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Agricultural Policymaking in Germany: Implications for the German Position in Multilateral Trade Negotiations

by

Stefan Tangermann & David Kelch*

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Summary

The German position on agriculture in the Uruguay Round of the GATT negotiations has been conditioned by over one hundred years of agricultural protectionism, a politically potent farm lobby enhanced by coalition politics, and Germany's role in development of the Common Agricultural Policy (CAP) of the EC. German influence in the shaping of the Common Agricultural Policy has been effective in; 1) creation of an agrimonetary system that results in high German farm prices, 2) opposing any substantial price cuts to farmers, 3) introduction of the milk quota, and 4) establishment of an EC set-aside program. German agriculturalists are very reluctant to rely on markets to determine farm prices and are strongly opposed to any agreement that would allow world supply and demand conditions affect domestic farm prices. However, they are aware of the constant trade friction the CAP has created for its trading partners and are prepared to make some policy changes. German industrialists have become aware of the high opportunity cost of German agricultural policy and the CAP and could influence the German government to compromise on agriculture in the GATT negotiations.

The German agricultural position is supportive of an aggregate measure of support (AMS) approach in the agricultural negotiations. Germans would prefer an AMS that would allow the EC sufficient flexibility to reconcile the disparate interests of EC member states in the CAP, and Germans would be particularly interested in gaining credit for supply controls and their social security program for farmers. The Germans might also be receptive to binding the degree of self-sufficiency in the CAP because of the precedents in the GATT and that implied by the maximum guaranteed quantities (MGQ) program in the CAP. A method could also be devised that would phase in world price effects on EC markets at a level and rate that would be politically acceptable to Germany. Tarrification is not acceptable to German agriculturalists because it either does nothing or it completely undermines the instruments of the CAP.

A principal goal of German agricultural policymakers in the GATT is to keep CAP mechanisms intact. While German farmers originally considered the CAP a national catastrophe because it lowered prices and protection, they would not now abandon the CAP. Another German goal in the GATT is to close the loopholes in the CAP which means "rebalancing" access to EC markets of nongrain feeds. Some form of "rebalancing" could be accomplished with little negative economic effect, but it would have a disproportionately positive psychological and political impact on German farmers.

Recent events such as German unification and the political and economic reforms in Eastern Europe and the USSR add to the pressure for Germany to successfully complete the Uruguay Round of GATT negotiations. German capital resources are stretched to the maximum in restructuring east German industry and agriculture, and in providing financial aid to Eastern Europe and the USSR. Germany needs access to export markets to finance the continuing needs of these regions. For non-EC agricultural-exporting countries, the most effective strategy when negotiating with Germany in the Uruguay Round is to insure that the German government is convinced that protecting farmers from external pressure cannot be successful without serious negative consequences for Germany's non-agricultural economic sectors.

Preface

This paper analyzes the historical development of German agriculture and agricultural policy with the purpose of providing a deeper understanding of the German position in international negotiations on agricultural trade. The paper has its origins in a 1989 study drafted by Stefan Tangermann under a cooperative research agreement with the Economic Research Service (ERS) of the U.S. Department of Agriculture. The agreement was administered through the National Center for Food and Agricultural Policy of the Resources for the Future in cooperation with the International Agricultural Trade Research Consortium. The study was part of a larger program of studies commissioned by the ERS in relation to the agricultural negotiations of the Uruguay Round of the General Agreement on Tariffs and Trade.

The original study by Tangermann consisted of 5 chapters which were revised and edited by David Kelch. These first chapters of the current study describe the situation as it appeared in 1989 and were not updated in order to retain the character of an analysis before the negotiations took place during 1990 and during the December 1990 GATT Ministerial meeting in Brussels.

One important event which had to be considered before publication in 1991 which could potentially change German attitudes toward the agricultural negotiations was German unification. David Kelch therefore added chapter 6 in order to incorporate some of the agricultural implications of this unexpected development.

The views expressed are those of the authors and not necessarily those of their employing institutions.

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Chapter 1. The Historical Background of Agricultural and Food Policies in Germany

Like in all European countries, German agriculture experienced overwhelming progress and revolutionary change during the nineteenth century. In the history of mankind, agriculture had been the major constraint of development. The sluggish growth of agricultural production had determined the growth of population and economic activity. Recurring production shortfalls had caused mass starvation, and secular agricultural crises had been synonymous with long-run depressions in the overall economy (Abel, 1966). A majority of the labor force had been engaged in agriculture, and many of those who could not be fed at home had to go overseas to look for new land.

From the Nineteenth Century until 1914

During the late eighteenth and throughout the nineteenth century, major social changes and technological breakthroughs provided the basis for what could be called an agrarian revolution in Germany. Unprecedented growth rates of agricultural output loosened the trammels of economic development and provided the basis for an industrial revolution.

Three main phases of this agrarian revolution can be distinguished in Germany (Abel, 1967). First, in the late eighteenth century mentalities changed. A great interest in agricultural questions aroused the general public. An increasing number of associations dealing with the advancement of farming were established. The most important result of this development was a considerable upswing in agricultural science. Second, around the turn of the century, the social and legal framework of farming underwent a major change. The liberation of peasants (Bauernbefreiung) brought an end to bondage, established new relations between peasants and feudal landowners, and liberalized the use of land. The emerging pattern of land ownership became a prominent factor of a growing intensity of land use which was further enhanced when, in the third phase of this development, around the mid-nineteenth century, increasingly available scientific and technological knowledge spread among farmers. Farming techniques were revolutionized and both crop and livestock yields increased at high rates (Haushofer, 1963).

Liberation of the Peasants

The liberation of peasants was probably the most important long-run structural development of German agriculture during this period. While in the United Kingdom the enclosure movement created large farm units and led to a class system of large landlords, smaller tenant farmers, and a mobile landless workforce, in Germany the foundations for a system dominated by a vast number of small family farms were laid. However, the liberation of peasants in the early nineteenth century, which varied in importance and developed differently in the individual German States, did not directly create a homogeneous system of small-scale owner-occupied farms. The compensating payments which the peasants had to make to the landlords in many cases had been fixed at such a high level that the liberation of peasants turned out to be a liberation of the land from the peasants.

Nevertheless, the legal preconditions for a more even distribution of land had been created. Together with a far-reaching policy of land-settlement (which relates back to the early eighteenth century, was intensified in the late nineteenth century, and continued in the post-World War I period), the current structure of German agriculture characterized by small family farms was established. Even so, a considerable number of very large estates survived until World War II. These estates were concentrated in the eastern part of the Reich and remained mainly in the hands of feudal landowners.

The Effects of Inheritance Laws

Another factor explaining the development towards small farm units in some parts of Germany was the customary laws of inheritance in agriculture (Abel, 1958). In the northern and eastern regions of Germany, like in most parts of northern Europe, it was usual to pass the undivided farm over to one of the heirs, generally the oldest son. This custom survived Napoleon's Civil Code and the Prussian edict of 1811 which tried to establish equal rights for all of the heirs of a farmer. However, in most of the western and southern parts of Germany, which then comprised about one-fifth of the Reich but a considerably greater share of what later was to become the Federal Republic of Germany (FRG), farms and even individual plots used to be partitioned among heirs and resulted in a fragmentation of farms and plots.

These diverse inheritance customs were abruptly abolished when, in 1933, the Nazis issued their Reichserbhofgesetz which established indivisible farms (Reichserbhöfe). After World War II more flexible laws of inheritance for agriculture emerged, which again gave a preference to transferring the farm undivided.

Trade Policy Changes

Events which probably had the most important and lasting effects on the long-run development of German agriculture were strategic trade policy decisions. Differing reactions of European countries to growing international competition in agricultural trade in the last quarter of the nineteenth century go far in explaining the diversity of agricultural structures and philosophies towards agricultural and food policy in today's member countries of the European Community (Tracy, 1982).

Germany experienced waves of decreasing and increasing degrees of protectionism during the nineteenth century (Eulenberg, 1929). The Zollverein (German customs union), strongly influenced by the trade policy of Prussia, started with relatively liberal policies, but became increasingly protectionist during the 1840's. The phase from the middle of the century until 1870, however, was characterized by a consistent move toward free trade. Germany, which was an agricultural exporter at the time, abandoned grain tariffs by 1865 and livestock tariffs by 1870 (Ritter, 1927). Other European countries behaved similarly, so that the end of third quarter of the nineteenth century can rightly be described as a period of free trade in agricultural commodities (Heidhues, 1978).

The Rise of Agricultural Protectionism

Economic conditions in agriculture changed fundamentally in the late 1870's, when an industrial depression coincided with an agricultural crisis. The latter was mainly caused by the rise of large scale imports of cheap grain from Russia and the United States as a consequence of the sharp decline in transport costs. While the United Kingdom stuck to its liberal import regime and Denmark and the Netherlands opted for specializing in livestock production based on cheap grain, Germany laid the foundations for its lasting agricultural protectionism during this phase.

It was by no means clear that German farmers would press for protection in the 1870's. Large landowners in particular had adopted a strong free trade attitude which was consistent with their interests as grain exporters. In fact, during a political campaign of the time, farmers had to be convinced that they should accept import duties (Strecker, 1958).

The pressure came mainly from two sides. German industrialists, who suffered from domestic recession and foreign competition, strove for tariffs on industrial goods. They suggested that agricultural markets should also be protected. Moreover, Chancellor Bismarck wished to increase fiscal revenues in order to strengthen the position of the central government of the Reich vis-à-vis the states. Eventually, farmers became convinced and voted for tariffs.

This switch from a free trade philosophy to protectionism on the side of farmers must be seen against the background of the changing net trade position of Germany during that phase. While net exports of total grain from Germany still amounted to .6 million tons in 1850, they were down to zero between 1860 and 1865. From then on, Germany became a consistent grain importer, importing .9 million tons in 1880, 2.5 million tons in 1890, 2.9 million tons in 1900 and 4.6 million tons in 1910 (Teichmann, 1955). At the same time, import prices for grain fell drastically.

Tariffs on grain imports were introduced in 1879 at rather low levels but increased rapidly (Ritter, 1927). Similarly, livestock imports were taxed at increasing rates (Ritter, 1927) and restrained by non-tariff measures (Ciriacy-Wantrup, 1936). During the 1890's, tariffs were somewhat reduced when Chancellor Caprivi had to enter into new international trade agreements in which he took account of foreign interests and of the changing situation of German industry which had rapidly developed an export position.

Farmers were strongly opposed to import tariff reductions because they had become accustomed to protection and now suffered from tariff cuts as well as from decreasing international grain prices. To strengthen their influence they founded the first really important pressure group of farmers in Germany in 1893, the Bund der Landwirte, which can be viewed as the historical root of the farming lobby in Germany. The farmers' protest eventually led to the dismissal of Caprivi and to the reestablishment of higher tariffs which, because of existing trade agreements, could not become effective before 1906 (Strecker, 1958).

Just as in the 1880's, the tariff structure, while providing protection for livestock farmers, protected grains even more. Large land-owners had been able to convince the smaller livestock-oriented farmers that grain, as the principal agricultural commodity, was most in need of protection. Though this is directly against the interests of livestock farmers, this view has never been abandoned by the German farming lobby as the larger crop-oriented farmers have always played a decisive role (Ackermann, 1970).

General economic conditions were relatively favorable for agriculture in the two decades from the mid 1890's to 1914. Industrial growth led to higher incomes and the concomitant increase in population augmented the rise in demand for food. Also, the competition from North American agriculture weakened which further strengthened domestic farm prices. This could have been a period for liberalizing agricultural trade, but agriculture was increasingly protected in Germany during this phase and has remained so since (Heidhues, 1978). The end of the nineteenth century can be said to be the historical origin of agricultural protectionism in Germany (Herlemann, 1969).

On the eve of World War I, the share of agriculture, forestry and fishing in total employment was 35 per cent, down from 55 per cent in the 1850's; the share in net national income at factor cost in 1913 prices was 23 per cent, down from 45 per cent. However, the absolute number of people employed in agriculture, forestry and fishing increased from 8.3 million around 1850 to 10 million in 1914 (Hoffmann, 1965).

The Period of Crises: 1914 to 1945

Price support for agriculture since 1890 had not prevented Germany from becoming increasingly dependent on food and feed imports. Though production had been growing at high rates due to improvements in production techniques and to favorable prices, consumption had grown at even higher rates. Aggregate self-sufficiency in food is estimated to have been around 80 per cent in the last years before World War I. Some 40 per cent of oilseed consumption, 15 to 20 per cent of meat and livestock products consumption, and 20 per cent of grain consumption had to be imported (Henning, 1978; Teichmann, 1955).

Food Shortages in World War I

German food policy had not prepared for any lasting cut in food imports due to wars or other emergencies. This is attributed by some authors to the fact that Germany had not experienced any extended, serious problems with food imports during wars in the last hundred years (Haushofer, 1963). Thus the effects of the blockade in World War I, which became effective in 1914, were very serious for German consumers. Crop production fell sharply because of decreased fertilizer availability. By 1918, production of wheat had dropped by 40 percent, potatoes by 35 percent, and sugar beets by 30 percent as compared to the average of 1909-1913 (Haushofer, 1963). Livestock production was also markedly reduced in response to the shortfall of feed supply.

German food policy reacted by establishing price ceilings, by introducing food ration cards, and by establishing an all-embracing bureaucracy, the

Kriegsernährungsamt, which was to administer the scarcity of food and agricultural products (Haushofer, 1963). The most immediate effect of these measures was the rapid emergence of a black market (Henning, 1978).

The overall outcome of the food crisis during World War I was a serious famine that affected much of the population. It is reported that during the war 800,000 people died of starvation in Germany (Haushofer, 1963). A noticeable animosity among the hungry urban population grew against farmers who allegedly held back supplies.

The Inter-War Period

The inter-war period was characterized by a succession of crises alternating with short phases of relative prosperity in agriculture, caused by developments within the food economy as well as in the general economy. Agriculture recovered slowly after World War I. It was not before the end of the 1920's that agricultural production had reached its pre-war levels again (Henning, 1978). Food rationing and price controls were kept in part until 1923. Tariffs on agricultural imports, which had been abolished at the outbreak of the war, remained at zero levels. This was consistent with the objectives of alleviating food shortages, enhancing industrial exports, and dampening inflation.

High inflation until 1923 brought a short period of relative prosperity for farmers. Food prices rocketed, land values increased, and farm indebtedness had practically disappeared. However, after a currency reform, monetary stability was regained and German food markets again became attractive for foreign exporters and German farmers suffered from strengthening international competition.

When compared to 1913 levels of per capita consumption, 1925 consumption was lower by 19 percent for bread and grain products, 17 percent for milk and dairy products, and 10 percent for potatoes and pork while consumption had only increased by 2 percent and 12 percent, respectively, for sugar and beef (calculated from Hoffman, 1965). In 1924, producer prices of crop products and meat were 14 percent and 2 percent, respectively, above those in 1913, while prices for agricultural machinery had risen by 37 per cent (calculated from Hoffman, 1965). Indebtedness of agriculture was again increasing at noticeable rates.

Germany's obligation not to establish import barriers in agricultural trade, as implied in the Treaty of Versailles, ended in 1925. In the vigorous debate about what trade policy to adopt then, arguments similar to those raised half a century ago again surfaced. This time, however, the big landowners were firmly on the side of those who voted for protection from the beginning (Tracy, 1982). Finally, a tariff slightly below that applying before the war was established in 1925, and gradually increased to prewar levels until 1929 (Haushofer, 1963).

The phase from 1925 to 1928 was a mixed period for German agriculture (Dietze, 1929). Import tariffs and the system of grain import certificates, which had existed before the war, kept prices above world market levels and gave some

support to agriculture (Teichmann, 1955). On the other hand, production levels had not yet recovered, taxes were relatively high, partly due to Germany's obligation to pay war reparations, and interest payments on rapidly increasing farm debts placed a heavy burden on farm incomes.

Government Intervention Expands

In 1928 the conviction gained ground that agriculture was in a serious crisis. In an emergency program (Reichsnotprogramm) the government directly supported the marketing of agricultural products among other direct interventions (Haushofer, 1963). In early 1929 the various farmers' associations, including the powerful Reichslandbund, the successor of the Bund der Landwirte, united and formed the "Green Front" in order to jointly press for increased protection and support (Haushofer, 1963).

One of the main suggestions, which was made on several occasions by various groups, was that the government should establish a grain trading monopoly. This proposal, which related back to a plan suggested already by Kanitz in 1894, was rejected by the government. However, a compulsory milling ratio for domestic wheat was introduced, rye prices were supported by intervention buying, and preparations for increasing import duties were made.
Thus German agriculture was already in difficulty before the Wall Street collapse in October 1929 initiated the worldwide economic crisis.

Rapidly declining world market prices and declining domestic demand during the severe recession grossly aggravated troubles on agricultural markets in most countries and resulted in a global development which Tracy describes as a second wave of protectionism after that of the 1880's (Tracy, 1982). In Germany, government interference with agricultural markets grew quickly in quantitative as well as in qualitative terms during this phase. From 1929 to 1932, 121 new laws and regulations dealing with food and agriculture were issued, of which about 60 had to do with agricultural trade (Haushofer, 1955; Weber,1932). The ease with which public control of agricultural and food markets spread in these years and later in the Third Reich may well reflect the degree to which public opinion and the administration had become used to interventions during World War I (Haushofer, 1958).

The main developments during the critical years from 1929 to 1932 were relatively prohibitive duties on agricultural imports, denouncements of international trade agreements, establishment of State monopolies, heavy intervention buying, compulsory cartelization of producers, imposition of production quotas, and regulation of qualitative aspects of food processing. Such instruments varied in composition and intensity for individual commodities, but on the whole they constituted a major step towards converting an agricultural and food economy that had been comparatively liberal until 1929 into a quasi-centrally planned sector (Teichmann, 1955; Weber, 1932).

However, these measures could not prevent agricultural conditions from deteriorating. Though imports were effectively restrained from 1928 to 1932, and import volume fell by 50 percent for grains, 61 percent for meat and 32 percent for dairy products and eggs (calculated from data in Hoffman, 1965), domestic producer prices dropped by 30 percent for crop products and by 40

percent for meat and livestock products (calculated from data in Hoffman, 1965). Farm debt increased rapidly so that by 1931/32, interest payments amounted to 14 per cent of agricultural revenues (Henning, 1978), and the number of forced auctions in agriculture trebled from 1927/28 to 1931/32 (Haushofer, 1963).

A program specifically designed to alleviate liquidity problems of large landowners in the eastern parts of Germany (the Osthilfe), assumed major importance among several emergency measures to help heavily indebted farmers, (Haushofer, 1963). It drove a wedge between farmers and the general public, and between large landowners and peasants thus aggravating extreme political trends within this latter group. This, in addition to the natural conservative and anti-republican tendencies among the largest farmers, may have contributed to the support which the National Socialists received from parts of the agricultural population.

The National Socialists Take Power

After Hitler and the National Socialists came to power in early 1933, the basic philosophy, objectives, and instruments of food and agricultural policy changed fundamentally. In the Weimar Republic, policies toward food and agriculture had essentially been shaped by reactive crisis management through emergency measures. In the Third Reich, a system was established in which farming formed an integral part of the overall ideology and policy. Farming was no longer viewed as just an economic activity, rather, the farmer was assigned a decisive role in racial ideology. The Yeomanry as the Life Source of the Nordic Race, the title of a book by Darré (Darre, 1929) who was to become Minister of Agriculture in 1933, is an appropriate expression of this ideology. Blut und Boden (Blood and Soil) became the popular slogan.

The development of a self-sufficient food economy became the overriding concrete goal of the National Socialists. This autarkic policy was consistent with the nationalistic attitude of National Socialism. In practical terms it constituted an essential step in preparing for war.

The establishment of a fully controllable system of producing, trading, processing, and distributing food formed the major basis of Nazi food and agricultural policy. This can be seen in the massive state interventions during the preceding years. However, this development, which neatly fitted in with the basic philosophy and objectives of the general policy, went far beyond the interventionism of the Weimar Republic. All activities in the food economy and the people, enterprises, and organizations involved were made part of one comprehensive institution, the Reichsnährstand (State Food Corporation). This all-embracing institution, which had an administrative as well as a political character, was hierarchically organized with a strong top-down chain of responsibility (Reischle and Saure, 1940). One of its main functions was to organize and control the marketing of agricultural products and food at all levels through specialized agencies (Hanau and Plate, 1975).

The guiding principle in agricultural marketing policy was to guarantee farmers fixed prices. The average producer price level was incrementally raised by one-third from 1932/33 to 1936. Later, as part of the fight against

inflation, the price level was kept nearly constant until 1939 but rose again during the war. Where further production incentives seemed necessary, and in order to keep consumer prices down, subsidies were introduced. If production did not grow at desired rates, input subsidies of various forms were granted. In addition to these economic incentives, moral suasion was used to induce farmers to produce more in what became called Erzeugungsschlacht (Battle of Production). Domestic market stability was achieved mainly by selectively controlling imports which showed up in grossly fluctuating import levels, particularly in grains.

The results of this policy were not overwhelming as far as autarky in food was concerned. As compared to 1932, degrees of self-sufficiency in 1938 had remained roughly constant for grains, potatoes, sugar, vegetables, pork and poultry meat, milk and dairy products, but had decreased for beef meat and only increased for eggs, animal fat, and oilseeds (from data in Grupe, 1957). Nevertheless, by the outbreak of World War II, German agriculture had recovered from the production shortfalls during and after World War I as well as from the economic difficulties of the late twenties and early thirties. Moreover, the whole food economy was organized in a way which made it easier for Hitler to pursue his war plans. In addition, contrary to the situation before World War I, the Nazis had built up large stocks of grain and fat.

World War II Controls on Agriculture

During World War II, the system of controlling the food economy was not changed in principle. Quantity controls were tightened and where they did not exist, they were introduced. Mandatory delivery was reinforced, consumption was rationed, and the fixed price system was continued (Hanau and Plate, 1975). Though production dropped during the war due to shortages in supply of fertilizers and imported feed and because agricultural labor and horses were called up for service in the war, the decline in production was far less pronounced than in World War I. Moreover, occupied territories were forced to deliver food to Germany. Though food consumption had to be reduced later in the war, the population was adequately supplied until 1944. Serious hunger did not begin until the last phase of the war (Henning, 1978).

The Post World War II Period

Extreme shortage of food supplies was the most prominent aspect of the German food economy in the years immediately following World War II. Food rations, which had been maintained at a level around 2,000 calories per head per day until early 1944, dropped to 1,400 or 1,300 calories between 1946 and 1948 in the Western Zones (Magura, 1970; Henning, 1978). In part this was due to two poor harvests in 1946 and 1947, but it also reflected the fundamental change in the basic structure of the German food economy resulting from the division of Germany.

The center of gravity in agricultural production had been in eastern Germany where more favorable conditions regarding soil fertility and topology prevailed and where population density was lower. In terms of 1935-1938 conditions, population per 100 hectares of agricultural area averaged 236 in the whole of the Reich, while the corresponding figure for

the area which was later to become the FRG averaged 282 (Statistisches Handbuch Landwirtschaft und Ernahrung, 1956). This reduction of the land/man ratio was grossly aggravated by the large inflow of refugees from the East. In 1948/49, population per 100 hectares of agricultural area in the FRG had already reached 352 (Statistisches Handbuch Landwirtschaft und Ernahrung, 1956).

In addition, because of the uneven distribution of farm sizes between the eastern and western regions, the average size of holdings in the FRG was noticeably smaller. In 1937, 7.5 percent of total acreage in the Reich had been farmed in holdings of 50 to 100 hectares, and 16.9 percent in holdings above 100 hectares, while the corresponding figures were 6.3 and 4.8 percent, respectively, in the area of the newly formed FRG (Henning, 1978).

Within the Reich there had traditionally been massive trade flows, particularly in grains, from the eastern to the western regions. The rigid partition of Germany in four zones brought these flows to an end and thus aggravated food shortages in the western zones. Lack of foreign exchange hindered imports, and the rapidly declining purchasing power of money induced farmers to withhold sales to the cities. The occupying powers helped to ease the situation by providing means to finance imports of food and agricultural inputs but they still were forced to closely ration food (Magura, 1970).

Since the German population had experienced two periods of massive food shortages within 30 years, it is understandable that the new government of the FRG in 1949 saw the expansion of food production as one of its major duties. Scarce foreign exchange and rocketing prices on world markets for agricultural products during the Korean War reinforced the importance of this objective.

On the other hand it was necessary to protect consumers against high food prices. These twin objectives were pursued by a combination of measures to help farmers increase their production, materially supported by funds from Marshall Aid (European Recovery Program), and measures to control prices and subsidize food and feed imports. In order to implement the latter, an elaborate administration was available which finally, in 1950 and 1951, was consolidated in the system of Einfuhr- und Vorratsstellen (Import and Storage Boards) which could be used to fully control foreign trade and domestic markets for agricultural products.

The basic question concerning the degree to which agriculture and food production and trade could be subjected to the free forces of the market was intensely discussed from the beginning in the FRG. The Ausschuß für landwirtschaftliche Marktordnung (Committee for the Organization of Agricultural Markets), a predecessor of the Scientific Advisory Council of the Federal Ministry of Agriculture, produced a report in 1950 and split on this question (Gutachten des Ausschusses fur landwirtschaftliche Marktordnung, vol.1, 1950).

The minority of its members held that the new FRG should exploit the benefits of the international division of labor and that this principle should guide agricultural trade policy. Interference with markets, it was argued, was advisable only in cases of temporary disturbances. The majority of the

Committee, however, referred to the experiences of the early thirties and suggested tight government control of the food economy. The majority view became more influential in actual policy. Though food rationing was soon abandoned, agricultural markets remained closely regulated.

The direction in which instruments of market policy were used was soon to be reversed. In 1952, Germany's balance of payments turned positive and agricultural imports could be financed. After the Korean Crisis was over, world market prices for agricultural products, particularly grain prices, dropped below the level which prevailed in Germany. Industrial activity and the general level of income recovered quickly, and consumer protection seemed less important. Instead, farmers' incomes became the focus of interest in agricultural policy. The third period of agricultural protectionism, after those of the 1880's and the 1930's, had begun.

The Emerging Farm Lobby

In terms of ideological developments, the rise of the concept of income parity was most noticeable. In 1951 the Deutscher Bauernverband (the German Farmers' Union, commonly referred to as DBV), which had been founded in 1948 and was to become the exclusive representative of farming interests in the FRG, had publicly claimed income parity as a goal. The consequent public debate finally led to the Landwirtschaftsgesetz (Agricultural Act) of 1955. The DBV had exerted a major influence on the formulation of this Act (Puvogel, 1957). Though no fixed parity ratio is laid down in the Act, it requires the government to "enable agriculture ... to offset the existing natural and economic disadvantages" in order to "equalize the social situation of people working in agriculture with that of comparable professions".

To prove its record in this respect, the Federal Government is bound by law to publish annually the "Green Report" (later renamed Agrarbericht) in which it has to demonstrate, on the basis of data collected from a sample of different types and sizes of farms, to what extent farmers receive comparable remuneration for their inputs in terms of labor, capital, and management. In an annual plan (formerly known as Grüner Plan) the government has to announce the measures with which it intends to pursue these and other objectives of the Act. The Act is still in force, and its vague income parity concept, which still is manifest in the comparative income calculation presented every year in the Agrarbericht, continues to play some political role in Germany.

The main instrument for price support was manipulation of agricultural imports as operated by the Import and Storage Boards. For many products this instrument was sufficient since the FRG still had to import large volumes of food and feed. Degrees of self-sufficiency in the FRG for wheat were 56 percent on average from 1952/53 to 1954/55, 73 percent for feed grains, 84 percent for sugar, 6 percent for vegetable oil, 67 percent for eggs, and 82 percent for poultry meat, while it was about self-sufficient in rye (101 percent), beef (92 percent), pigmeat (97 percent) and butter (96 percent) (calculated from data in Statistiches Handbuch Landwirtschaft un Ernahrung, 1956).

Import policy was used to maintain stable and high domestic prices, either by imposing a levy on imports, which was determined much like the variable levies under today's Common Agricultural Policy (CAP) of the European Community (EC), or by controlling the volume of imports. Where import policy did not suffice to secure the desired price level, intervention buying took place. The average nominal rate of protection was somewhat below 20 percent in the mid-fifties (McCrone, 1962) and increased to about 33 percent in the early sixties (Neidlinger, 1967).

Though farm income support was mainly achieved through high market prices and consumers bore most of the burden, there were also direct government-financed subsidies. Milk production, which tended to be in surplus, has been subsidized since 1957 on the pretext of promoting high quality. Egg production has attracted subsidies since 1956 which were justified by the high grain costs (OEEC, 1958). Massive transfers to agriculture were also effected by subsidies on fertilizer, which were paid from 1955/56 to 1962/63, and by exempting agriculture from the tax on diesel fuel since 1961 (Magura, 1970).

The greatest share of government finance flowing to agriculture, however, was channeled through so-called structural policies. An important set of measures had been devised to support settlement of farm families expelled from the east. But the major effort was oriented towards increasing the efficiency of existing farms. During the 1950's and early 1960's this meant mainly the consolidation of fragmented holdings, the transfer of farm buildings from villages to countryside, and various improvements of the infrastructure.

The general mood of the time regarding agricultural policy was rather conservative. The problem of low incomes in agriculture was recognized, but it was attributed to unfavorable natural, structural, and technical characteristics and to adverse market conditions for agriculture rather than to insufficient economic adjustment (Schmitt, 1972). The long run nature of agricultural problems was seen in a static rather than in a dynamic context (Hanau, 1958).

From 1950 to 1960, the number of farms smaller than 0.6 hectares had been reduced by about 15 per cent, and the labor input on these farms (measured in man year equivalents) had decreased by nearly two-fifths (calculated from Statistisches Jahrbuch uber Ernahrung, Landwirtschaft und Forsten-STJELF-various issues). Thus, in reality developments were exceptionally dynamic. Nevertheless, the DBV and the government based their philosophy on the idea that every farmer should have an opportunity to remain a farmer rather than help farmers adjust to a dynamic market. In an economy which had only recently recovered from the war, was struggling with unemployment, and had to absorb millions of refugees from the East, this attitude was quite natural.

By the late 1950's the basic problems in the overall economy had been largely settled and the time was ripe for a reconsideration of the basic concepts of FRG agricultural policy. However, it coincided with the emergence of the CAP of the EC which subjugated the agricultural policy of the FRG to the goals of European economic integration. This phase of European history with its major tensions was not ideal for freely rethinking the agricultural policy of the FRG.

The Emergence of the Common Agricultural Policy

There had never been any doubt that the Federal Republic of Germany was determined to be an active partner in European integration. Germany's dreadful recent history formed the background for the FRG's strong desire to become a fully integrated member of the Western world. In all negotiations which had taken place within various institutional frameworks during the 1950's, the FRG had made it clear that it was prepared to make major contributions to foster integration in Europe, and it was without any hesitation that the FRG became a member, first of the sectoral, and later of the full European Economic Community.

There were agricultural interests in Germany which were less than enthusiastic about the prospects of integrating Europe's agriculture. After several attempts during the 1950's to establish a sectoral union for agriculture in Europe, it was clear that the agricultural exporters among the prospective member countries, above all France, would never accept a European Community excluding agriculture. Thus Germany was never seriously in opposition to making the agricultural sector an integral part of the Community in the Treaty of Rome.

The Treaty of Rome still left considerable scope for the actual method and intensity of integrating agriculture. However, in spite of the fact that several analyses of the problems of harmonizing agricultural markets in Europe were available, it seems that the difficulties which FRG agriculture had to face in the Community had not been fully recognized from the outset. This may have added to the vehemence with which the issue of agricultural policy harmonization was debated in the FRG during the early 1960's.

After the Council of Ministers had taken the basic decision that the Community was to opt for a full harmonization of markets with common protection vis-à-vis third countries and free internal trade, it was obvious that agricultural support prices, which differed widely among member countries, had to be harmonized at one common level. FRG prices were considerably above the average of the Community, and for many products the FRG had the highest prices of all member countries. Prices of grain, sugar, and milk were particularly high in the FRG. Pork, poultry and egg prices tended to reflect the high level of feed grain prices, although beef was protected at a somewhat lower level (Plate, Woermann, and Grupe, 1962).

Because of the central importance of grain in the production and use of agricultural products, it was logical that grain was the first commodity for which the common price level had to be negotiated among member country governments. At this stage it became fully clear what kind of pressures FRG agriculture had to fear. The process of deciding on the common grain price level turned into a heated fight in which the DBV used all its power and used every method at its disposal to safeguard what it supposed to be the interests of its members (Ackermann, 1970). This led to the most intense clash in German agricultural policy in the post World War II period. The importance of the issue and the vigor with which it was debated were probably not less than that of the dispute about the introduction of tariffs in the last decades of the nineteenth century (Tangermann, 1979).

The clash culminated when a panel of professors, who had been commissioned to investigate the consequences of agricultural price harmonization and especially the effects of a reduction in FRG grain prices, submitted their report (Hanau, 1971). This report (Professorengutachten) was a highly objective and purely positive analysis which projected, for two alternative assumptions on future farm product prices (maintenance of high FRG prices, and reduction to some lower Community price level), the possible future developments of total income of FRG agriculture and the resulting need for outmigration of farmers if their average income was to grow in parallel with non-farm incomes. The DBV, however, thought differently about the report when it was published. Instead of using it as a basis for arguing in favor of adjustment support for the farming industry, the farmers' union treated the report as if it had been a proposal to cut farm product prices in the FRG. Militant demonstrations were organized and the authors of the report were personally reviled.

The FRG government originally tried to persuade the other member countries to raise their prices to the German level. Chancellor Adenauer had even promised the FRG farmers to not lower German grain prices. Erhard, who replaced Adenauer in October 1963, was somewhat more cautious in this respect, but his government still fought hard for high support price levels in Brussels. It finally became obvious that this line could not be held. The FRG government, under strong pressure from Brussels, won the assent of the DBV to a reduction of support prices but at high financial costs. In a special Act (EWG-Anpassungsgesetz), the government committed itself to spending, during four adjustment years, 1.03 billion DM annually on various measures above normal spending. This was what the president of the DBV had demanded as general support.

In addition, German farmers were granted, during the adjustment period, full financial compensation for the loss in revenue due to the cut in grain prices. In part this was paid, like compensation payments for Italy and Luxembourg, out of the Community budget. However, due to the budgetary problems of the EC, in part caused by the 1966/67 recession, less was paid than originally had been promised. This failure is thoroughly remembered in German agriculture and is still being used as an argument against direct income payments in political debates (Hanau, 1971).

The FRG government finally accepted a decision on common grain prices which meant a nominal reduction of German prices by 10 to 15 percent. The subsequent reduction in livestock and product prices, the common level of which was decided at a later stage, was less pronounced. In spite of massive financial compensation, this cut in nominal prices, and the corresponding increase in competition from the other member countries, was felt to cause considerable hardship for FRG farmers. The establishment of the CAP was thus regarded by many FRG farmers, as well as by many officials in the FRG agricultural ministry, as a national catastrophe.

German Agricultural Policies in a Community Framework

After the common market regimes had been established, the FRG had to abandon its market policies such as quantitative import controls and producer

subsidies on milk. The basic approach to agricultural price policy, however, and many of the instruments used in the common market regimes were rather close to the FRG's policy. Yet, the level of protection afforded to agriculture was lower under the CAP than what FRG farmers were used to, and they complained bitterly.

It is not surprising that after the establishment of the CAP, the strategy of the FRG Ministers of Agriculture was to use all possible means to provide continued support to their farming constituency. Their aims were, first, to keep the system of market regimes intact and to increase common support prices (or at least support prices prevailing in the FRG), as far as politically feasible; and, second, to retain as much national freedom as possible in non-price policies.

In their efforts to keep price support in the Community at a high level, FRG agricultural policymakers were rather successful, and their influence on the Community's agricultural market and price policies has been significant. The FRG even managed to persuade the Community that it needed a special exchange rate regime in agriculture, and this regime has been used by the FRG's Ministers of Agriculture to keep the level of price support higher than in other EC member states. These developments will be discussed regarding FRG influence on agricultural policymaking in the Community in chapter 2.

After static ideas had prevailed in the 1950's, the view gained ground in the 1960's that agriculture was in a process of secular adjustment and that it was necessary both to encourage outmigration from agriculture and to avoid social hardship in the adjustment process. These views were appropriately expressed in two influential government reports of 1968, published by the Ministry of Agriculture (Arbeitsprogramm fur die Agrarpolitik der Bundesregierung, 1968) and the Ministry of Economic Affairs (Der Bundesminister fur Wirtschaft, 1968). Even the DBV changed its earlier position and recognized the need for continuing structural change (Deutscher Bauernverband, Oct. 6, 1968).

Structural adjustment, however, was seen as a continuous process. In this regard the FRG approach was fundamentally different from the Mansholt proposals for CAP reform which were made at about the same time and called for massive structural reform suggesting a concentration of aids on farm units of a minimum size which was totally out of the range of prevailing farm sizes in the FRG. Consequently, the Mansholt proposals were strongly opposed in the FRG, and they are still referred to with hostility as a prime example of a brutal policy designed by technocrats.

Agricultural policy in the FRG, nevertheless, did take a small step in the direction of the Mansholt proposals. In 1971, a new program of investment aids for individual farms (Einzelbetriebliches Förderungsprogramm) became effective which restricted investment aids to farmers who could demonstrate that they were able to earn incomes comparable to non-farm income levels. In a supplementary program for non-viable farms (Soziales Ergänzungsprogramm), special measures to help outmigrating farmers and aids for those farmers who had to bridge the time until retirement were offered. European Community regulations for its 1972 structural policy were very close to these programs.

This swing towards a growth-oriented policy of selective aids for viable farms was later reversed. Decreasing growth rates in the overall economy and deteriorating labor markets made many policymakers feel that outmigration from agriculture should no longer be fostered. In addition, it proved politically difficult to be thoroughly selective and exclude major segments of agriculture from a given set of public aids. Thus, while the selective program in principle remained in existence, it was complemented by an array of measures which in practice entitled any farmer to some form of investment aid. Structural policy in the FRG, therefore, effectively reverted to undifferentiated investment support on a rather large scale.

It soon became increasingly difficult to continue a policy of open investment aids. As the Community began to produce more and more surpluses, its programs for investment subsidies were curtailed and constraints were imposed on the extent to which member countries could support farm investments. Moreover, it was politically difficult to explain why investment subsidies should be continued at full scale, while at the same time measures like quotas for milk production had to be adopted in order to reduce market imbalance. Consequently, investment subsidies were greatly reduced.

The agricultural policy of the FRG finally completed a full circle back to conserving existing structures in the farming industry. In 1988, a bill for supporting the family farm (Gesetz zu Förderung der bäuerlichen Landwirtschaft) was adopted, which excludes larger farms from certain benefits. The philosophy behind this bill reflects the static view on agricultural structures which prevailed in the 1950's. In today's agricultural policy debate, any policy which would foster structural change in agriculture is reviled as a policy of Wachsen oder Weichen (grow or leave), and FRG agricultural policymakers are again heard to state that one of their objectives is to keep as many farmers on the land as possible.

Social policy for agriculture in the FRG continually gained in importance from the 1960's. Government contributions to the social security system in agriculture have exhibited the highest growth rates of all single expenditure items in agriculture and in 1988 accounted for 57 percent of the total budget of the Federal Ministry of Agriculture. The social security system for agriculture, i.e. the old age pension scheme and health and accident insurance, has been established in isolation from the rest of the population in the FRG (Wissenschaftlicher Beirat beim BML, 1979). Its most prominent feature is the fact that financial contributions of farmers are lower by far relative to expected benefits than those in other economic sectors.

A considerable expansion of the array of measures covered by the system, high growth rates of the benefits, and increasing commitments of the government to make financial contributions, have rendered social policy into a means of effecting massive income transfers to agriculture. On occasion, social policy has been deliberately used as a device for granting farmers compensatory payments. Moreover, government contributions to the social security system for farmers are more recently understood as a form of decoupled payments to farmers.

Economic Factors Influencing Agricultural Policy in the FRG

From the historical record it is obvious that agricultural policy in Germany has tended to be rather conservative and to strive for a comparatively high level of protection for the farming industry. This may seem to have been inconsistent with the general economic characteristics of the FRG for there are some economic reasons why Germany should have a preference for low farm prices and liberal trade in agriculture.

The general approach to economic policy in the FRG was firmly entrenched in the liberal philosophy of the free market economy. In comparison with other western countries, government interference with markets in the FRG was fairly limited, and trade policy was liberal in principle. In overall economic terms, the FRG fared extremely well with this economic system, and there are few politicians in Germany who would deny that the "Wirtschaftswunder" (economic miracle) of rapid growth in the post-war FRG was to a large extent a result of this liberal economic policy. In international fora, above all in GATT, the FRG had regularly been among those countries which in general advocated a global liberalization of trade and limitation of state intervention in markets. FRG agricultural policy did not fit into this picture.

The FRG's agricultural trade balance should have meant that it prefer low support prices because west Germany has always been and remains a large agricultural importer. Even after the massive increase in agricultural production over the last twenty years the overall degree of self-sufficiency in food and feed was still only 94 percent in 1986/87, and without production from imported feedstuffs it was only 80 percent (STJELF, 1988). During the early post-war years, import dependence was a valid argument for expanding domestic production. However, when the FRG became a member of the increasingly self-sufficient Community, there was no longer a real danger of being cut off from agricultural imports. Consequently, security of supplies was not really a concern (Sohn, 1984), and even among politicians it was rarely used as an argument for price support in the FRG.

In this situation a low degree of self-sufficiency should have induced the FRG to opt for low levels of price support since the consumer benefit from low food prices had more economic weight than producer benefits from high prices. Equally, an importing EC member country which opts for high price support incurs a national economic loss. This loss comes on top of the "normal" welfare loss due to protection.

It has been shown that substantial economic transfers from the FRG to the rest of the Community were effected by the CAP and that these transfers increased whenever the support price level was raised (Koester, 1977). Overall, the FRG suffered an economic loss from high CAP prices and it only gained financially from the milk market regime. If the central objective of the FRG agricultural policy was to maximize national economic welfare, one would have expected the FRG's agricultural policymakers to strive for relatively low farm product prices in the Community.

However, the FRG's agricultural policymakers were not really concerned about overall economic welfare. Their objective was to support farm incomes, as far as this was politically and economically possible. There were some political reasons for this, which will be discussed in the following section. However, there were also some economic factors which made it plausible for the FRG's agricultural policymakers to favor a relatively high level of price support. Some of these factors exerted a pressure for high income support while others made high farm prices an effective or at least tolerable means of farm income support.

The most obvious factor causing low farm incomes in the FRG was an unfavorable farm size structure. In 1986, the average size of farms above one hectare was 16.8 hectares in the FRG, as compared to the EC-10 average of 17.4 hectares or average farm sizes of 29.1 hectares in France and 69.3 hectares in the UK (calculated from STJELF, 1988). A small average farm size results in a low endowment of the agricultural labor force with acreage. In 1985, the agricultural area per person employed in farming (full-time equivalent), was 13.1 hectares in the FRG, while it was 20.0 hectares in France, 34.3 hectares in the UK and 14.2 hectares on average in the Community of 10 (calculated from STJELF, 1988).

A low land/man ratio tends to depress labor productivity as long as this is not sufficiently outweighed by a high intensity of production. Relatively intensive livestock production in the FRG worked in this direction. The value of final production of livestock products in 1986 was 1540 ECU/ha in Germany while it was 888 ECU/ha on average in the EC-10 and only 670 ECU/ha in France and 586 ECU/ha in the UK. However, livestock production is by far less pronounced in Germany than in the Netherlands where the corresponding figure was 4472 ECU/ha (calculated from STJELF, 1988).

A further factor that depressed productivity in FRG agriculture was the fragmentation of plots in some parts of the country where the customary laws of inheritance favored the division of land. Thus, various studies came to the conclusion that labor productivity in German agriculture was comparatively low (Kommission der EG, 1969; Britton and Hill, 1975; Behrens, 1981). As income per head is closely related to labor productivity, this goes far in explaining relatively low farm incomes in the FRG.

The resulting pressure for high income support was particularly strong in the FRG as non-farm incomes and, hence, income expectations of farmers were relatively high. Valued at market exchange rates in 1986, GDP per capita in the FRG was 25.1 percent above the Community average, 11.9 percent above France and 52.0 percent above the UK (calculated from STJELF, 1988). Thus it is no surprise that FRG farmers, who wished to earn incomes comparable to those in the rest of the economy, should desire higher prices than in other member countries.

High non-farm incomes, on the other hand, are a first major factor explaining why a high support price level and, hence, high food prices seemed relatively tolerable. In 1987, a middle income family in the FRG spent 11.4 percent of its private expenditure on food (Agrarbericht, 1988). Of this expenditure, 63.3 percent was made up of the processing and trading margin and only 36.7

percent accrued to farmers (STJELF, 1988). Thus consumers could be more generous to farmers than in those countries where higher percentages are spent on food.

The same logic holds with the relatively small size of the agricultural sector in the FRG. In 1987, agriculture accounted for 4.7 percent of total employment and 1.5 percent of overall GDP (STJELF, 1988). Such a small sector, one could argue, can easily be supported.

Some economic characteristics of FRG agriculture made price protection a relatively effective instrument for income support because most of an increase in revenue of the farming industry is reflected in rising incomes of farmers' households. One factor which works in this direction is the predominance of owner-occupied farms which means that little of an increase in revenues gets lost in the form of rising rents. In 1985, only 34.0 percent of agricultural area was rented, while rented acreage accounted for 51.8 percent in France, 38.1 percent in the UK, and 36.0 percent in the Community (STJELF, 1988).

The small share of hired workers in the total agricultural labor force in the FRG worked in the same direction. In 1987, only 11.6 percent of total labor input in FRG agriculture, measured in man-year equivalents, was hired labor (STJELF, 1988). A noticeable structural change has taken place since World War II. In 1950/51, the share of hired labor was still at 22.9 percent (STJELF, 1959).

Even if income support accrued to farmers' households, its long run effect on income per head would be limited if it would reduce outmigration from agriculture and thereby increase the number of farm households which have to share the given amount of income support. Though this certainly happened in the FRG, for a long time this effect may have been comparatively small as labor markets rapidly expanded until the early seventies, and rates of unemployment were relatively low at that time. From 1950/51 to 1973/74, the average annual rate of decline of labor input in German agriculture, measured in man-year equivalents, was 4.8 percent (Agrarbericht, various issues).

However, since the middle of the seventies, higher unemployment in the overall economy has retarded outmigration and reduced the decline in agricultural labor input. From 1975 to 1987, the average annual rate of decline in the agricultural labor force was only 2.8 percent (Agrarbericht, 1989), not much more than the natural demographic decrease. Parallel to the decline in labor input, the number of farms has more than halved during the past three decades, while average farm size more than doubled (Agrarbericht, various issues). Whatever the negative effects of farm support on resource allocation may have been, one cannot say that structural change in German agriculture since World War II has not been rapid, in particular up until the mid-seventies.

In addition to the above factors, the particular stress which was placed on the milk price has to be commented upon because the FRG interest in high milk support prices has had a considerable impact on EC milk price policy and the introduction of dairy quotas in 1984 (see below). In part, the FRG's desire for high milk prices is explained by the predominance of small low-income farms in which dairy production plays an important role. The average size of

dairy herds in the FRG was 16.0 cows in 1987, while it was 20.0 in France, 63.2 in the UK, and 18.5 in the EC-10 (STJELF, 1988).

Another important factor is the regional distribution of dairy farms. In general, FRG agriculture exhibits about average natural conditions with respect to climate, soil fertility etc. However, there is a heavy concentration of grassland and, hence, dairy farming in some regions dominated where cropping is rarely an alternative. These regions (the Lower Alps, the coastal strips in northern FRG and some highland areas), moreover, happen to be characterized by a relatively low level of non-agricultural economic activity, which means that farmers have only limited alternatives to earning their income from dairy farming.

On the other hand, that great emphasis in the FRG was also placed on high grain and sugar prices can only be explained historically by referring to the fact that grain and sugar have been protected at relatively high levels since the 1880's in Germany. The real root of this phenomenon is the dominant position which the large landowners have always occupied in the German farming lobby.

One specific feature of FRG agriculture does not directly fit into this explanation of the desire for high farm price support. Part-time farming plays a relatively important role in Germany. According to the definition in FRG statistics, 41.7 percent of all farms were part-time in 1988, and even of the remaining full-time farms, around one-sixth earned ten per cent or more of their income from non-farm activities (Agrarbericht, 1989). Part-time farmers on average earn less than 10 percent of their total income from farming (Agrarbericht, 1989). Thus, there was an important group of farms in FRG agriculture which was only marginally affected by price support. Should problems of low income prevail in this group, this could rarely be redressed by the help of agricultural price policy. However, this is not an argument against high price support as long as full-time farms are the main focus of agricultural policy which has been the case in west Germany for many years.

The Political Background of Agricultural Policy in Germany

Perhaps more powerful than the economic factors discussed in the previous section are the political factors which are behind the west German attitude towards high farm price support. In German history of the last hundred years or so, the political weight of farmers has been substantial in part because of their numbers, but more importantly because of agriculture's particular role as a central pillar of the prevailing social system. Moreover, Germany has suffered through a succession of famines in its history, and it was easy to argue for policies which helped to increase domestic food production. However, food security is no longer a valid political argument in west German agricultural policy.

The percentage of farmers in the general electorate in west Germany is now so small that it would appear that farmers should have lost the political influence which they were able to exert a few decades ago. Moreover, a protectionist agricultural policy does not seem to fit German political needs since west Germany is an industrial exporter interested in an open

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international trading environment and generally favors liberal economic policies.

Such considerations do not come close to explaining the depth and weight of agriculture in German politics. In Germany, as in many other countries, agricultural policy is not really a policy which truly represents the economic interests and the political weights of all groups of society in a very balanced manner. To put it bluntly, agricultural policy in west Germany has been made by farmers for farmers.

Ministers of Agriculture, both at the Federal and at the Bundesländer (state) level, have usually been farmers themselves, and the same holds true for parliamentarians dealing with farm policy in the committees of agriculture of the Federal Parliament and the State Parliaments. Asked what he feels should be the main goal of his policy, a German minister of agriculture would typically answer "to preserve the family farm" or even "to preserve as many family farms as possible". The designation of the Federal Ministry is Ministry for Food, Agriculture and Forestry. But an old joke says that in reality it operates as the ministry for feeding agriculture.

Relatively few activities of the Federal Ministry are geared towards consumer affairs, and essentially none of them takes up the economic concerns of consumers. For example, out of a total of 134 pages of text in the 1989 Agrarbericht, only two pages dealt with consumer affairs. The consumer interest is protected to a certain extent but only as far as the quality of food is concerned.

The link between the Ministry for Food, Agriculture, and Forestry on the one hand, and food consumers on the other, is further weakened because a number of food issues are dealt with by other ministries (for example, the Ministry for Health, Youth and Family Affairs). Moreover, when the Federal Ministry for the Environment was established in 1986 (after Chernobyl), a number of responsibilities in relation to the environment were taken away from the Ministry for Agriculture. When it comes to price support and financial aids, the interest of the farming industry is of overriding weight in the Ministry for Agriculture and in German agricultural policy.

How can one explain this apparently biased political situation?
A number of studies have tried to apply the concepts of the political economy to this phenomenon with interesting results (Haase, 1983; Beusmann and Hagedorn, 1984). Yet, there is a number of relatively straightforward factors which explain why agricultural policy is as it is, and not as it should be from the point of view of an economist (Schmitt, 1984; Tangermann, 1979). Some of these factors are the following:

- People outside agriculture have relatively little information on agricultural policy matters and do not realize how they are affected by agricultural policy.

- For farmers it is worthwhile to vote for those policies which increase their welfare rather than the overall welfare of society. As there is no countervailing political force, it is natural that agricultural

policymakers feel that they can gain votes from the farming community without losing votes from other sectors of the electorate. This asymmetry of the political process can also explain why even those political parties which traditionally represent the workers' or consumers' interest are farmer-oriented when it comes to agricultural policy.

- Interests of small groups, like farmers, are much more easy to organize into effective political pressure groups than those of large groups like consumers and taxpayers.

- The farming lobby has been successful in securing solidarity while maintaining insularity from consumers and taxpayers for what has been politically "sold" as rather modest and unobjectionable claims of the farming community. The farming lobby has been able to leave the general public with the impression that farmers are a disadvantaged group that provides many important services to society (Schmitt, 1984).

It is revealing that a German minister of agriculture can make statements of the following type without opposition: "The present CAP has brought consumers great advantages, namely stable prices which have dampened inflation, and a marvelous quality of food in overwhelming variety, and it has also opened up excellent opportunities for producers inside and outside the EC" (Kiechle, 1984 as translated by Tangermann).

The power of the farm lobby in a fragile national political context and the ignorance of the general public about the economics of agriculture help explain why agricultural policy in general exhibits a significant bias towards the farmers' interest. These factors seem to have worked particularly effectively in the FRG. It was often difficult to distinguish between statements made by a representative of the farmers' union and those made by politicians while listening to an agricultural policy debate in the FRG. Moreover, all major political parties in the Federal Republic adopted the same pro-farmer attitude with regard to agricultural policy, thus changes in government did not significantly affect the FRG's agricultural policy nor its position on the CAP. It was only in the early 1980's that certain differences of opinion on agricultural policy matters emerged among parties (Tangermann, 1982).

The political factors in the FRG outlined above became even more pronounced in the framework of the CAP. There are many reasons which could be mentioned in order to support this hypothesis (Koester, 1977; Schmitt, 1984; Tangermann, 1983), but the main point is that there was, at least before the EC budget crisis of the 1980's, very little effective political control over what farm ministers decided in the Brussels' Council meetings. Or, to put it differently, the Community framework for agricultural policy meant that both economic and political costs of agricultural policy decisions can be externalized. Thus, any opposition against farm policy that could arise was neutralized by the fact that there was no lever which national political forces could bring to bear on "Community" decisions.

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The resulting behavior of the Agricultural Council in the EC was described as "happy accompliceship" by a high level official of the FRG Ministry of Agriculture. The degree of satisfaction which the agricultural industry in the FRG derived from this political situation in Brussels has been most clearly demonstrated by the fact that the German farmers' union has become a keen defender of the CAP. This does not imply that German farmers are happy with everything which goes on in the CAP. However, German farmers would not be willing to give up on the CAP.

Trends Immediately Preceding Unification

Basic attitudes towards agricultural policy have not significantly changed in west Germany over the past twenty years or so. However, weights shifted slightly, mainly because of the changed economic environment, but also because of political developments in the FRG and as a consequence of emerging problems in the Community. Among the many interesting trends before German unification in west Germany's agricultural, political, and economic environment, only five shall briefly be described here: 1) concerns about a downturn in farm incomes; 2) an increasing emphasis on distribution aspects in agriculture; 3) the emergence of environmental considerations; 4) farmers' behavior in elections; and 5) the changing position of industrialists on agricultural policy. German unification will be addressed in the final chapter.

Farm Income

Throughout the 1950's and 1960's, farm incomes in the FRG grew roughly in line with incomes in the rest of the FRG's economy (Tangermann, 1976). According to the official income comparison in the Agricultural Reports (Agrarbericht) of the FRG, labor income in agriculture, after accounting for implicit interest on capital and land, was always considerably below comparative wage income in non-agricultural occupations. There are a number of unresolved questions concerning the method of income comparison (von Witzke, 1975), and there are also doubts concerning an insufficient accounting of non-farm income of farm families (Schmitt, 1983).

However, in the political debate such methodological concerns have never played any significant role. In any case, farm income increased at approximately the same rate as income outside agriculture, and the gap between the agricultural and non-agricultural income levels received less and less political attention as the Ministry of Agriculture increasingly tended to emphasize rates of income change rather than absolute income levels.

The parallel trend of farm and non-farm incomes continued until the mid-seventies. Since then, however, farm incomes lagged behind and fell considerably in real terms. From 1974/75 to 1987/88, real farm income per head dropped by 28 percent, while real wage income per head in non-agricultural occupations rose by 13 percent in the same period (Agrarbericht, 1989). There are a number of factors behind this deterioration of the farm income situation in Germany. Price developments have contributed to this change in income development. Real producer prices fell by 1 percent annually between 1950/51 and 1974/75, while they decreased by 1.8 percent per year from 1974/75 to 1987/88 (calculated from STJELF, various issues).

Another major factor was the significant deceleration of structural change in German agriculture. As pointed out above, the decline in agricultural labor, which averaged 4.8 percent per annum from 1950/51 to 1973/74, decreased to 2.8 percent per annum for the period 1975 to 1987. A simple calculation can show that if outmigration had gone on at rates which prevailed until the early 1970's, income per head in agriculture would have roughly kept pace with non-agricultural income growth in the second half of the 1970's and 1980's. However, this simplification rests on the rather questionable assumption that this change in outmigration would not have affected aggregate income of the agricultural sector.

Whatever the full explanation for the rather significant drop of real farm incomes since the mid-1970's may be, the consequences of this development for the FRG's agricultural policy were obvious. There was rather strong opposition against policy changes which could further aggravate the farm income situation so the debate about income distribution in agriculture became more acute in west Germany.

There was also a lively debate on the dangers of "factory farms" and the virtues of "family farms". The debate continues today even though it appears that farm and herd sizes which are considered to be of the "factory" type are of the size which in some other European countries would still be considered a small family farm. There is a strong tendency to introduce restrictions on herd sizes and some people would even like to establish restrictions on the growth of acreage per farm. If one looks into the size distribution of herds in west German agriculture, there is no reason at all to be concerned about the emergence of "factory farms" by any standard with the exception of the poultry sector where all restrictions would come too late anyway (Wissenschaftlicher Beirat beim Bundesministerium fur Ernahrung, Landwirtschaft und Forsten, 1983).

However, there is much political interest in the issue, and it may well be that at some stage restrictions on herd sizes could be imposed. It appears that this is becoming a preferred area of agricultural policy action in a time in which expansionary price support runs against the ceiling of public budgets. Restrictions on the growth of farms do not cost public money, but they convey the impression that agricultural policy is active and that it helps the family farm. When aggregate farm income does not grow, pressure to redistribute it towards the smaller farms will increase.

Actual restrictions on farm or herd sizes were not yet imposed in the FRG, but in 1988, the above-mentioned bill for supporting the family farm ("Gesetz zur Förderung der bäuerlichen Landwirtschaft") was adopted which contained the first steps in this direction (Wissenschaftlicher Bierat beim Bundesministerium fur Ernahrung, Landwirtschaft und Forsten, 1989). The immediate reason for adopting this bill was the fact that as of January 1, 1989, the special value added tax (VAT) benefits for farmers, which had been introduced in 1984 in compensation for a revaluation of the green Deutschmark, had to be reduced from five to three percentage points (see below).

In the Brussels Council, the FRG had obtained the right to replace the two percentage points of the VAT benefits by some type of production-neutral payments. These new payments were made on a per-hectare basis (DM 90 per hectare), with a minimum payment of DM 1,000 and a maximum payment of DM 8,000 per farm. The minimum and maximum payments meant that smaller farms receive higher benefits compared to what they received under the VAT benefit scheme.

In addition, eligibility limits were introduced that were related to the absolute number of animals per farm and the number of animals per hectare. The limits per farm are: 120 dairy cows, 400 beef cattle, 1,700 pigs, and 50,000 layers. The limits per hectare are: 4.5 cattle (over 2 years), 21 pigs, and 300 layers (Agrarbericht, 1989). Farms which exceeded these limits were completely excluded from the new payments. This meant that larger livestock enterprises were disadvantaged.

The fact that on this occasion limits were defined for what is considered a "family farm" may well turn out to play a role in future agricultural policy decisions, and in retrospect, this new bill may only be the first move in the direction of putting an agricultural policy brake on further structural adjustments in German agriculture. Another step in the direction of redistributing payments among farms was the introduction in 1985 of additional subsidies to farmers' contributions to the social security schemes in agriculture where smaller farms receive higher subsidies than larger farms.

Environmental Concerns

Growing awareness of environmental problems in agriculture is not surprising in times in which protection of the environment has become a priority issue. Environmental concerns are now a central political theme in Germany, and the rise of the Greens as a political party is both a consequence of, and a reason for, this development.

Heated debates about the relationships between farming and the environment are frequent in Germany and the arguments take various tacks. On the one hand farmers are accused that they damage the environment by using too many chemicals which end up in food and groundwater; that pig and poultry operations emit noxious odors on a large scale; that cutting down hedges diminishes the variety of species in fauna and flora; that draining land reduces the size of natural marshlands, etc. On the other hand, farmers claim that they preserve the countryside, cultivate natural resources and keep the landscape attractive for tourists. At the same time they complain about their crops and their land being damaged by emissions from industry. There is an endless debate about dying woods and acid rain, and a number of measures have been adopted in order to limit the damage done to forests.

The public media often report on these issues, and such environmental concerns in relation to farming receive much more critical attention in the general public than economic issues such as high farm and food prices. "Alternative farming" is a favorite idea of environmentalists and the media, and the role it plays in many discussions is completely out of proportion if compared to its actual quantitative significance (0.3 % of total agricultural acreage) (Agrarbericht, 1988).

There is some truth in both types of arguments, i.e. that farming has some actual and potential detrimental consequences for the environment, but that farmers also provide positive ecological services (Rat von Sachverstandigen fur Umweltfragen, 1985). The debate on these issues is likely to remain lively in Germany for some time to come . It is also likely that this public debate will continue to figure much more prominently than issues such as farm price policy or trade liberalization in agriculture.

The Farm Lobby and Political Parties

Agricultural policymaking in west Germany is still dominated by farmers' interests, rather than by concerns of the general public. It appears that in recent years, the leverage which the farm interest has on agricultural policymaking has increased rather than diminished in spite of the decreasing number of farmers. To a large extent this was a reflection of the relative strength of different political parties after the 1984 elections. The effects have been particularly acute for the Christian Democrats (the CDU) and its Bavarian counterpart, the CSU. Since the 1984 elections, the CDU/CSU has feared loss of the farm vote, and with it the ability to govern in the FRG.

This political trend began with the 1984 election of the European Parliament. In April 1984, milk quotas had been introduced in the CAP, mainly because of pressures from the FRG government (see below). Though the west German farming industry and the DBV had always argued for milk quotas, the actual implementation of quotas raised harsh criticism and much bitterness among farmers. Farmers were upset that milk production was actually cut back under the new quota system and by the way in which quotas were allocated to individual farms. This was not how FRG farmers had imagined a quota system to work.

Disappointment was particularly pronounced among Bavarian farmers, many of whom depend heavily on milk production. A considerable number of Bavarian farmers expressed their anger by returning their CSU membership cards. Moreover, Bavarian farmer groups announced that they would abstain from the European Parliament election, and many of them did.

For the CSU and its leader, Mr. Strauss, this development was a serious shock. As a consequence, Mr. Strauss took the agricultural policy lead in the Bonn coalition government (of the CDU/CSU and the Free Democratic Party) by pressing for even more farmer-friendly policies. As a national newspaper put it, "the absurd political rank which agricultural policy has gained ... in the cabinet of Helmut Kohl ... is largely a result of political remote control from Munich" (Suddeutsche Zeitung, July 9, 1985). However, not only Strauss and the CSU, but also the CDU and Chancellor Kohl began to be convinced that the farm vote was a significant factor in their political fortunes.

The more fundamental reason for this further upswing of the political influence of farmers in the CDU/CSU was the combination of three developments since the early eighties. First, west German farmers were increasingly disappointed with the way in which agricultural policy developed, and they have attributed their deteriorating economic situation to agricultural policy rather than to market developments and the overall economic situation. A

number of farmers began to express their disappointment by abstaining from elections.

Second, simultaneously with the change in farmers' voting behavior, the CDU/CSU began to lose votes in all elections-- at the European, the federal, the state, and the local level. The loss in votes for the CDU/CSU was significantly larger than what could be explained by the failure of some farmers to go to elections. However, farmers were one of the relatively few groups which the CDU/CSU identified as having changed its voting behavior. Hence the CDU/CSU considered it important to regain the farm vote.

Third, at the same time the Greens began to turn up in FRG parliaments at all levels. One important consequence of this development was that the margin of votes between the Social Democrats and the Christian Democrats had narrowed and competition for votes between these two political blocks became even more intense. In such a situation, any identifiable homogeneous group of voters gains political leverage. Farmers are one of the few such homogeneous groups. While it is true that the farming vote is only a marginal percentage, if success or failure in an election depends on one percent of the votes, even marginal groups can become very important.

Though farmers have on many occasions had a more than proportionate political weight in Germany, their influence on political thinking in the CDU/CSU has rarely ever been as pronounced as it was after 1984. This resulted in a large number of farmer-friendly decisions in national agricultural policy in the FRG and a further strengthening of the pro-farmer oriented attitude of the FRG government in Brussels' debates about the CAP.

The increasing weight of the farming interest in FRG policymaking was not effectively balanced by opposing views of other groups in society. The growing ecological concern about modern farming practices has not gone unnoticed. However, it was treated as an important but separate issue, not related to economic matters such as price support and subsidies. When it came to economic issues, the Greens and their political allies were against price pressure on farmers, and they argued for economic measures which would make it easier for small farmers to survive. The only politically important group which recently has criticized excessive economic support for farmers are German industrialists.

Concerns of German Industrialists

Criticism from the side of industrialists was an interesting development. For a long time, FRG industry was silent about agricultural policy matters. This is certainly surprising given the strong export dependence of FRG industry and its interest in a liberal trading system. West German industrialists are particularly concerned about trade wars triggered by protectionist agricultural policies in the EC and the FRG. It is not exactly clear why FRG industry was silent about its interests and concerns for such a long time. To some extent it may have had to do with close personal and family relationships between leading figures in the Bundesverband der Deutschen Industrie (BDI), the association of German industrialists, and in the farmers' union (DBV).

Another factor certainly was (and still is) the fact that some sectors of west German industry, in particular the chemical industry, producers of farm machinery, and some parts of the food industry, are secondary beneficiaries of agricultural protection. However, the situation changed in 1987 and the BDI became an outspoken critic of the CAP. It is not quite clear what made the situation change although an important consideration was that agricultural policy should not be allowed to block progress in the Uruguay Round negotiations.

After an intensive internal debate in 1987, the new president of the BDI, Dr. Tyll Necker, succeeded in revising the BDI's attitude towards agricultural policy. The new position of the BDI was plainly expressed in a document which received wide publicity (Bundesverband der Deutschen Industrie, 1987). In this document the BDI openly criticized, for the first time in its history, the existing agricultural policy. Because of the importance of this change in the position of the BDI, it is worthwhile to consider some citations from the preface of this document.

> "The international reactions to EC agricultural policy are detrimental for the whole economy. The stress which increasing worldwide and EC agricultural protectionism and the international subsidies race place on world trade is alarming. It is certain that all international trading partners can only lose in the long run as a consequence of this policy. The burden on the European political dialogue which results from agricultural policy is depressing. ... Presently there is the danger that EC problems resulting from agricultural policy seriously hamper the completion of the Common Market.
>
> The dependence of farmers on administrative decisions is inconsistent with the guiding principle of the overall economic policy of the Federal Republic--the social market economy.
>
> Industry wants to emphasize the economically harmful misallocation of resources which results from current agricultural policy. The chronic financial calamity in the EC budget, related mainly to agricultural expenditure, handicaps European progress in other areas. Tasks which are important for growth and the future of the Community cannot be advanced. Yet, a large part of public support does not even reach agriculture. A reform of EC agricultural policy must follow the guiding principle: 'Less dirigisme, more market'.
>
> Excessive prices stimulate further production growth, increase surpluses, and result in unbearable financial burdens. It is necessary to separate market and price policy from incomes policy. ... Prices which are better in line with markets, and regional support of German agriculture which is production-neutral are the better and less costly solution.
>
> At the international level, a concerted and balanced reduction of subsidies which stimulate production must be aimed at, in order to avoid distortions of competition and to provide no excuses for maintaining old or introducing new subsidies. We call upon the government of the Federal Republic, the Council of Ministers and the EC Commission, as well as the

governments of other states, above all the USA and Japan, to develop a multilateral solution in the framework of the GATT negotiations."

In the main part of its 25 page document, the BDI provides a careful analysis of the situation of agriculture and of the consequences of agricultural policy. It expresses sympathy with the economic and social difficulties of farmers, but the BDI clearly points out that current agricultural policies are an inefficient and ineffective way of improving agricultural conditions. The negative implications of these policies for the overall economy and for industry are clearly spelled out. The document also argues strongly for moving away from price support and towards direct income aids.

Individual industrialists are now more interested in agricultural policy matters, and the negative implications of traditional agricultural policies for the economic well-being of industry are discussed with more interest. However, it appears that this significant change in the position of west German industrialists has not made much of an impact on the attitude of the German government toward agricultural policy. But the industrialists' position has at least helped to support the position of those people in the Ministry of Economic Affairs who try to act as critical watchdogs in agricultural policy matters, particularly in relation to the ongoing GATT negotiations.

Chapter 2. Germany's Impact on Agricultural Policymaking in the European Community

In the previous chapter, the point was made that the "philosophy" on which the FRG's agricultural policy was based is more protectionist than that of some other member countries in the European Community. This became obvious in the early negotiations on the common level of support prices in the emerging CAP. As described earlier, the FRG's agricultural policymakers tried to push CAP prices as high as possible. The FRG usually argued for particularly high price support and other forms of protection in the Community. However, what is less obvious is the extent to which the FRG was able to influence the overall development of the CAP in a direction which fit the FRG's agricultural policy interest.

It is impossible to quantify the extent to which any individual member country has been able to influence the course of events in the CAP. However, it appears that the FRG time and again was able to exert a particularly pronounced influence on the way in which the CAP has developed. This hypothesis will be illustrated on the basis of four selected examples of strategic decisions taken in the CAP in which it appeared that FRG agricultural policymakers were able to get their views effectively across to the other member countries.

While such individual cases can provide no more than anecdotal evidence, the evidence shows that decisions taken on these occasions were important for the overall development of the CAP. The FRG's influence on these decisions was sufficiently pronounced to conclude that the German "philosophy" on agricultural policy contributed significantly to shaping the general evolution of the CAP.

The Introduction of Green Money in 1969 and Later Modifications1/

The existence of "Green Money" in the CAP, i.e. the use of special exchange rates for agriculture, has allowed Germany to keep its support prices significantly above those in the rest of the Community. The agrimonetary system, and the related monetary compensatory amounts (MCA's or border taxes and subsidies which compensated for the price differences that arose because of differing agricultural exchange rates), were not intended to allow any member country to influence its level of price support in any particular direction, but over time countries gained some degree of control over national prices.

For countries with devaluing currencies, the agrimonetary system resulted in domestic prices below Community prices (negative MCA's or border taxes on exports and subsidies for imports), and in countries with strong currencies the agrimonetary system allowed domestic prices to be maintained above the common price level (positive MCA's or border subsidies on exports and taxes on

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1/ The following three sections are largely based on various issues of Agra Europe (German version) and Agrarwirtschaft.

imports). Since the Deutschmark has consistently been a strong currency relative to other European currencies, the result of the agrimonetary system has been that FRG farmers regularly received prices above the common EC level.

Given the German interest in high farm price support, it is no surprise that German agricultural policymakers have always argued strongly for the Community's agrimonetary system. However, it is also true that the FRG was not the first country where MCA's were used. Because of the historical sequence of currency changes, France was the first member country to introduce compensatory border measures or MCA's, after the devaluation of the french Franc in August 1969.

Immediately after the federal election in the FRG in September 1969, which changed the majority from a CDU/CSU-SPD coalition (the "Great Coalition") to a SPD-FDP coalition, the Deutschmark, which had been under strong upward pressure for some time, was allowed to float. The FRG obtained permission in the Community to establish positive MCA's of up to five percent. After the new government had been formed in October 1969, the Deutschmark was formally revalued by 8.5 percent against its original rate, and MCA's could be applied in accordance with that revaluation.

The agrimonetary system and the resulting MCA's were considered only an interim solution by the EC Commission at the time. The original decision was for negative MCA's in France to be abolished by the beginning of the 1971/72 crop year at the latest. When the Deutschmark was allowed to float and then was revalued, the Commission vainly attempted to prevent the introduction of positive MCA's in Germany. In fact, the Commission originally tried to block German MCA's and suggested that Germany enforce a complete ban on all relevant agricultural imports which would have made MCA's unnecessary.

The FRG, after appealing to the European Court, finally succeeded in obtaining permission to apply positive MCA's until the end of 1969. After that date, the FRG was allowed to introduce national compensation for its farmers through a special relief on the VAT for farmers and through acreage-based payments, co-financed by the Community. While MCA's had not yet become a permanent feature of the CAP, the FRG succeeded in establishing the principle that farmers had the right to be compensated for the effects of currency revaluations.

This principle proved important when in 1971, in reaction to the international monetary crisis and the consequent exchange rate changes, the agrimonetary system was introduced as a permanent instrument of the CAP. After the acceptance of the agrimonetary system, the debate was limited to the level of MCA's and the speed of their reductions through green rate devaluations and revaluations. In these debates, successive FRG governments were successful in maintaining positive MCA's as high as possible. The history of the periodic arguments in the Council and the Commission with the FRG over adjusting German MCA's downwards is full of individual success stories for FRG agricultural policymakers.

The best example of the extent to which the FRG has been able to exert an influence on the way in which the agrimonetary system of the Community was

handled is the "reform" introduced in 1984. This reform, which established the "switchover" mechanism which converted positive MCA's in some member countries into negative MCA's in others through the effective introduction of a new "Green ECU", was a purely German invention.

The FRG Minister of Agriculture had always had political problems with the German farming community when he returned from price negotiations in Brussels only to report that FRG farm price increases were less than the agreed increases in common ECU prices because positive German MCA's had to be reduced. To remedy this problem an official in the FRG Ministry of Agriculture came up with the idea that the FRG Minister would no longer face this dilemma if there were no longer any positive German MCA's. This could be accomplished by converting positive German MCA's into negative MCA's in other member countries. The FRG Minister of Agriculture would no longer come under pressure to reduce positive German MCA's in Brussels and could not be criticized by German farmers for having made a specific German concession to their disadvantage.

The technical solution for this new system was the introduction of a positive "corrective factor" which is applied to the ECU before ECU support prices are converted to domestic currencies in all the member countries. At the time this corrective factor was equivalent to the existing positive German MCA's which were converted into negative MCA's in other member countries of around 3 percent.

Later this corrective factor was to increase in parallel with the exchange rate of the strongest currency in any member country (in effect the Deutschmark), so that no new positive MCA's could emerge. Hence, the value of the new Green ECU was 14.5 percent above the value of the official ECU in July of 1991. This meant that the target level of price support in the Community (i.e. the level of support prices which would prevail if all MCA's were abolished) was higher than it would have been.

This new "switchover" system exerts an automatic upward pressure on CAP support prices. Other member countries, and certainly the Commission, were strongly opposed to building such an automatic upward pressure into the CAP support price mechanism. In spite of its advantage in avoiding the problem of dismantling positive MCA's, the solution was viewed as dangerously inflationary in countries with negative MCA's as well as by the German Minister of Economic Affairs and Finance.

It may well be that at the time the new system was introduced, the consequences of the corrective factor were not fully appreciated although some observers have pointed out these consequences were obvious from the beginning (Petit et. al., 1987). The desire of the FRG to reduce domestic political difficulties over reductions in positive German MCA's finally prevailed over the views of the Commission and of other member countries, and the whole of the Community eventually was effectively led into an inflationary agricultural pricing mechanism.

The FRG government also obtained permission by the Community to grant national compensation for that part of its positive MCA's which it had to dismantle by

January 1, 1985, again co-financed by the Community. In spite of the delicate balance of opinions on this matter in the Council, the FRG government, under pressure from the DBV, broke the rules and decided unilaterally to provide higher compensation than what had been agreed in the Council through a special relief on the VAT for farmers. This was one of the first and most obvious indications of the new fear in the CDU/CSU that they might lose the farm vote.

The particularly surprising but revealing fact was that Mr. Stoltenberg, the then FRG Minister of Finance, was highly instrumental in topping-up farmer compensation on this occasion, though this resulted in a large additional burden on the FRG budget. Other member countries protested but eventually gave in. "The fact that this unilateral decision was not seriously challenged in later Community discussions, and was eventually accepted at the June 1984 Fontainbleau summit, probably reflects the fact that all the actors involved recognized the political difficulties faced by the FRG government and, as a result, accepted the need to modify the compromise" (Petit et. al., 1987).

The Introduction of Milk Quotas in 1984

Growing surpluses on the milk market and the resulting high and rising budget expenditures for this market have been a problem since the inception of the CAP. Consequently, EC dairy policy has always been accompanied by a lively debate about its necessary reform, and a number of diverse reform measures have been taken over the years including measures such as premiums for slaughtering cows, co-responsibility levies on milk production, and a guarantee threshold for total EC milk output.

In this debate, the DBV had long argued against measures which would reduce producer prices, and for the introduction of quotas for milk production on individual farms. One of the arguments used by the DBV was that a quota system was working satisfactorily on the sugar market and that it could be applied equally well to the milk market. The German government had argued for the introduction of milk quotas in Brussels as early as February 1969.

In the confused 1969 debate over reform of EC dairy policy, the then FRG Minister of Agriculture, Mr. Höcherl, had originally proposed a scheme which would have led to a flat rate producer levy of up to 10 percent of the producer price if global EC milk production exceeded a given threshold. In a way, this proposed scheme would have combined two measures which later became elements of the CAP for milk, i.e. the co-responsibility levy and the guarantee threshold.

However, Mr. Höcherl's proposal was strongly criticized by the DBV and by parliamentarians of Höcherl's own political party, the CSU, who correctly regarded such a new levy as a method of reducing the producer price. Mr. Höcherl, who obviously had not co-ordinated with the DBV and members of his party before he tabled his proposal in Brussels, then suddenly changed his proposal by suggesting that the global EC quantum should be allocated on the basis of current actual output to the individual dairies which could then allocate their quota to their farmers.

Through this apparently minor but absolutely decisive modification, the Minister had effectively aligned himself with the milk quota proposal of the DBV, and he argued for it in the same way by suggesting that a solution had to be found similar to that on the sugar market. Thus, the first proposal for milk quotas which a FRG government tabled in Brussels predates the eventual introduction of quotas by fifteen years.

Mr. Höcherl's successor as Minister of Agriculture, Mr. Ertl (1969-1983), a member of the Liberal Party (FDP), was not in favor of farm-level milk quotas which appeared to him to involve too much bureaucracy in agriculture. A completely different view, however, was adopted by Ertl's successor, Mr. Kiechle, a member of the CSU, who took office in May 1983. Mr. Kiechle is from a Bavarian region with much milk production, and had been a dairy farmer and a leading official of dairy organizations in Bavaria. Mr. Kiechle had always subscribed to the view of the DBV that milk quotas were the only way of avoiding price cuts, and as Minister of Agriculture he immediately put this position forward. This is no surprise since quotas are fully in line with Mr. Kiechle's general slogan "quantities down, prices up", a philosophy which is fundamental to his agricultural policy position.

In the Bonn cabinet, Mr. Kiechle had to overcome the skepticism of the Ministers of Economic Affairs and of Finance who were fundamentally opposed to even more government intervention in agriculture. However, his argument that quotas would help to curtail EC expenditure on the milk market soon won support of the cabinet majority.

The sequence of events in 1983 and early 1984, which finally led to the adoption of the so-called CAP reform package, including the introduction of milk quotas on March 31, 1984, has been well documented (Petit et. al., 1987). In formal terms, the first step on the road towards milk quotas was the proposal for CAP reform which the Commission presented to the Council in July 1983 (COM 500). In this document the Commission argued that there were essentially only two ways in which the surplus problem could be solved. Either support prices would have to be cut significantly (by 12 percent according to the Commission, a figure never explained or questioned but which supposedly was based on the guarantee threshold mechanism for milk) or milk production would have to be reduced and constrained through a quota system like that for sugar.

In the following debates in the Council and in the Athens summit of heads of state in December 1983, it turned out that most member states were opposed to milk quotas at the beginning. The only exception was the FRG. The Minister, Mr. Kiechle, had made up his mind that quotas were necessary in order to maintain reasonably high prices (Petit et. al., 1987). The reasons why all the other member states originally were against milk quotas differed from country to country, but in most cases the opposition was pretty strong (Petit et. al., 1987). In the course of the debate, however, more and more member countries gave in. Finally, after a protracted process of confrontations and intense bargaining, the decision was reached to establish a quota system for the EC milk market.

Through this apparently minor but absolutely decisive modification, the Minister had effectively aligned himself with the milk quota proposal of the DBV, and he argued for it in the same way by suggesting that a solution had to be found similar to that on the sugar market. Thus, the first proposal for milk quotas which a FRG government tabled in Brussels predates the eventual introduction of quotas by fifteen years.

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Among observers of the events during this period, there is general consensus that the FRG Minister of Agriculture played a highly important role in this decision process, but that the behavior of the French Minister, too, had a significant impact. "In the events between the publication of COM (500) and the March 31 [1984] decision, Mr. Kiechle and Mr. Rocard seem to have stolen the spotlight; the adoption of the milk quotas as well as the other measures composing the 'package' are largely attributable to the performance of these two leading actors. ... An Orwellian paraphrase stating that all countries are equal but some are more equal than others, would certainly be obvious" (Petit et. al., 1987).

The French government was very strongly opposed to the introduction of milk quotas from the beginning, and--for domestic political reasons--only very late in the process did France change its position and finally support the decision in favor of quotas. This change in the French position in the end was highly instrumental in the tactical process of forming a majority for quotas. Yet it cannot be argued that the introduction of quotas was in the immediate French interest. A high level French official privately said that there was simply no other way to reach a unanimous decision given the determined way in which the FRG Minister was pushing for quotas.

The FRG was the only member country that initially wanted milk quotas and it was successful in moving the whole of the Community in this direction. However, this would probably not have been possible without the determined support of the EC Commission provided by its July 1983 proposal and by its support throughout the whole bargaining process until March 1984.

Not very much is known about the internal debate regarding milk quotas within the Commission during the 1983-84 period except that DG VI (the Directorate General for Agriculture) was very important in this debate, and that the proposal document COM (500) was rather controversial among the Commissioners and was finally adopted by a majority margin of one vote (Petit et. al., 1987). It is not publicly known to what extent the Commission was influenced by the fact that the FRG Minister of Agriculture, and later the FRG government, was so keen to establish a quota system for milk. Irrespective of the source, the introduction of milk quotas certainly is a case which illustrates the important role of the FRG in formulating important decisions in the CAP.

The Blockage of Grain Price Cuts in 1985

Another opportunity for demonstrating his belief that price cuts are not an appropriate way to deal with surplus problems was seized by Mr. Kiechle during the negotiations on the CAP price package for the 1985/86 crop year. In accordance with the guarantee threshold mechanism for cereals, the Commission proposed to reduce cereal support prices by 3.6 percent. Though some member countries were not exactly happy about such a price cut, nearly all of them were prepared to accept it. After all, such a price reduction would have been fully in line with an earlier decision of the Council of Agriculture Ministers since the guarantee threshold mechanism had been agreed as a type of self-imposed restraint by the Council itself in 1981.

The only country which was absolutely not prepared to accept this price cut was the FRG. Mr. Kiechle, who had not yet been in office when the guarantee threshold for cereals was established, strongly argued against any reduction of cereal prices in the Council, pointing out that this was the wrong way to deal with the Community's cereal market problem and that other ways of reforming the CAP for cereals had to be found. On this occasion, Mr. Kiechle had the support of the whole FRG cabinet from the beginning. Even Chancellor Kohl made the FRG's strong opposition to cereal price cuts known in bilateral talks with EC heads of state.

Negotiations on the price package in the Council took even longer than in other years, and the main reason for the impasse, which could not be resolved in seven marathon meetings of the Council, was the FRG's resistance to grain price cuts. Finally the package was taken apart, and decisions on all other measures were taken, except for support prices for cereals (and rapeseed). In order to reach a compromise, the Commission later was prepared to settle for a cereal price cut of only 1.8 percent. However, even that was too much for Mr. Kiechle who would not accept more than a maximum price cut of 0.9 percent.

In the end, the FRG was completely isolated in the Council. The possibility of taking a majority vote was seriously considered. However, at this stage Mr. Kiechle reverted to the "Luxembourg Compromise" which suggested that member countries could veto Council decisions which threatened to violate their "vital" interests.

The FRG had always maintained that the "Luxembourg Compromise" was against the spirit of European integration and that it was inappropriate for individual member countries to block majority decisions. However, on this occasion the agricultural interests overruled the long-run European policy interest of the FRG government, and Mr. Kiechle was given a green light by the cabinet to use the veto option in spite of the European policy consequences which this might have. As a result of this first German veto in the history of the Community, the FRG endangered the reform of Community institutions which had been planned for the Milano summit.

After Mr. Kiechle threatened to veto the grain price cut of 1.8 percent, five member countries (UK, France, Ireland, Greece, Denmark) did not participate in the voting procedure on the grounds that they did not want to question the validity of the "Luxembourg Compromise" even though they were generally in agreement with the Commission proposal.

In the end, no Council decision was taken on cereal prices for the new crop year. Instead, the Commission acted in place of the Council and unilaterally reduced intervention prices for cereals for the 1985/86 crop year by the proposed margin of 1.8 percent. Thus, in addition to strengthening--against overall FRG interest--the validity of the "Luxembourg Compromise", the FRG's opposition to a price cut in cereals had been instrumental in adding a new twist to the already complicated relationship between the powers of the Council and those of the Commission.

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The Introduction of Set-Aside in 1988

In order to reduce pressure for further cuts in cereals price, Mr. Kiechle and the DBV had favored acreage reductions. This strategy was fully in line with Mr. Kiechle's philosophy of "quantities down, prices up". As a first step in this direction, the FRG unilaterally embarked on this option and installed premiums for set-aside in Lower Saxony as an experimental pilot program in 1986. The existence of this program, and experiences gained with it, were later used by the German government to push the Community towards a CAP program for land set-aside.

The debate about a Community program for set-aside was closely interlinked with the negotiations about a stabilizer scheme for cereals in 1987 and early 1988. The FRG government pushed hard for the introduction of Community-wide set-aside and made it a precondition for accepting a stabilizer scheme. In order to convince other member countries, the FRG government raised this issue not only in the agricultural Council, but at various political levels, including the Council of Foreign Ministers and the Summit.

The debate on set-aside was most intensive in the agricultural council. At one point, Mr. Kiechle pushed this debate in a rather interesting direction. He came up with a completely new proposal for the EC cereals market regime. According to this proposal, the mechanism of "financial solidarity" in the CAP would have been significantly changed for cereals, such that each individual member country would have been made financially responsible for additional grain surpluses produced by its farmers. The idea has been succinctly described by the Secretary of State in the Federal Ministry of Agriculture, Dr. Eisenkrämer:

> "A substantial problem results from the current financial system of the Community, which so far does not contain any incentives for adopting, at the national level, measures to reduce production growth, but rather supports the efforts of some individual member countries to pursue an expansionary national farm policy at the expense of the Community budget. For this reason Germany has proposed, for example, for cereals in its function as a guide crop, a mechanism for financial sanctions which would, on the basis of an EC maximum quantity, secure that the governments of member countries actually adopt measures to limit production. Under this mechanism, each member country which does not adhere to the common decisions for market relief would be held financially responsible." (Eisenkramer, 1988 as translated by Tangermann).

The mechanism envisaged by the FRG Ministry at the time has never been described in any detail in public. But it may be that the general concepts behind it were similar to an academic proposal which had been advanced somewhat earlier (Thoroe and Tangermann, 1987).

The idea is rather straightforward. Under the existing "financial solidarity", the shadow price of an agricultural product for any individual member country in the EC is not the world market price but a price close to

the domestic price because import levies flow into, and export refunds are paid out of, the Community's budget rather than the budget of the member country concerned (Koester, 1977). For this reason the incentive for each individual member country to adopt national policies which expand agricultural output is much larger under common financing than it would be under national financing. Incentives for persuading farmers through national measures to produce less are also much weaker than they would be if each individual member country had to finance its own agricultural market policy.

It is therefore tempting to suggest that some link should be established between the volume of agricultural production in each member country on the one hand and the financial contribution of that member country to the Community budget on the other hand (Thoroe and Tangermann, 1977). This would mean that for each extra ton of production over and above some reference quantity, the country where this production occurs would have to pay the equivalent of the export restitution for one ton into the Community budget. "Financial solidarity" would thus be eliminated at the margin, though it would continue to prevail for all fundamental financial flows in the Community.

The FRG Minister's proposal for national quotas obviously went one step further by suggesting that member countries should establish measures such as farm level quotas or set-aside programs in order to adhere to the maximum quantities allocated to them. However, since Mr. Kiechle's proposal also provided for "financial sanctions" in case individual member countries did not stick to their maximum quantities, it could be seen as a new financial mechanism for the CAP.

It has never been clear whether Mr. Kiechle at the time really wanted to establish national quotas and a corresponding new financial mechanism in the CAP, or whether his proposal was mainly a tactical move in his fight for a set-aside program in the Community. It appears that Mr. Kiechle's proposal for national quotas has not really been discussed seriously nor in any detail in the Council. However, it has certainly played an instrumental role in preparing the decision for introducing set-aside in the Community.

In retrospect, the 1987 Kiechle proposal may one day possibly appear as a precursor of a system of mandatory production control for cereals in the CAP. If some member countries should continue to apply the current set-aside program rather loosely, it could well be that German agricultural policymakers revert to Mr. Kiechle's proposal for a quota system because it would be politically difficult for them to maintain a situation where German farmers cut back on cereals production while farmers in other member countries continue to expand (Tangermann, 1989a).

On the set-aside issue, Germany was less isolated in the Council than on the issue of milk quotas. Some other member countries came round to the view that set-aside should be given a chance, though for reasons which in part differed from those considered in the FRG. For example, the United Kingdom joined the FRG relatively early in the Council debate, though not because it saw set-aside as a means of avoiding price cuts, but because it considered it less problematic than other possible alternatives, particularly mandatory supply control.

Other member countries were strongly opposed to set-aside as an instrument to solve the Community's cereals market problem. They would rather have accepted price cuts. These member countries for some time tried to convince the Council that set-aside, if it were introduced, should be voluntary in the sense that each member country could decide whether it wanted to offer such a program to its farmers. However, Mr. Kiechle was, and still is, of the firm and internally consistent opinion that set-aside makes sense only if it has to be offered to farmers in all member countries, and hence he fought strongly for the introduction of such a mandatory scheme.

In the end, set-aside won the day and became an element in the political package of "CAP reform" as adopted by the Brussels summit in early 1988. The introduction of set-aside in the CAP is yet another example of the strong influence which the "philosophy" of German agricultural policy exerts on the fundamental decisions of the CAP.

Chapter 3. Consequences of Agricultural Trade Liberalization for Germany

Given the strong tendencies towards high price support and protection in German agricultural policy, any multilaterally agreed move in the direction of agricultural trade liberalization would significantly change the policy environment for German agriculture. The exact consequences, however, would depend on the nature of the policy changes required and on the extent to which individual policy instruments would have to be changed. Different groups in society would be affected rather differently by such policy changes, and the size of losses and gains has been analyzed in a number of studies. At the same time, there are possibilities for compensation to the losers. These issues will be discussed in this chapter.

Nature and Extent of Policy Changes

The nature and extent of policy changes required for agricultural trade liberalization depends and how trade liberalization is defined. Trade liberalization is not necessarily synonymous with the complete elimination of all agricultural policies. Some policy measures which are arguably not trade distorting may well be maintained. New and additional policy measures may also be introduced simultaneously with trade liberalization in order to support the move towards free trade in agriculture and to enhance its positive effects on the allocation of resources.

The issues to be considered in this context are essentially those which are discussed under the heading of "policy coverage" in relation to defining an aggregate measure of support (AMS) for use in GATT arrangements. As long as this debate about policy coverage has not come to a conclusion, it is impossible to provide a definition of trade liberalization which is precise and practical in the sense of indicating the types of policy changes which may be required as a consequence of the Uruguay Round negotiations. In addition, before multilateral agreement has been reached on the time schedule for policy adjustments, the sequence and speed of policy changes must be considered.

Some types of policy measures are obvious candidates for elimination if true trade liberalization is the goal. Border measures and domestic subsidies/taxes which are used to support domestic farm product prices and isolate them from price developments in international trade are obvious candidates. It is safe to assume that trade liberalization implies, at a minimum, the elimination of price support. This is the operating assumption of most quantitative studies of the effects of trade liberalization. There are rarely any quantitative analyses of the effects of removing other types of agricultural policy measures because it is analytically much more difficult to quantify the effects of non-price policies.

Price support is the dominant agricultural policy measure in the CAP as is obvious from the existing producer subsidy equivalents (PSE) estimates. For most of the major commodities, output-dependent price policies contribute more than 95 percent to overall PSE's as measured in the existing studies (Tangermann, 1988).

These studies have so far excluded national policy measures of the individual member countries and there is no doubt that these national policies add considerably to the existing Community programs, at least in terms of public expenditure. At the same time it is true that many of the national measures are not directly output-dependent, and that a large part of them are therefore potential candidates for exclusion from AMS commitments and, hence, from the set of measures which would have to be eliminated under trade liberalization. Some of these national measures in German agricultural policy will be discussed below in relation to how they could be dealt with in multilateral negotiations.

For the remainder of the present chapter, trade liberalization implies the modification or elimination of price support. The magnitude of price changes which may be necessary in west Germany in order to eliminate all price support will be discussed in the next section in the context of price assumptions made in the study by Braune and Henrichsmeyer (table 3.2 and graphs 3.1 to 3.3).

Losers and Gainers from Trade Liberalization

A number of quantitative studies have looked into the consequences which different agricultural price policies would have in west Germany. For the purposes of this paper, these studies can be classified into three general categories.

First, there are studies which have concentrated on an analysis of economic conditions within agriculture and on the way in which they would be affected by different policies. Such studies have been based on rather comprehensive and complex quantitative models of the farming industry which provide much detail on a disaggregated level. In the context of the present paper, such studies can essentially help to identify losers from agricultural policy reform.

Second, there are studies based on more aggregate models which investigate, along the lines of welfare analysis, the effects of policy changes on the large groups of producers, consumers and taxpayers. These studies provide information, among others, on groups gaining from agricultural policy reform.

Third, the effects of agricultural trade liberalization have recently been studied with the help of computable general equilibrium (CGE) models. Such studies improve our understanding of the implications of agricultural policy changes for other sectors in the economy and for overall economic well being.

Losers: Changes in Farm Income 1/

Given the preoccupation of German agricultural policymakers with farm incomes, it is no surprise that studies on the effects of agricultural policy changes, commissioned by the Federal Ministry of Agriculture before German unification, focused on the implications of policy changes on west German farm incomes.

1/ Helpful comments from Wilhelm Henrichsmeyer on this section are greatly appreciated.

The most comprehensive and detailed study done for the Ministry is that by Braune and Henrichsmeyer (1988). The methodological base of the analysis is a large scale linear programming model of agricultural production, factor and input use, and income, which is differentiated with regard to regions (42 regions), farm size groups (four different size groups in each region), and commodities (32 different production and input activities in each size group). The central aim of this study was to provide projections of the medium and longer term developments of agricultural production and income in west Germany under different scenarios regarding future price policies until 1992 and 2000.

The first price scenario can be called the "restrictive" price policy. Under this scenario, it is assumed that, beginning in 1985, support prices are continuously adjusted such that producer prices are reduced by an annual rate of 3.5 percent in real terms for all commodities on average. Such a price policy would be more restrictive than past price policy. For example, from 1975 to 1985 real producer prices went down by an annual rate of 2.3 percent (calculated from STJELF, various issues). For the "restrictive" price policy, Braune and Henrichsmeyer present results for both 1992 and 2000.

The second price scenario may be called the "rigid" price policy. Under this scenario, the annual rate of decline in real producer prices is 5.5 percent. For this "rigid" price policy, Braune and Henrichsmeyer only present results for 1992.

For individual commodities, assumptions on real price developments deviate from the assumed trend of the average producer price index depending on; 1) expected productivity developments, 2) the respective market situations and, 3) the nature of the market regimes. Price assumptions for individual commodities are reported in table 3.1. Grain and pigmeat prices are assumed to decline more sharply than the average, while prices for the two products under quotas, i.e. sugar and milk, and rapeseed prices, are assumed to decline less than the average.

Table 3.1--Price assumptions made by Braune/Henrichsmeyer: Annual change of real producer prices in Germany

	"Restrictive"	"Rigid"
	Percent	
Rapeseed a)	-2.5	-4.5
Barley b)	-5.0	-7.0
Soft Wheat	-5.0	-7.0
Corn b)	-5.0	-7.0
Sugar	-5.0	-7.0
Milk	-2.5	-4.0
Beef	-4.0 c)	-6.0
Veal	-3.5	-5.0
Pigmeat	-4.5	-6.0

a) oilseeds, b) coarse grains, c) -3.0 from 1992 to 2000.
Sources: Braune and Henrichsmeyer (1988).

To what extent the price developments assumed in this study would bring domestic prices in Germany into line with world market prices, and hence to what extent the scenarios analyzed can be considered to model trade

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Sources: Braune and Henrichsmeyer (1988).

To what extent the price developments assumed in this study would bring domestic prices in Germany into line with world market prices, and hence to what extent the scenarios analyzed can be considered to model trade

liberalization, depends of course on the assumptions one makes on world market prices. Braune and Henrichsmeyer have not looked into this issue since their study was concerned only with domestic price policy. However, one can interpret their scenarios in trade liberalization terms if one adds assumptions on world market prices.

Table 3.2 presents Tangermann's estimates of what the price scenarios studied by Braune and Henrichsmeyer could mean in terms of PSE developments. In addition, graphs 3.1 to 3.3 plot the price scenarios against Tangermann's assumptions about future world market prices.

Table 3.2--Assumptions on world market prices and resulting PSE's in the EC
Annual change of real world market price c)

	Resulting Trade PSE	1992 "Restrictive"	1992 "Rigid"	2000 "Restrictive"
		Percent		
Rapeseed a)	-0.8	38.3	28.7	29.2
Barley b)	-0.8	-13.7	-31.9	-60.7
Soft Wheat	-0.7	5.2	-10.1	-35.1
Corn b)	-0.7	6.4	-8.6	-33.4
Sugar	-0.7	50.5	42.5	29.4
Milk	1	36.0	28.6	15.1
Beef	0	34.5	24.1	16.4
Veal	0	1.7	-9.7	-30.7
Pigmeat	-1	-8.7	-21.4	-44.9

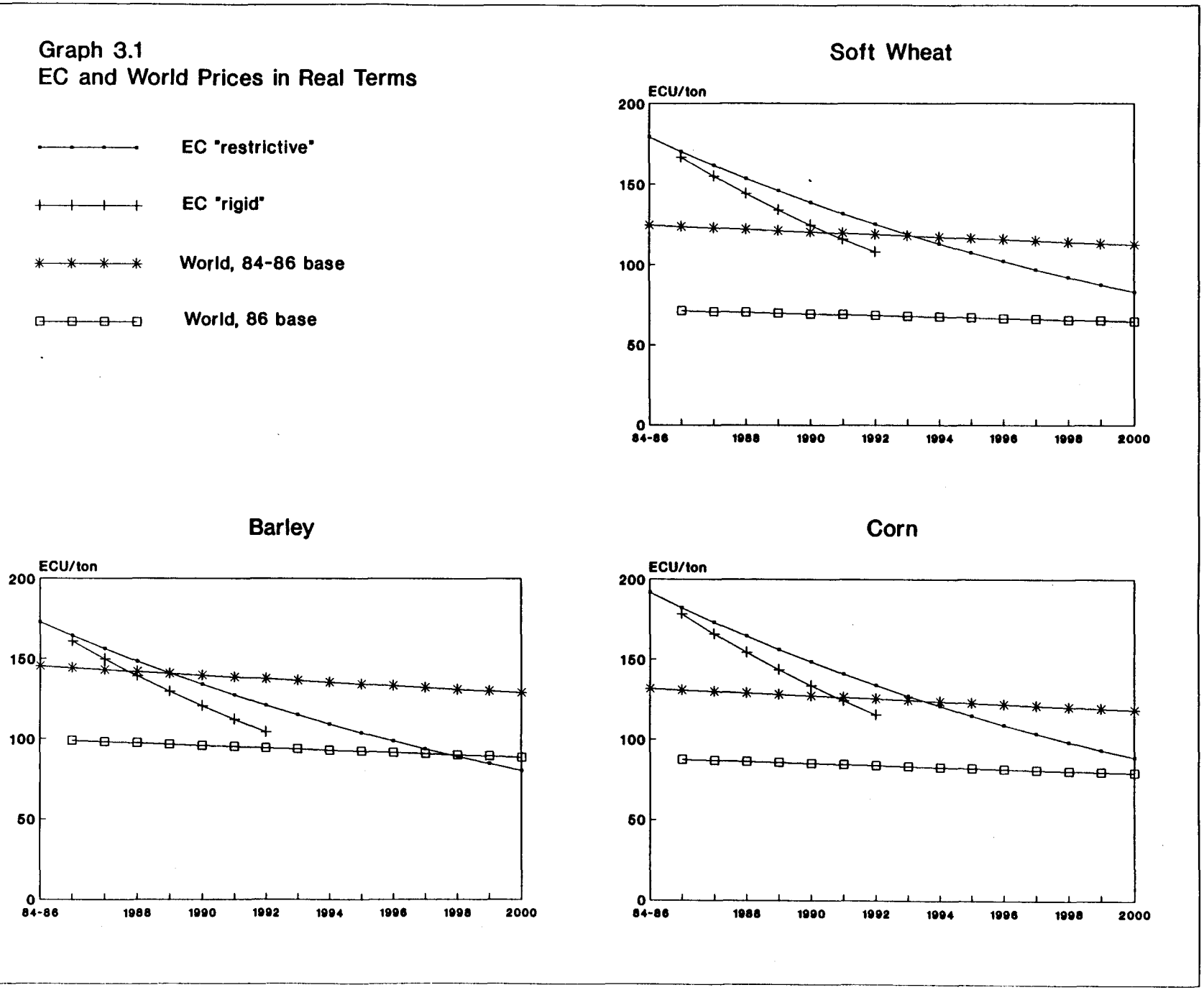
a) oilseeds, b) coarse grains, c) world market prices projected from 1984-1986 base.
Sources: Econ. Res. Serv., USDA, 1988, and assumptions and calculations by Tangermann.

The following procedure has been adopted in making these projections of world market prices. As a starting point, data from the USDA estimates of PSE's for the EC have been used (USDA, 1988). From these data, the average EC producer price for 1984-86 has been calculated in ECU/ton and may not be the same as the base year prices used by Braune and Henrichsmeyer since the latter used German price averages in Deutschmark. The implicit world market price for 1984-86 has then been reconstructed by deducting the policy transfers resulting from trade measures (transfers in millions of ECU, divided by level of production) from the EC producer price.

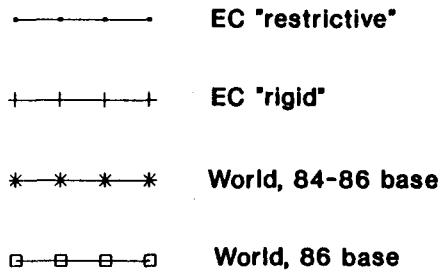
Assumptions on future rates of change of real world market prices are based on the estimates by Scandizzo and Diakosavas (Scandizzo and Diakosavas, 1987). These are derived from trends in the commodity terms of trade ($U.S. commodity prices relative to the U.S. index of unit value of exports of manufactured goods) on the basis of long-run time series for the period 1900 to 1982. Their results for the average annual change in these terms of trade have been used as assumptions on world market price developments for wheat, corn, and sugar as given in table 3.2.

Assumptions on the remaining products have been subjectively set by Tangermann. Though the analysis by Scandizzo and Diakosavas was done in terms of U.S. dollars, it was assumed that the same developments in real ECU terms

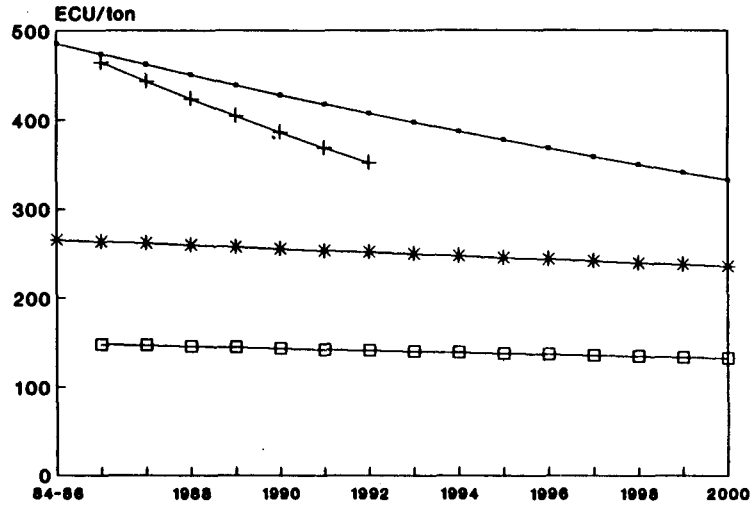
Graph 3.1
EC and World Prices in Real Terms



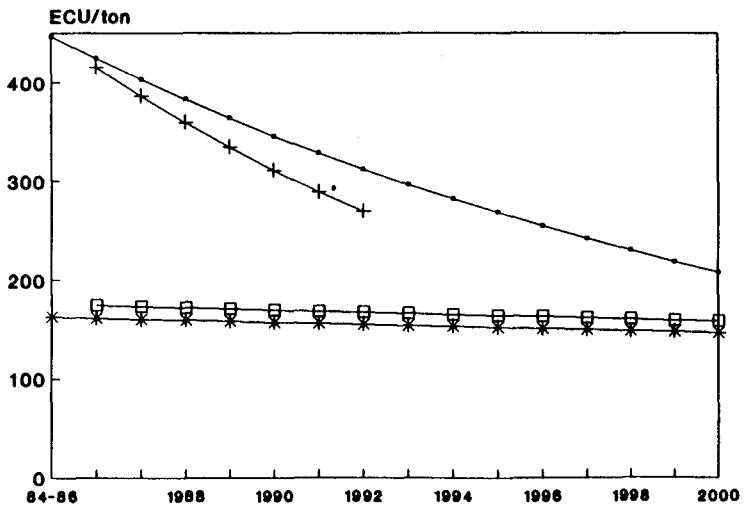
Graph 3.2
EC and World Prices in Real Terms



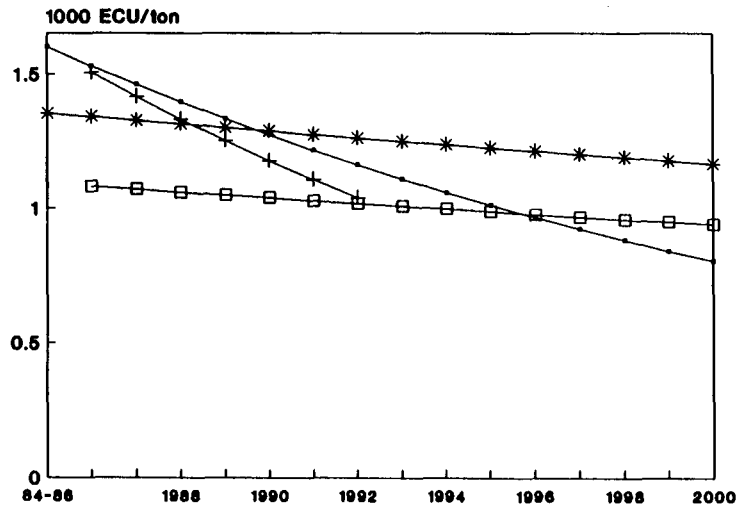
Rapeseed



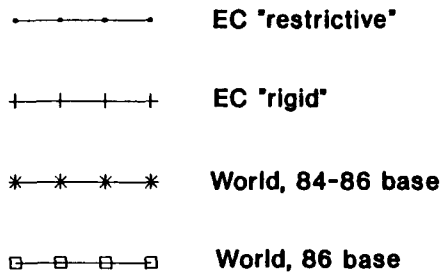
Sugar

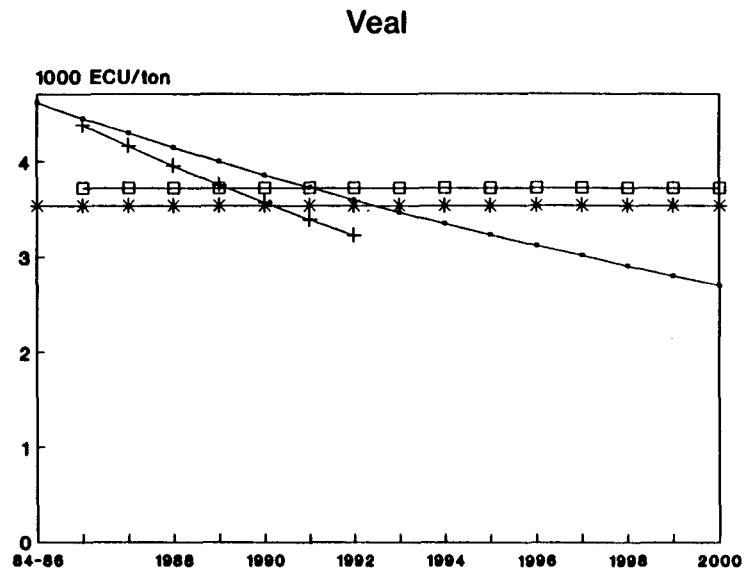


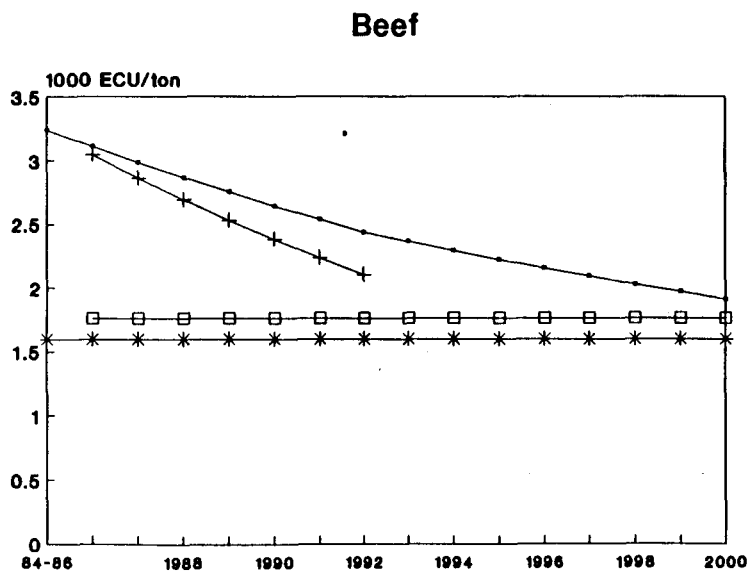
Pigmeat

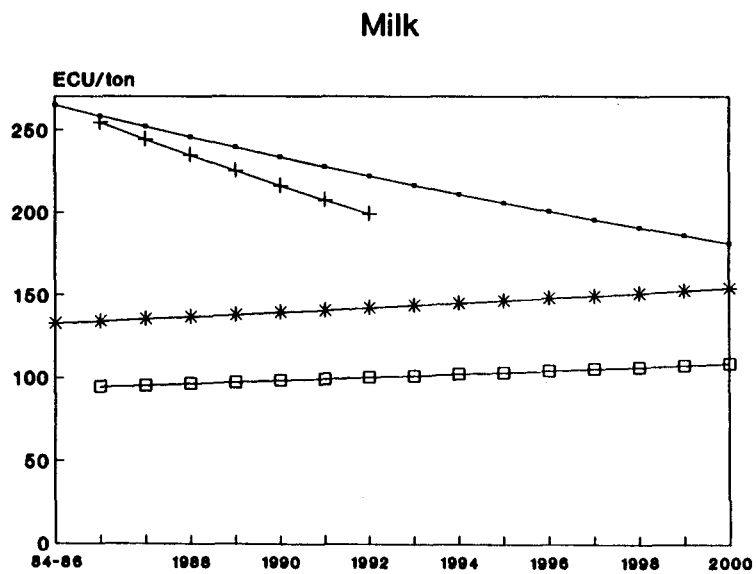


Graph 3.3
EC and World Prices in Real Terms









prevail which would be realistic as long as the ECU/dollar rate develops according to purchasing power parity. On the same grounds, it was considered reasonable to apply Braune's and Henrichsmeyer's assumptions on real price developments in Deutschmarks to the ECU producer prices given in PSE estimates by the U.S. Department of Agriculture.

These projections of world market prices have been made without explicit regard to the possible effects of policy changes. In principle, they should map the trend of world market prices with current policies in the absence of global trade liberalization. If agricultural trade were liberalized as a result of a multilateral agreement, prices in international trade might go up.

It appears clear from a number of analyses that such policy-induced changes of world market prices may be relatively small compared with annual price fluctuations. Hence, in projections of world market prices over some years, it may be difficult to distinguish between "normal" fluctuations and the effects of trade liberalization. It is particularly difficult to decide on the appropriate base period from which to project international prices into the future. As an illustration, two different base periods for world market prices, 1984-86 and 1986, are shown in graphs 3.1 to 3.3.

The PSE's given in table 3.2 have been calculated using world market prices projected from the 1984-86 base. It should be noted that PSE's as calculated here are not the usual PSE numbers, but only the partial PSE's resulting from trade policies which measure exclusively the gap between EC prices and world prices. Overall PSE's would be higher to the extent that structural and other policies transfer income to farmers.

As can be seen from the graphs and from the PSE projections, EC prices, as implicitly assumed by Braune and Henrichsmeyer, would indeed get close to, or even below, world market prices. The tendency for this to happen, under the assumptions made, is particularly pronounced for cereals, pigmeat, and veal.

Domestic EC and west German prices for other commodities would remain well above international prices. Domestic prices for rapeseed, sugar, milk, and beef would still be significantly higher than world market prices, even under the "rigid" price scenario for 1992 and under the scenario for 2000.

The study by Braune and Henrichsmeyer, therefore, does not fully analyze the effects of trade liberalization for west German agriculture. However, the overall level of domestic prices studied in these scenarios may come close to what could be expected under trade liberalization if one considers that world market prices may increase as a result of multilateral trade liberalization. It may not be completely unreasonable to interpret the "rigid" scenario for 1992 and the scenario for 2000 as approximating the effect of trade liberalization.

Selected aggregate results of the study are summarized in table 3.3. Production trends would differ markedly among commodities. Cereal production would go down as a result of price reductions. Oilseeds (essentially rapeseed) production would increase significantly because of the assumed positive price trend for this commodity group. Given the different assumed

movements of cereals and oilseeds prices relative to world market levels (see graphs), trade liberalization would probably lead to smaller price cuts for cereals, but larger price reductions for oilseeds, such that the production trends of these two commodity groups would be less divergent than what is estimated in the Braune/Henrichsmeyer study.

Table 3.3--Aggregate results of Braune and Henrichsmeyer
(Index Values)

	1985 Base	1992 "Restrictive"	1992 "Rigid"	1999 "Restrictive"
Production:				
Cereals	100	100	75	81
Oilseeds	100	191	169	208
Sugarbeets	100	100	100	100
Milk	100	90	90	89
Beef & Veal	100	83	77	57
Pigmeat	100	108	108	116
Factor Use:				
Area	100	90	78	70
Labor a)	100	80	76	64
Net Value Added in Agriculture b):				
Total	100	79	63	56
Per Hectare	100	87	81	80
Per Labor	100	99	83	87
Land Rent per Hectare b)	100	59	32	37

a) full-time equivalents of "labor required" as defined by Braune/Henrichsmeyer.
b) in real terms.
Source: Braune and Henrichsmeyer, 1988.

Production of sugar and milk in the model is determined by quotas. For sugar, no change in quota volume has been assumed. The reduction of milk quotas included in the model is the quota reduction which has taken place since 1986. Under true trade liberalization, profitability of both sugar and milk production would be reduced to the extent that quotas would no longer be binding and production of both sugar and milk would likely go down.

Production of beef and veal would be reduced significantly because of the reduced number of dairy cows in reaction to cuts of milk quotas and lower meat prices. Pigmeat production would increase somewhat because of lower feed costs and because of greater demand for pigmeat due to lower consumer prices.

Labor input would decrease by roughly one-fourth until 1992 under the "rigid" policy scenario, and by one-third from 1985 to 1999 under the "restrictive" scenario. Such reductions in the size of the agricultural labor force may sound dramatic but they are by no means unprecedented.

The projected development of the agricultural labor force would mean a reduction of 3.8 percent annually from 1985 to 1992 under the "rigid" scenario, and a decrease of 3.1 percent annually from 1985 to 1999 under the "restrictive" scenario. Such rates of decline in the agricultural labor force

have been observed for a long time in west Germany and were significantly higher until the mid-seventies (table 3.4).

The projected development of the labor force in agriculture is highly relevant when it comes to assessing future developments of farm incomes. According to the study by Braune and Henrichsmeyer, a "rigid" price policy maintained until 1992, or a "restrictive" policy pursued until 1999, would result in a reduction of total net value added in German agriculture by around 40 percent in real terms. This would be a very significant loss of income for the farming industry, and quite obviously for the industries linked to agriculture and in those rural areas where the farming population is still a major factor. Income per capita in agriculture would decrease much less because of the decline in the agricultural labor force. Net value added per unit of labor in agriculture would decrease by around fifteen percent.

Clearly, under the more gradual reform scenario (the "restrictive" price policy until 1999), the decline in income per capita in agriculture would be less pronounced than under the more rapid type of reform (the "rigid" price policy until 1992) because farmers would have more time to adjust.
The significance of this decline in farm incomes is obvious if one compares it with expected income developments outside agriculture.

Table 3.4--Annual rates of decline of the agricultural labor force a) in West Germany

Period	Annual Rate of Decline
	Percent
1961 - 1965	5.7
1965 - 1970	4.3
1970 - 1975	5.2
1975 - 1980	3.3
1980 - 1985	1.7
1985 - 1988	3.1

a) Full-time equivalents ("Voll-AK").
Source: STJELF, various issues; Agrarbericht, 1989.

In their study, Braune and Henrichsmeyer project an annual increase of real gross wages for workers outside agriculture of 2.1 percent from 1985 to 1992 and 2.6 percent from 1992 to 1999. Under these assumptions, farm incomes per capita would drop to 65 percent of what they would have been had they increased at the same rate as wages outside agriculture. Looked at in a different way, total net value added in agriculture in 1999 under the "restrictive" scenario would be roughly six billion Deutschmarks (in 1985 prices) below what it would have to be if farmers' incomes per capita were to increase at the same rate as gross wages outside agriculture. Hence this sum could indicate an order of magnitude of possible claims for compensation.

The validity of compensation claims would be questionable for at least two reasons. First, it appears that the model used by Braune and Henrichsmeyer does not include all the adjustments within agriculture that would likely occur in reaction to changing economic conditions. Second, even without an

explicit reform of the CAP in the direction of trade liberalization, farm incomes may come under pressure because of the mounting problems on EC agricultural markets. Hence, farmers' incomes may not increase in line with non-agricultural incomes.

It would be wrong to attribute the total decline of farm income relative to non-farm income to any reduction in price support that occurs after a multilateral agreement to liberalize agricultural trade. It would be necessary to forecast the development of farm prices which would occur in the absence of multilateral trade liberalization in order to single out the additional effects of a multilateral agreement.

Income developments as projected by Braune and Henrichsmeyer differ significantly within agriculture. Income effects in different farm size groups averaged across all regions are summarized in table 3.5. Under the "rigid" policy scenario, from 1985 to 1992, real income per labor unit would drop most (by 26 percent) in the largest size group (50 hectares and more), while in the smallest size group (10 hectares and less) real income would even increase (by 6 percent) in spite of the price cuts. These results appear rather plausible since it is usually assumed that larger farms benefit more from price support (von Witzke, 1979).

Table 3.5--Real income per labor unit a) in farm size groups Projected by Braune and Henrichsmeyer

Size Group	1985 Base	1992 "Restrictive	1992 "Rigid"
		Percent	
< 10 ha	100	111	106
10 - 20 ha	100	94	78
20 - 50 ha	100	101	81
> 50 ha	100	91	74
Average	100	99	83

a) Real net value added per labor unit "required".
Source: Calculated from Braune and Henrichsmeyer, 1988.

Such different income effects of policy changes in different farm groups would significantly affect the income distribution within agriculture. Table 3.6 presents Braune's and Henrichsmeyer's results in terms of the income position of different farm size groups relative to average income in agriculture. Per capita incomes in agriculture differ significantly among farm size groups in the base situation (1985). Net value added per labor unit in the largest size group is nearly three times as large as that in the smallest size group. It should be pointed out that income here is only on-farm income; total income differs less between farm groups.

Reductions in price support, however, reduce the income gap between the different size groups. Under the "restrictive" price scenario, incomes are less unequal among farm groups in 1992 than they were in 1985, while under the "rigid" price scenario, the spread is even further reduced.

Table 3.6--Income per labor unit a) in farm size groups relative to average income in agriculture

Size Group	1985 Base	1992 "Restrictive"	1992 "Rigid"
		Percent	
< 10 ha	65	73	84
10 - 20 ha	73	70	70
20 - 50 ha	116	119	114
> 50 ha	180	166	162
Average	100	100	100
Std. Deviation b)	46	39	35

a) Real net value added per labor unit "required".
b) Standard deviation of the four index values above.
Source: Calculated from Braune and Henrichsmeyer, 1988.

Another dimension of much political interest is the regional implication of agricultural policy reform. The projected development of real value added per labor unit in different states ("Bundesländer") of west Germany is summarized in table 3.7. At this level of disaggregation, there is not much difference between different regions of west Germany. Regional income changes under the different policy scenarios would not diverge much from the aggregate income changes in west Germany. From a political point of view, it may be interesting to note that agricultural income in Bavaria tends to suffer most from cuts in support prices. However, the income difference between Bavaria and other states is not really large.

Table 3.7--Net value added per labor unit a) in different German States

	1985 Base	1992 "Restrictive"	1992 "Rigid"
		Percent	
Schleswig-Holstein	100	101	82
Niedersachsen	100	97	81
Nordrhein-Westfalen	100	99	87
Hessen	100	97	79
Rheinland Pfalz/Saar	100	101	85
Baden-Württemberg	100	102	88
Bayern	100	99	78
Germany, Total	100	99	83

a) Real net value added per labor unit "required".
Source: Calculated from Braune and Henrichsmeyer, 1988.

Since the implications of the different scenarios do not differ very much among the different states, the relative positions of the states vis-a-vis the average for west Germany do not change significantly. Table 3.8 presents index values relative to the German average. From this table, the very significant North-South differential in agricultural income per capita in west Germany is obvious. In 1985, value added per labor unit in Schleswig-Holstein (i.e. in the north) was nearly 70 percent above that in Bavaria (i.e. the south). However, the spread among states does not change much under the different scenarios.

Income implications of the different policy scenarios differ markedly at the more disaggregated level of the 42 individual regions distinguished in the Braune/Henrichsmeyer study. For example, under the "rigid" policy scenario, changes in real net value added per labor unit from 1985 to 1992 vary between a gain of 5.1 percent in the wine-producing region of Badisches Rheintal and a loss of 34.7 percent in Franken und Oberpfälzer Wald, a dairy and cereal area.

Table 3.8--Net value added per labor unit a) in German States relative to average in Germany

	1985 Base	1992 "Restrictive"	1992 "Rigid"
		Average for Germany = 100	
Schleswig-Holstein	140	143	138
Niedersachsen	122	120	119
Nordrhein-Westfalen	107	108	113
Hessen	101	99	97
Rheinland Pfalz/Saar	98	100	101
Baden-Württemberg	85	88	91
Bayern	83	83	78
Germany, Total	100	100	100
Standard Deviation	19	19	8

a) Net value added per labor unit "required".
Source: Calculated from Braune and Henrichsmeyer, 1988.

Gainers: Changes in Consumer and Taxpayer Welfare

While farmers would lose from agricultural trade liberalization, consumers and taxpayers would gain. The extent of these gains, as well as the size of the overall loss to agriculture, has traditionally been studied with the help of partial equilibrium welfare analysis. One such study for the European Community as an aggregate, as well as for individual member countries, has been provided by Buckwell, Harvey, Thomson and Parton (BHTP) (Buckwell et. al., 1982). The base year for their estimates was 1980. Unfortunately, it appears that no other comprehensive study that specifies the taxpayer and consumer effects of agricultural trade liberalization in west Germany has been published more recently.

The BHTP model includes production and consumption of 16 commodities- all cereals, sugar beet, beef and veal, pork, poultry, eggs, butter, cheese, skimmed milk powder, cream, and condensed milk. Supply and demand estimates are based on assumed matrices of own and cross-price elasticities. Changes of world market prices are derived from assumed supply and demand elasticities in the rest of the world.

According to BHTP, complete agricultural trade liberalization in the EC, i.e., removal of all CAP price support, would have resulted in a reduction in the index of real producer prices of 38.3 percent from the 1980 base. This is slightly higher than the 37.2 percent reduction estimated in the Braune and Henrichsmeyer study under the rigid price assumption. As a result of the corresponding decrease of production and increase in consumption, the degree of self-sufficiency in west Germany would have dropped from 96 to 63 percent.

The total loss of annual farm income in west Germany resulting from this price reduction would have been 6.5 billion ECU (1 ECU=$1.392). West German taxpayers would have saved 2.7 billion ECU per year and the annual consumer gain would have been 9 billion ECU. Annual overall economic welfare in west Germany would thus have increased by 5.2 billion ECU. This overall welfare gain would have amounted to "only" around 0.9 percent of west German GDP in 1980. However, there are few individual policy changes which can increase overall welfare by a similar magnitude.

The overall welfare increase from trade liberalization results from the fact that consumers and taxpayers pay more than what farmers receive from existing price support. According to BHTP, west German taxpayers and consumers lost 1.8 ECU for each ECU which west German farmers gained. A large part of this welfare loss could be saved through some other form of income transfer to farmers which would not distort production and resource allocation decisions.

Among all individual member countries of the Community, the FRG would have derived the highest welfare gain from liberalizing the CAP. Nearly half of the aggregate EC welfare gain which could have been made in 1980 by liberalizing the CAP would have accrued to the FRG. In per capita terms, FRG gains would have been much higher than in any other member country. German taxpayers and consumers would have made an annual gain of 469 ECU per head, while the average gain in the Community (EC-9) would have been 321 ECU. In the Community on aggregate, taxpayers and consumers paid 1.5 ECU per ECU received by farmers.

The reason why west German gains from liberalizing the CAP are particularly high is because the FRG was a net importer of agricultural products and because the degree of self-sufficiency in west Germany (96 percent in 1980 according to BHTP) is below that in the Community on average (112 percent). This means that west German taxpayers are making net contributions to the disposal of surpluses generated in other member countries.

According to BHTP, these net contributions of west German taxpayers were equivalent to 0.89 billion ECU in 1980. Moreover, west German consumers are paying high internal EC prices for imports from EC member states rather than lower world market prices. The resulting income transfer from German consumers to farmers in other EC member countries was 0.85 billion ECU in 1980. Thus the total cost to the German economy of pursuing agricultural policy in a Community framework rather than with a national policy was equivalent to 1.74 billion ECU in 1980.

In other words, a significant part (roughly one third) of the total welfare gain which the FRG would have made from liberalizing the CAP would have resulted from eliminating the income transfers which flowed from west German consumers and taxpayers to farmers in other member countries. Looked at from a different perspective, when the FRG government pressured Brussels to raise CAP support prices, the FRG transferred even more income to farmers in other member countries. For marginal price changes the effects are even more pronounced than for total liberalization. According to BHTP, with a small uniform price increase, west German taxpayers and consumers lost 2.24 ECU per ECU gained by German farmers.

In the BHTP study, it was assumed that only the EC liberalized its agricultural policy. If other countries liberalized their agricultural policies, world market prices would increase by more than what was implied in the BHTP study. Hence, both the loss in farm incomes and the gain in consumer welfare would be smaller although the reduction in the taxpayer burden would not change with complete liberalization.

Since the FRG was still a net agricultural importer, the overall welfare gain would have been smaller than under unilateral EC liberalization. However, it would still have been positive and significant. Moreover, because both production and consumption have grown since 1980, and because EC prices have increased, the absolute magnitude of the results would now tend to be higher than it was in 1980.

Spillover Effects: Overall Economy

While the studies cited in the two preceding sections were exclusively concerned with the agricultural implications of farm price policies, a study by Dicke, Donges, Gerken, and Kirkpatrick (1988) looked into the effects of agricultural policy on the overall economy in the FRG. The model designed and used by Dicke, Donges, Gerken, and Kirkpatrick (DDGK) is a general equilibrium model for the west German economy, derived from the Australian ORANI model (Dixon et al., 1982). The model has 13 sectors (agriculture, food processing, coal mining, seven manufacturing, and three service sectors). Agriculture is treated as one homogeneous sector.

Some of the model's characteristics include rigid real after-tax wages and, by implication, determination of employment by labor demand according to nominal gross wages; full mobility of labor and capital between sectors although with final wage rate and interest differentials between sectors; differentiation between skilled and unskilled labor; imperfect substitutability between home and overseas goods; small-country assumption for FRG imports and large-country assumption for FRG exports; constant nominal government expenditure on goods and services; a balanced government budget with an endogenous direct tax rate; and an exogenous balance of trade surplus with an endogenous exchange rate.

In the study, two different policy scenarios are analyzed; agricultural liberalization, and full liberalization in all sectors of the FRG economy. Under agricultural liberalization, both border protection and domestic subsidies are removed. Border protection for agriculture in the base year (1980) is assumed to be equivalent to the nominal rate of protection of 54 percent derived from the Anderson and Tyers estimate (Anderson and Tyers, 1987). This appears to imply that DDGK have assumed that the PSE resulting from trade measures is around 35 percent. This would be roughly in line with the USDA estimate of the overall PSE for all products in the EC for the 1982-86 average (USDA, 1988).

In addition, the DDGK study apparently assumed that domestic subsidies to FRG agriculture are around 70 percent of the protection provided through border measures (Dicke et al. 1988). The total PSE for FRG agriculture in the base situation, according to the study, would then appear to be around 60 percent.

This would be significantly higher than estimates for the total PSE in the EC provided by USDA and OECD. Hence, the reduction of value added in FRG agriculture, as assumed by the study in its liberalization runs, may be significantly higher than what one would expect on the basis of available PSE estimates. The DDGK study also assumed that world market prices for agricultural products would rise by 10 percent when the FRG liberalized because other countries were implicitly assumed to liberalize their agricultural trade as well.

The macroeconomic effects of both agricultural and full liberalization in the FRG, according to the DDGK study, are summarized in table 3.9. West German GNP would increase by 3.3 percent if agricultural protection in west Germany were eliminated. This overall gain is very large, much larger than estimated in any of the partial equilibrium studies. Indeed, it is surprising to learn that removal of protection in a sector with no more than two percent of total GNP could boost overall GNP by more than three percent.

Table 3.9--Macroeconomic results of the DDGK Study

	Percentage Changes in Variables	
	Agricultural liberalization	Full liberalization
Macroeconomic variables:		
GNP	3.3	9.0
Real income	2.5	6.9
Real consumption	2.7	7.9
Aggregate imports and exports	5.1	24.8
Real exchange rate [a]	-1.8	-4.7
Employment of unskilled labor	3.8	10.2
Employment of skilled labor	4.0	11.7
Real wages after tax[a]	0.0	0.0
Real wages before tax[a]	-0.1	-8.8
Consumer price index	-1.8	-4.7
Government finance:		
Average direct tax rate	-0.2	-17.7
Direct tax revenue	1.4	-20.4
Revenue from direct and indirect taxes	-2.4	-20.4
Subsidies excl. export subsidies	-9.5	-94.8
Government expenditure	0.0	0.0
Real government expenditure	1.7	3.7

a) Defined with respect to the consumer price index.
Source: Adopted from Dicke et. al., 1988.

In purely technical terms this is not impossible, since it could well be that people are retained in a sector where value added per worker is low (or even negative). If these people were released to other sectors where they actually made a positive contribution to value added, GNP could increase by much more

than the loss in the protected sector. Moreover, since the tax burden on other sectors and on consumers is reduced, economic activity in the country concerned may expand significantly.

Nevertheless, it seems surprising that such a relatively small sector as agriculture should be able to hold back an entire economy to such an extent. It is even more surprising that liberalization of agriculture would achieve more than one-third of the overall gain in GNP which could be made if all sectors of the west German economy, including other highly protected sectors as coal mining, iron and steel, and textiles and clothing, were liberalized.

Another interesting result of the DDGK study relates to the overall employment effects of agricultural protection in the FRG. According to the study, aggregate employment in Germany would increase by 3.8 percent for unskilled labor and by 4.0 percent for skilled labor if agricultural protection were removed. In absolute terms this would mean the creation of 850,000 new jobs in west Germany if agricultural trade were liberalized. If this expansion of employment were actually achieved, west Germany would reduce its massive unemployment by around two-fifths.

The fact that agricultural protection could reduce overall employment has been indicated by a number of general equilibrium studies. The study by Stoeckel (1985) on the macroeconomic effects of the Common Agricultural Policy, and studies on other countries summarized by Stoeckel (1988), generate similar results. Such results run counter to one of the main arguments for agricultural protection advanced by the farm lobbies and agricultural policymakers. Agricultural support is necessary because it contributes to the protection of jobs in agriculture which would otherwise be lost. Such arguments have been advanced vigorously since overall west German unemployment has risen to such dramatically high levels (around 9 percent) in the 1980's. Intuitively, this argument is rather convincing, and nearly every debate on agricultural policy in west Germany raises this point.

However, for an economist it is not surprising to find that protection retards rather than creates employment. Protection reduces the efficiency of the economy and its international competitiveness. Yet, it is not easy to get this message across to the general public because the economic relationships which cause this result are rather complex. One major factor behind the economic growth that occurs because of agricultural trade liberalization is an increase in aggregate demand (table 3.9). Real government expenditure on goods and services expands because the government saves on subsidy payments and has higher tax income. Moreover, private real consumption increases in part due to a reduction in the consumer price index. However, increasing real consumption is also caused by higher overall income which results from growing production in all non-agricultural sectors except food processing (table 3.10).

Expanded non-agricultural output also increases employment. This is a result of two main factors: 1) wage costs to industry are reduced (real wages before tax), and 2) the real exchange rate depreciates (by 1.8 percent) leading to expanded exports and import substitution.

Table 3.10--Sector results of the DDGK Study

Production sector:	Percentage Changes in Output				
	Liberalization Agricultural	Liberalization Full	Labor Demand	Consumer a) Demand	Land
1. Agriculture, forestry, and fishery	-24.7	-15.4	23.8	3.8	17.2
2. Food processing and beverages	-10.3	-1.1	-10.3	2.0	-
3. Coal mining	5.4	-64.5	5.5	1.5	3.6
4. Iron and steel	7.8	5.8	7.9	2.1	-
5. Basic commodities	5.7	16.1	5.9	2.1	-
6. Aerospace	7.5	-25.3	7.6	0.0	-
7. Electrical engineering, data processing	9.0	30.8	9.2	1.2	-
8. Metal working and mechanical engineering	5.3	18.2	5.4	1.3	-
9. Clothing and textiles	15.1	-24.9	15.3	2.2	-
10. Other consumer goods	4.2	8.9	4.4	1.3	-
11. Construction and housing	2.8	11.1	3.2	2.6	-
12. Market services	3.4	8.7	3.7	3.8	-
13. Non-market services	1.8	4.1	1.8	1.7	-

a) As relative wages are held constant, skilled and unskilled sectoral employment alter in the same proportion to overall sectoral employment.
Source: Adopted from Dicke et. al., (1988)

The consequences of agricultural liberalization for the non-agricultural sectors are probably the most interesting results of the DDGK study. As already mentioned, it was only recently that west German industrialists have begun to criticize the CAP. Earlier lack of criticism by industry may have been caused by insufficient insight into the way and the extent to which agricultural protection affects the economic well-being of industry.

Agricultural liberalization would even lead to pronounced output expansion in "troubled" industries such as coal mining, iron and steel, and clothing and textiles (table 3.10). Even more important in an economic context are the significant output increases which would occur in such important sectors as electrical engineering, data processing, metal working, mechanical engineering, and aerospace.

The volume and structure of German foreign trade would also change significantly, as shown in tables 3.9 and 3.11. In nearly all non-agricultural sectors, the volume of imports would go down and exports would expand. The output and export expansion in non-agricultural sectors, as estimated by the DDGK study, is a striking indication of the extent to which agricultural protection taxes other industries in west Germany.

In addition to the results of partial analysis studies concerning the overall gain in economic welfare and GNP which would result from agricultural trade liberalization in west Germany, the general equilibrium study by DDGK identifies those industries which would be the major beneficiaries of agricultural policy reform in the FRG. From these results, it is obvious that German economic policymakers should contribute towards a successful outcome of the Uruguay Round negotiations on agricultural trade liberalization, and that

individual industries in the Germany economy should also have a strong incentive to press for agricultural policy reform.

Table 3.11--Sectoral Trade Shares and Changes Resulting from Agricultural Trade Liberalization as Estimated by DDGK

	1980 Shares in Percent and Percentage Changes in Variables					
Production Sector:	1980 Share of: Imports a)	Exports b)	Volume of: Imports	Exports	Price of: Imports	Exports
Agriculture, forestry, and fishery	7.7	.7	33.9	-33.0	-44.0	15.5
Food processing and beverages	5.8	4.0	71.9	2.3	-11.8	-1.1
Coal mining	.4	1.0	-9.6	2.9	0	-1.5
Iron and steel	3.9	6.1	-3.5	9.2	0	-1.4
Basic commodities	39.7	18.9	-.4	5.4	0	-1.1
Aerospace	1.0	.5	.7	6.6	0	-1.3
Electrical engineering, and data processing	6.9	9.5	-1.8	14.4	0	-1.4
Metal working and mechanical engineering	10.6	32.0	-4.7	7.3	0	-1.5
Clothing and textiles	6.9	3.4	-15.3	6.6	0	-3.3
Other consumer goods	7.5	7.0	-6.4	2.8	0	-1.4
Construction and housing	1.6	2.3	.4	1.3	0	-1.3
Market services	8.0	14.3	.5	3.2	0	-1.6
Non-market services	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.

a) Import price in domestic currency including tariffs: Foreign prices are fixed.
b) Foreign currency export price including the effect of any export subsidies.
N.A.= Not available.
Source: Adopted from Dicke et al., 1988.

Could Gainers Compensate Losers?

The results of both the partial and the general equilibrium welfare analyses show that there would be a significant overall welfare gain for the FRG if the CAP were liberalized. In terms of sectoral income distribution, this means that non-farmers gain more than what farmers lose. In aggregate terms there is no doubt that agricultural policy liberalization would easily create the means to compensate farmers for their income losses. Since non-farmers' gains are larger than farmers' losses, either farmers' incomes could be raised after liberalization, or non-farmers' welfare could increase, or both.

The issue of compensation for farmers is not whether it can be done, but how it can be implemented in practice. This is a purely political question, loaded with sensitivities (see Tangermann, 1989c). Like farmers in other countries, and possibly even more so, west German farmers argue that they do not want to live on welfare payments. This became very obvious when the first detailed proposal for direct income aids to farmers was published in the FRG (Koester and Tangermann, 1976), and it was again demonstrated when the Scientific Advisory Council to the Federal Ministry of Agriculture issued a report which argued against a specific incomes policy for agriculture (and in particular against price support) and suggested that farmers in need could turn to the general social welfare scheme available in the FRG (Wissenschaftlicher Beirat, 1982). The reaction of west German farmers to

such proposals was plainly hostile and the authors of these proposals have been anathematized for a long time.

The political issue of how to compensate farmers for any income losses resulting from price cuts is not so much one of developing schemes which exactly offset the effects of prices cuts without distorting production and investment decisions, but one of finding ways to achieve compensation which do not look like welfare. Probably the best way of doing so is to develop programs which arguably pay farmers for something they do, rather than paying farmers for not doing anything.

One such possibility is to pay farmers for giving up the "right to produce". This is essentially what happens under the recently introduced set-aside scheme. However, such schemes have the disadvantage that, since they reduce the market surplus, they trigger political demands for price increases in later rounds. A better alternative is to pay farmers for leaving agriculture. Early retirement payments, introduced in the CAP mainly because of pressure from the FRG, is one example of a sensible policy.

A different approach, which can easily be combined with payments for leaving agriculture, is to pay farmers for preserving the environment. In principle, such payments should be highly regionalized and closely linked to activities which improve ecological conditions in the individual regions. However, from the point of view of finding a politically feasible means of compensating farmers for income losses resulting from significant price cuts, it may be worth considering schemes which are less specific and more generous in income terms. One context in which such considerations may be important is in defining the policy coverage for an Aggregate Measure of Support in the context of GATT arrangements. Some of the issues involved will be discussed in somewhat more detail in chapter 5.

Chapter 4. The "German Approach" to Multilateral Agricultural Policy Reform

The results of studies presented in the previous chapter have shown that west Germany could make significant overall economic gains if agricultural trade were fully liberalized. Moreover, there is no doubt that the export-oriented sectors of Germany have a strong economic interest in a successful overall outcome of the Uruguay Round negotiations. This is even more true with the financial needs of German unification (see Chapter 6). Hence, to the extent that the success of the Uruguay Round depends on progress in agriculture, German negotiators should have every incentive to work constructively for a positive approach towards agricultural trade liberalization.

Agricultural interests have usually carried the day in the FRG as described in chapters 1 and 2, and west Germany is strongly opposed to liberalization of trade in agricultural products. As indicated earlier, west German farm incomes would come under significant pressure if the level of price support in the European Community had to be reduced significantly, at least in the short and medium run. Given the relatively unfavorable development of farm incomes in west Germany since the middle of the 1970's, there is strong and increasing resistance against any further pressure on farm incomes. From this perspective, it is no wonder that German agricultural interests argue strongly for at least maintaining the current level of price support.

German political efforts still concentrate on internal CAP decisions and on specific German policies. GATT matters do not figure very prominently in the German agricultural policy debate. However, neither the DBV nor the Minister of Agriculture have been completely silent about the Uruguay Round negotiations. It is therefore possible to make a few statements regarding their thinking about agricultural policy reform in relation to multilateral negotiations on agricultural trade.

The Position of the Farmers Union

The DBV has critically commented on all EC proposals for the agricultural negotiations in the Uruguay Round. After pointing out that German agriculture is in major difficulty because of unfavorable income developments, and because of further pressure due to policy adjustments in the CAP, the DBV warns the EC Commission and the Council of Ministers not to use the GATT negotiations as another lever to put pressure on agriculture. "Trade policy, too, must make a contribution towards fulfilling the commitment of the Landwirtschaftsgesetz and the Treaty of Rome."1/

More specifically, the DBV cites a number of claims:

- "In all international negotiations, the structural differences of agriculture in all parts of the world, which have developed historically, have to be taken into account;

1/ All quotes and citations in this section are from Deutscher Bauernverband, 1987 and were translated by Tangermann.

- the instruments of the CAP, in particular the regulations, restitutions and levies, must not be the subject of international negotiations;

- integration of imports of all substitutes, as well as oils and fats, into the import regime of the Community, with the objective of better market stability;

- liberalization of international trade is not a sufficient motivation for trade negotiations. The specific situation of agricultural production (dependence on weather, rhythm of production, perishability of many products, inelastic demand) requires government efforts for stabilizing markets and prices, without which agricultural policy objectives cannot be obtained;

- the 'free' world market for agricultural products is no more than a residual market on which all trade partners want to sell their surpluses recklessly. The DBV invariably maintains its view that a way out can only be found in a framework of international arrangements. A pure market economy orientation cannot be realized because of the great influence of temporarily strongly fluctuating demand from centrally planned countries and because of the strong market position of large trading companies and parastatal boards. The DBV invariably maintains its view that centrally planned countries should not acquire agricultural products from western countries below certain minimum prices;

- acknowledgement of measures which stabilize the internal EC market as "advance concessions" for stabilizing world agricultural markets. In the GATT negotiations this has to be taken into account in solving open questions (e.g. substitutes)."

In the remainder of its statement, the DBV then comments on individual elements of the EC proposal. In doing so, the DBV repeatedly emphasizes its request for including cereal substitutes, oilseeds, and protein crops in the protective system of the CAP. However, the DBV expresses its doubts as to whether cuts in domestic CAP support prices are an appropriate negotiating offer for finding acceptance for "balancing EC markets" among the Community's negotiating partners.

The DBV repeatedly warned the Commission against using the GATT negotiations as a way of lending force to the Commission's attempts at reducing support prices in the Community. It feels that the Commission uses the international trade negotiations as an alibi for pushing through its 'Greenbook policy' of price pressure internally in the Community (Commission of the European Communities, 1985). Finally, the DBV warns against making PSE's a negotiating instrument:

> "The underlying basis of this measurement instrument,'world market prices', depends on so many uncertainties and inaccuracies (e.g. currency changes) that it lacks any measure of objectivity. Moreover, there are doubts whether past efforts of the Community towards reducing

its production (e.g. introduction of quotas) can be gauged at all with this instrument. Aids and subsidies exist also in the industrial sector, as for example for coal, steel and aircraft. Since no efforts are currently made in the GATT to implement PSE calculations for these sectors as well, an isolated application of these calculations to agriculture has to be rejected."

It comes as no surprise that a farmers' union in a country where agriculture is as highly protected as it is in Germany should have such skeptical views on international efforts to liberalize agricultural trade.

The Position of the Minister for Agriculture

The German Minister of Agriculture has not been very outspoken on current GATT negotiations. Like most other people in German agricultural policy he concentrates on current CAP issues and on domestic German agricultural policies. However, on various occasions he has made it clear that his position on the Uruguay Round negotiations is not very far from that of the DBV.

It is clear that farmers and agricultural policymakers in Germany have a tendency to strongly resist any major move towards true liberalization of agricultural trade. On the other hand, German agricultural policymakers have had to learn that past agricultural policies have had a number of undesirable results and that the current policies cannot be continued without adjustments. The German perspective on agricultural policy reform is more determined by domestic concerns than most countries.

It is the development of domestic EC markets and the emergence and growth of surpluses in an increasing number of agricultural products in the Community that is at the core of agricultural policy concerns in Germany. The fact that world markets for agricultural products do not offer much hope for expanding EC exports significantly is becoming understood in Germany. However, it is not so much the implications of EC surpluses for international trade, but domestic financial consequences which have triggered the reluctant preparedness to consider agricultural policy reforms in Germany.

Budgetary problems in the CAP remain in spite of all the allegedly new mechanisms like "stabilizers" and "budget discipline", which in reality are not really new at all (Tangermann, 1989). Farmers and agricultural policymakers in Germany are much impressed by the financial difficulties of the CAP which have arisen after 1983, and by the consequent major political attempts to embark on what is incorrectly considered a fundamental "reform" of the CAP, that there is still sufficient sense of urgency in German agriculture. Therefore, it would be wrong to think that German agricultural policy is not prepared to consider any further changes to the CAP.

The type of policy changes which the German agricultural community might be prepared to accept are certainly not in the direction of true agricultural trade liberalization. Which types of policy adjustments would come closer to the thinking of German agricultural policy makers? Given the German preoccupation with the domestic consequences of agricultural policies and the

lack of interest in and feel for international implications, the nature of acceptable policy adjustments would be defined primarily from the point of view of how they could solve the Community's agricultural policy problems without doing too much harm to farmers.

Whether and how such policy adjustments could also be integrated in the framework of multilateral trade negotiations would appear to be a secondary concern for German agricultural policymakers. It would appear to be useful to look into the types of agricultural policy adjustments which might come close to German thinking in the agricultural community before later considering the way in which German agricultural policymakers might want to influence GATT negotiations so that their domestic concerns are taken into account.

The credo of the German Minister of Agriculture, Mr. Kiechle, is to "essentially orientate production in the European Community to the needs of 320 million consumers".2/ In other words, Mr. Kiechle's view is that Europe's farmers should produce no more, but also no less, than what domestic consumers in the European Community will buy. His arguments for this orientation are:

- "Only then can one reckon on a stabilization of domestic prices for agricultural products;
- only then will it be possible to avoid trade conflicts on world markets which would be disadvantageous for everybody;
- only then can we avoid the export of cash money which we can better use at home;
- only then can agriculture shake off the reputation of wasting money."

One of Mr. Kiechle's slogans is "produce less". According to him, there are only two ways to reach this, "either drastic price cuts, or direct quantity reductions, i.e. limitations at the source". It is clear that he dislikes the first alternative, and he hastens to make the point that "in Brussels, we have fought for direct quantity limitations, for milk as well as for crops". The adoption of such a strategy fits one other slogan of Mr. Kiechle: "quantities down, prices up".

In relation to the set-aside program introduced in 1988, Mr. Kiechle argues that set-aside is "an offer to farmers: non-production is remunerated". In explaining why there is no alternative to set-aside, he argues that "for farm quotas for cereals there is no accountability bottleneck in the marketing channel, but there is no support in Brussels for national quotas". The remark on cereal quotas for individual member countries obviously relates to the corresponding proposal made by Mr. Kiechle during the 1987 CAP debate about introducing set-aside.

2/ Citations and quotes are translations by Tangermann of a 1988 press statement by Minister Kiechle.

Mr. Kiechle's view on future developments in agricultural policy is that "besides quantity controls and remunerating farmers for less production, the only other options are alternative uses for production of agricultural products and direct income aids in order to help agriculture in the fight against surpluses and income problems". He points out that the German government is making considerable efforts to promote research on the use of agricultural commodities as renewable resources for industrial purposes and energy production. However, he also notes that agricultural products are not yet competitive with fossil fuels.

With regard to direct income aids, the position of the German Minister for Agriculture is interesting. He has strongly argued that "general direct income aids cannot replace price policy for the following reasons:

- Since savings in expenditure on market regimes are not sufficient to make the necessary means available, budget appropriations would have to be raised dramatically. In the EC, it would not be possible to reach consensus on this. Equally, the complete or partial re-nationalization of income transfers, as proposed by some people, would not find agreement.

- Agricultural incomes would increasingly become dependent on public budgets and the struggles for allocating public funds which are always scarce.

- Policymakers, administrators, and farmers would be confronted with nearly unsolvable questions as to how to allocate funds. This also applies to the criteria currently discussed, such as for example the number of family workers, acreage, or returns in a base year.

- Other groups in society would feel disadvantaged vis-a-vis an agriculture with incomes guaranteed by government."

Mr. Kiechle points out that price cuts, with or without direct income transfers, are not an acceptable approach for solving agricultural policy problems. He feels that farmers need sufficient prices for their products in order to be adequately remunerated for their capital input and their labor. He also believes that as long as the scope for agricultural price policy is limited because of surpluses, agriculture increasingly needs other forms of income-enhancing support.

In spite of these critical remarks about direct income aids as an agricultural policy option, Mr. Kiechle has pointed out that "direct income aids and other government measures have been steadily expanded." He pointed out in 1988 that the west German government spent 8,300 Deutschmark per farm through the agricultural security system (Kiechle, 1988). The dilemma between the philosophical aversion to substituting direct aids for price support on the one hand, and the political desire to let farmers know that the German government is coming to their aid in times of pressure on farm prices on the other hand, has not yet been settled in German agricultural policy.

The preferred strategy for future agricultural policy in Germany can be roughly summarized as:

- keeping support prices as high as possible;

- where resulting surpluses can no longer be sustained, for financial reasons or because of threatening trade conflicts, support prices should not be cut, but production should somehow be reduced through either; 1) direct farm level quotas where technically feasible, as in the cases of milk and sugar, 2) paid reduction of inputs, in particular acreage set-aside, or 3) paid extensification for environmental purposes;

- increasing diversion of agricultural production capacity away from traditional markets, into the production of renewable resources;

- if all these measures are not sufficient to secure an acceptable development of farm incomes, direct aids may have to be used to a larger extent; such aids should come in a form which does not smack of social welfare; in principle the German government is prepared to finance such direct aids out of its national budget.

German Preferences for GATT Arrangements

It has been emphasized above that these views about what should happen in future agricultural policy in Germany are primarily determined by domestic considerations. In that sense they cannot directly reveal what German agricultural policymakers would like to see happen in the Uruguay Round. Moreover, when it comes to making statements about agricultural negotiations in the GATT, even German agricultural policymakers cannot completely lose sight of the fact that they are constrained both by non-agricultural interests in Germany and by the views of governments in the other member countries of the European Community. Preferences for future agricultural policy developments expressed by German agricultural policymakers are probably a useful guide for speculating about what German agricultural policymakers would like to achieve in the agricultural negotiations of the Uruguay Round if they were not constrained by influences from other sectors and other EC member countries.

Quantity versus Price Approaches

Preferences for direct quantity controls, as often pronounced by German agricultural policymakers, reflect a profound mistrust of market forces in agriculture. The idea that prices should be allowed to guide agricultural production does not find any support in these quarters. When it comes to international markets for agricultural products, this mistrust of market forces is even more pronounced, and world market prices are considered irrelevant.

Minister Kiechle certainly does not believe that developments on world markets should be allowed to influence domestic markets for agricultural products. So, free trade would be unthinkable for him. According to a 1985 speech, Kiechle does not even believe that the world market price is any kind of measure for

the agricultural policy of the European Community (Kiechle, 1985). In the speech, Mr. Kiechle also claimed that this "imaginary and strongly fluctuating price" is completely distorted through an endless number of public interventions, and, that for important commodities, the world price is not nearly in line with production costs in low-price countries, let alone costs in the United States. He continued by saying, "World market prices are generally either the result of production costs in 'coolie countries' with expropriation of human labor, or they result from subsidized surpluses which cannot be sold on domestic markets - be it the USA, Canada, Australia or New Zealand - and are sold with direct or indirect subsidies, on the so-called world market."3/

Opposition to world market prices would, according to Mr. Kiechle, be valid even if the EC Commission promised that income problems would be alleviated through direct income aids. A policy of massive price cuts might in the long run achieve market balance, but in the eyes of Mr. Kiechle only few of those now working in agriculture would live to see that since price cuts over several years in a row would ruin the majority of farmers.

From this perspective there is no point in comparing domestic prices with world market prices because the calculation of rates of protection is a useless exercise. The logical conclusion is that rates of protection are not a sensible thing to negotiate in international trade talks. For most people in the German agricultural community, it is unthinkable that the European Community, or any other country for that matter, should be prepared to bind its domestic agricultural prices in any way to international prices in multilateral negotiations.

The official position of the German government regarding negotiations about using some type of aggregate measure of support appears to be somewhat in contradiction to this perspective. However, as will be discussed below, there is a particular type of logic in German thinking about the current negotiations which reconciles these seemingly contradicting positions.

The "German approach" to agricultural negotiations in the GATT (assuming the farming lobby and agricultural policymakers controlled the negotiations), would not be based on the notion of removing the gap between EC and world market prices. But German agricultural policymakers would probably agree that the international trading system needs improvement since they are aware that continuing problems in agricultural trade would trigger undesirable trade conflicts. However, their approach would not favor trade liberalization.

In line with their preferences for particular types of domestic agricultural policies, German agriculturalists may be inclined to argue for agreements which would bring the quantities traded under control. In particular, they might be prepared to agree that aggressive export subsidization, which leads to a belligerent capturing of export markets, is both unfair and uneconomical and that it should not be possible without limits.

3/ Kiechle may have mentioned the United States because of an earlier proposal by the Commission to bring CAP prices in line with domestic U.S. prices.

However, the political argument in Germany is not always consistent on this point. Though the suggestion is often advanced that certain markets belong to certain traders, German agricultural policymakers are not unhappy about increasing agricultural exports from Germany. Whenever the latest trade statistics become available, Minister Kiechle usually takes the opportunity to comment about increasing agricultural exports from Germany and points out that this export performance proves both the efficiency of the German farming and food industry and the success of German agricultural policy:

> "When it comes to agricultural exports, the Federal Republic is going strong. She is the fourth largest agricultural exporter in the world. ... German agricultural exports to western countries are distinguished by quality and specialty. ... Around twenty percent of returns of German farmers come from food exports. How much farmers depend on sales outside our borders is shown by the degree of self-sufficiency in important agricultural products. In the past year it has been 106 % for wheat, 124 % for sugar, 118 % for beef, and 105 % for milk" (Kiechle, 1989).

On such occasions, there is usually no mention of the fact that such exports depend on subsidies and that they cause serious economic problems both domestically and internationally. In the eyes of German agricultural policymakers, exports from their own country are a good thing while exports from other countries are a potential threat to a well-functioning international market system. However, the multi-faceted nature of political argumentation, and the differences of wording, emphasis, and sometimes even substance among speeches to different audiences is a common phenomenon, and probably should not be taken too seriously.

The existing pride in growing agricultural exports from Germany is not at all comparable to the French philosophy that their agricultural exports have a major, if not central, role to play in the overall economic development of France. In Germany there is nothing which would even remotely resemble the French philosophy of the "divine right to export" in agriculture. Moreover, German agricultural exports consist more of processed agricultural products than raw materials.

In spite of the occasional positive domestic remark about agricultural exports from Germany, it is probably true in multilateral trade negotiations that German agricultural policymakers would be prepared to end the battle for markets in international agricultural trade. Hence, some type of a multilateral solution by which all countries were assured their "natural" markets, without having to fight for them through a doubtful price mechanism, would probably come close to German thinking. What would likely be sought by German agricultural politicians is an extension of their domestic philosophy to international trade. Since they feel that the price mechanism does not result in an acceptable outcome, they would naturally prefer quantity control.

Keeping CAP Mechanisms Intact

There is a second closely related element in what might be the "pure" German approach to agriculture in the GATT. According to thinking in the German

agricultural community, each country should be free to pursue its domestic agricultural policies. It may be necessary to impose constraints on the extent to which domestic policies cause international difficulties. Hence, it may be unavoidable to agree on certain trade implications of agricultural policies. However, each individual country should then be allowed to pursue its own domestic agricultural policies as long as the trade implications of these policies remain within the agreed limits.

German agricultural policymakers would certainly not want to forego the right to stabilize domestic market prices for agricultural products independent of world market developments. A two-price system, where domestic prices are kept above, and independent of, international prices would appear to be an absolute essential in the eyes of German farm policymakers. In more technical terms, this means that the EC system of variable levies and export restitutions is sacrosanct from the German point of view. It is not without pride that the remark is often made in Germany that the device of variable levies was a German invention.

The "positive" implications, for domestic price formation, of this type of market regime are fully in line with that element of German agricultural philosophy which maintains that world market prices are irrelevant for the farming industry. It is unthinkable for German agricultural policymakers that German farmers should ever be exposed to the vagaries of world market prices, even if it were only the movements of international prices and not their level.

In CAP jargon, the system of variable import levies and export restitutions is often paraphrased as the principle of "Community preference". In technical terms import levies and export restitutions would not have to be variable in order to guarantee EC farmers preference over farmers in other parts of the world since fixed tariffs and export subsidies would also ensure that EC farmers receive higher prices than those prevailing on world markets. The view goes unchallenged in the domestic agricultural policy debate in the Community that there needs to be a fixed threshold price below which supplies from abroad cannot enter the Community market in order to guarantee EC farmers the desired preference.

The principle of "Community preference" is usually taken to imply a regime of variable levies and its concomitant on surplus markets, variable export restitutions. Since this principle is always considered to be one of the three "pillars" of the CAP (the other two being "unity of the market" among member countries, and "financial solidarity"), there is generally strong support in most member countries for not giving up this principle in international negotiations.

In Germany, this principle is considered so fundamental that no negotiations on it would appear acceptable. Statements like "Community preference as a constituent pillar of the Common Agricultural Policy must be maintained" (Kittel, 1989) are a common element in statements by German agricultural policymakers about the Uruguay Round negotiations on agriculture.

Closing the Loophole in the CAP

A third highly important element in the German position on the Uruguay Round negotiations is the desire to "close the loophole in the CAP" that allows imports of cereal substitutes, meals and cakes, and possibly oilseeds and vegetable oils into the EC. It is felt in Germany and in some other EC member countries that the scope for lowering price support in the cereals sector is severely limited by the fact that "substitutes"4/ come in so freely into the EC market. There is almost no discussion about agricultural policy in Germany in which this issue is not raised, both by farmers and by agricultural policymakers.

Farmers are generally upset since they feel that the "open flank" of the Community's agricultural market regime undermines any attempt at stabilizing the domestic EC cereals market. They cannot see why they should have to compete with what they consider inferior products substituting for home-grown cereals. Agricultural policymakers often make the point from today's perspective that the arrangements made in the Dillon Round of the GATT, which established open entry for substitutes, were a mistake. Consequently, the Uruguay Round is seen by many people in Germany as the historical opportunity to correct the imbalances which have resulted from earlier GATT negotiations. It is impossible to overestimate the importance attached by German agricultural policymakers of finding a solution to the "substitutes problem" during the Uruguay Round negotiations.

Given the enormous weight of this issue in the German agricultural policy debate, it is necessary to make a few more comments although it will not be possible to cover this subject with any degree of comprehensiveness. The economic merits and drawbacks of doing something about the "substitutes problem" need not be discussed here since there is a rather comprehensive study on the economic and political consequences of finding a balanced solution to the "open flank" problem in the CAP (Koester, et. al., 1988). Moreover, a number of studies have looked at these issues from the specific German perspective (Wissenschaftlicher Beirat, 1985). What is more important in the context of the present study is the political background to the debate about substitutes in Germany.

There are three specific issues which should be considered in an attempt to understand the German position on the "open flank" problem. First, there is the question of why German farmers think differently about substitutes than farmers in some other member countries. Second, there is the question of why this issue figures so prominently in German agricultural policy debate.

4/ The term "substitutes" is often not clearly defined in the agricultural policy debate. It always includes energy-rich non-grain feeds such as manioc, sweet potatoes and brans. It usually includes more protein-rich items such as corn gluten feed. It is less clear whether oilcakes and meals are also included, and sometimes the term is used so broadly that it includes oilseeds, fats and oils. In what follows, the term "substitutes" is deliberately used vaguely in the same way that it is used in the agricultural policy debate unless it is explicitly defined in the text.

Third, it is important to understand why this issue is such an important item on the agenda from the German perspective for this current round of GATT negotiations.

It may be somewhat surprising that west German farmers should express much of an interest in reducing the availability of substitutes on EC markets. After all, of total EC imports of cereal substitutes (including corn gluten feed, but excluding oilseed meals and cakes, according to the definition in Annex D of the common market regime for cereals), one-quarter to one-third goes to Germany (Agrarbericht, 1989), and around one-quarter of German livestock production is based on feeds imported from third countries (Winterling, 1986). From the above, one would assume that the German farming industry would have an interest in maintaining access to imported feeds which play such an important role in German livestock production and which, because of their low prices, should only increase the profitability of livestock operations in Germany. From this point of view one, would assume that the German farming industry should join the Dutch opposition against limiting access to low priced feeds, and argue strongly against changing the current import regime for substitutes.

An assumption that west German farmers should oppose restrictions on cereal substitutes would overlook three important aspects of the German situation. First, a large part of German livestock production is based on mixed farming systems, where livestock operations and crop production are combined on the same farm. This means that there is a large number of farmers who use cereals grown on their own farm for feeding their livestock. As long as prices for livestock products on EC markets are relatively depressed because of the availability of cheap imported feeds, farmers with mixed operations find that the implicit returns from their cereals production are depressed to the extent that they use these cereals in their own livestock production. Since these farmers tend to be the majority of German farmers in terms of numbers, if not in terms of the volume of their livestock production, their views prevail over the interests of the highly specialized livestock producers which benefit from the availability of cheap feeds.

This is certainly different from the Dutch situation where highly intensive livestock operations based on purchased feeds have a much higher weight in the overall farming structure. Moreover, in Germany there is a number of large crop farms which are highly specialized in cereals production and these farmers have no interest whatsoever in cheap feeds. On the contrary, their interest is in high cereal prices. These farmers see their interests undermined by the availability of low-priced substitutes which tend to constrain the scope for higher price support for cereals and other crops. These farmers have traditionally played an important role in the German farming lobby, and their views have often dominated those of the more livestock-oriented sectors in the German farming industry.

Also, use of cereal substitutes in German livestock production is highly concentrated in northern German regions close to sea ports. Consequently, the "substitutes problem" has also become an issue in the struggle between different regions.

Farmers in areas more distant from sea ports complain about unfair competition from livestock producers in northern Germany who have access to cheap imported feed. Since the number of farmers who have access to low-priced imported feeds because of geography is much smaller than the number of farmers who make less use of substitutes in their feed rations, the political balance tends to lean towards the interests of farmers who would rather see the availability of substitutes reduced. In a country like the Netherlands, where the geographical distribution of different types of farming activities is much less uneven than in Germany, regional differences about the desirability of access to cheap imported feeds are less pronounced.

There is also a tendency to downplay the political and economic interests of highly intensive livestock operations in Germany. The national mood is generally opposed to "factory farming" because of fundamentalist currents in German agricultural philosophy. Typical examples of "factory farming" are large poultry operations and highly intensive pig operations which are located in those northern German regions in which the use of substitutes is most pronounced. It is probably true that the availability of cheap feeds has contributed to the establishment and growth of such operations. However, this factor is probably less important politically than the fact that the mood is now generally against such types of farms.

The recent introduction of the "bill for the support of peasant agriculture" (Gesetz zur Förderung der bäuerlichen Landwirtschaft) is an indication of this political trend in Germany. In a situation like this, large and highly intensive livestock operations are generally regarded with much suspicion, and their interest has little weight in the agricultural policy debate. These farms also have the strongest interest in maintaining access to cheap imported feeds. However, since the general mood is against them, they find it difficult to be heard.

The <u>second</u> reason why the substitutes issue figures so prominently in the current agricultural policy debate in Germany has to do with both the overall difficulties of the CAP and the specific German attitude as to how to overcome them. Surpluses have grown so dramatically, and the resulting financial burden has become so unbearable, that reform is unavoidable. CAP reform has generally negative implications for farmers because farmers experience price cuts and more price cuts are expected.

Because of the restricted financial situation in the CAP, there is not much scope to pursue agricultural policy actions which might look positive from the point of view of farmers. Everything is geared to restrictive policies, and farmers feel threatened from all sides. Hence, there is enormous political pressure to engage in some actions which offer hope for farmers. The political temptation to engage in something that could be viewed positively by farmers and not cost public money is irresistible. Restricting the availability of substitutes on EC markets is one of the few potential actions that satisfy these criteria. So it is not surprising that policymakers have seized the opportunity to make this one positive promise to farmers.

The temptation to restrict substitutes in Germany is even more pronounced than in the rest of the Community given the German approach to CAP reform. The

German approach is to reduce quantities produced in order to gain scope for continuing high price support. However, if there is an "open flank" through which imported products can enter Community markets, the strategy of reducing EC production in order to support domestic prices is severely undermined. The strategy of "quantities down, prices up" requires a closed system. If markets were open to inflows from abroad, even in the form of substitutes, the concept is not workable.

German agriculturalists also believe that it is better to do something about quantities than to cut prices. This easily lends support to the view that the quantities coming into the EC market should be restricted. Such a strategy would also be in line with Mr. Kiechle's view that the EC should not expand its costly exports but that the domestic EC market should be reserved for EC farmers.

It would be politically difficult to get the message across to farmers that they should reduce their production if any drop in domestic production is potentially outweighed by increased imports. German farmers tend to argue that if they have to reduce their output, it would only be fair to request that foreign suppliers should also reduce their shipments to the EC. This attitude is even more prevalent after set-aside was introduced into the EC because of German pressure. German farmers feel that they are making a determined contribution to what should be a general effort to reduce cereals production in the EC. They are unhappy that farmers in other member countries have not begun to make a proportionate contribution. They find it completely incomprehensible that continued or even expanded imports of substitutes could be allowed to overwhelm their efforts at securing a better balance on the EC cereals market.

It is politically imperative for Germans to argue for restrictions on substitute imports and it does not matter whether the economics of the case are really sound. What appears to be largely overlooked in the German debate is that restrictions on substitutes would probably provide only limited breathing space. For many years, imports of cereal substitutes into the EC have been essentially stagnant at around 15 million tons a year. Although they have surged somewhat because of fuller integration of Spain and Portugal into the Community, large increases in the near future are not expected. Consequently, a binding at the current amount of substitute imports would not alleviate the actual market situation very much. Any reduction in the current volume of substitute imports would have a one-off effect which may reduce the EC cereals surplus by a volume roughly equivalent to the reduction in the volume of substitute imports by channeling more EC grain into feed rations. This may provide scope for a small increase in EC cereal prices.

However, everything else would go on as before after this had been achieved. The necessary annual decrease in EC cereal prices would have to continue at the same rates as in the absence of restrictions on substitute imports. This was pointed out by the German Scientific Advisory Council (Wissenschaftlicher Beirat, 1985) which also indicated that the existing self-restraint arrangements on manioc made it difficult to do anything else on manioc.

It would appear that any reduction of substitute imports would at best provide a rather limited breathing-space without changing the underlying trend in agricultural market conditions in the European Community. This fact appears to be completely ignored by most German farmers and agricultural policymakers who seem to believe that the CAP could enter into a completely new era if it were possible to do something about substitute imports. Accordingly, there are enormous hopes among German agriculturalists that something could be achieved on substitutes.

There is yet a third reason why the substitutes problem is such an important item on the German agenda for the current round of GATT negotiations. Apart from the arrangements with Thailand and other suppliers of manioc, there have been several attempts at "closing the loophole". For example, in 1983 the Commission wanted to negotiate restrictions on exports of corn gluten feed to the EC. There is also a long history of attempts at introducing a consumption tax on vegetable oils in the EC.

The German government has generally been guarded in these debates. In fact, the German government has always opposed introducing a tax on vegetable oils, and German opposition appears to be a major reason why such attempts have failed. Why is it, then, that Germany now attaches such great importance to do something about substitutes in the Uruguay Round negotiations?

The earlier FRG opposition to further restrict substitute imports, and to the introduction of a consumption tax on vegetable oils, was not based on agricultural policy considerations. Agricultural policymakers in the FRG were always keen to reduce the availability of cereal substitutes and they would also have been happy to see the EC agricultural budget relieved through a tax on vegetable oils. FRG opposition to the proposed tax originated in the Ministry of Economic Affairs which was concerned about the negative overall trade consequences which could result. The Minister of Economic Affairs took the US arguments against EC restrictions in the substitutes and oilseeds sector seriously and was afraid that if the EC adopted such measures, the United States might retaliate and thereby damage US-EC trade relations. The Economics Ministry of course was afraid that German exports might suffer in the end.

Contrary to most other agricultural issues on which the views of the Minister of Agriculture usually prevail in the FRG cabinet, the Minister of Economics managed to carry the day. The argument that unilateral EC action would violate the Community's GATT obligations and that the Community could, therefore, not pursue such measures without prior agreement with the United States (which could not be won on earlier occasions) convinced the cabinet that it should not allow the Minister of Agriculture to agree to such measures in Brussels. Moreover, the FRG government had maintained its general line that GATT obligations had to be taken seriously and that international law had to be respected.

The case is different now that a new round of GATT negotiations has begun. Germany would probably still not agree to unilateral introduction of restrictions by the EC. However, the German government would find it difficult to argue that one should not even try to discuss the "rebalancing"

of EC agricultural markets in a wide-ranging set of negotiations, as long as it is clear that one would not act without having reached a multilateral agreement.

There is a need to explain to farmers in Germany and other EC member countries why the European Community should be prepared to negotiate a significant reduction in agricultural support. For the U.S. Administration, the domestic political situation is much easier in this regard. U.S. farmers tend to believe that they would eventually gain from a global liberalization of agricultural trade, even if this would also mean that the support they currently receive from domestic US policies would have to be reduced. Hence, it may be easier for the U.S. Administration to argue for a universal reduction in, if not complete elimination of, agricultural support.

EC farmers in general, and most German farmers, are convinced that they can only lose from a global reduction in agricultural support. The EC's GATT proposal should offer a reduction in agricultural support for more general trade reasons and take another step in the direction of reforming the CAP. There is thus a political need to include something positive for EC farmers in a GATT package which otherwise looks terrible from the perspective of EC agriculture.

The need to include at least one positive element in a GATT package is imperative for Germans. German farmers are absolutely horrified by the prospect of agricultural trade liberalization. If one wants to prevent German farmers and the German Minister of Agriculture from losing all interest in the agricultural negotiations of the Uruguay Round, one has to provide them with at least one potentially positive element in the negotiating package. This element is the hope for improvement in the substitutes sector. This was the view of the German Ministry of Economic Affairs when they finally accepted, contrary to their earlier opposition, that "rebalancing" of the CAP could become an item on the list of the EC proposals for the Uruguay Round negotiations.

It is still true that the German government, including the Minister of Agriculture, would not argue for unilateral action by the EC on these issues. Contrary to the view of many German farmers, the German government is still committed to avoid violations of GATT obligations. It therefore wants to use the occasion of the Uruguay Round negotiations, and the possible reshuffling of GATT rules on agriculture during these negotiations, as an opportunity to gain the legal right to somehow reduce imports of substitutes. It would have been difficult for the Ministry of Economic Affairs to argue that the possibility of doing something about substitutes should not even be considered in the negotiations.

Given all these factors it should not come as a surprise that the substitutes issue is an important element in German thinking about the agricultural negotiations of the Uruguay Round. Whenever the Uruguay Round is discussed by German agricultural policymakers, the topic of substitutes figures prominently. Leading officials from the Ministry of Agriculture have even gone so far as publicly stating that substitutes were the central theme of the Uruguay Round.

From a purely German point of view, the political argument about substitutes may even have gone too far because hopes may have been raised which at the end of the day may be difficult to fulfill. Some farmers in Germany may have adopted the view that a "solution" of the substitute problem is the central indication for success of EC negotiators in the Uruguay Round. If it should finally turn out that the EC does not manage to make progress on this issue, the emphasis placed on this topic by German agricultural policymakers may seriously undermine Germany's desire to successfully conclude the Uruguay Round.

It is not generally understood among German agriculturalists that the Community would have to make concessions, and possibly very significant concessions, if it wants to achieve the right to "rebalance" the CAP. It is also not generally known that there is a specific background to the compromise between the Ministry of Economic Affairs and the Ministry of Agriculture which cleared the way towards inclusion of the substitutes item on the negotiating list.

When the Ministry of Economic Affairs gave the green light to negotiations on substitutes, it did so because there might be an opportunity for making concessions which could make restrictions on substitutes acceptable for the Community's trading partners. However, the Ministry of Economic Affairs made it perfectly clear that such concessions could not come from the manufacturing sector. In other words, the Ministry of Economic Affairs accepted negotiations on substitutes only on the precondition that any concessions would have to be made within agriculture.

Officials in the Ministry of Agriculture know this. As a high Ministry official, Mr. Kittel stated, "for a modification of the import regime the Community has to make concessions. For the time being, it is not yet predictable how such an arrangement would affect production and trade of cereals". However, this aspect has not received much attention in the general public, and many farmers may believe that the Community will be able to make progress on substitutes without losing ground on other agricultural issues.

The "Ideal" Package from the German Point of View

Considering the German preferences for GATT "solutions", as discussed in the previous section, a package of arrangements emerges which German agricultural policymakers might ideally want to achieve in the Uruguay Round negotiations. Such a package could consist of four major elements; 1) GATT acceptance of CAP instruments; 2) inclusion of substitutes (rebalancing the CAP); 3) binding of self-sufficiency; and, 4) a food aid convention.

GATT Acceptance of CAP Instruments

The first element in the "German" package would be assurance that the CAP system of variable levies and export restitutions is fully accepted in the GATT. For the time being, there is some ambiguity in the GATT about the legal status of variable levies. Variable levies are usually counted among the "grey area" measures which are neither explicitly prohibited nor explicitly allowed in the GATT. EC policymakers and German officials do not get tired of

stating that the EC variable levy regime has been "accepted" by the USA since the Dillon Round, but they know this was at best a de facto acceptance, not an explicit legal recognition.

Since this legal ambiguity results in a slightly uneasy feeling on the side of EC and German agricultural policymakers, they emphasize time and again that the CAP regime cannot be put on the negotiating table. The ideal solution, from the German point of view, would be to gain explicit legal GATT recognition of the variable levy and export restitution system of the CAP. More important than this formal legal recognition would be explicit acceptance that they are free to set the domestic support price level independently of world markets.

Inclusion of Substitutes

As a second element in their preferred GATT package, German agricultural policymakers would want to reach an arrangement regarding substitutes. Ideally such an arrangement would allow the Community to set quotas for the volume of substitute imports since this would allow the Community to control imports so that they do not interfere with EC market developments. However, German agricultural policymakers might also be prepared to consider a set of self-restraint agreements in which exporters of substitutes promise to limit the amount shipped to the EC market. Even an agreement that substitute imports would not exceed recent levels would be preferred over the current situation with unlimited access at low or zero tariffs.

As stated previously, it is not quite clear what the term "substitutes" would really include for German agricultural policymakers. It would certainly include everything which is on the "official" EC list of substitutes as annexed to the EC cereals market regulation, i.e. all energy-rich feeds, including corn gluten feed. German agricultural policymakers would probably also want to include oilseed cakes and meals in a GATT arrangement regarding substitutes. Whether they would also attach great importance to including oils and fats in a new import regime is less clear.

German agricultural policymakers would probably have a tendency to stress the need to include oilseeds in the variable levy regime. They would at least want to impose tariffs on imports of oilseeds in order to save on deficiency payments for EC oilseed production while gaining more scope for higher prices for EC oilseed producers. It would be difficult, for technical reasons, to impose import restrictions on oilseeds and meals, but not for oils and fats. Restrictions on oils and fats may also increase demand for butter in the EC, thereby helping milk producers. It would thus appear that the "substitutes" would include oils and fats as well. German agricultural policymakers realize that they would have to offer something in order to achieve such results. Elements three and four in the package might include such offers.

Bind Degree of Self-Sufficiency

The third element in the "German" package could be an agreement to bind degrees of self-sufficiency or maximum amounts of production in individual countries for major agricultural products. Such an arrangement could follow

the lines considered for cereals during the Kennedy Round. At that time, the government of the FRG was positively inclined to accept an arrangement on maximum degrees of self-sufficiency in cereals (90 percent) close to what the United States had requested and had even considered a compromise with the United States on a higher rate of U.S. support. With a little more negotiating time, an arrangement on binding degrees of self-sufficiency in cereals might have been possible in 1967 if the United States had not dropped the idea in order to reach an agreement at the last second (Schauz, 1989).

The German government would no longer accept binding the degree of self-sufficiency in cereals at 90 percent for the European Community. Cereals production in the Community (of the six original member countries which were negotiating in the Kennedy Round) has grown considerably since the end of the 1960's, and any new agreement would have to be based on a more recent reference period.

It is not possible to say with any degree of reliability what the exact degrees of self-sufficiency or maximum quantity of production would be acceptable to the German government. In addition, any arrangement would have to be concluded for the European Community so the quantities agreed would have to be set for the EC, and not just Germany.

However, the CAP has recently evolved in a way which provides a slightly sounder basis for speculation about what degree of self-sufficiency or maximum agreed quantities of production might be acceptable to German agricultural policymakers. With the recent introduction of "stabilizers" in the CAP, there are now "maximum guaranteed quantities" (MGQ's) for a number of commodities (Commission of the European Communities, 1988). The MGQ's have been set from a purely domestic point of view and their main purpose is to trigger cuts in domestic support prices once EC production exceeds these threshold quantities. They were set after intensive debate in the Council of Ministers and indicate quantities of production which are politically acceptable among the member countries.

Like in any negotiations, there is a tendency to start from a position more favorable than what might be acceptable in the end. German negotiators (through their influence on the Commission which actually negotiates in Geneva) would try to get away with bound production quantities or degrees of self-sufficiency as high as possible. However, the MGQ's currently set in the CAP would certainly influence thinking on these matters. It would not appear impossible that Germany might finally be prepared to bind quantities of production which more or less correspond to the MGQ's currently in force in the EC. Alternatively, and more likely, a binding of the degrees of self-sufficiency corresponding to these MGQ's might be considered.

The proposal could even differ from commodity to commodity. Take the example of cereals. The MGQ currently in force in the EC is 160 million tons. This quantity was set by the heads of state in February 1988 in a process of intensive political bargaining. The exact figure of 160 million tons, as such, does not have any economic basis. However, in the debate about where the MGQ for cereals should be set, some elements in the EC market balance for cereals were occasionally referred to.

In determining the MGQ, it was argued that account should be taken of the fact that the Community imports around 15 million tons of cereal substitutes. It was thus argued that the MGQ for cereals had to be above domestic EC cereals utilization in order to include the equivalent of substitute imports because it was not fair to penalize EC farmers for the inflow of substitutes. This type of argument could be based on a historical precedent in the CAP for cereals. When the original "guarantee threshold" for cereals was introduced in 1982, the decision was taken to link the actual threshold quantity to the volume of substitute imports. The higher the volume of substitute imports, as defined in Annex D of the CAP market regime for cereals, the higher was the guarantee threshold and, correspondingly, the smaller the cut of support prices for cereals envisaged in the mechanism.

The current stabilizer scheme for cereals no longer provides a link with the volume of substitute imports. However, given the German interest in doing something about substitutes in the GATT negotiations, it is conceivable that German negotiators might have an interest in establishing a link between an agreement on cereals and an arrangement regarding substitutes. Such a link could take a form analogous to the earlier guarantee threshold mechanism for cereals in the EC.

For example, an agreement could be sought by which the EC binds its volume of cereals production or the corresponding degree of self-sufficiency to 160 million tons, plus or minus any change in the volume of substitute imports from its base in a given reference period (say, 15 million tons). It could be argued that with such a link between the binding on cereals and an arrangement for substitutes, a GATT agreement along the lines considered here may be more easy to sell domestically in Germany. German negotiators could also argue that negotiating partners in the GATT might find it easier to accept an arrangement on substitutes if the quid pro quo is lowering EC cereals production.

The logic of internal EC debates might lend support to such a proposal. As was mentioned above, the German Minister of Agriculture would like to establish national maximum quantities of cereals production for each individual EC member country. He has not been able to convince other member countries to accept such a new regime and instead opted for the much looser instrument of set-aside.

However, German agricultural policymakers and farmers are unhappy that other member countries have not really seriously embarked on this new policy. In such a situation it might be tempting for German policymakers to use the GATT negotiations as a means of pushing the other member countries of the European Community in the direction of firmly bound national production limits. A multilateral GATT agreement to bind production volumes or degrees of self-sufficiency may, therefore, look particularly attractive from the German point of view.

Food Aid Convention

The fourth element in the "ideal" German package for GATT negotiations could be an extended Food Aid Convention, with a larger volume of total food aid

committed under that Convention, and with a larger EC contribution to overall commitments.

German negotiators might also be sympathetic toward increasing the EC commitment to contribute to the International Emergency Food Reserve. Along similar lines, German negotiators might be prepared to consider a multilateral agreement on holding internationally coordinated emergency stocks. In this regard, too, there would be a historical parallel with the Kennedy Round negotiations.

It should be emphasized that the "ideal" German package described here is nothing other than speculation on what German agricultural policymakers might want to achieve in the GATT negotiations if they were unconstrained by factors which would not make it politically possible for them to actually pursue such an outcome. However, in order to support the hypothesis that the four points mentioned here might be major elements in the German package for GATT negotiations, this section will conclude with some citations from the agricultural policy program of the CDU and CSU, worked out in 1986 under the chairmanship of the then Prime Minister of Lower Saxony, Ernst Albrecht:

- "CDU and CSU adhere to the fundamental principles of the Common Agricultural Policy--Community preference, common prices, common financing. ... CDU and CSU say yes to the system of EC agricultural market regimes. The system of market regimes has, in principle, proven successful; it has, however, to be adapted to the new conditions on EC markets and world markets."

- "For re-establishing market balance, CDU and CSU consider a package of measures necessary at the EC level:

  1) putting a floor under coarse grain prices. For quality cereals an effective price floor at a higher level;
  2) limitation of imports of oilseeds, vegetable fats, and concentrated feeds through GATT negotiations or self-restraint agreements;
  3) long-term security for production of oilseeds, in particular rapeseed;
  4) utilization of export possibilities;
  5) expansion of food aid; ..." (CDU/CSU, 1986)

The firm commitment of the senior party in the current government coalition to such agricultural policy principles would appear to suggest that these policy lines will be followed at least as long as the current Federal Government is in power.

Chapter 5: Constrained GATT Options for Germany

The preceding chapter discussed the kind of GATT arrangements that German agricultural policymakers would like to achieve if they were unconstrained in their political actions. In reality there are constraints which limit the degree to which German agricultural policymakers can achieve the results they desire in the GATT negotiations. These constraints include:

- the views of other groups in German society, as represented in the German government by other ministries, above all the Ministry of Economic Affairs and the Foreign Office;
- the interests of other member countries in the European Community;
- the effective negotiating power of the Commission of the European Community, both internally in the EC and internationally in the GATT;
- the interests and negotiating strategies of other contracting parties in the GATT.

There is little doubt that the outcome of the Uruguay Round negotiations will differ significantly from what German agriculturalists would like to obtain, and German agricultural policymakers are aware of the constraints under which they have to operate. They may not even try to push for those solutions which they would like to achieve knowing that they are unattainable. In that sense the preceding chapter is purely hypothetical. If it has one purpose, it is to provide some basis for understanding why German negotiators may adopt certain positions in the ongoing talks.

The present chapter will adopt a more realistic point of view. Its major objective is to explore solutions which may not completely upset Germany's negotiating partners, both in the European Community and in the GATT, while at the same time taking into account at least some of the concerns of German agricultural policymakers.

The options considered in this chapter may still be far from the sort of compromise that finally comes out of the Uruguay Round. There would not be much point in trying to outline a possible GATT compromise for two reasons. First, trying to outline a feasible compromise would essentially mean trying to predict the outcome of the Uruguay Round negotiations. The final result achieved in the negotiations will, by definition, turn out to be the only compromise which was really feasible. Second, an outline of the feasible compromise, if it could be provided at all, would not necessarily contain much useful information on the topic of this study, since what is "feasible" depends not only on the German position, but also on the position of all the other negotiating partners, not the least of which is the position of the United States. The purpose of this study is not to describe the amalgam of all parties' interests in the negotiations, but to provide a better insight into the German approach to the negotiations.

The approach adopted in the first section of this chapter will be to look at each individual element in the "ideal" German package in order to see whether

and how these elements could be modified so that they come closer to true liberalization of agricultural trade without completely losing any German touch. The second section of this chapter will then discuss the political implications of such solutions from a German point of view, as well as incentives which may help to move German policymakers in the direction of considering such solutions more seriously.

Modifications of the "German" Package

The first element of the ideal German package mentioned in chapter 4 was assurance that the mechanisms of the CAP remain intact, in particular its variable levies and export restitutions. German agricultural policymakers would also hope the European Community can retain the right to set its support prices at levels considered appropriate from a domestic point of view. This position is diametrically opposed to agricultural trade liberalization. True liberalization would require that all price support be eventually eliminated and that domestic market prices move up and down with international prices.

Tarrification

Most people would agree that full liberalization is a target which can only be reached after some adjustment period. A strategy of liberalizing agricultural trade therefore must envisage arrangements for the interim period during which agricultural price support is gradually eliminated. The most liberal strategy for the adjustment period, in the sense of providing the greatest possible scope for market forces to influence international trade in agriculture, is "tariffication", i.e. conversion of all existing non-tariff barriers into bound tariffs, which are then gradually reduced towards zero.

Tariffication is exactly what German agricultural policymakers would not want to agree to. If the European Community had to convert its variable levies into bound tariffs, it would lose the ability to control domestic market prices independently of world markets. EC and German markets for agricultural products would then become subject to the "vagaries" of international trade, and producer prices could fluctuate in unpredictable ways. For German agricultural policymakers this is absolutely inconceivable.

Tariffication could be handled in the Uruguay Round if the new tariffs are set at such a high level initially that they do not effectively constrain the Community's variable levies at existing levels of the EC's threshold prices. These tariffs would bind the core CAP products which currently are subject to a variable levy regime. In legal GATT terms this would not be impossible since a contracting party, which has at some stage bound a tariff, can always apply an actual tariff which is lower than the bound rate. In addition, the new tariff could also be varied from time to time, like a variable levy, as long as it does not exceed the bound tariff rate.

It would also be possible to tailor a GATT agreement where contracting parties would bind the maximum levels of per unit export subsidies for their agricultural exports in parallel with the introduction of new bound tariffs where bindings did not already exist. This is not necessarily what those

parties have in mind for tariffication. However, one could argue that rather than completely prohibiting export subsidies, a more balanced and politically more promising analogue of the conversion of non-tariff barriers into tariffs would be to bind levels of export subsidies (Tangermann, 1989b). Bound levels of export subsidies could then be set so high initially that they would not constrain existing levels of export subsidization in the EC.

Would an arrangement along such lines constitute a possible compromise between trade liberalization and the German position? Proponents of trade liberalization would probably argue that such an arrangement would not really change anything, and that it therefore would not constitute the necessary improvement in the current state of affairs. Understandable as this view may be, it would not be quite correct.

If the European Community were to bind tariffs and export subsidy levels for those commodities where it currently uses variable levies and export subsidies, it would constitute a major change in the legal status of the CAP in the GATT. The European Community currently has no specific GATT obligations for these commodities. There is no specific constraint to the level of domestic support prices which the Community may set for these commodities.

The only general constraint which the Community currently must honor for these commodities is the "equitable share" rule for exports under Article XVI of the GATT. However, this constraint is weak in practice. Moreover, where the world market for a given commodity happens to grow rapidly such that EC exports could be expanded significantly without violating the "equitable share" rule, the Community domestic price support could be raised significantly.

The binding of tariff and subsidy levels for commodities with variable levies and export restitutions in the EC would be useful since it would significantly change the legal framework in which the CAP can operate. However, the practical value of such a concession by the EC would remain small for the Community's trading partners as long as the bound levels of tariffs and export subsidies are so high that they do not effectively constrain price support under the CAP. This would quickly change if the bound levels of tariffs and export subsidies were then negotiated down so they would begin to lower EC prices and production. At this stage the nature of the CAP would suddenly change dramatically. Domestic market prices in the EC would then no longer be determined by politically-set support prices, but by world market price developments and the fixed levels of tariffs and export subsidies.

Occasionally, the EC might still temporarily revert to the old variable levy/export restitution regime in periods when world market prices are so high that the level of support prices desired in the EC does not require the Community to make full use of the bound levels of tariffs and export subsidies. However, the Community would essentially be in a new world where its sovereignty in setting its institutional prices would be severely constrained. This is exactly what Germany's agricultural policymakers would find completely unacceptable.

Tariffication, in whichever way it is pursued, would not really be a compromise solution. Either it does not change anything in the practice of the CAP or it would change the nature of the CAP so dramatically that German agricultural policymakers would find it completely unacceptable.

The Aggregate Measure of Support (AMS)

Is there any other solution which could more truly serve as a compromise? A natural candidate for such a compromise is the aggregate measure of support (AMS) approach. An AMS-type arrangement would make it possible to constrain the level of overall trade-distorting support and thereby make progress towards more liberal trade. It could also be designed with enough flexibility for the Community to implement its agricultural policies in a way that domestic EC prices are not directly governed by world market price fluctuations.

There are many possible variants of the AMS approach which could lead to rather different results. A compromise solution could lean more to the side of trade liberalization or more to the side of domestic policy sovereignty, depending on how the AMS approach is designed. The extent to which an AMS agreement would be acceptable to German policymakers would probably depend on its particular design. However, before such details are discussed it is worthwhile to consider more generally the German position towards such a type of an arrangement.

Germany supports use of an AMS approach in the negotiations. For example, the press statement of the Federal Ministry of Agriculture on the mid-term agreement of April 1989 says that "in Geneva the EC has been able to make sure that, instead of the complete elimination of support as originally requested by the United States, negotiations will now only be on a longer-term base with a gradual substantive reduction of agricultural support, to the extent that it is trade-distorting. As determined by the EC Council in November 1988, this can be done through a general method for measuring agricultural support where the advance concessions made since 1986 will be taken into account" (Federal Ministry of Food, Agriculture, and Forestry, 1989). From many semi-official statements, it is quite clear that Germany favors an agreement on an aggregate measure and that within the European Community, the suggestion that the EC should work for an AMS agreement has the definite support of the German government.

Why is it that German agricultural policymakers favor an arrangement which in the end would constrain the room of maneuver for the CAP? Given the lack of public debate on this issue in Germany, one can only speculate about the answer to this question.

First of all, it has to be emphasized that any such constraint on domestic policies is not really what German agricultural policymakers would like to accept. It is only in the face of other options which could be forced upon them that German policymakers may have a relative preference for this approach. They may feel that anything else could only be worse. In particular, if the only possible choice were between tariffication and an AMS

approach, there is no doubt that German agricultural policymakers would opt for the latter solution.

From the German point of view, there is also one positive aspect which an AMS approach could offer--at least if it is designed according to German tastes. German representatives would like to design an AMS agreement such that credit is given to countries which pursue domestic supply control. If this were done, any existing and future attempt by the EC to control domestic production would not only cure the Community's domestic budget problem, it would also win the Community credit at the international level. Apart from fully-fledged commodity agreements, an AMS agreement is probably the only way to receive credit at the international level for controlling domestic supplies.

With such an AMS approach, it would be possible to trade-off reductions in domestic production against increases or lack of reductions in domestic support prices. Given the strong preference of leading agricultural policymakers in Germany for the strategy of "quantities down, prices up", it is clear that they would like the AMS approach. Hence, it may be understandable that if they cannot avoid being forced into some type of international discipline they would at least want to make sure that they can pursue their preferred agricultural policy strategy within this framework. An appropriately designed AMS approach might provide that chance.

An additional reason stated by German officials for why an AMS approach would be appropriate is that such an approach would allow the Community to receive credit for the domestic reform measures which have been adopted under the CAP in recent years. The German point of view on this issue is fully in line with thinking in other member countries and in the Commission.

An AMS approach might also make it easier to find a common denominator on GATT negotiations. One of the potential advantages of an AMS approach in the overall GATT negotiations on agriculture is that, because of its flexibility, the AMS can cater to different types of agricultural policies under one general umbrella. An AMS agreement would impose balanced discipline on everybody in the GATT without requiring implementation of the same agricultural policy measures.

This property of the AMS approach carries over to the level of internal EC decisionmaking. There is no doubt that different member countries of the Community have different views about how the CAP should develop as well as what should come out of the Uruguay Round negotiations. Agreement on a negotiating mandate for the Commission requires that a common position on the GATT negotiations be formulated. It is easier to do this using the AMS approach than if more detailed positions must be formulated on individual policy measures.

An AMS approach would also make it easier for the Community to impose discipline within the CAP to correct the distortions between member states caused by national agricultural policies. In addition, the statement made by a high level official in the Federal Ministry of Agriculture that Germany has an interest in keeping access to EC markets constrained while other EC member

countries have more of an interest in securing sufficient scope for export subsidies makes an AMS approach even more appealing.

With regard to the details of how to design an AMS approach, German policymakers would certainly have preferences. Without going into all the details which would have to be considered in implementing an agreement on the basis of an AMS (Hartwig, Josling, and Tangermann, 1989), four considerations appear to be of particular significance from a German perspective. These aspects are:

- specificity regarding policy measures;
- policy coverage;
- treatment of domestic supply control;
- definition of the external reference price.

These areas of particular interest to Germany became obvious when the Scientific Advisory Council to the Federal Ministry of Agriculture drafted and issued its report on the Uruguay Round negotiations (Wissenschaftlicher Beirat, 1988). In this report, the Advisory Council outlined alternative options for an AMS approach, some of which may be more acceptable than others from the point of view of German policymakers.

Specificity of Commitments

Regarding the specificity of policy commitments, the central issue is whether GATT agreements, and commitments for individual contracting parties, are defined in terms of support rates or whether an agreement on a given reduction in all countries' AMS is only used for defining the overall target, with concrete commitments specified in terms of individual policy measures. It appears that German policymakers would have a preference for the former approach because it would leave more flexibility for implementing agricultural policies.

Any binding of agricultural policies is difficult in the eyes of German agricultural policymakers, but if it has to be done, they would least like to bind individual policy measures. If the European Community had to respect a ceiling for agricultural support rates it would at least want to have the freedom to chose which policy instruments it should adjust in order to honor the overall ceiling for support.

In the report by the Advisory Council, it was pointed out that there is an obvious tradeoff. Binding aggregate support without agreeing on country plans for specific policy measures means that there is more freedom to switch between policy instruments. However, this freedom can also be used by other countries, and they may switch to policies which from the home country's point of view are less acceptable. Hence, more freedom for implementing one's own policies goes hand in hand with less security regarding other countries' policies. However, faced with this tradeoff it appears that German policymakers would rather forego the security regarding other countries' policies if they can retain more flexibility in implementing EC policies.

German policymakers would like to retain one additional degree of freedom--the binding of the overall value of support for all agricultural commodities rather than for individual commodities. However, it appears that this will not be feasible in the negotiations and that it might imply more dangers in terms of what other countries could then do than it is worth in providing more flexibility for the EC.

Policy Coverage

As for policy coverage, it appears that there is not yet a very definite position in Germany. It is clear that the same type of tradeoff as in the case of policy specificity exists. If policy coverage is limited, there is more scope for compensatory policies in the EC and Germany. At the same time, other countries could do all sorts of things with their policy instruments which have not been included in the AMS and this could cause trouble for the EC. Though it appears that no clear view on how to proceed in this regard has yet emerged in Germany, it is clear that German agricultural policymakers would like to keep their preferred national policies outside any AMS.

Their prime candidate for exclusion from an AMS would certainly be the contributions which the German government makes to the special social security schemes for German agriculture such as old age pensions, health insurance, and accident insurance. In 1989, the German government planned to spend more than 5 billion Deutschmarks on social security schemes in agriculture. This is 54 percent of the Federal government's budget for national agricultural policy in Germany (Agrarbericht, 1989), and around one-quarter of total Federal expenditure on agricultural policy including German contributions to FEOGA.

Current annual government contributions to the social security system for farmers amount to 7,700 Deutschmark per farm on average. Given the economic and political weight of this part of agricultural policy in Germany, agricultural policymakers would find it completely unacceptable to see their room for maneuver constrained in this regard. They would argue, with some justification, that government contributions to social security schemes for agriculture in Germany have to be regarded as decoupled payments and should not be included in any AMS agreement.

Another candidate for exclusion from an AMS would be the compensatory payments in disadvantaged areas. After a considerable increase in the areas eligible for these payments in 1986, around 50 percent of Germany's agricultural area is now defined to be "disadvantaged". Total expenditure on this program was budgeted at 755 million Deutschmark in 1989. Per farm payments will be around 3,000 Deutschmarks on average.

Since these payments are basically made per unit of livestock or per unit of certain crops, they cannot really be called decoupled. On the other hand, there is a ceiling for payments per hectare, and in most cases this ceiling is binding such that a large part of these payments are effectively made on the basis of a flat per hectare rate, though the farmer has to produce the eligible products in order to receive payments. One could therefore argue that this program is decoupled at the margin.

The German government may modify the program such that it provides incentives for reducing, rather than expanding production (Agrarbericht, 1989), and if an AMS approach became reality in the GATT, and decoupled payments were not counted against the AMS, there would be another reason for actually modifying the program in this direction. The German government would also argue that payments for set-aside should not be included in the AMS.

Domestic Supply Control

The third aspect, treatment of domestic supply control, would be a central issue in German thinking. Given the strong preference of German agricultural policymakers for supply control, they would want to design an AMS approach which grants credit in those cases where domestic supply is effectively constrained. Indeed, taking supply control into account in an AMS approach may be a necessity for Germany, since the possibility of receiving credit where domestic production has been reduced through supply control measures is probably one of the main reasons why German agricultural policymakers may have any interest at all in an AMS approach.

There are different ways in which one could take supply control into account in an AMS approach (Tangermann, Josling, and Pearson, 1987). A solution which might be acceptable for German agricultural policymakers could be to give countries the choice whether they want to bind per unit AMS (ECU per ton) or the value AMS (total ECU's). In cases where effective domestic quotas are in place such as for sugar and milk, the EC could then opt for binding the value AMS, which would open up the possibility of reducing the volume of quotas allocated to farmers rather than lowering producer prices.

The External Reference Price

German preferences are also clear regarding choice of the external reference price. With all the German mistrust of international market prices, it cannot come as a surprise that German agricultural policymakers are unlikely to agree to bind the actual AMS as measured against current world market prices. Germany is rather firmly on the side of the EC Commission in arguing for defining the AMS so that it is measured against a fixed external reference price in domestic currency. The Commission's concept of the SMU (support measurement unit), which is largely the PSE as used in the OECD but with some arguably decoupled policies disregarded and with a given constant world reference price in ECU instead of the actual world price, is fully in line with German thinking on these matters.

For German agricultural policymakers, it appears pointless to adjust domestic market prices to the fluctuations of international prices or to changes in exchange rates. They might argue that they have not fought for over two decades to insulate German farm prices from exchange rate shocks through the Community's agrimonetary system only to allow German prices to be fully exposed by a GATT agreement to the vagaries of international capital markets and weather shocks in other parts of the world.

If an AMS approach based on a fixed external reference price were adopted in the GATT, then bindings would essentially apply to domestic prices of the

countries concerned, rather than to the gap between domestic and international prices. In some sense such a scheme would have similarities with the "stabilizer" scheme adopted in the EC in 1988. For example, in the cereals sector it is likely that the maximum guaranteed quantity of 160 million tons will be exceeded in most years, so that the price cut of three percent will be made in most years. Hence, the stabilizer scheme for cereals essentially amounts to a commitment to cut EC cereal support prices by a fixed percentage per year in nominal ECU terms over a given period. If an AMS with fixed external reference prices in domestic currency were bound, and an annual reduction of this AMS by a given percentage were agreed, the result would be similar. Since the German agricultural community is now used to the prospect of regularly declining support prices, it might accept a similar commitment at the multilateral level if the annual price cuts envisaged were not too high.

It is difficult to judge whether German negotiators would be prepared to go beyond completely fixed external reference prices so that domestic prices were at least somewhat responsive to international prices and exchange rates without going all the way towards a rigidly bound AMS measured against world market prices. There are different technical ways in which such a middle route could be implemented.

For example, instead of annual averages of actual world market prices, a moving average of world market prices and exchange rates could be used. As the number of years included in calculating such a moving average is increased, the average would tend to become more and more stable and any degree of stability of the external reference price could be chosen.

Another approach has been described in the report by the Scientific Advisory Council (Wissenschaftlicher Beirat, 1988; analyzed by Tangermann, 1988). Under this approach, the overall period over which the agreed AMS cut has to be made would be broken down into a number of sub-periods and the overall AMS cut would also be broken down into an equal number of tranches. For example, the overall period could be 10 years with 5 sub-periods of 2 years each and an overall cut of 50 percent broken into 5 tranches of 10 percent each. Within each sub-period, the external reference price would be kept fixed at the level in the beginning of the sub-period, and the AMS which was calculated against this reference price would have to be reduced by the agreed tranche during the given sub-period. With the beginning of the next sub-period, a new AMS for this sub-period would be calculated on the basis of actual world market prices observed at that time. If world market prices have fallen or the currency of the country concerned has revalued, this new AMS could well be higher than the AMS of the preceding sub-period.

This would not require an immediate adjustment of domestic prices to the lower level of the reference price. It would mean that the absolute size of the AMS cut to be achieved during this period is larger than the preceding period. The absolute size of the cut in domestic prices required would also be larger. In this way domestic prices would gradually follow the moving target of the international price level without ever having to fully fluctuate with it (Tangermann, 1988).

At what point German policymakers could be persuaded to accept a solution somewhere between fully fixed external reference prices and fully re-coupled domestic prices is difficult to predict. The agrimonetary regime of the European Community with its MCA may provide some clues.

German agricultural policymakers might have sought to keep the German green rate completely fixed since 1969 but this would have moved German prices completely out of line with prices in the rest of the Community. German agricultural policymakers had to accept green rate adjustments from time to time depending on the Deutschmark exchange rate. One could argue, therefore, that German agricultural policymakers now understand that some lagged and gradual adjustment of the external reference price in an AMS approach may be necessary and that it could be acceptable as long as it does not result in dramatic fluctuations in domestic market prices.

Closing the Loopholes in the CAP

When it comes to closing the loopholes in the CAP, or in EC jargon, to "rebalance the CAP", it is more difficult to see what a compromise solution might look like. As described above, German agricultural policymakers are so set on doing something about cereal substitutes that any agreement which didn't make progress in this direction would not appear to be of much interest to them. However, the German position on this issue is not non-negotiable. In multilateral negotiations on wide-ranging sets of issues, there must be some tradeoffs which would make it possible to compromise on a relatively limited issue like the substitutes question.

The political significance of the substitute issue is probably much greater than its economic importance for both the EC and the United States. It may be possible to find a compromise solution which satisfies the Community's and German political concerns without doing much economic harm to the Community's trading partners.

There are two dimensions in which one could try to shape an agreement on "rebalancing". First, the parameters of any trading regime for substitutes can be varied. Second, compensation in areas other than substitutes might make it possible or even attractive for the Community's trading partners to consider accepting an agreement on "rebalancing".

Both the nature of measures being brought to bear on substitutes and the quantitative level at which these measures are applied can be negotiated. Regarding the type of instruments to be used, the German government would, if it could proceed without any constraints, feel safest if quantitative restrictions could be imposed on substitute imports into the Community. However, given the general thrust for moving away from quantitative restrictions in the GATT, it should be easy to get the point across that there is no chance for an agreement on new quantitative restrictions in a sector where they haven't existed. For similar reasons it is unlikely that the Community's trading partners would be prepared to negotiate seriously about an inclusion of substitutes in the variable levy system of the CAP -an option which would certainly be welcomed very much in Germany.

A slightly more appealing solution might be tariffs on imports of cereal substitutes, oilseeds, and oilseed products. This option was explored in the "Disharmonies" study prepared for the EC Commission (Koester et al., 1988). From the Community's and Germany's point of view, it would have the attraction of generating additional budget income for the Community, in addition to reducing the volume of substitute imports into the EC. As a hybrid of a quantitative restriction and a tariff, a tariff quota could also be considered.

Another option would be to enter into self-restraint agreements with all major suppliers of substitutes. From the point of view of the countries exporting substitutes into the EC, a self-restraint agreement might be the least objectionable solution. In purely economic terms, a self-restraint agreement might even improve the welfare of the exporting countries.

For example, it has been shown that the self-restraint agreement between the Community and Thailand on manioc has probably raised potential welfare of Thailand because it has raised the export price for Thailand so much that the decrease in the quantity exported was overcompensated (Winterling and Tangermann, 1987). Whether this could also be expected in cases other than manioc would have to explored.

In legal terms, a self-restraint agreement would give away less of the rights of substitute exporters than an unbinding of EC tariffs on substitutes. On the other hand, self-restraint agreements would imply all sorts of technical and legal problems. One major problem, for example, would be how to treat the many actual or potential exporters of substitutes which might replace exports from the countries which have entered into a self-restraint agreement with the Community. In the case of manioc, this problem was dealt with through tariff quotas for non-Thai exporters of manioc (Hartwig and Tangermann, 1987). Whether this approach could work for substitutes other than manioc would also have to be explored.

In Germany, a self-restraint agreement would probably be considered superior to the imposition of tariffs. A self-restraint agreement would provide the security that imports remain under control while the imposition of tariffs might result in a lowering of the world market price of the commodities concerned without leading to much of a price increase or quantity reduction on the domestic EC market (Koester et al., 1988). From the agricultural policy perspective, at least in Germany, it is much more important that quantities are brought under control than additional tariff revenue be added to the Community treasury.

Regarding the quantitative parameters of a new regime for substitutes, the most important variables are the level at which tariffs would be set if a tariff regime were chosen, or the import quantities if a tariff quota or a self-restraint agreement could be negotiated. In the "Disharmonies" study, a 10 percent tariff on all imports of substitutes, oilseeds, and oilseed products into the EC was studied. Analysis showed that anything significantly lower than 10 percent would probably have such a small effect that it would not be worth the negotiating effort.

If a tariff quota or a self-restraint agreement were considered, the quantities to be agreed upon would have to be negotiated. It is difficult to say what the result of such negotiations might be. From the perspective of German agricultural politics, reaching any agreement at all is more important than the actual quantity agreed. The economic effects of restricting access for substitute imports would be limited relative to the longer run market trends anyway. What is important is the psychological and, hence, political effect of "closing the loophole" in the CAP.

It might be that German negotiators could settle for an agreement which would not actually reduce the quantities currently imported, but make sure that there was no further increase in these quantities. If it turned out that this was not a possible compromise, they might even consider an agreement which would provide for the possibility of some limited increase of quantities imported if there were ultimately a ceiling on imports.

The real "compromise" element in any new regime on the Community's substitute imports would have to come in the area of compensatory measures. German policymakers are aware of the fact that the Community has to compensate its trading partners if it wants to get concessions on substitutes. The report on the Uruguay Round negotiations by the Scientific Advisory Council (Wissenschaftlicher Beirat, 1988) spelled this out very clearly. In its earlier report on the substitutes problem (Wissenschaftlicher Beirat, 1985), the Advisory Council had also strongly warned against any further access restrictions for substitutes on the grounds that such restrictions might eventually provide more scope for higher price support for cereals and livestock products in the Community.

In its 1989 report on the Uruguay Round negotiations, the Advisory Council changed its views by arguing that in multilateral negotiations the Community could enter into commitments on price support which would insure that access restrictions for substitutes would not be used for increasing the level of EC price support. In this context, the Council not only pointed to the disadvantages which such new tariffs would have for exporting third countries, but it also expressed concern that new restrictions on EC imports of cereal substitutes and oilseeds could mean that the reduction of the level of EC price support, which the Advisory Council considers necessary, would be delayed.

The Advisory Council also pointed out that GATT negotiations could lead to a binding reduction of agricultural support and to the introduction of tariffs which could be linked to the commitment to reduce cereals support even more. Under these conditions, the Advisory Council placed less emphasis on its earlier concerns and no longer argued against moderate levies on imports of cereal substitutes, oilseeds, and oilseed products, provided the level of price support for cereals in the EC were reduced even more. However, the Advisory Council warned not to push so strongly for the introduction of a new import regime such that a positive overall result of the agricultural negotiations in the Uruguay Round is risked. The Advisory Council also pointed out that the EC would probably have to provide significant compensation (Wissenschaftlicher Beirat, 1988).

The "compromise" regarding substitutes could come not only in the form of relatively mild restrictions on access for substitutes into the EC, but also in the form of EC concessions which would be more significant than what German agricultural policymakers might like to accept. There may be a point in trying to see how flexible Germany and the EC are regarding external reference prices in an AMS agreement. For example, a three year moving average world market price as the basis for AMS calculations and bindings against some mild form of "rebalancing" might be proposed.

Other Elements

It was suggested that German negotiators might be prepared to consider binding the degree of self-sufficiency in the European Community. The assumption was made that Germany might be willing to negotiate a binding of the level of EC production at the current maximum guaranteed quantity of 160 million tons, plus or minus any change in the volume of substitute imports from a given base year volume.

Such bindings would have to be understood as being very significant concessions by the Community. None of the Community's negotiating partners has so far requested anything similar from the EC, nor has any partner in the negotiations stated that it was prepared to accept such types of commitments for its own agricultural policy. Any such offers by the Community would go far beyond what is expected of the Community.

Other member countries of the Community, and therefore the Community in aggregate, may not be prepared to even immediately consider such offers. It is therefore unlikely that the German government would propose to make such offers in the ongoing negotiations. There is no reason to consider possible "compromise" solutions which would entail even more significant concessions by the Community. It would probably make more sense to discuss how far it may be possible and whether it would be desirable at all to push the Community in such a direction.

The assumptions made on the possible willingness of the German government to negotiate a larger EC contribution to global food aid and to emergency stocks of cereals go beyond what is currently negotiated in the Uruguay Round. Negotiations on such issues may at some stage be held during the Uruguay Round in relation to the request for special and differential treatment of developing countries and in relation to the commitment to develop ways "to take into account the possible negative effects of the reform process on net food importing developing countries" as agreed in the April 1988 framework for the agricultural negotiations.

If food aid and emergency stocks should become elements of the overall package, any compromise on these elements would be in terms of the quantitative contributions individual parties are prepared to make. Since any concrete proposals as to what such an agreement should look like have not been made in the negotiations, there is no point in discussing the size of the contributions which the German government might consider.

Forging a Compromise

How could the German government be convinced that it should accept compromise solutions such as those outlined above, or that it should actually go further in the direction of agricultural trade liberalization? What sorts of influences could the trading partners of the European Community bring to bear on the EC and on Germany in order to increase the chances that the CAP is more thoroughly reformed as a result of the Uruguay Round negotiations? Are there any ways of explaining to German policymakers that they should not stick to requests like "rebalancing" the CAP? Three different types of strategies can be tried simultaneously or alternatively as in most negotiations: persuasion, enticement, and threat.

Persuasion requires that German policymakers be convinced that it is in their own interest to accept a fundamental reform of agricultural policy and that this reform should go in the direction of more liberal trade. German agriculturalists already understand that reform is unavoidable, and to some extent they also actively participate in reform endeavors. However, the direction in which they are prepared to change agricultural policy does not lead to more liberal trade, but to more government interference with agricultural markets. German agricultural policymakers find it particularly difficult to accept the notion that decoupled payments could be a general alternative to continued high price support.

In order to persuade German agricultural policymakers that more reliance on decoupled payments would be in their own interest, it would be necessary to deal with their two main arguments against decoupled payments. One argument is that farmers want "fair market prices" rather than welfare payments. The other argument is that direct income aids would be too costly for the public budget.

It may be that the "fair price" versus "welfare" argument can be gradually overcome if more acceptable political reasons can be found for granting payments to farmers which are not perceived as "welfare". In addition to the large contributions the German government is already making to the special social security schemes for agriculture, such politically acceptable reasons for making direct payments to farmers could come in relation to ecological considerations. Farmers like to think of themselves as custodians of the countryside, and they are generally happy to accept payments for providing what they feel is a service to the environment.

There are many reasons to doubt whether farming is a generally useful contribution to ecological objectives (Winters, 1988). In fact, it is well known that a number of agricultural activities are rather detrimental to the environment (Rat von Sachverstandigen fur Umweltfragen, 1985). However, this does not affect the political appeal of arguments for helping farmers to help the environment. In Germany this appeal is felt across all political parties.

The Greens are particularly keen to make sure that agriculture contributes to preserving the environment. However, the Social Democrats, who generally argue for more direct payments to farmers, are also happy to support the idea that more should be done in order to improve the ecological effects of farming

activities. The Christian Democrats also emphasize the need to shape agricultural policies so that ecological concerns are taken into account.

In German agriculture, there is increasing talk of the need to compensate farmers for the non-market services they provide. To some extent, this is an implicit way of saying that farmers want more direct income aids. Farmers have certainly understood that there is not much hope for expansionary market policies and increasing price support in the EC. However, they don't want to ask for direct income aids. If ways to link direct payments to some notional service which farmers perform can be devised, they would probably be happy to receive such payments.

The Community's trading partners may be able to support such developments through appropriate analysis and by public relations efforts which help to spread the word that it is good to shift agricultural policy emphasis from price support to ecological concerns. In multilateral negotiations such considerations come into play when policy coverage is discussed in relation to an AMS approach. It would be counterproductive if attempts were made to define decoupled policies so narrowly that a number of policies which could arguably be considered to be ecologically positive would have to be constrained.

For example, if Germany were prepared to change its program for compensatory payments to farmers in disadvantaged areas such that they would become slightly more production-neutral than they are now, these payments could be said to be decoupled and would not be included in support measurement. Such decisions would certainly help German policymakers to switch more and more to direct payments.

The second argument against direct income aids which German agricultural policymakers like to advance is that such payments would be too costly for the public budget. This is simply no longer true in the German case. As is shown in table 5.1, total public expenditure on agricultural policy, including special tax benefits for farmers, has grown rapidly in Germany over the past thirty years, much faster than income in agriculture. Public expenditure is now more than twenty percent higher than total income in German agriculture. This comparison might not be quite fair since agricultural income as defined in this table (net domestic product in agriculture) does not include some components of disposable farm incomes received from public expenditure budgets in the form of social security benefits and tax relief.

The expenditure shown in this table includes only FEOGA disbursements in Germany, not German contributions to FEOGA which are around 4 billion DM higher than what FEOGA spends in Germany (the difference being contributions which Germany makes to financing FEOGA expenditure in other member countries). The burden which current agricultural policies place on the German public budget is so enormously high in relation to actual farm income that it is difficult to argue that direct income aids could not be financed. It would certainly be worth a determined public relations effort to bring this message home to German agricultural policymakers.

Table 5.1--Public Expenditures on Agriculture and as a Percentage of Agricultural Income in Germany

Year	Million DM	Percent of Net Domestic Product of Agriculture
1955	1,514	11.4
1960	4,157	18.2
1965	7,748	46.1
1970	11,623	69.6
1975	15,076	71.7
1980	20,159	113.6
1985	22,713	110.7
1988	25,401	121.0

a) FEOGA spending in Germany, expenditure by the Federal government, the states and local communities, including special tax benefits for farmers.
Source: Schmitt and Tangermann (1988).

Enticement

Enticement to reform agricultural policies in Germany and the EC could essentially come in two different forms. First, rewards could be offered within the area of agricultural trade and in other sectors. Within agriculture, one obvious offer attractive for German agricultural policymakers is agreement to allow the Community to "rebalance" the CAP. However, such an offer would be against the interests of some of the Community's major trading partners and they would have to consider very carefully whether greater progress toward more liberal trade in other agricultural products would justify sacrifices in the sector of substitutes.

A second enticement which should be of great interest to German agricultural policymakers is the issue of GATT rules for exports of processed agricultural products. According to the letter of the GATT, there should not be any subsidies for exports of processed agricultural products. However, the European Community and many other countries grant massive export subsidies on many processed agricultural products. In Europe, Germany has particular interests in exporting processed foods, and the German food industry is proud of its many specialties and of its competitive position.

Given the high prices of raw agricultural commodities in the EC, the German food industry would find it difficult to remain competitive on international markets if subsidies could no longer be paid on the raw material content of its processed food exports. Since the practice of international trade policy on processed agricultural products deviates so significantly from the letter of the GATT, the Uruguay Round negotiations on agricultural trade would be the proper occasion to address this issue.

There are different ways in which this could be done (Tangermann, 1989b). If the European Community's negotiating partners were prepared to accept a framework which would essentially legalize most of the current EC subsidy practices in the area of processed agricultural products, then the EC might be more forthcoming in the area of agricultural policy reform in general. Since most trading partners of the Community have less of an interest in processed food exports than the EC, and because Community processors must pay higher

prices for their raw materials because of the CAP, acceptance of export subsidies for processed food should not be impossible for them. German negotiators would be particularly attracted by the possibility to make progress in this area.

Enticement in sectors other than agriculture could come from concessions on trade in manufactures. Germany's manufacturing industry has a very strong interest in gaining better and safer access to other countries' markets. In previous multilateral negotiations, it was not always easy to use Germany's industrial interests as a lever on agricultural issues because German industrialists were not prepared to turn against the interests of German agriculturalists. However, things have now changed significantly.

The manufacturing industry in Germany has now begun to speak out openly against agricultural protectionism and, in particular, against the CAP. Interest in analyses of the negative consequences of excessive agricultural support has grown significantly in the manufacturing industry and the level of awareness is now generally much higher.

This has certainly strengthened the position of the Minister for Economic Affairs vis-a-vis that of the Minister for Agriculture in the cabinet. It would be much more difficult for the Minister of Agriculture to resist determined efforts of the Minister for Economic Affairs to influence the agricultural talks in GATT negotiations. The link between the agricultural negotiations and negotiations on other issues should now be much stronger in Germany. If significant offers of interest to German industry were made on condition that Germany be more forthcoming on agricultural issues, the Minister for Agriculture would come under strong pressure from his colleague from Economic Affairs. It would be also be more difficult to convince the general public in Germany that agricultural issues should be allowed to block progress in other sectors.

Threats

A strategy of threat has its dangers. In particular, it is possible to exaggerate threats so much that they become unconvincing, and threats can also be counterproductive if they completely block thinking on the side of the negotiating partner. For example, there is probably only a small margin between using industrial offers as leverage on agricultural issues and threatening industrial retaliation for agricultural resistance to such an extent that solidarity among German Ministries and in the general public finally forces everybody to help domestic farmers against the "external enemy". It is therefore necessary to target threats very carefully.

One possible example of a potentially productive threat could come in the area of "rebalancing" the CAP. What the Community wants to achieve in this regard is essentially the withdrawal of an earlier GATT concession. The Community's negotiating partners could, instead of requesting compensation through EC concessions in other areas, "threaten" to withdraw concessions, or raise tariffs on items imported mainly from the EC if the EC persists in its attempt at "rebalancing" the CAP. If this strategy were considered by the Community's

negotiating partners, the question would arise as to which products would be most suitable.

When it comes to "rebalancing", threats against EC agriculture may not be the most productive strategy, at least not as far as German response is concerned. As mentioned above, it appears that the German Ministry of Economic Affairs was prepared to accept the request for "rebalancing" in the EC negotiating proposal only on condition that compensation is to be provided within agriculture. If the Community's negotiating partners were to propose raising tariffs on some industrial items in case the EC were to raise tariffs on substitutes, the Ministry of Economic Affairs would probably find it very difficult to go along. Hence the "threat" to request negotiations on raising certain industrial tariffs in exchange for negotiations on "rebalancing" the CAP might greatly reduce German pressure for "rebalancing".

Only a few examples for actions in the areas of persuasion, enticement and threat have been given here. There are probably other actions which could be tried in order to convince German policymakers that they should more seriously consider approaches to agricultural trade liberalization in the GATT. However, it would be wrong to assume that German positions on agricultural policy are easily given up. As always in negotiations, a compromise will have to be found through give and take. In any case, chances for a slightly more forthcoming German position on agricultural trade have probably never before been as good as they were before December 1989 and with German unification the German position on the Uruguay round could be even more forthcoming.

Chapter 6. Agricultural Policy Implications of German Unification

Political unification of the Federal Republic of Germany and the German Democratic Republic was realized on October, 3 1990 after 11 astonishing months of accelerating political change. Germany was whole again geographically and politically but confusion was perhaps the dominant characteristic in the economic and social makeup between west and east. The German Economic and Monetary Union (GEMU) had preceded political union on July 1 of the same year whereby the west German Deutschmark became the official currency in the five new east German states. The Berlin Wall had only been broached the previous November and the rapidity of the succeeding political and economic events will not likely be fully absorbed nor understood for another generation.

The fundamental cause of the economic and social problems since unification derive from the inescapable fact that the economic, technological, and social gap between eastern and western Germany was much greater than anyone realized. Before unification, GNP per capita in eastern Germany was estimated to be 63 percent of that of western Germany, whereas, latest available data suggests that the figure was closer to 30 percent (Jackson, 1991). And that does not even take into account the enormous environmental damage in eastern Germany or the gap in the quality of goods produced or the public infrastructure. It should not be forgotten that the wall did prevent escape to political freedom and a better economic life under a threat of death. Nevertheless, thousands took the risk. Even after the wall fell, and freedom was no longer the motive for migration to western Germany, hundreds of thousands crossed from east to west for economic reasons.

The impact of GEMU and the subsequent political unification of Germany had large and immediate impacts on east German agricultural commodity markets with significant effects on markets in west Germany and other EC member states. Before examining some of these effects and the overall implications of unification on German agricultural policy, a brief review of east German agriculture under communist rule and a comparison between east and west German agriculture is required in order to understand the present, and possibly future, dichotomous nature of German agriculture.

East German Agriculture from 1945-1990

The occupation authorities of the Soviet Union began a system of government intervention after World War II with widespread forced collectivization by the East German communist regime. The large estates (above 100 hectares) of eastern Germany were all expropriated by the Soviets and distributed as small farms. When the German Democratic Republic was established in 1949, intense pressure was exerted against private farms in various forms so more and more land was abandoned to the government (Hillberg-Seitzinger, 1990).

Collectivization of farms into cooperatives called Landwirtschaftliche Produktionsgenossenschaften (LPG's) began in 1952. By 1957, nearly 6,700 had been established and they controlled 25 percent of the GDR's agricultural land. Even though the economic performance of cooperatives was not very satisfactory, private farms continued to be forcibly collectivized and an

additional 40 percent of the land was collectivized in the first 3 months of 1960. Policies such as tax and subsidy discrimination favored the LPG's, and horizontal and vertical integration of the LPG units was intensified in order to achieve industrialization of agriculture on a large scale. The LPG's were specialized by activity into crop, livestock, input services, seed, and breeding activities with the intention of realizing economies of scale, rapid diffusion of technological advances, and equalizing rural/urban living conditions.

The end result was that the LPG's became self-contained communities with their own schools, doctors, construction crews, and social services. Farmers became salaried workers with a fixed work schedule, paid vacations, and health and social benefits. By 1989, through consolidation and specialization, 3,855 LPG's and 465 state farms were in operation (Henrichsmeyer 1990). Only 5.4 percent of the land was in church and privately held farms.

State control was guaranteed through a centrally planned system which served as the decisionmaking unit for the allocation and distribution of inputs and outputs. All agricultural enterprises were allotted production and investment goods which determined their expected output. Input and output prices were fixed while producer prices were based on production cost calculations but in effect they were only accounting prices (Henrichsmeyer, 1990). Price reforms in 1984 adjusted the prices of farm inputs, raised producer prices, and realigned prices among commodities.

Wages were determined by comparisons with occupations in the industrial sector and were only marginally related to profitability of the enterprise. Profitable enterprises were taxed in order to compensate enterprises that made losses. Hence, agricultural enterprises with a comparative advantage in production had little incentive to increase productivity while inefficient enterprises laboring under extremely marginal conditions stayed in production and absorbed resources that would have had a higher return elsewhere (Henrichsmeyer, 1990).

While livestock and crop production increased under this regime, neither the productivity nor the quality of east German production kept pace with west German production. The goal of food self-sufficiency in the GDR was only met for milk, meat, and rapeseed. Consumption was subsidized so it is little wonder that a combination of low food prices and an inefficient production system would not attain food self-sufficiency in spite of the fact that nearly 11 percent of the population worked in agriculture full-time (Madell, 1990).

A Comparison of East and West German Agriculture

On October 3, 1990 the addition of east Germany to west Germany added 16.7 million people and 108.3 thousand square kilometers to the European Community. Germany thus expanded its total population by 27 percent and its agricultural population by 70 percent, its land area by 44 percent, and its utilized agricultural area by 51 percent.

The most outstanding characteristic regarding the incorporation of agriculture of the 5 eastern states into west Germany is the difference in <u>farm structure</u>

(tables 6.1 and 6.2). As an immediate result of unification, the German Minister of Agriculture was faced with making policy for an agriculture that had a combination of numerous small, inefficient farms and some of the largest inefficient farms in the Western world.

Table 6.1: Distribution of agricultural land, 1988

German Democratic Republic		Federal Republic of Germany	
Total agricultural land-	6,181,878 ha	Total agricultural land-	11,951,000 ha
Use	percent	Use	percent
- cultivated land	75.8	- cultivated land	60.9
- pasture land	7.7	- pasture land	18.9
- meadow land	11.1	- meadow land	17.9
Farm type		Farm type 1/	
- socialist enterprises	94.6	UAA under 5 ha	4.4
- state owned farms	7.3	UAA between 5 and 15 ha	15.5
- of those, for crops	88.2	UAA 15 - 30 ha	27.2
		UAA 30 - 50 ha	24.7
- cooperative farms	86.4	UAA 50 - 100 ha	20.4
- of those, for crops	98.4	UAA more than 100 ha	7.9
non-socialist enterprises	5.4		

1/ data for 1987: UAA means Utilized Agricultural Area
Sources: Statistisches Jahrbuch fur die Bundesrepublik Deutschland, 1989.
Statistisches Jahrbuch der Deutschen Demokratischen Republik, 1988 and 1989.
Agrarbericht der Bundesregierung, 1988.

In 1988, west Germany had over 680,000 farms with an average size of slightly under 18 hectares while east Germany had about 4,600 farm enterprises with an average size of 1,350 hectares. In addition, 30 percent of west German farms were under 5 hectares in size and only 9 percent were over 100 hectares, whereas, in east Germany, the average cooperative grain farm had 4,500 hectares with some reaching as high as 15,000 hectares. (Madell, 1990).

Another important characteristic that differentiates the two agricultures is efficiency which is reflected by greater production per farmer in west Germany and is also reflected in yield data (table 6.3). East German yields for crops and livestock production are significantly below yields in west Germany even though prior to 1945 yields were higher in eastern Germany. The lower yields in eastern Germany occur in spite of generally higher input use but of low quality- particularly labor, fertilizer, and pesticides (table 6.3). In addition, the overall quality of the output in the east was significantly below that of the west as attested to by the abrupt change in east German consumption after the Berlin Wall was breached (Madell, 1991).

There are many reasons for the development of inefficient agriculture in east Germany. The most important factor is the inherent nature of state cooperative farming. State farms in general have: 1) insufficient economic incentives; 2) an inability to adjust the labor force to changing conditions; 3) low propensity for saving and investment; and, 4) a complicated and rigid hierarchical decision structure (Henrichsmeyer, 1990). Modern production technology was not forthcoming from this institutional setting. The end

result was that yields were low, production costs high, and too much labor and administrative personnel were employed. Estimates are that even dividing the labor force by half would not be sufficient to increase productivity and income to reasonable levels (Henrichsmeyer, 1990).

Table 6.2: Farm Numbers and Types in East and West Germany, 1987

German Democratic Republic		Federal Republic of Germany	
Total farms	4,574	Total farms	682,884
	percent		
- state owned	10.2	Size	percent 1/
- crops	17.0	---	
- animals	66.9	farm income under DM 40,000	50
		farm income DM 40 - 60,000	26
- cooperatives	84.3	farm income over DM 60,000	24
- crops	30.1		
- animals	69.9	farm type	

- cooperative gardens	4.4	Grain and other field crops	16
		Fed livestock 2/	63
- other coop.	0.1	Transformation 3/	5
		Long-term cultivation 4/	7
- coop. fish farms	1.1	Mixed farms	9

1/ as a percentage of the 336,000 farms earning all income from farming.
2/ chiefly cattle and dairy.
3/ chiefly pigs and poultry.
4/ viticulture, orchards.
Sources: Statistisches Jahrbuch fur die Bundesrepublik Deutschland 1989.
Statistisches Jahrbuch der Deutschen Demokratischen Republik, 1988 and 1989.
Agrarbericht der Bundesregierung, 1988.

Table 6.3: Comparison of Yields and Input Use in East and West Germany

	East Germany	West Germany
Average Yields, 1983-1988:		
Grains	4400 kg/ha	5230 kg/ha
Potatoes	23360 kg/ha	33360 kg/ha
Sugar Beets	30230 kg/ha	49040 kg/ha
Winter Oilseeds	2560 kg/ha	2940 kg/ha
Milk	3821 kg/cow	4713 kg/cow
Eggs	220 per hen	257 per hen
Inputs, 1989:		
Labor	8.2/100 ha	5.2/100 ha
Nitrogen	141.3 kg/ha	121.0 kg/ha
Phosphates	56.4 kg/ha	56.8 kg/ha
Potassium	94.4 kg/ha	72.1 kg/ha
Calcium Oxide	272.7 kg/ha	122.4 kg/ha
Pesticides	4.9 kg/ha	2.3 kg/ha
Tractors1/	1.4 kW/ha	4.0 kW/ha
Threshers2/	0.8/100 ha	3.2/100 ha

1/ 54 percent fully depreciated.
2/ 43 percent fully depreciated.
Sources: Henrichsmeyer, Commission of the EC, and BMELF.

Agricultural policy in east Germany emphasized livestock production in order to earn scarce foreign exchange. This is reflected in table 6.4 where production of animals relative to population was higher in the east than in the west; and west German imports of east German animals was the largest

imported item while oilseed cakes for animal feed was the largest east German import from west Germany.

Table 6.4: Animal numbers

Year	German Democratic Republic				Federal Republic of Germany			
	cattle	pigs	sheep	lay hens	cattle	pigs	sheep	lay hens
	1000 head				1000 head			
1980	5723	12871	2038	26844	15048	22374	1145	55800
1986	5804	12840	2647	24801	15627	24180	1296	49700
1987	5721	12503	2656	24745	15305	23670	1383	47900
1988	5710	12464	2634	24665	14887	23670	1414	46842

Sources: Agricultural Situation in the Community, 1988, 1986, 1989.
Statistisches Jahrbuch der Deutschen Demokratischen Republik, 1988 and 1989.

German Agricultural Trade

The GDR and the FRG had well-established agricultural trade agreements before unification. The FRG constitution included the five states that comprised eastern Germany, before the GDR was established, as part of German territory and East German citizens were legally classified as West German citizens. These legalities were accepted by the EC and incorporated into the Treaty of Rome in 1957.

Agricultural trade between the two Germanies was considered internal German trade. Other EC member states treated East German products as they would non-EC products. East Germany was treated favorably in the two-way trade of agricultural and other products. Within given value quotas, East German agricultural products entered West Germany duty-free on a non-reciprocal basis but could only be consumed in West Germany. The exchange rate used for inter-German trade was on a one-to-one basis and East Germany received around $450 million annually from West Germany in interest-free credits (Madell, 1991).

The composition of the trade between the two Germanies reflected the two countries' agricultural policies. West Germany exported mostly processed agricultural products, particularly oilseed products to East Germany, while the GDR principally exported live animals, grains, and sugar and sugar products to West Germany. East Germany was able to earn much-needed foreign exchange from these trade arrangements which were so concessionary as to be deemed foreign aid. Important as these foreign exchange revenues were for the GDR, West German agricultural imports from the GDR added only marginally to total supplies in the FRG.

Table 6.5: Composition of inter-German agricultural trade

	East German Imports from West Germany		
	1987	1988	1989
Agricultural Products	($1,000)		
Raw tobacco	7,745	7,452	1,509
White wine	2,834	3,443	3,192
Horticulture	1,481	946	895
Meat products	228	239	97
Tropical wood	1,442	4,698	3,404
Fish products	480	583	589
Food products			
Meal-,dough-, baked goods	7,836	5,766	10,851
Sugar & products	52,303	54,298	56,381
Milk, butter.	13,289	12,841	11,240
Tobacco products	13,481	11,489	12,312
Oilcakes/meals	134,105	118,329	149,425
Meat,fish products	12,120	10,975	10,569
Drinks 1/	16,768	15,559	17,113

	West German imports from East Germany		
	1987	1988	1989
Agricultural Products	($1,000)		
Winter wheat	22,247	13,620	10,426
Summer wheat	5,064	6,507	2,296
Oats	21,087	29,400	16,984
Brew barley	48,996	48,577	28,853
Grass seeds	4,667	4,496	5,047
Horticulture	4,523	4,812	4,040
Live animals	84,009	88,759	111,484
Forestry products	9,038	8,666	5,766
Fish products	1,039	2,680	2,092
Food Products			
Meal and dough-baked goods	16,800	14,091	13,297
Sugar and products	65,736	65,785	60,279
Meat,fish products	15,565	15,610	19,950
Drinks 1/	21,330	27,319	30,028

1/ alcoholic and non-alcoholic drinks
Source: Statistisches Bundesamt, Handel, Gastwerbe, Reiseverkehr, Fachserie 6, Warenverkehr mit der Deutschen Demokratischen Republik und Berlin (Ost), various years.

East Germany in the CAP

The CAP has been formally applied to east German agriculture since October 3, 1990, the day of political unification, but in practice many elements of the CAP had already been implemented in the GDR immediately after monetary and economic union was established in July 1990. As east Germany had already accepted the west German deutschmark as its currency, CAP prices, converted into deutschmarks by the German green rate, became east German prices. In the long run, this should prove to be an advantage to east German farmers because they will be able to buy modern inputs with deutschmarks and because Germany

has the highest producer price in the CAP with the exception of Spain. However, in the short run, harmonization with CAP prices is causing massive adjustment pains in east Germany because GDR producer prices had been more than double the level of CAP prices1/ and because it will take east German agriculture quite some time to overcome its many inefficiencies.

East Germany also had to accept EC law, including EC 1992 legislation, although some exceptions have been made. For example, air and water standards will not be fully in effect for East Germany until 1996 and full adoption of EC veterinary and plant health laws will not occur until the end of 1992.

East Germans now have their own CAP milk quota of 6.59 million tons which is 80 percent of previous production. The sugar quota was set at 847,000 tons, somewhat above current production levels. The intervention ceilings for EC beef, butter, and skim milk powder were increased by 15 thousand tons, 25 thousand tons, and 6 thousand tons, respectively, because of German unification.

For the time being, East German production of grains and oilseeds will not be counted against the maximum guaranteed quantities (MGQ) above which EC producers must accept price cuts, but east German producers will face the same price cuts if EC production exceeds the MGQ. The MGQ will be reviewed over the next two years before east German production is incorporated (Madell, 1991).

Like farmers in other EC member countries, east German dairy farmers will be compensated for some part of the production cuts. Many east German farmers live in "less favored areas" and will receive EC payments. The German government spent $2.8 billion in 1990 and has budgeted $4.8 billion for payments to east Germany to facilitate adjustment in its agricultural sector. In addition, the EC has estimated that east German agriculture will qualify for about 3 billion ECU's for the 1991-93 period from the EC Social Fund, the Regional Development Fund, and the Guidance fund of the CAP, though a fair share of these subsidies will go towards non-agricultural uses in rural areas.

One immediate impact on the EC agricultural markets of German unification was the disruption of the beef market since east German slaughterhouses in part refused to accept cattle for slaughtering because the sudden elimination of subsidies left them without profits. The situation on the beef market further deteriorated when farms were forced to slaughter dairy cows because of the quota.

The EC hog market was also disrupted because east German consumers preferred western style foods and because the quality of the pork did not measure up to EC standards. Prices of both beef and pork dropped precipitously in east Germany and in the EC. Such abnormal price fluctuations in the EC are anathema to EC member states. It is likely that these price fluctuations, in combination with other world events such as the war in the Persian Gulf which

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1/ Calculated at the official exchange rate

affected EC prices adversely, exacerbated EC fears that the GATT negotiations could be used to expose EC farm prices to the unexpected winds of change outside the EC.

However, the long-term impact of German unification may be even more significant as east Germany increases productivity, particularly in the products that are already in surplus in the EC. The implications for EC and German agricultural policy are significant and will in turn affect world agricultural trade.

Perhaps the greatest effect will be in the political calculus of the CAP budget. Germany has long been the largest net contributor to the CAP and gained power in the decisionmaking process, among others, because it was viewed as the paymaster of the CAP. With German unification, much of east Germany will qualify for funds from the structural and guidance budgets of the CAP. In addition, east Germans have relatively low incomes and will not contribute as much to VAT contributions as their western counterparts. Consequently, Germany's net contribution to the CAP may decline for some time while those of France and Great Britain may increase. This presents a particularly difficult dilemma for the French who have long considered themselves the granary of Europe and a major exporter and competitor in world markets.

Effects on German Agricultural Policy

The effects that German unification might have on agricultural policy in Germany, and on the German position in multilateral agricultural negotiations, are not yet obvious and will take some time to clearly emerge. For the time being east German agriculture is in a difficult situation with state-owned farms and cooperatives receiving lower prices and returns after unification. Reduction of the rural labor force has begun at a high rate, reallocation of production inputs and outputs is underway, and adoption of new technology is increasing, but efficiency has not generally increased to make most farms profitable. Most importantly, the process of structural change has only begun and in most cases the large uneconomic farms have not yet been redistributed and new ownership patterns are only beginning to emerge.

Vulnerability of East German Farming

These developments would seem to reinforce the tendency of German policymakers to strive for an higher level of support than before unification. Relatively small farms in west Germany demand high protection, and the inefficient east German farms which are under so much economic stress are doing the same. Hence, there is no reason to believe that the German position has eased, rather, it would seem to have hardened in the short run. This was evident in the protracted negotiations on the 1991/92 CAP price package where the German Minister of Agriculture argued strongly against the price cuts proposed by the EC Commission just as he has done in earlier price negotiations. There is some change in the German position on CAP structural policies because the German government must now consider what structural policies mean to the large east German cooperatives. However, when it comes to market and trade policies there has not yet been any noticeable change in the German position.

There is no sign either of any political parties or pressure groups having fundamentally changed their position on agricultural policy. This is not surprising given the enormous amount of work and decisionmaking which has to be done in order to integrate east Germany into the EC and the unified Germany. There is a staggering amount of concrete issues which must be dealt with on a daily basis which occupies many functionaries in solving these mundane "technical"issues rather then adopting fundamentally new strategies on agricultural policies.

The DBV, for example, has yet to decide which of the old or newly established farmer groups in east Germany should be allowed to become members. This process is difficult because of the varying personal and political backgrounds of the different east German farm groups; the uncertainty about their long-run viability; the competition among different groups in east Germany; the difficulty in predicting the future ownership and farm size structure in east Germany and the relationship of the different groups with different types of farms; and the implications any of these decisions have for the structure of farmers' representations in the individual states in west Germany.

Emergence of Large Farms

It is likely that after some time, a farming industry will emerge in east Germany that is potentially much more efficient than that of west Germany. Some basic trends appear to be emerging even though the process of structural change has only begun. It is unlikely that many of the cooperative farms will survive in the longer term even in restructured forms. Agriculture in east Germany is destined to be dominated by family farms as in all western countries. Some of these farms will be similar in size to small farms in west Germany but most will likely be larger. Such farms will originate where members of cooperatives, who still have titles to the land they or their parents were forced to bring into the cooperatives, are claiming the land and are re-establishing their family farms. In most cases these farms will be larger than their previous farms because these new farmers have an interest in, and frequently the possibility of, renting more land from former members of the cooperative.

There will also be rather large farms far beyond the any size known in west Germany. These large farms originate from two processes: 1) Some farmers who have the managerial skill and capital to develop new large farms by renting land from a large number of small landowners who have no interest in farming; nearly all of these farmers are from west Germany and the farms range in size from a few hundred to a few thousand hectares: 2) Some of the owners of previously large estates that were expropriated have shown an interest in reclaiming and farming their estates again. These potential large farmers cannot simply claim their land and begin to farm since the Supreme Court confirmed the ruling in the unification treaty that the land expropriated between 1945 and 1949 will not be given back to its previous owners. However, in some cases they have begun to rent their former estates from the Treuhandanstalt (the current owner). In other cases they may use the financial compensation they will receive and opt for buying the land back from the Treuhandanstalt on favorable terms. In still other cases the estates will be sold by the Treuhandanstalt and they may survive undivided. In any case

the farm-size structure that will emerge in east Germany is likely to be much more favorable than the structure in west Germany. Moreover, tenant farming is likely to play a much more important role.

These factors argue for a more competitive agriculture in east Germany in the longer run which is less dependent on, and even less interested in, high price protection. The managerial farmers who may become prominent in east Germany may have more of an interest in free markets and free decisionmaking on the farm putting them in opposition to government intervention programs like quotas and mandatory set-aside. However, many of the employees of cooperatives and state farms would prefer the security and benefits they had under the old regime, thus there is likely to be resistance to any movement to free markets.

East Germany may develop a rather competitive food and processing industry. In the GDR processing industry, machinery and buildings were outdated, technology was obsolete, quality standards were poor, marketing activities were essentially non-existent, and managerial capacity was limited. Large parts of the east German food processing sector will be re-created by capital and know-how from west Germany and other western countries. The industry that emerges from this process is likely to be modern and competitive like German industry was after its rapid re-establishment after World War II.

Implications for Multilateral Negotiations

What are the implications of such prospects for the German position on multilateral negotiations? Time will be an important factor. The trend towards larger and more competitive farms in east Germany and towards a modernized food industry is obvious, but it has not yet materialized to an extent that it would influence thinking in the agricultural policy circles in Bonn. It will probably take a number of years to restructure in east Germany and the new situation will not then be reflected for many years in the federal government's position on agricultural policy matters such as price support and trade liberalization. The Uruguay Round negotiations are therefore unlikely to be affected by such potential changes in agricultural policy trends in Germany.

For the remainder of the Uruguay Round negotiations (assuming they are finished in 1991 or 1992) it is likely that the economic stress on agriculture in east Germany will reinforce most of the positions of German agricultural policy held before unification. The tendency to opt for continued price support in combination with set-aside now appears to be even stronger than before unification. This is because set-aside payments are an important cash-flow for many farms in east Germany. The special set-aside program, which the German government introduced for east Germany soon after unification, proved to be very attractive even though payments were lower than in west Germany. About 600,000 hectares were taken out of production in 1990, or 12.8 percent of arable land, compared to 4.3 percent in west Germany, because government payments offered a secure cash income to farms whose managers had no other source to pay wages to the members of their cooperatives.

Some analysts assume that up to 25 percent of east German land may be idled in the medium term because the GDR had utilized marginal land and had marginalized other land through overuse and misuse of fertilizers and pesticides in a bid for greater food self-sufficiency (Henrichsmeyer, 1990). Other analysts expect a much smaller share of east German land to be set-aside because efficient farms are likely to emerge in parts of east Germany and will want to compete in the market rather than only collect government payments (Tangermann, 1991). In any case, set-aside in east Germany is expected to remain proportionally more significant than in west Germany.

The continued German tendency towards a combination of price support and set-aside may well be reflected in the "reform" of the CAP which, as agreed among EC Commission and Council members, will be debated in the second half of 1991. If that is the case, the EC would then be likely to pursue the Uruguay Round negotiations so that its "new" domestic policy is covered by the multilateral agreements.

An indication of the direction this policy could go was given by the outcome of the 1991/92 CAP price negotiations. The Commission had proposed that cereal prices should be cut in spite of the fact that 1990 EC cereal production had remained below the guarantee threshold by a narrow margin. German farmers and Mr. Kiechle strongly opposed such a price cut while some member countries were prepared to accept it. Mr. Kiechle argued strongly for an intensified and extended set-aside program in order to make, as he put it, a first step towards reforming the CAP. It was eventually agreed that the co-responsibility levy on cereals be raised and a program of "super" set-aside in 1991/92 be added to the normal set-aside such that farmers who participate in the additional program be exempted from the co-responsibility levy. Mr. Kiechle used this "success" to present to German farmers as a victory for them in that he had managed to push the EC a bit in the direction where he thought CAP reform should go.

Mr. Kiechle is not alone in his thinking about the role od set-aside in CAP reform. Agricultural Commissioner MacSharry is heading in a similar direction. The MacSharry plan for CAP reform is also very much based on set-aside, and the incentives for farmers to participate would also come from price differentiation such that farmers participating in the set-aside receive higher prices than farmers who do not. In the MacSharry scheme, there would be deficiency payments and price differentiation would be brought about by excluding farmers who do not participate in the set-aside program from such payments rather than having them pay co-responsibility levies like under the current system. Such differences are relatively minor in political terms but not in economic terms.

As far as the GATT negotiations are concerned, the EC in aggregate may be more forthcoming as a consequence of the increasing domestic pressures for CAP reform. The position of the German agricultural policymakers, however, may not be much different from what it was before 1990, except that German interest in set-aside policies may now be stronger. Hence, Germany and possibly the EC on aggregate may have even more of an interest in making sure that credit is given for set-aside policies and other forms of supply control in any AMS arrangement.

German Unification Accentuates Need for an Overall GATT Agreement

Germany has far more to lose than before if the Uruguay Round is not successful. Germany's willingness to make significant contributions to financing political and economic reforms in Eastern Europe and the Soviet Union further increases the need for capital in Germany. The trade implications of unification, the restructuring of Eastern Europe, and support for the Baltics and other Republics from the old U.S.S.R. is that Germany should now have even more of an interest in earning foreign exchange by ensuring access to other countries' markets in order to export its manufactured goods and services (Agra Europe, December 7, 1991).

German unification may also affect the overall attitude of the German government to multilateral trade negotiations. German politicians and the general public very much appreciate the political support that Germany has received from many countries in achieving unification. It is therefore likely that German politicians will consider more carefully the interests of those countries' that were instrumental in helping achieve rapid unification.

German unification has significantly changed the macroeconomic situation of Germany. West Germany has traditionally run a large surplus in its foreign exchange balance. This situation has now changed significantly. High east German consumer demand and large investment requirements for east Germany have rapidly turned the German trade balance into the negative. This situation is likely to persist for some time and is quite acceptable to Germany as it has been a capital exporter for a long time and is now in need of capital imports to finance the enormous investments required to develop the infrastructure and industrial base in east Germany. On the other hand, the German government has had to increase taxes in spite of promises not to do so because the costs of German unification were apparently greatly underestimated (The Economist. July 20, 1991).

The question remains whether nonagricultural economic interests will be able to overcome the entrenched and powerful agricultural interests in the short run in Germany in order to conclude a significant agreement in agriculture in the Uruguay Round. While there are formidable obstacles to an agreement in agriculture from the point of view of German agriculturalists, German unification provides more impetus to the opportunity to reach a compromise on agriculture with Germany which has never been greater.

Chapter VII. Conclusions

The German position on agricultural talks in the Uruguay Round of the GATT negotiations has been shaped by a unique political, historical, and economic background that makes Germany a key player in the bid to liberalize agricultural trade. Germany has been the major influence on the development of price support and protectionist policies in the Common Agricultural Policy (CAP) of the European Community (EC) and its politically powerful farm lobby will resist any erosion of its support. On the other hand, German industrialists are more aware than before of the opportunity costs of the German position on agriculture in the Uruguay Round. Germany also stands to gain most among EC member states from trade liberalization. Based upon that background, it becomes more apparent where Germany might stand fast and where it might compromise in agricultural trade negotiations.

Germany's unique history has led to three periods of agricultural protectionism, the 1880's, the 1930's, and the 1950's to present. Germany's tendency towards agricultural protectionism, in combination with its bouts with starvation in the two world wars of the twentieth century, led the newly established Federal Republic of Germany (FRG) in the 1950's to a policy of import restrictions and high farm prices. A farm lobby also evolved that continues to wield disproportionate political power because of the nature of German coalition politics. This power is evident in The Agricultural Act of 1955 of the FRG which requires the government to "enable agriculture to... offset the existing natural and economic disadvantages" in order to "equalize the social situation of people working in agriculture with that of comparable professions".

German farm structure has led to one of the least efficient farming sectors in the EC and its small mixed farms have led German officials to push for high prices for all farm products. Grain and sugar prices are favored because of the historically powerful large landowners who have occupied an important role as a central pillar of the prevailing social system, and who dominate the powerful farm lobby. Resistance to structural change in German agriculture affects the CAP and reached a legislative peak in Germany in 1988 with the adoption of a bill that excludes larger farms from certain benefits and has as its objective to keep as many farmers on the land as possible. The philosophy implied in this legislation is not unlike the philosophy of the current CAP reform as proposed by the EC Commissioner for Agriculture, Ray MacSharry.

German agriculture was dragged into the Common Agricultural Policy (CAP) for larger political considerations. German farmers suffered nominal price cuts of 10-15 percent when the CAP was introduced and contend they were never fully compensated as they had been promised. The establishment of the CAP was regarded by many German farmers and agricultural ministry officials as a "national catastrophe" because it forced German farmers to accept lower prices and less protection than its previous national policy.

German officials in Brussels have used their uniquely powerful position within the CAP to influence the CAP to the advantage of German farmers. The most successful efforts have led to:

1) An agrimonetary system that has kept German farm prices above the prices of all other EC member states and far above world prices;
2) keeping EC nominal prices at high levels through use of its veto power;
3) the introduction of an EC milk quota;
4) the establishment of the EC set-aside program.

The CAP as it is currently constituted is now accepted by German farmers and they would not be willing to abandon it easily.

Even though the CAP costs German consumers and taxpayers more than the net farm income that their own farmers receive, German agricultural policy remains insulated because:

1) People outside agriculture simply do not have the information to apprise themselves of the effects of the policy;
2) political asymmetry allows politicians to be pro-farmer without losing votes from other sectors;
3) organization of a small, homogeneous group of farmers is easy compared to consumers and taxpayers;
4) the farm lobby has convinced the German electorate that it is a disadvantaged group that provides many useful services to society.

Agricultural trade liberalization in Germany will be a wrenching political and economic experience that will be greatly resisted by entrenched interests in spite of the positive impact on the overall economy. However, most German agriculturalists recognize that the CAP and Germany's agricultural policies must change. The agricultural talks in the Uruguay Round offer an opportunity to influence these policy changes although the negotiations are considered a side issue by most German agriculturalists, and at a minimum, as an opportunity to "rebalance" the CAP by restricting imports of cereal substitutes and oilseeds. While there is some appreciation of the need to avoid serious international trade conflicts among German agricultural policymakers, they regard the opening up of borders to international competition and market signals as both dangerous and unnecessary.

Mistrust of market forces by German farmers and the German Ministry of Agriculture has led them to push for quantity rather than price controls. Within an international context, Germans consider it unthinkable to bind domestic prices in any way to world prices. Hence, German priorities in a GATT package might consist of four fundamental elements:

1) Maintain the CAP mechanisms, particularly variable levies and export restitutions which would legitimize the two-tier price system of the CAP.
2) Loopholes in the CAP must be closed which means limiting the imports of cereal substitutes. This is considered an essential component in any GATT agreement by Germans. Often called "rebalancing," this aspect of the agricultural negotiations is of unique importance to German farmers and agricultural officials for economic and political reasons. It is considered the only potentially positive development for German farmers amidst CAP reform and trade liberalization. Rebalancing, even an economically insignificant agreement, is a necessary condition for an overall GATT agreement in agriculture.

3) Germans would be willing to bind the degree of self-sufficiency in the EC and there are precedents in previous GATT negotiations and in the CAP for such an effort.
4) The establishment of an extended Food Aid Convention consisting of a larger EC commitment.

The Germans will be constrained in what they can achieve in a GATT agreement and realistic compromises might be attained that would not completely upset its negotiating partners in the EC and in the GATT. However, the German position on tariffication is that it cannot be a compromise solution for Germany because it would either not change anything or it would change the legal and philosophical nature of the CAP that agricultural policymakers would find totally unacceptable.

A compromise for Germany could lie in an aggregate measure of support (AMS) approach which the EC also supports. While this approach restricts the CAP's room for maneuver, it could be the least restrictive available. An AMS approach where credit is given to countries that pursue supply control would allow Germany to trade-off reductions in domestic production against increases or lack of reductions in domestic support prices, i.e., it reduces the trade distorting impact but allows domestic support. The flexibility of the AMS approach imposes balanced disciplines but allows different types of policies under one umbrella. This flexibility would enable internal EC decisionmaking to reconcile disparate interests.

There are four aspects of an AMS which would be of particular significance to Germany: 1) specificity regarding policy measures, 2) policy coverage, 3) treatment of domestic supply control, and 4) definition of the external reference price. Essentially, Germany would like to have the freedom to choose the policy instruments to adjust to bindings on aggregate support and they would like to receive credit for their social security schemes for agriculture and its disadvantaged areas. Such credit could even serve as an incentive to Germany to "decouple" some social security schemes to the extent that they are production-enhancing. In addition, the Germans would prefer AMS credit for domestic supply control so they could lower quotas and not prices and provide direct income payments.

Germany would not accept an external reference price which would fully expose German prices to the shocks of international capital markets and the weather. However, if an AMS approach were based on a fixed external reference price and bindings applied to the domestic price and not to the gap between domestic and world prices, then Germans might be more forthcoming because this is essentially what the CAP does with its cereal stabilizer scheme. Alternatively, technical solutions to the problem could include a moving average of world prices or a subset of time periods where reductions are phased in. EC prices could then gradually follow the international price level without having to fully fluctuate with it. The agrimonetary system provides a precedent because the CAP eventually forces this kind of adjustment.

The "rebalancing" effort of Germany and the EC must be addressed for political reasons even if it does not have any great economic significance. German

farmers are not going to constrain cereal and oilseed output to see it replaced by cereal substitutes or oilseed imports. Various forms of compensation in agriculture for "rebalancing" could be made attractive to the EC's trading partners. Even a voluntary restraint agreement could be a profitable alternative for those countries exporting substitutes to the EC. For Germans it is much more important that the quantities of substitutes have a ceiling rather than a tariff that generates revenues.

Current developments in Germany which could affect the German agricultural position and the outcome in multilateral agricultural negotiations are German unification, the events in Eastern Europe and the Soviet Union, and the awakened interest of German industrialists in a successful conclusion to the Uruguay Round. The potential emergence of an efficient agriculture in east Germany is of less importance than the immediate need for high prices to support farm revenues, which is not consistent with trade reform. However, the German government acknowledges the political debt they owe to other countries for German unification and the need for a strong GATT agreement that keeps market access open for German exports needed to finance unification, support Eastern Europe, and deal with the Soviet Union.

The most important negotiating strategy in forging a compromise in agriculture with Germany in the Uruguay Round is to insure that the German government recognizes the linkage between agriculture and industry. German industrialists are waking up to the economic cost of German agricultural policy and are attempting to prevent German agricultural interests from dominating the outcome of the multilateral trade negotiations. However, their position is weak if German politicians are convinced that protecting farmers against outside pressures can be accomplished without significant negative repercussions for German industrial trade prospects.

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