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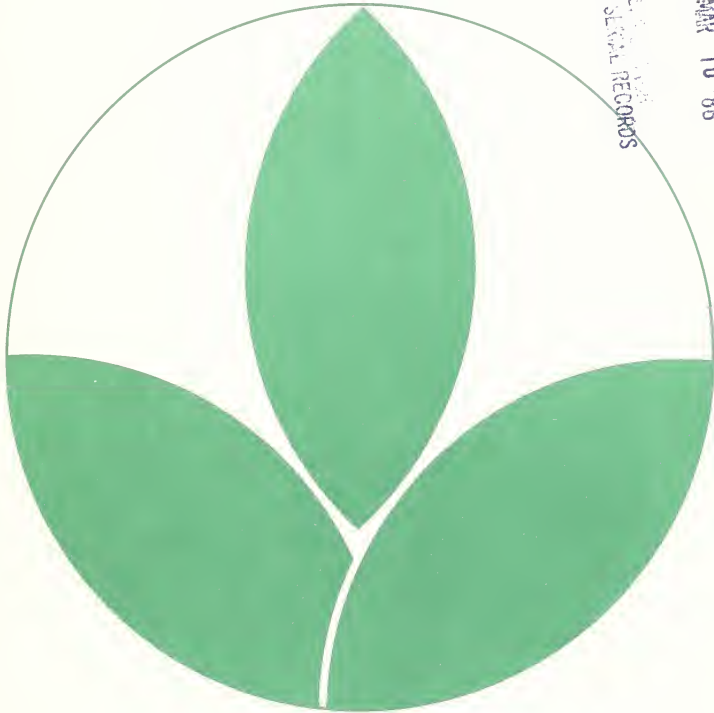
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The aim of my address is to present the highlights of two recent studies the BAE has completed on the agricultural policies in the European Community and their effects on world trade and prices and the Community itself (BAE 1985; Stoeckel 1985). There are two aspects of these studies I want to highlight:

- what our findings were; and, more importantly,
- why we did the studies in the first place.

In fact I hope you will see that the approach we have adopted here goes to the root of the protectionist problem and is an essential step to secure reductions in world agricultural protectionism. Indeed, I will go so far as to say that, without this sort of analysis, multilateral trade negotiations are less likely to achieve significant gains for world agricultural trade.

First, I need to place EC agricultural production into some sort of global perspective. As we all know, many of the markets for major temperate agricultural products are depressed. In particular, world prices are depressed for sugar, rice, dairy products, cereals and oilseeds. The reasons are large stocks, static demand and the intense competition on markets, with export subsidies being common.

Let me briefly describe what has happened and look back to the early 1970s (see Figure 1). The 1970s was a decade of rising world import demand, and during this period, world trade increased by some 55 per cent. Most of this increase occurred in the developing and centrally planned economies, with virtually no growth in the developed countries.

Over the period the increases in export supplies were roughly equal to the increase in world demand. About 80 per cent of the increase in exportable supplies was from developed countries (if intra-EC trade is excluded) and roughly 80 per cent of that increase was from two sources - the United States and the European Community, each taking about half.

For the United States, the real depreciation of the dollar during the 1970s played an important role in stimulating production as did increasing world import demand and productivity growth.

For the European Community, however, market support and insulation (that is, protection) and a dualism in EC agriculture combined with high productivity growth all contributed to the increase.

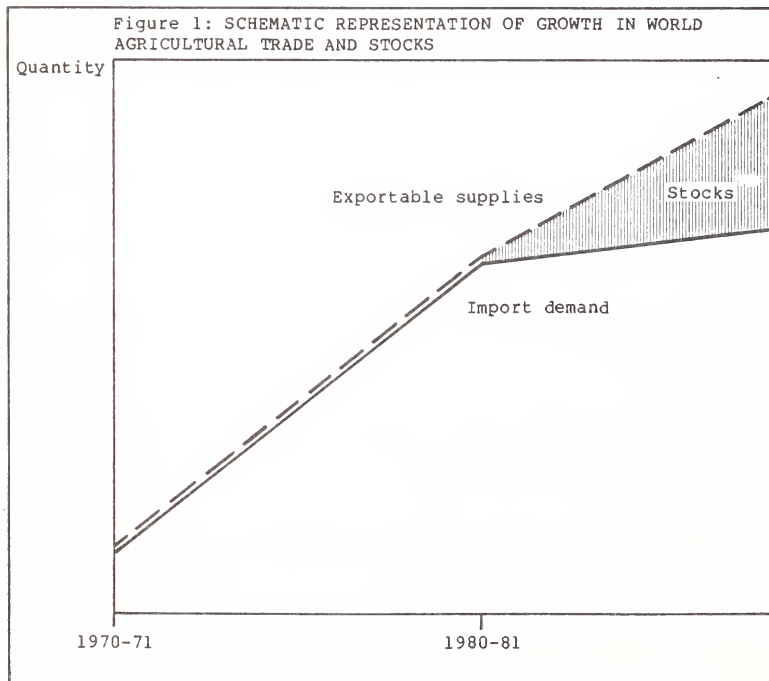
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This dualism factor - whereby the price level under the Common Agricultural Policy is set to support the viability of many small producers but has given greater stimulus to investment and production by large producers - is discussed later in the paper.

Since 1980, world import demand largely stopped growing. This was a result of a combination of global recession, the international debt crisis which hit import demand by developing countries extremely hard and changing policies in centrally planned economies aimed at self-sufficiency in agriculture.

However, world exportable supplies continued to rise and stocks have risen, as illustrated in Figure 1. While there has been a stabilising of production at high levels in the United States since 1981 (partly because of the diversion programs which have so proved costly), this has not been the case in the European Community. Growth in production and exportable surpluses in the Community have continued unabated.

And here is the major problem for world agricultural trade - a large proportion of the world's producers are shielded or protected from world market developments and so there is no general mechanism to cut back

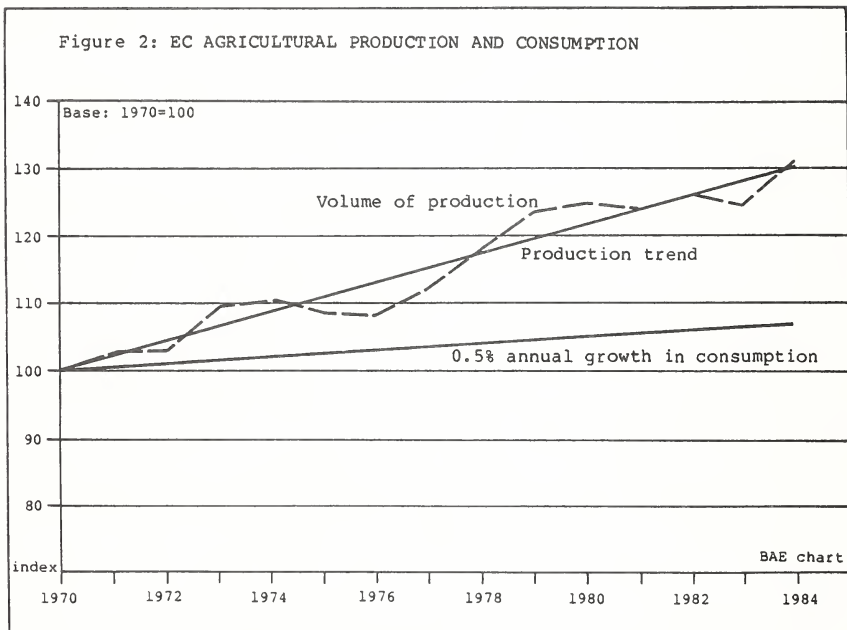


production. In some cases there have been quotas applied, but often these procedures have had little impact on reducing production. It is in this environment of rising stocks, increased export subsidies that we prepared our study of EC agricultural policies. Let me turn to the highlights of these two studies.

HIGHLIGHTS OF BAE STUDIES

In the first study and main document, we examined the nature and effects of the Common Agricultural Policy and assessed its importance for world agriculture and for other agricultural exporting nations like Australia. We also made an assessment of the policy alternatives and the prospects for reform of the CAP in the future.

One of the most striking things about the Common Agricultural Policy is the effect on the trading position of the Community. Under their agricultural policies, production has risen much faster than consumption, as shown on Figure 2, and so stocks have risen, as have exports. This has led to a massive turnaround in the agricultural trading position of the Community.



The Community has changed from being one of the world's largest importers of temperate zone agricultural products to now being the world's second largest exporter. This change in trading position has been achieved at high cost to both the Community and agricultural producing nations as a whole. It is estimated that, over the past decade, about 60 per cent of the value added by agriculture in the European Community has come from consumers and taxpayers by way of transfers and subsidies. These have amounted to between 60 000m ECU and 70 000m ECU a year, in 1984 values.

Of significance as well is the fact that only one-quarter of this 60-70 billion ECU transfer comes from the EC budget. The other three-quarters comes from national government expenditures and the consumer by way of hidden transfers. This is an important point because one of the main functions of the European Commission is to administer the EC budget and a lot of the so-called reforms are directed at solving the 'Budget Crisis'.

So what we have is most of the effort and activity being focused on only one-quarter of the problem. And we estimate that three-quarters of this assistance goes to the largest one-quarter of farms.

It is further estimated that EC agricultural policies, which have stimulated production and subsidised exports, have depressed world prices of major temperate agricultural products by, on average, some 16 per cent. In addition, we found that EC policies have destabilised world prices more than have the protective policies of other countries.

This lowering and destabilising of world prices has had adverse effects on other agricultural exporting nations, particularly countries dependent on agricultural exports. The cost to the Australian economy, for example, has been estimated at almost \$A1000m a year in recent years.

The effects of EC policies on world agricultural trade are a consequence of the European Community pursuing domestic policy objectives with a system of largely open-ended price support. It is concluded that EC policy objectives could be achieved at substantially lower cost, both to the Community themselves and to other countries. That conclusion is reasonably well known and the more interesting question is:

If there are better policies in terms of lower costs to the Community itself, then why aren't those policies being pursued now?

The answer to that question goes to the heart of the problem - how can agricultural protectionism be reduced in practice?

If the Community, or anyone else for that matter, is not pursuing what we might call 'better' policies, it must be either that people do not appreciate the real costs and benefits of the CAP and the alternative policies available - that is, they do not believe that the alternatives are in fact 'better' - or it must be that there are real political and institutional factors preventing or substantially limiting change in the right direction.

It is true that institutional rigidities certainly do operate. However, when we came to examine whether there were assessments of the costs and benefits of the CAP, we found a surprising lack of any systematic studies covering the whole Community. In particular, there was a lack of an assessment of the benefits and costs of alternative policies that may be put in place to achieve their objectives. And, in fact, it was at the conference in Brussels when we released these studies, that the opening speaker and a former Commissioner for Agriculture, Mr Lardinois, made his major criticism: he said that the BAE study had not focused on the real costs of the CAP to the economy of Europe as a whole.

There is some truth in that and it explains the second study that was prepared (Stoeckel 1985). Let me now turn to a brief summary of the conclusions of this study and why it is so important in terms of assessing and enhancing the prospects for reform of this very important world agricultural protection issue.

As I mentioned before, the increase in production and restriction of imports in the Community has seen a transformation from its being the world's largest importer of temperate zone agricultural products to the world's second largest exporter. That is a massive trade turnaround, and it could be expected that it would have general equilibrium effects on other traded sectors.

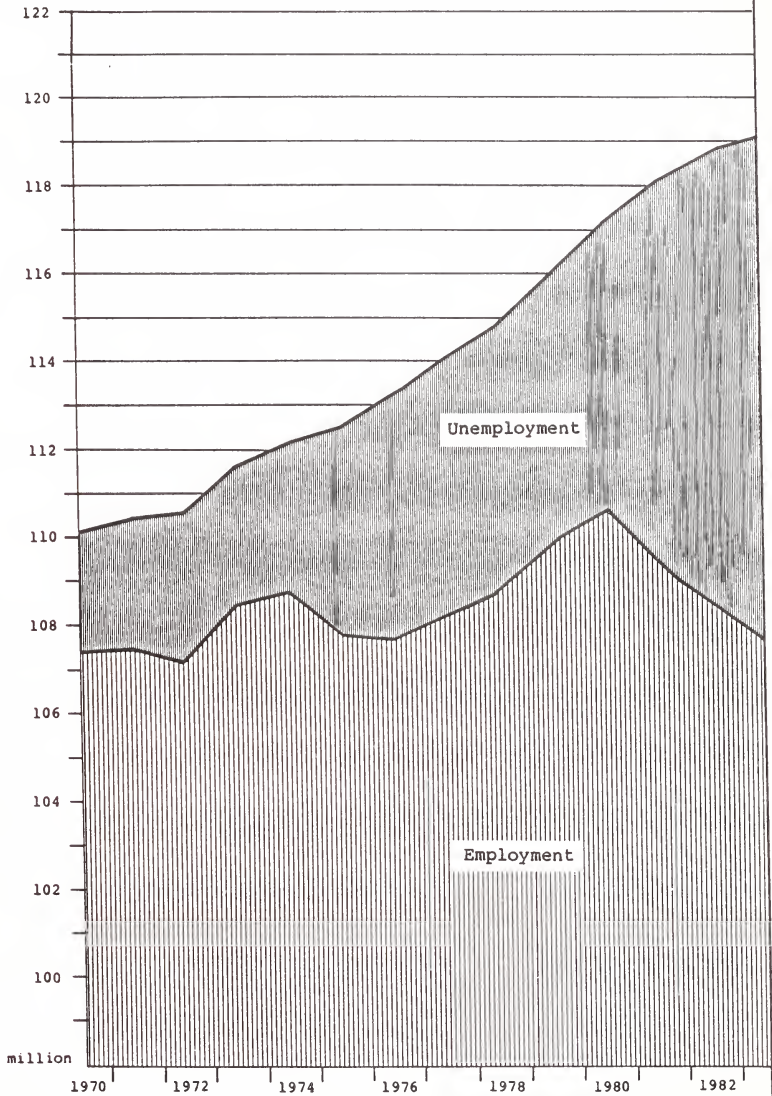
Basically, if a country stops all imports, it will eventually stop all exports - this is the familiar proposition that an import tax acts as an export tax. The European Community has by restricting agricultural trade, in effect, placed a tax on net exports of manufactured goods. And while the imports of agricultural products have contracted in the European Community, as shown in this Figure 3, the imports of manufactured goods have expanded considerably, particularly equipment goods.

Further, the EC share of exports in equipment goods in OECD trade has fallen over the last decade and a half, while the share of imports has risen. That is, there has been a major loss of competitiveness in the EC manufacturing sector.

At the same time, manufacturing output has tended to stagnate in the Community and employment in that sector has fallen considerably.

Standard theory suggests that protection to agriculture would have contributed to the unemployment problem in Europe, which is quite considerable. Unemployment is now 11.5 per cent, or 12.5 million people, and there has been virtually no increase in the number of people with jobs over the last decade. This unemployment is shown in Figure 4. Of course, a lot of defenders of the Common Agricultural Policy will argue that protectionism of agriculture has saved employment in the rural sector. Further, it is argued that reform of the CAP is not possible while there is this high level of unemployment. And this is where this dualism of the European production becomes important.

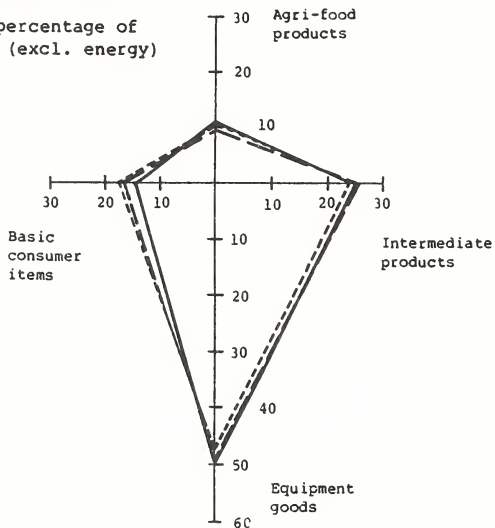
Figure 3: EC-10 WORKING POPULATION



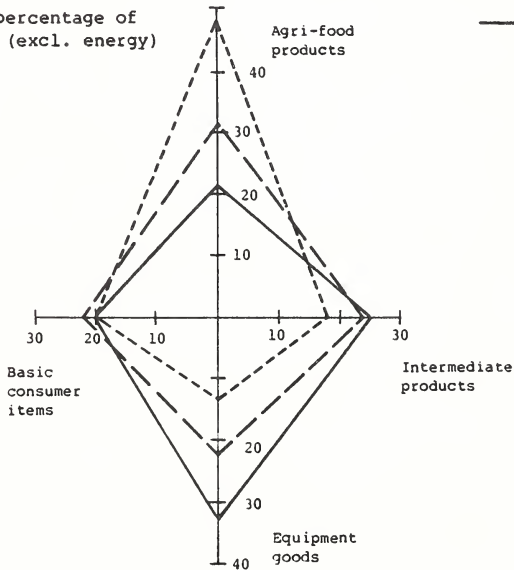
Source: Eurostat (1984).

Figure 4: COMPOSITION OF EC-10 TRADE

Exports as a percentage of total exports (excl. energy)



Imports as a percentage of total imports (excl. energy)



----- 1963
 - - - - 1973
 _____ 1981

Source: Commission of the European Communities (1983, pp.108-9).

Over one-half of the output from European agriculture comes from just 10 per cent of the farms. These large farms are more efficient and, with the technological bias toward their production system, output has expanded considerably. This expansion has occurred by increasing the use of large scale machinery and through new technology, including higher yielding varieties, and the use of more inputs like fertilizer, but not from additional labour.

At the same time, these large farms have taken over the more numerous smaller farms. So, in effect, the subsidies to agriculture are encouraging the shedding of labour from agriculture and, in the Commission's own words, there has been 'a loss of 1 job out of agriculture for every minute over 20 years' (Commission of the European Communities 1984). That is, there has been a shedding of jobs from agriculture and no new jobs have been created as a result of the loss of competitiveness in the manufacturing sector in Europe through the trade distortion effect I mentioned earlier so unemployment has been adversely affected.

By using a small applied general equilibrium model for the European economy in the study (Stoeckel 1985), I estimated that the CAP has probably cost Europe around one million jobs. If that is true, it implies that, contrary to one of the arguments often put against reform of the CAP at present, namely that policy reforms are not possible at times of high unemployment, the reverse is probably true - not to reform the CAP is probably exacerbating the unemployment problem in the long term.

Now why is that analysis so significant?

The reason is that people only change when there is an incentive to change. People will have that incentive to change if they have generosity or goodwill to others or if they believe it is in their own self-interest to change. Self-interest has always proved to be a more potent force than generosity toward others.

For small economies like Australia, the mere exhortation or complaining that policies of one country are damaging is not enough to lead to change.

For large countries like the United States, however, external pressure can be more effective because there can be the implied threat that if changes are not forthcoming it may end up costing something. And back comes self-interest in a negative sense.

However, it has to be recognised that, while external pressure by a country like the United States is important, it has its limits. The reason is that the Community is a diverse collection of ten member states (at the moment) and one of the factors promoting reform is the different interests of some countries, particularly the United Kingdom as they have been net contributors to the CAP.

One thing a costly 'trade war' could do is provide a common external threat to the member countries - and act as a unifying force. It would give a political reason for increasing financial resources from the Community budget to fight this new 'external threat', to blame someone else and it could in fact have the opposite effect.

Our conclusion was that self-interest was more significant as a means to change and what we were demonstrating in these studies is that there are alternative policies within the Community under which their objectives could be achieved at a lower cost.

Ultimately, the strongest and most effective opponents of the CAP will be the Europeans themselves, who are largely unaware of what the agricultural policies are actually costing them in real resource terms.

The proposed new GATT round of trade talks would be most significant here because such negotiations recognise the value of self-interest. The significance of multilateral talks aimed at reduced trade protection are twofold. First is the obvious point that the net gains from multilateral reductions are greater than unilateral reductions. Second is the fact that the structural change required under a reduction in protection is more likely to be successful under multilateral reductions than unilateral reductions because of the dynamics of the adjustment process. Under multilateral reductions the benefiting industries expand through an increase in demand as well as through access to resources displaced from those industries disadvantaged by the changes. That is, resources are 'attracted out' of the protected industries.

Under unilateral reductions, however, the expansion of benefiting industries occurs through attrition and contraction of the protected industries. That is, resources are, in the first instance, 'driven out' of the protected industries.

For these reasons, multilateral trade liberalisation should be politically more 'saleable' and should have a higher chance of success. An important requirement in the multilateral process is that countries are prepared to make concessions. Unless participants fully appreciate the benefits of unilateral trade liberalisation and are prepared to make concessions, a strong incentive is built into the negotiation process to 'do well' at the expense of others and this can serve to militate against significant liberalisation being achieved. The difficulty is that the net gains to a country from somebody else reducing protection can easily appear to outweigh those from unilateral reductions, where significant structural adjustment is involved. The desire to 'do well' out of the negotiation process creates an incentive to go into a new round with a 'high base' and to first 'concede' reductions in protection that are meaningless. Also, trade negotiations tend to focus on the measurable levels of protection, and hidden protection can be overlooked.

Ultimately significant liberalisation in agricultural trade can only be attained by changing domestic policies. Multilateral negotiations are a vitally important step in increasing the pressure for change on those domestic agricultural policies. Trade liberalisation, therefore, is very much a long-term strategy and, to enhance its prospects, there is a need for those countries to recognise that a reduction in protection is in their own interests and a need to promote the search for ways to enable these countries to achieve reductions.

In this regard, it is important to recognise that one of the most practical, powerful and cost-effective means for achieving this is the promotion of research and discussion on the costs and inefficiencies of the agricultural policies adopted by other countries - particularly the costs borne by the countries which impose them.

That was the motivation behind the studies of the agricultural policies in the European Community and the contribution they make.

It is when there is the coincidence of internal debate on reform with international debate through trade talks that the best chance of significant improvement in freeing world agricultural lies.

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