number of factors. It would depend on the rate of inflation, affecting the real purchasing power of producers' incomes, and the rate of inflation affecting the costs of the necessary product inputs. It will also depend on the level of year-on-year yield

increases for cereals and the profit potential of other enterprises. The level of current net margins for cereal growers (and thus their ability to take what will amount to a real reduction in price) will also affect the overall supply response.

Compared with prices in the early 1980s, real cereal prices have declined in both ecu and sterling terms - and market prices for cereals in the U.K. have fallen to a greater extent than intervention prices, due to the delay in intervention payments introduced in 1982, and the gradual build-up of surpluses in the U.K. (See Figure 3.)

Despite this fall in prices, the production of both barley and wheat has increased, although there have only been increases in acreage for wheat. The increase in production has been stimulated by the rise in yields brought about by improved technology. The H.G.C.A. estimates for yield increases referred to earlier imply an average annual increase of between 4-5% for wheat and 3-4% for barley. The fall in real prices has eroded some of the gains made by technology, but even so, in terms of real revenue per hectare, cereal farmers have not fared so badly. (See Figure 4.)

In addition to this stimulus from technology on the output side, the costs of variable inputs apart from energy have also followed a downward trend (see Figure 5) since the beginning of the 1980s, and thus real revenue per hectare probably underestimates the index of profitability during the 1980s for most cereal farmers.

Figure 3

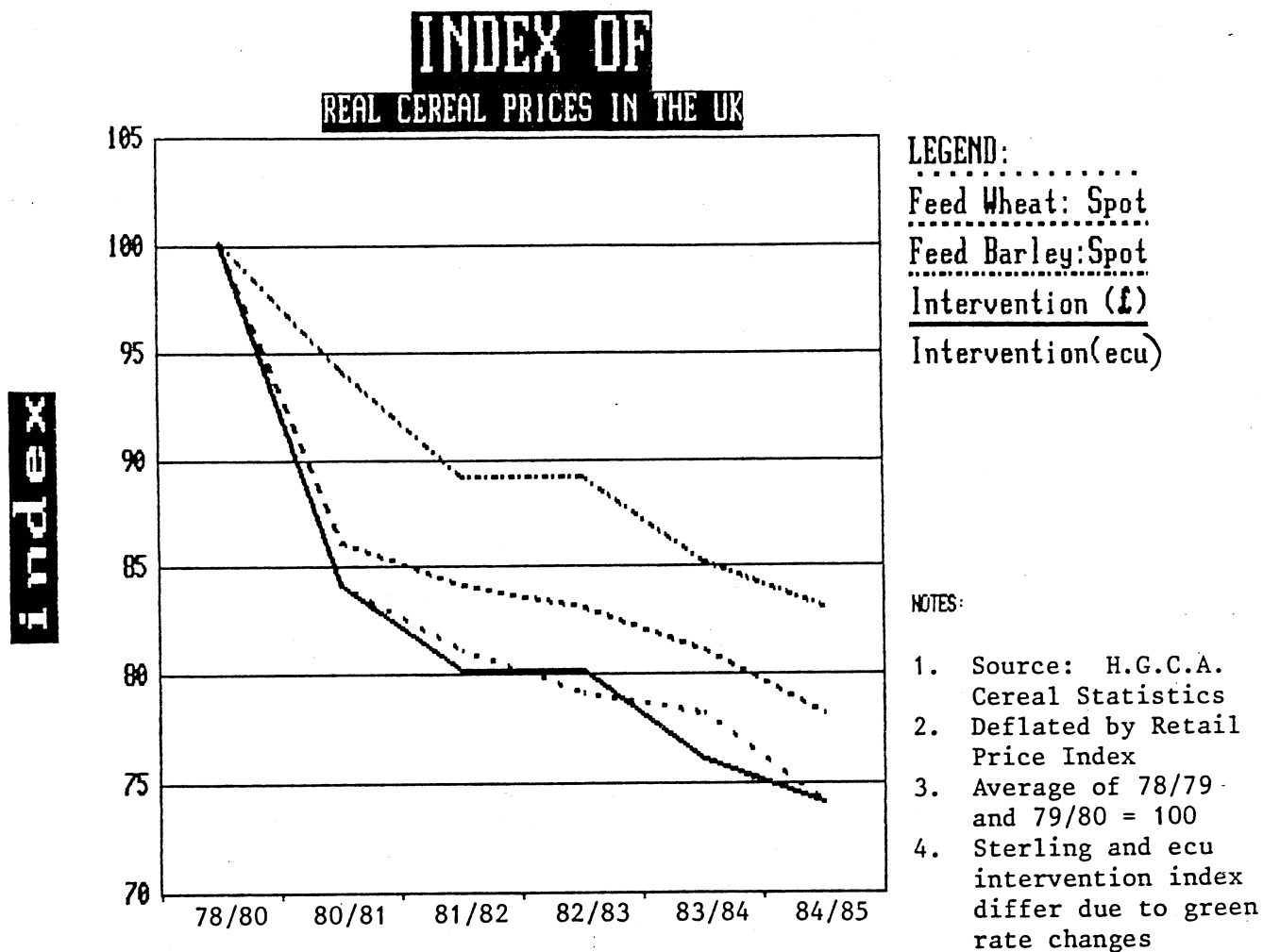


Figure 4

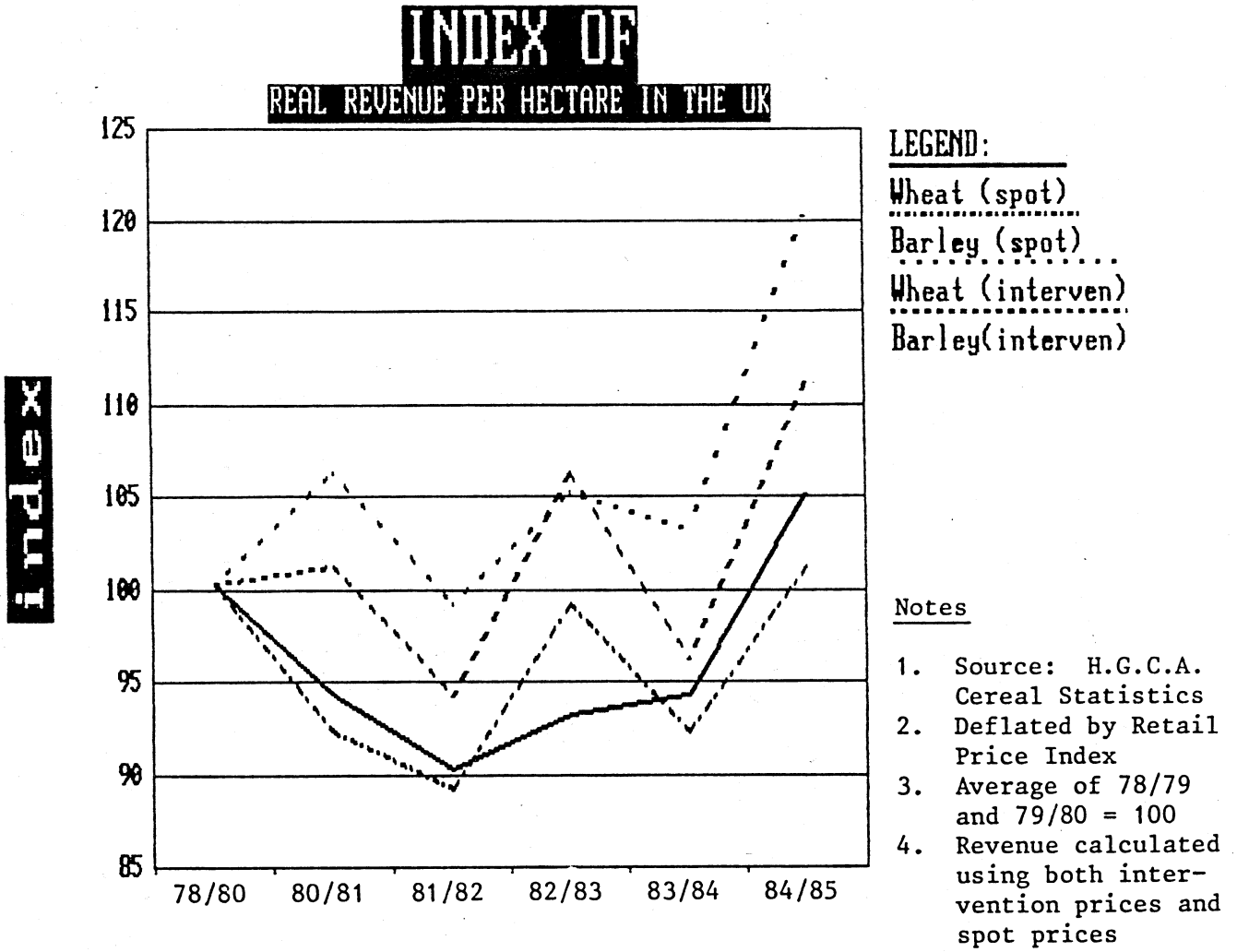
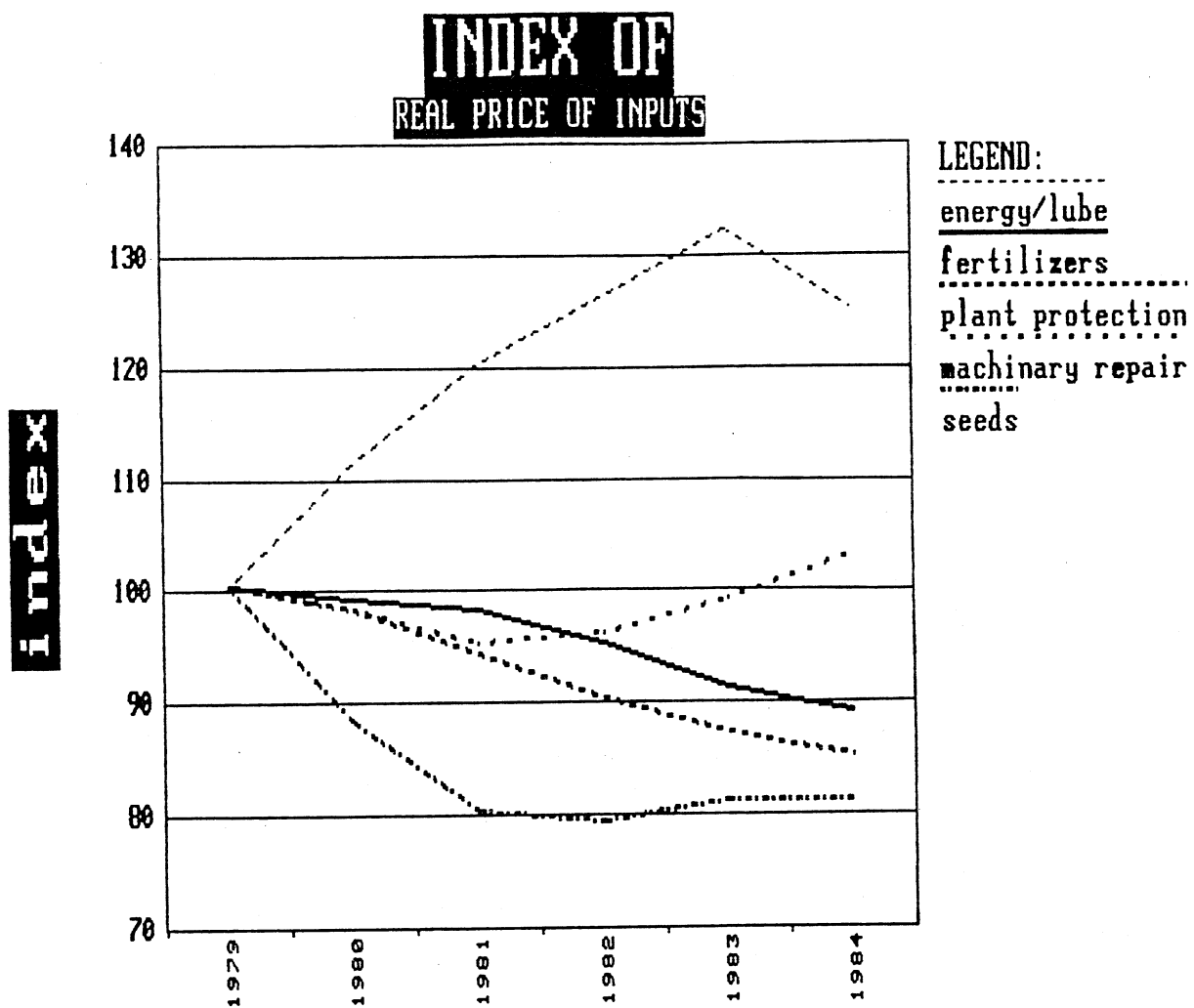


Figure 5



The impact of a price freeze on production levels is thus going to depend on three main factors: the supply response by farmers to a decrease in real prices; the rate of inflation and thus the degree that a price freeze will be translated into a reduction in real product prices; and the rate of increase in yields.

Table 1 gives an indication of the impact of a price freeze given different assumptions about producers' response to declining real prices and the rate of inflation.

Table 1

Percentage reduction in planned quantity of cereals
as a result of a price freeze

Inflation rate	-	5%	6%	7%	
giving real price cut of	-	-5%	-6%	-7%	
	(	0.5	-2.5%	-3.0%	-3.5%
Supply response*	(	0.4	-2.0%	-2.4%	-2.0%
(Price elasticity)	(	0.3	-1.5%	-1.8%	-2.1%

* The price elasticities of supply, representing the response of quantity produced to price cuts, are based on previous calculations by agricultural economists. They are calculated on the assumption that all variables that influence supply, other than price, remain at constant levels, and thus are an attempt to extract the influence solely of price on supply. The recent Agra Europe Report on "Cereal Supply control in the E.E.C." (5) puts the co-efficient at 0.5, whilst other sources (for example, Buckwell et al (6) who base their estimate on a synthesis of estimates) used a more conservative figure of 0.4.

Taking into account the different assumptions about supply responses and inflation, the highest reduction in production as a consequence of a price freeze would be 3.5%, and the lowest only 1.5%. In view of the past trends in technology and input prices mentioned earlier, it is

clear that the chances of a price freeze even containing production at present levels are remote.

The E.E.C. is unlikely to adopt a pricing policy which is more severe than a price freeze. For many years, agricultural economists have favoured price cuts as a means of reducing surpluses and more recently the E.E.C. Commission has favoured them as a policy instrument. These recommendations have fallen on deaf ears in the Council of Ministers. Price cuts are extremely unpopular with all Member State governments (except perhaps that of the U.K.) and although the E.E.C. has succeeded in reducing both institutional and market prices in real terms (see Figure 3) price cuts would have to be substantial in order to make any significant reduction in the budgetary burden of cereal surpluses. For instance, to bring E.E.C. prices to world levels and eliminate export refunds, which have averaged (but with substantial deviation) at least 50 ecu per tonne in recent years, would mean a reduction in the intervention price of nearly 30%.

II.4 A Co-responsibility Levy

II.4.1 The Pros and Cons

The idea of a Co-responsibility Levy is that producers should be responsible for financing part of the cost of surplus disposal. They are popular for a number of reasons:

(a) Because the Co-responsibility Levy raises funds the effective

reduction in price to the producer in order to meet a specified budgetary target does not have to be as great as it would have to be with a "straight" price cut. It has been estimated (7) that every 1% of levy would bring in four times more to the budget than would be saved by a 1% price cut.

- (b) The idea of "co-responsibility" has a "Community" feel.
- (c) There is the potential for exclusions and special cases.
- (d) Producers are seen to be contributing to their own upkeep, (although, arguably, the Co-responsibility Levy is actually a tax on consumers - that is, experience suggests that in practice, the Council raise institutional C.A.P. prices to offset the incidence of the levy on producers).

The disadvantages of the Co-responsibility Levy may be listed as follows:

- (a) It can be costly, and for some products difficult to collect.
- (b) As already mentioned, it is in effect, a tax on consumers.
- (c) If institutional prices are increased or world prices fall, the Co-responsibility Levy must be adjusted accordingly or it will no longer cover the costs of disposal. This has happened in the case of sugar where the Levy has failed to adjust to falling world prices and the internal price of sugar has not been reduced. As a

result, the Levy is no longer enough to cover the cost of export restitutions.

(d) From the U.K. point of view, derogations based on farm size would not favour the U.K.

II.4.2 The Size of the Co-responsibility Levy if it were used to Finance Cereal Surplus Disposal

If we take an average of the F.E.O.G.A. costs of the cereals sector during 1983 and 1984 (cereals took a high share of the agricultural budget in 1983 but a relatively low proportion in 1984) then total expenditure would have been as follows:

Table 2

Average F.E.O.G.A. Expenditure on Cereals 1983 and 1984 (Million ecus)

Export refunds	1,407.5
Intervention	847.5
TOTAL	2,282.0

SOURCE: Agra Europe, Special Report No. 25 (5)

The size of the levy to be charged depends on the volume of cereals on which it is levied. For a total production of 130m tonnes the levy required to cover costs of disposal during this time period would have been about 7% on the Target Price, or 9% on the Intervention Price (£10.20/tonne at 1983/84 prices). However, since almost 25% of the

cereals produced in the E.E.C. are used on-farm, a Levy collected only on marketed production, would have to be higher. On the assumption that only 100 million tonnes goes through the market, the Levy would have to be increased to nearer 10% of the Target Price, or 12% of the Intervention Price (£13.07/tonne at 1983/84 prices).

It is unlikely that a Levy of this size would ever be introduced on a flat rate basis, and the Commission itself makes it clear that applying a Levy equal to the total cost of F.E.O.G.A. guarantee expenditure on the cereals sector is a "long term objective" rather than something which should be done immediately. If it was, it would affect not only the total quantities of cereals produced but also the proportion of cereals passing through the marketing system. The scope for evading the Levy if collected by first-hand buyers (accepting that inter-farm sales would be difficult to police) would depend on: the potential for increasing on-farm use by feeding to livestock either on the same farm or neighbouring farms; the amount of reasonable on-farm storage available; and the ability for individual farms to mix feeds on-farm which give similar performance levels to bought-in compound feeds. Clearly, the larger the levy, the greater the incentive to make adjustments in the proportion of cereals sold through normal marketing channels.

II.4.3 Types of Co-responsibility Levy

There are various forms that a Co-responsibility Levy can take.

It could be a flat rate per tonne or per hectare of grain produced, or

the Levy could be imposed only when cereal production exceeds self-sufficiency levels - a form of "super-levy", as with sugar ("B" quota) or potatoes in the U.K.

There could also be exemptions for farms below a certain size.

II.4.4 Exemption from the Co-Responsibility Levy for Certain Cereal Growers

The Commission favours an exemption for all cereal growers for the first 25 tonnes of cereals marketed. It has not yet been made clear whether this is for wheat and barley together or for each crop separately. Obviously, under such a scheme, countries with a large number of cereal producers relative to total production will gain the greatest total exemption from the levy.

Apart from the fact that derogations give the Co-responsibility Levy a greater chance of being accepted by all E.E.C. countries, the other interesting implication of introducing them at this stage is that the groundwork is already being laid for the introduction of quotas if need be. Indeed, in a sense, there will be a quota of 25 tonnes for each producer which will be "Co-responsibility free". How the system will be organised and policed is difficult to say. One possibility is that producers will be given a warrant of entitlement to market 25 tonnes without the Levy, and once such a warrant has been endorsed by the buyer, the rest of the producer's cereals will have to be sold with the levy payable. The higher the levy the greater the temptation to offer a cash incentive to the buyer not to stamp the warrant.

The table below shows the structure of cereal production in each of the E.E.C. countries (except Greece) and gives an indication of the contribution to output by size of farm in each country.

Table 3

Distribution of Cereal Growing Farms and Cereal Areas in E.E.C. Member States by Size of Cereal Enterprise 1979/80

	West Germany	Nether- lands	France	Belgium	Luxem- bourg	Denmark	U.K.	Ireland
hectares:								
	% of cereal-growing holdings growing:							
less than 10	76.7	75.3	68.5	83.5	55.7	45.8	42.1	85.2
10 - 30	19.8	21.2	21.3	14.3	42.5	41.5	26.3	11.5
30 - 80	3.2	3.3	8.1	2.4	1.8	11.4	19.3	2.7
over 80	0.3	0.2	2.1	0.2	*	1.4	12.3	0.5
% of cereal area covered by holdings growing:								
less than 10	35.1	32.3	19.3	43.2	27.3	14.9	4.9	32.9
10 - 30	41.3	41.6	29.0	35.8	65.6	43.2	13.3	33.7
30 - 80	17.9	16.4	30.9	17.3	7.0	29.8	26.8	21.7
over 80	5.8	9.7	20.7	3.7	0.2	12.1	55.0	11.7

* negligible

SOURCE: H.G.C.A. Weekly Digest, Vol. 11, No. 45, 17.6.85

If the E.E.C. decided to introduce exemptions on the basis of size rather than an across the board exemption then the countries with the highest levels of self-sufficiency in the Community, Denmark, France and the U.K., would also find themselves contributing a greater proportional share of the levy since small cereals farmers in these countries account for only a small proportion of the national output. Nevertheless, a comparatively large number of producers would be exempt from the levy in France, whilst West Germany (the country which

most opposes any reduction in support to the cereal sector) would have a relatively large number of growers exempt from the levy. This being the case, an exemption from the Co-responsibility Levy on the basis of size looks to be a politically, and some might argue, economically, attractive proposition to the Community.

II.4.5 The Quantity of Cereals By-passing Normal Marketing Channels in the U.K.

The current proposals seem to favour the collection of the levy on marketed production, rather than on the basis of the area grown. Given the policing difficulties associated with collecting a levy on inter-farm sales or on-farm usage, the likelihood is that the Co-responsibility Levy will have to be collected by first-hand buyers. If so, as already mentioned there would be an incentive for producers to try to by-pass normal marketing channels and either use the grain on-farm for themselves, or sell direct to other farmers.

A Co-responsibility Levy which financed the disposal of all cereal surpluses would undoubtedly cause such diversions from the market. U.K.A.S.T.A. are of the opinion (personal communication) that even a levy of 2% or 3% could cause considerable diversions if the Levy were collected on first hand sales. A consideration of the French market may provide a pointer to the likely outcome. Currently, all marketed cereals in France are subject to a levy of approximately £5 per tonne to provide finances for para-fiscal and fiscal taxes. This is collected by first-hand buyers of grain, all of whom must be registered with and approved by the Office National Interprofessionnel

des Cereales (O.N.I.C.). Grain used on farm is not subject to tax, and currently 11% of all wheat and 36% of all barley production is utilised on-farm (8). Inter-farm sales are prohibited and evasion of the levy is only possible by unauthorised farm-to-farm sales. While data concerning possible evasion is not available the O.N.I.C. believe that it is insignificant. Their requirement that all licenced traders and grain users provide monthly data on stocks, sales, usage and destinations ensures that the O.N.I.C. can monitor almost all cereal movements in France. With the introduction of a Co-responsibility Levy on top of the current levy, the incentive to evade the tax would be far greater in the future.

In the U.K., the only comparable organisation to the O.N.I.C. is the Home-Grown Cereals Authority (H.G.C.A.) although this does not exist to regulate the U.K. cereal market in the rigid way that applies in France. First-hand buyers currently collect a 3 pence levy per tonne for the H.G.C.A. on marketed grain, but this is insignificant relative to the overall price. There is no ban on inter-farm sales and no compulsion for sales to be channelled through registered traders. Overall, the U.K. market is much more "open" than the tightly controlled French market.

Table 4 shows the quantities of grain used on-farm and marketed in Great Britain over the past four years.

As can be seen from Table 4, the quantity of grain which by-passes the market varies from year to year, but there has been a tendency for

Table 4
Grain Marketed in Great Britain
(million tonnes)
(figures in brackets are percentages)

	1981/82	1982/83	1983/84	1984/85**
<u>Wheat</u>				
Total output	8.71 (100.0)	10.35 (100.0)	10.80 (100.0)	14.96 (100.0)
Marketed	8.06 (92.5)	9.23 (89.5)	9.66 (89.4)	12.87 (86.0)
Used on-farm	0.15 (1.7)	0.18 (1.7)	0.29 (2.7)	0.31 (2.1)
Other non-marketed*	0.51 (5.8)	0.90 (8.8)	0.85 (7.9)	1.78 (11.9)
<u>Barley</u>				
Total output	10.23 (100.0)	10.96 (100.0)	9.98 (100.0)	11.06 (100.0)
Marketed	7.05 (69.0)	7.29 (66.5)	6.59 (66.0)	6.80 (61.5)
Used on-farm	1.91 (18.7)	2.22 (20.2)	1.81 (18.1)	2.04 (18.4)
Other non-marketed*	1.27 (12.4)	1.45 (13.2)	1.58 (15.9)	2.22 (20.1)

* "Other non-marketed" - includes grain sold direct to intervention by farmers; grain sold by farmers to other farmers; grain used by non-sale compounders.

** H.G.C.A. forecast

SOURCES: H.G.C.A., Weekly Bulletin (Marketing Note) Vol. 19 No. 32 and Vol. 20 No. 6, Weekly Digest Vol. 12 No.s 9, 12 and 13, and Cereal Statistics 1984

the proportion to increase. The proportion used on-farm in Great Britain is much smaller than the proportion used in France, and this could be partly because of the taxes currently collected on French grain.

The potential for the U.K. figure for on-farm usage to rise to the French level will depend to some extent on the structure of farming and the capacity for on-farm storage. Recent surveys (for example, see 9) have indicated that storage facilities in the U.K. are probably adequate for considerable quantities of grain to be stored on the farm. The most likely constraint on greater on-farm use in the U.K. will be problems with cash-flow.

II.5 Delay in Intervention Support Until Near the End of the Season

This would have a similar effect to the delay in intervention payments currently imposed by the E.E.C. The difference would be that the market would have to carry the costs of storing the grain, as well as the finance charges that they already bear as a result of the delay in intervention payments; thus the Intervention Price would have to be discounted in order to reflect these charges. The Intervention Price for the market at the beginning of the season would therefore be the Intervention Price set for the first month of intervention buying discounted by the equivalent monthly finance and storage charges.

The effect of such a measure on market prices would obviously depend on the month in which intervention buying was destined to start, and the level at which the price was set. In addition, the impact on early season prices would depend on the levels of non-intervention storage available, the cash flow situation of farmers and merchants, and the facilities for keeping grain to intervention standards in anticipation of the later sale. Merchants with access to reliable and large quantities of credit are likely to be at an advantage, especially since grain not yet accepted for intervention will be a less attractive source of collateral for creditors than under the present system with delayed payments after the grain has been accepted into intervention.

II.6 Stricter Quality Standards

The effect of increasing intervention quality standards on market prices will obviously depend on conditions during the growing and harvesting period. Under normal climatic conditions, stricter quality standards are likely to exclude a higher proportion of grain from U.K. intervention stores than on the Continent.

Present intervention standards for barley tend to be higher than those required by the feed compounders, but wheat intervention standards are lower and thus intervention can be used more as a market of "last resort" in the case of wheat. Since wheat is the cereal which is most in surplus in the E.E.C., it is likely that it would be wheat standards that would be raised

Some of the options for changing quality standards open to the Community are: increasing the specific weight requirement; increasing the protein requirement; and introducing a Hagberg Falling Standard for feed wheat. Proposals from the Commission so far include introducing a specific weight requirement of 76kg/hectolitre, a protein standard of 11%, and a Hagberg Falling number of between 220-240.

An examination of the H.G.C.A. Quality Surveys gives an idea of the variability of quality from one harvest to the next and the eligibility for intervention if these standards were introduced. If specific weight requirements were increased to 76kg/hectolitre, then between 1980 and 1984 between 55% to 15% of the U.K. wheat crop would

have been excluded (since milling wheats have been included in this figure, the total exclusion for feed wheats would have been even higher). An 11% protein requirement would have caused even greater exclusions.

Although there would seem to be no commercial justification for introducing a Hagberg Falling Number standard for feed wheat, the significance of its introduction would be that intervention would no longer provide an effective floor to the market. Under the present quality conditions, if grain does not match the moisture requirements it can be bought from farmers at a discount and dried. There are possibilities for mixing grains of inferior protein qualities if the market price provides an incentive, and specific weights can also be influenced, to some extent, by drying. However, the potential for mixing sub-standard grain which exceeds a specific Hagberg requirement in order to bring up the average quality are more limited, and thus the possibility of a truly dual market arises: one for intervention and one for non-intervention grains.

A further implication of higher intervention quality standards is that there would be much more uncertainty about the effectiveness of intervention as a means of market support from year to year.

However, even with the lower intervention quality standards currently in force, the average quality of both feed wheat and barley which is actually delivered into intervention is higher than the present minimum standards and much of this grain received a bonus for quality.

For 1984/85, a year when intervention purchases were particularly important in the U.K., the average quality of wheat and barley going into intervention for Northern England, Scotland, and the U.K. as a whole, is shown in Table 5.

Table 5
Average Quality of Feed Wheat and Barley Delivered Into U.K.
Intervention 1984/85 (Aug-12 March)

	Intake tonnage (⁰⁰⁰ t)	Moisture Content (%)	Specific Weight (kg/hl)	Broken Grains (%)	Grain Impurities (%)	Total Impurities (%)	Quality Bonus (£/t)
<u>WHEAT</u>							
U.K.	2,715.9	13.59	76.84	2.19	1.04	3.54	2.15
N. England	355.7	13.50	77.74	2.07	0.96	3.33	2.26
Scotland	99.6	13.33	78.08	1.45	0.62	2.59	2.37
<u>BARLEY</u>							
U.K.	865.8	13.46	69.53	0.72	4.33	5.64	2.26
N. England	54.8	13.68	69.79	0.66	4.35	5.62	2.03
Scotland	315.3	13.47	69.52	0.59	4.11	5.42	2.26

SOURCE: H.G.C.A., Weekly Digest Vol. 11 No. 33, 25.3.85

One other quality criteria which it would make commercial sense to change but (to date) has not been proposed, is to abolish the bonuses for moisture contents below 15%, since the cost of bringing the moisture content from, say, 15% to 13% seems to be less than the bonus paid.

II.7 A Combination of Policy Measures

So far, the analysis has shown that: (a) the impact of a price freeze would probably be outweighed by yield increases; (b) a Co-

responsibility Levy that made the cereals sector self-financing would have to be in the region of 12%; (c) the price reduction necessary to bring E.E.C. prices down to world trading levels needs to be in excess of 30%; and (d) the impact of tightening quality standards would be variable, and therefore unreliable in terms of budgetary saving. In essence, it seems that individually any of these measures would either be ineffectual in controlling budgetary expenditure, or if effective, politically unacceptable.

The final outcome is likely to be a combination of policies. Which ones, and to what extent they are to be used, will only be determined by the inevitable political haggling which will take place between now and the actual Council decision. Based on past experience, these could be announced during an indefinite period after next April. The permanency of the decisions will depend upon their success in containing E.E.C. expenditure on the cereals market.

Table 6 is presented as an indicator of how effective a policy consisting of a 2% Co-responsibility Levy and a price freeze (either due to the freezing of intervention price levels, or as a result of nominal increases but stricter quality standards and/or a restriction on intervention buying).

Any of the assumptions in Table 6 could be questioned, but it does serve to give a broad indication of how such a combination of policies would work, and it sets out a framework within which alternative policy packages might be tested. Under our assumptions, if the price freeze/Co-responsibility Levy policy package was allowed to stick, the

cereals sector would be 45% self-financing by 1990. Potential production would have been reduced by just over 10%. If this reduction was made by large farmers taking 10% of their land out of production, it would probably prove politically acceptable. If, however, a 10% reduction in production means, for the sake of argument, a 25% reduction in the number of farms growing cereals, then it is far less likely to be acceptable. Although budgetary expenditure would have been cut by over 50%, the sector would not be self-financing and the cost in terms of bankrupt farmers would probably be considered too high.

Table 6
Impact on E.E.C. Production and Budgetary Expenditure of an
Intervention Price Freeze and a Co-responsibility Levy of 2%

	1986/87	1987/88	1988/89	1989/90	1990/91
Total E.E.C. cereal production with 3% technological increase, based on trend with average 83/84/85 as base. ('000t)(1)	141,747	145,999	150,379	154,890	159,537
Total production taking into account price freeze + 2% Co-responsibility Levy ('000t)(2)	137,948	139,358	140,782	142,221	143,675
Exportable surplus ('000t)(3)	26,948	25,358	23,782	22,221	20,675
Finance raised by Co-responsibility Levy ('000ecu)(4)	330,868	334,250	337,666	341,117	344,605
Finance required to dispose of exportable surplus ('000ecu)(5)	1,616,880	1,343,974	1,117,754	933,282	764,975
Finance raised as % finance required	21%	25%	30%	37%	45%

NOTES:

- (1) Average production for 83/84/85 = 137,618,000 tonnes
- (2) Assuming price inflation of 5% per annum and 2% Co-responsibility Levy with price elasticity of supply of +0.4.
- (3) Assuming imports of 7 million tonnes and internal consumption based on price elasticity of demand of -0.5.
- (4) Based on 0.65 of production, to make allowances for non-production and/or small-farm exemptions. Levy of 3.69 ecu/t.
- (5) Based on initial disposal cost of 60 ecu, and 2% nominal increase in world prices, giving required export refunds declining from 60 ecu/tonne, through 53, 47, 42 to 37 ecu/tonne for each year.

III A Hypothesis Proved?

The hypothesis put forward in Section II.1 contains almost as many unquantifiables and ambiguities as any E.E.C. declaration of policy objectives! How the E.E.C. would judge an exercise to be "successful" in terms of budgetary savings would be difficult to say (even the implementation of quotas in the dairy sector can hardly be deemed as "successful" in reducing expenditure on that sector). However, the policy combination examined in Section II.8, consisting of a price freeze (reduction in real terms) and a Co-responsibility Levy of 2%, is probably approaching the most radical alternative that the E.E.C. could hope to implement given its present decision-making process.

Given enough time to take effect, any of the proposals put forward will eventually mean a fall in output. If that fall in output is achieved by a large number of farmers going bankrupt, on past experience, it will be unacceptable to the politicians in the Community. The only way that politicians can exert some sort of influence over who is cut, and where, is through quotas. A Co-responsibility Levy with exemptions will be laying the groundwork for such a system.

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