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EC Agricultural Policy in 1992-93: Implementation of CAP Reform

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Topical information is given on the development and management of major EC agricultural markets, on the farm price decisions for the coming year, and on the consequences of recent changes in the Common Agricultural Policy. The compromise between the EC and the US which may lead to a solution to the ongoing GATT negotiations is discussed, and the problems in implementing the new agrimonetary regime are considered.

1. Introduction

The Common Agricultural Policy (CAP) reform which had been agreed to in 1992 has been neither the once-for-all reorganization of an over-stretched price support policy nor the clear break with former goals and mechanisms which some people believed it to be. As time passes the clearer the problems become. With several markets having avoided any changes, reform has been only partial. Doubts arise also on whether or not the European Community (EC) will have the political will and strength to subsequently reform the remaining markets. Bureaucratic intervention and the sector's dependence on subsidies and state interference have not diminished. Taking into consideration the steep increase in direct payments, the huge disposal cost of present stocks and future surpluses, the inflationary effects of new agrimonetary rules and the additional cost of public administration, the financial burden may turn out even greater than before. In spite of all these defects, reform will have substantial impacts not only on EC agriculture but also on related industries (fertilizer, pesticide, farm trade) and - although depending on later policy management - on world markets. Farmers grumble at the strict implementation of the new regulations especially in those (northern) countries where administrative capabilities ensure that the rules are being scrupulously effected. The farm ministers on the other hand are coming under increasing pressure to engage themselves in an early reform of the CAP reform. Most attempts have so far been rejected by the Commission - with the remarkable exception of those alterations agreed to in the context of the 1993 farm price decision. Thus, EC agricultural policy deserves no less attention by economists than before.

2. EC Agricultural Markets

2.1 Cereals

The EC cereals crop was about 167.3m tonnes in 1992 (cf. Table 1). Due to an extended drought in several member states it fell short of the previous year's result by some 7 per cent. The area harvested was down by 1.4 per cent. But there was no further reduction through set-aside partly because farmers were uncertain about the rules and compensation of existing programs, or about an eventual future treatment of set-aside land under the provisions of pending CAP reform. There are also other reasons for this situation. In France, for instance, set-aside programs are still unpopular and widely seen as contrary to national export targets. In some of the new German Länder (federal states) where participation had been very high, state authorities revised their attitude and now prefer a more balanced cultivation of land coupled with opportunities for

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The following average exchange rates may be used for conversion of ECU prices and monetary amounts mentioned in this article (units of national currency per ECU). The value of the ECU used in the CAP ("green" ECU) is, however, higher than is indicated by the real exchange rates. The "central rate conversion factor" is the appropriate multiplier for making necessary adjustments.

	$Aus	$US	DM	Factor
1989	1.39	1.10	2.07	1.1373
1990	1.63	1.27	2.05	1.1449
1991	1.63	1.24	2.05	1.1451
1992	1.77	1.30	2.02	1.1523
April, 1993	1.71	1.22	1.95	1.2055

Table 1: Supply and demand of cereals in the European Community (EC-12, 1000 tonnes)

Item	1988/89	1989/90 (A)	1990/91 p	1991/92 p	1992/93 e
Area harvested '000 ha	34,910	34,945	35,751	35,672	35,172
Production	163,959	161,461	169,247	180,249	167,265
Opening stocks	30,769	31,221	33,845	34,570	45,380
Imports	6,249	5,776	5,370	5,113	4,357
Exports	34,994	33,875	30,448	34,759	37,227
Domestic consumption	134,762	133,632	141,505	140,684	136,694
of which feed	81,190	79,375	81,899	83,679	80,023

(A) EC-12 excluding East Germany; p = preliminary; e = estimated.
Sources: Agrarbericht (1993, p.114), *Agrarwirtschaft* 42(1), 30,
EC Commission (AEL 26.3.1993, M14)

more jobs in agriculture and agribusiness. Especially in the five new Länder, 130,000 hectares of set-aside land were brought back into cultivation. Additionally, the trend to replace rye for higher yielding wheat continued at a rapid pace.

Following the bumper crop of 1991, there was a large increase in cereals stocks. Domestic consumption stagnated at around 140m tonnes. Imports remained at usual levels (ca. 5m tonnes) partly to meet international commitments (maize and sorghum imports agreed to after the Spanish accession to the EC), and partly to improve the quality of milling wheat (imports for the British and Italian markets). Thus, there was an exportable surplus from current production of about 45m tonnes and, since export opportunities were restricted (both financially and politically), an increase in stocks of about 10m tonnes resulted. The disequilibrium in durum wheat, where one-quarter of the 11m tonnes crop was in excess of market demand, was particularly serious and caused extensive intervention activity in Italy and Greece. Large stocks of soft wheat (and barley) were registered in France (5m tonnes) and Germany (6m tonnes), while structural advantages and short transport distances continued to facilitate subsidized export of British grain surpluses.

Producer prices reflected plentiful supplies. At the beginning of the marketing year 1991/92, in particular, when intervention was still closed in the Northern member states, the spread between intervention prices and market prices was more pronounced than usual. This gap steadily diminished during the following months (exports of about 4m tonnes of cereals to the Newly Independent States of the former USSR (NIS) contributed to increased prices) and,with the beginning of marketing year 1992/93, the price situation had normalized again. Subsequently, it even improved over the previous year, since the 3 per cent reduction of intervention prices which followed from the 1991 crop surpassing the Maximum Guaranteed Quantity (MGQ, 160m tonnes), was more than off-set by the suspension of the 5 per cent co-responsibility levy (CRL) which supplemented CAP reform. Moreover, smaller supplies of and increased demand for better quality grains strengthened prices. These tendencies made themselves felt especially in East Germany where local buyers, grain agents and foreign wholesalers competed for the attractive lots of high quality wheat; remarkably low marketing costs often resulted in producer prices surpassing those normally paid in West Germany.

Although the price situation had considerably improved, intervention still played an active role. The reason for continued intervention was widely held fears that the marked change in the price level

expected to result from the CAP reform would cause an anticipated price erosion to take place all over the marketing year 1992/93. These fears were unfounded as far as prices were concerned but intervention stocks again grew rapidly. Thus, the first year of the new CAP reform will start with 32m tonnes of cereals in intervention stocks which means a financial cost of not less than 3,500m ECU for the EC Budget (of which major parts have already been written off at the time of intervention) and a potential threat for world cereals prices.

Despite the EC's new 15 per cent set-aside requirement under the reformed CAP arable crops scheme, the total cereals area in the Community is expected to be reduced in 1993 by only 7 per cent as against 1992. The forecast issued by COCERAL (the EC grain traders association) in March 1993 (AEL 26.3.1993, M13) showed the biggest relative reductions to be in Belgium and Denmark (by around 10 per cent). In the group of main grain producers, the United Kingdom (UK) and France (reduction by 8 to 9 per cent) took the lead over Spain, Italy and Germany (minus 5 to 6 per cent). Based on the assumption of average growing conditions, COCERAL expected the 1993 cereals crop to range between 155 and 160m tonnes. The smaller crop was expected to cause a sharp fall in intervention stocks of between 5 to 10m tonnes - the first decrease after a period of continuous build-up. But hopes for lower stocks ultimately depend on export opportunities which were described as "not very optimistic" since the Commission had not yet announced new credit facilities required for grain sales to Russia. In 1992/93, one-third of total EC cereals exports to Russia (i.e. 6 to 7m tonnes out of 18m tonnes) were sold through credit or barter deals.

With regard to overall set-aside area reductions, COCERAL estimated a rate of 8 per cent of the EC base area would be achieved in 1992/93. This figure was later revised by the Commission to be close to 9 per cent (cf. Table 2). But while the UK was initially thought to have idled 14.2 per cent of its base area, this rate was later reduced by almost 2 percentage points. The correction was made shortly after the higher figure had successfully been used in support of British demands for a lower rate of non-rotational set-aside (cf. footnote 5 and related text).

Table 2: EC base area and set-aside

Member Country	Base area (a)		set-aside(b)		
	'000ha	EC = 100	'000ha	EC = 100	%
Belgium/Lux	521.3	1.1	38	0.9	7.3
Denmark	2107.4	4.3	227	5.3	10.8
Germany	9820.6	20.2	953	22.3	9.7
Greece	1491.7	3.1	25	0.6	1.7
Spain	9228.8	18.9	739	17.3	8.0
France	13522.0	27.7	1468	34.3	10.9
Ireland	345.0	0.7	30	0.7	8.7
Italy	5800.0	11.9	202	4.7	3.5
Netherlands	436.3	0.9	10	0.2	2.3
Portugal	1054.0	2.2	38	0.9	3.6
UK	4407.3	9.0	548	12.8	12.4
EC total	48734.4	100.0	4278	100.0	8.8

(a) from crop year 1993/94; (b) effective in 1992/93 estimated.

Source: (AEL 4.6.1993,E3)

Table 3: Production of oilseeds and pulses in the European Community (EC-12, '000 tonnes)

Item	1988/89 (A)	1989/90 (A)	1990/91 (A) p	1991/92 p	1992/93 e
Total oilseeds	5,035	4,844	5,724	5,466	n.a.
of which: Rapeseed	1,811	1,679	1,981	2,443	2,325
Sunflower seeds	2,145	2,099	2,635	2,420	2,742
Soybeans	530	629	665	482	421
Dried pulses	1,928	1,876	1,900	1,820	1,860
of which: Fieldpeas	812	843	914	870	925
Total oilseeds	11,598	11,074	12,671	12,595	n.a.
of which: Rapeseed	5,230	5,058	5,877	7,414	6,150
Sunflower seeds	4,019	3,481	4,295	4,149	4,089
Soybeans	1,655	1,985	2,065	1,574	1,231
Dried pulses	5,459	5,091	5,934	5,200	5,300
of which: Fieldpeas	3,635	3,630	4,580	4,050	4,140

(A) EC-12 excluding East Germany; p = preliminary; e = estimated.
Source: *Agrarwirtschaft* 42(1), 26

2.2 Oilseeds

Oilseeds crops in 1992 were hit by drought regionally even worse than the cereals crop. Rapeseed output was especially affected, producing some 1.2m tonnes less than the 7.4m tonnes harvested in 1991. Sunflower seed slightly increased by quantity although a much larger area had been planted (cf. Table 3).

The 1992 crop was the first one marketed under the new EC oilseeds regime. Thus, the producer price was considerably lower (-60 per cent) than those supported by the former crushing subsidy, and all participants in the market had to adjust their behaviour to the new situation. This was not achieved without friction. In Germany, producers of rapeseed expected to get 350 DM per tonne, a price hypothetically deduced from the new regulations. But this price was considered too high by the crushers since at actual dollar exchange rates soybeans had become more competitive. Some traders blamed the producers for withholding a large part of the rapeseed crop and thereby inducing the oil mills to switch to soybeans instead. It was not always taken into consideration, however, that the German rapeseed crop was not only smaller than usual but that supplies were further reduced following the Canadian crop failure. When by the end of October world soybean prices rose again, the controversy vanished and the crushers returned to milling rapeseed.

New problems in the oilseeds sector arose from linseed which was (erroneously?) omitted from the CAP reform and where limits corresponding to those imposed on the other oilseed crops in October 1991 did not apply. Consequently, more and more farmers - principally in the UK - switched to linseed production. This move was stimulated by the generous production subsidy and facilitated by the availability of surplus capital equipment and grower experience arising from the earlier expansion of rapeseed growing. As linseed was further stimulated by the restrictions on other crops resulting from the stabilizer policies applied since 1988,

production tripled within only two years (1989-91; cf. AEL 19.3.1993, P1).

In search of a solution, the Commission recommended a drastic change in subsidy and the inclusion of linseed in the category of arable crops subject to the set-aside program. The older price support based on world (Canadian) prices, multiplied by an indicative yield, was to be abolished and replaced by a less generous flat rate payment (to be multiplied by the regional average cereals yield in order to arrive at the acreage subsidy). The Commission further proposed that the rate of payment should decrease from 87 ECU/tonne in 1993/94 to 75 ECU/tonne in the following year. In the UK, where over 90 per cent of EC linseed is produced, these figures would result in a subsidy of 523 and 450 ECU/hectare, respectively, as against an amount close to 680 ECU/hectare in 1992/93. In addition, linseed growers would also be required to set aside 15 per cent of linseed land formerly devoted to production.

2.3 Sugar

Under present CAP regulations and with East Germany included, the EC sugar beet area is about to stabilize just below 2m hectares (cf. Table 4). Fluctuations are normally seen in some southern member states, especially in Greece and Italy, while the new German Länder are still adjusting their beet areas in compliance with increasing yields and quota restrictions. Although in 1992 only France and the UK experienced record high sugar yields, the overall result for the Community as a whole was 7.75 tonnes of white sugar per hectare, well above all previous figures. Total production (including white sugar from molasses, from Spanish cane and French overseas departments) comprised 15.79m tonnes compared to roughly 11.9m tonnes of consumption. Therefore, taking into account some 1.8 to 1.9m tonnes of sugar which the EC is committed to import under the British and Portuguese accession treaties, and about the same quantity which was available at the beginning of the marketing year (1 October), the exportable surplus was some 7.5m tonnes. No attempt was made to export such a big quantity of sugar. Economic and political reasons were expected to prevent exports of more than 5.4m tonnes with a consequent increase in stocks.

Although the EC regulation of the sugar market was due to expire by the end of June 1993, the Commission failed to make a timely proposal for a new sugar regime, either as part of the CAP reform package or at a later occasion. Farmers' protests against the reform as well as against the pending Uruguay Round finally resulted in another roll-over of the existing regime for one additional year.

Table 4: Supply and demand of sugar in the European Community (EC-12, '000 tonnes white sugar equivalent)

Item	1988/89 (A)	1989/90	1990/91	1991/92 p	1992/93 e
Area harvested '000ha	1,828	2,073	2,085	2,014	1,978
Production	13,915	14,273	15,870	14,796	15,794
Beginning stocks	2,323	2,006	1,541	2,036	1,822
Imports	1,804	1,928	1,877	1,860	1,870
Exports	5,140	5,388	5,435	4,955	5,400
Domestic consumption	10,896	11,278	11,817	11,915	11,900

(A) EC-12 excluding East Germany; p = preliminary; e = estimated.
Source: *Agrarwirtschaft* 42(1), 38

Despite continued ministerial propaganda pointing to the model-like character of the present EC sugar regime, future reform is clearly inevitable. Nevertheless, reform will pose a number of key problems if some basic standards are to be met (cf. Sommer 1993, p.38). Part of those requirements should be, first of all, that the new regime will contribute to liberalization of world markets and comply with commitments following from a future GATT agreement. Moreover, any new regime should allow market forces to play a greater role in allocating production and reducing overall production cost. EC sugar prices should be reduced to better fit into the system of agricultural prices and consumers should be given free choice of sweeteners at unsubsidised prices.

It would be unrealistic to demand such changes immediately. EC sugar policy has hitherto protected both the beet growers and the processors, and all participants in the market were lulled into a sense of security by national and EC authorities that this policy was to be continued. The investments made in the past - and even the recent heavy investment in East German sugar mills (including two completely new installations) - appear to have been based on continuation of the present sugar regime. Thus, any proposed change in the Community's sugar policy has to take into consideration the likely cost of reallocating production inputs. On the other hand, there are a few measures which, even without fundamental policy changes,could be taken in the short term.

Administratively, the EC could reduce the quantity of sugar eligible for export subsidies. Since this step might provoke increased exports of quota C sugar - a reaction to be expected especially at times of stronger world prices - carry-over of a certain quantity of C sugar would need to be made compulsory. National subsidies and non-uniform prices could be abolished. By allocating the quota presently held by the processing firms to the beet growers, the implicitly guaranteed processing margin could be abolished. Through announcing at the same time that the quota will become tradeable not only within the catchment area of existing sugar mills but internationally within the Community, the necessary reallocation of production could be initiated. A more flexible exchange of sucrose quota into fructose quota[1] would give consumers broader access to low cost sweeteners and increased competition would further reduce production cost.

With regard to an impending reform of the EC market regulation, the Commission is reported to be still considering the opportunities for a radical change. The basic idea of this initiative is said to be that, after the 1994/95 marketing year, production beyond the level of domestic consumption should not be supported anymore. This would certainly imply the abolition of the B quota and of the subsidization of sugar production attributable to this quota. It would leave open the question of the future system and level of prices. Currently, the profits made by beet growers and processors on the production of both highly protected quota A sugar and (less subsidized) quota B sugar, allow the industry to produce considerable quantities (2-3m tonnes) outside the quota. This quantity is exported without (additional) subsidies despite a 40 per cent gap between EC and world prices. Abolition of the B quota would therefore drastically reduce the Community's potential for sugar exports and have dramatic consequences on the structure of the industry and on the (windfall) profits earned under the present system.

In view of the extent of those consequences, immediate abolition of the B quota seems too radical to be acceptable to all member countries. Germany and others would likely point to the different degrees of sacrifice to be demanded from the various member countries (cf.Table 5). Other countries would likely question the differences in the coverage of domestic consumption by the national quota and request a more balanced redistribution of A quota. On the other hand, the proposal can also be seen as offering substantial advantages. EC consumers and the Community budget would be relieved of a considerable cost, although new compensatory payments would have to be financed by the Community. Pressure on world sugar prices, presently exerted by EC surpluses, subsidized carry-over stocks and profitable exports, would be re-

[1] The quota provided for isoglucose or High Fructose Corn Syrup which is also included in the EC regulation of the sugar market.

Table 5: EC sugar production quota (white sugar equivalent, 1991/92 through 1993/94)

Member Country	A-quota '000t	A-quota EC = 100	B-quota '000t	B-quota EC = 100	B % A
Belgium/Lux	680.0	6.1	146.0	5.9	21.5
Denmark	328.0	2.9	96.6	3.9	29.5
Germany(a)	2655.3	23.7	817.0	32.8	30.8
Greece	290.0	2.6	29.0	1.2	10.0
Spain	960.0	8.6	40.0	1.6	4.2
France(b)	2996.0	26.7	805.8	32.3	26.9
Ireland	182.0	1.6	18.2	0.7	10.0
Italy	1320.0	11.8	248.3	10.0	18.8
Netherlands	690.0	6.2	182.0	7.3	26.4
Portugal(c)	63.6	0.6	6.4	0.3	10.0
UK	1040.0	9.3	104.0	4.2	10.0
EC total	11204.9	100.0	2493.3	100.0	22.3

(a) includes new Lander with 655, 290t A-quota and 204,710t B-quota;
(b) includes French overseas departments - total 512,000 tonnes;
(c) includes Spanish Azores - total 10,000 tonnes.

Source: (AEL 7.5.1993, P1)

duced. Moreover, the reduction of protection would be more than sufficient to fulfil a future GATT agreement on the volume of subsidized exports, the rate of export subsidization and on the volume of domestic support.

At the same time as the opportunities of reforming the market regulation towards lower protection were reviewed, inulin syrup (a new high-fructose sweetener obtained from chicory and Jerusalem artichokes) was proposed for inclusion in the sugar regime. Since this new sugar substitute came onto the EC market it has been produced outside current CAP sweetener legislation with the effect of unrestricted growth of production. To prevent an eventual disruption of the tightly regulated sugar market, the Commission is now recommending that an inulin quota be established on the basis of production between 1992 and 1993, but also taking into consideration production capacities of each producer on 1 October 1992 as a corrective factor. Thus, the same principle is likely to be applied as in the case of isoglucose,which was put under the market regulation in 1981.

2.4 Milk

In 1992/93, the ninth milk marketing year (starting at 1 April) under the quota regime, EC milk deliveries continued to stagnate. With some 102.09m tonnes they were estimated to fall short of the overall quota by 1.84m tonnes (cf. Table 6). However, since it is not the milk quantity itself but the quantity corrected for increased fat content which has to be counted against the quota, there was in fact an excess of 795,000 tonnes over quota. Italy was again the main offender. This country exceeded its quota by almost 20 per cent or by 1.65m tonnes - an obvious result of the government's total failure to correctly implement the quota regime[2]. The other four surplus countries showed an excess over quota of less than 2 per cent each and totally made up for

[2] Detection of large excess milk production in Italy did not come as a surprise. It has never been a secret to market analysts that the Italian authorities reported highly dubious production figures. These figures were carefully designed to save the industry hundreds of millions of ECU otherwise payable for exceeding the national quota.

Table 6: Provisional EC milk quota balance (April 1992 through March 1993)

Member country	deliveries '000t	quota '000t	fat adjusted '000t	balance excess '000t	balance in % of quota
Belgium	2,989	3,095	166	60	1.9
Luxemburg	248	266	13	-5	-1.9
Denmark	4,427	4,428	0	-1	-0.0
Germany	25,653	27,550	1,130	-767	-2.8
west (a,b)	20,558	21,392	824	-10	-0.0
east (a)	5,095	6,158	306	-757	-12.3
Greece	496	526	0	-30	-5.7
Spain	4,408	4,458	13	-37	-0.8
France(b)	22,866	23,363	416	-81	-0.3
Ireland	5,247	5,199	6	54	1.0
Italy	9,894	8,312	71	1,653	19.9
Netherlands	10,542	10,877	424	89	0.8
Portugal	1,522	1,743	0	-221	-12.7
UK	13,082	14,113	357	46	0.3
EC total	102,094	103,930	2,596	760	0.7

Deliveries and quota: direct milk sales not taken into account.
Quota: maximum available quota with quota transfer (Reg 857/84) taken account of only in Belgium (175,000t).
(a) Deliveries from east German producers to west German dairies (estimated at 640,000t) attributed to east German deliveries.
(b) Including deliveries from other EC countries (estimated at 172000t).

Source: (AEL 16.4.1993, M11)

240,000 tonnes of excess milk. In East Germany and Portugal, on the other hand, roughly 12 per cent (757,000 and 221,000 tonnes, respectively) of the delivery quota were left unused, a fact which draws attention to structural impediments of properly (re)organizing milk production.

In the case of East Germany there are still major difficulties to be faced by the direct successors of former communist cooperatives as well as by newly established family farms. Both types of enterprises suffer from scarcity of financial resources. The cooperatives, which utilize large scale production facilities, are legally required to service the mortgage which the predecessor organizations had raised (or had to raise for political reasons) on buildings which are ill adapted under present conditions (uneconomically high labour and maintenance cost). Moreover, annual payments on those mortgages have drastically changed. While under GDR conditions interest rates ranged between 1 and 3 per cent, they are now 7.5 to 10 per cent. Even the legal obligation of the banks to grant suspension of liabilities in cases of imminent insolvency does not provide opportunities for new investment since any profits have to be used, in the first place, for

liquidation of debts. On newly established farms, on the other hand, investment in buildings, capital equipment and livestock often accumulates to levels that prevent rebuilding livestock production. On the whole, these difficulties are reflected in the current number of East German dairy cows which is only half of what it used to be before 1990 (similar relations apply to cattle, sheep and pigs).

EC dairy quota, instead of being reduced as was envisaged and formally recorded in the CAP reform negotiations, are being increased by an unbelievable 2.7m tonnes (cf. Table 7). This "happened" because of three measures which have to be considered separately. First, the increases in quota in Greece (+100,000 tonnes), Spain (+500,000 tonnes) and Italy (+900,000 tonnes), which were conceded in the context of or shortly after the CAP reform agreement[3], represent only a partial adjustment of quota in line with actual production. Actual surpluses above this should in theory be reduced by buy-back programs for relieving the market (Spain and Italy had made commitments to buy-up quota or otherwise remove excess production of about 800,000 and 1,550,000 tonnes, respectively). Second, the 0.6 per cent quota increase in the other member countries, a gift from the 1993 price negotiations to be put into a national "quota reserve", will however almost certainly cause a corresponding rise in deliveries. It will give greater scope for the balancing of over-deliveries with unused quota. Third, the increase in the quota for deliveries to dairies in East Germany at the expense of direct sales quota (50,000 tonnes) will take some time to make itself felt. All three measures will contribute to the difficulties of maintaining supply restraint and keeping budgetary expenditures within the limits of the agricultural guideline.

Reduced cow milk production (-1.3m tonnes; cf. Table 8) made itself felt most strongly on EC

[3] A proper implementation of the quota regime had been made a condition for the three countries to get their quota increases. Spain was the first considered to "deserve" its supplement but by the middle of April 1993, Greece, too, had established a central agency for dealing with production records and eventual levies and had made progress on allotting individual quota to producers. Italy, however, still lagged behind and even when the Commission urged the Council to concede Italy the additional quotas, few members were really convinced that the government was about to comply with the conditions set up by the Council.

Table 7: EC consolidated milk quota for 1993/94 (revised after 1993/94 price decisions)

Member Country	delivery		direct sales		
	'000t	EC = 100	'000t	EC = 100	%
Belgium	2937.2	2.8	373.2	13.0	12.7
Luxemburg	268.1	0.3	1.0	0.0	0.4
Denmark	4454.4	4.2	1.0	0.0	0.0
Germany	27727.8	26.0	100.0	3.5	0.4
west	21520.2	20.2	91.2	3.2	0.4
east	6207.6	5.8	8.8	0.3	0.1
Greece	626.0	0.6	4.5	0.2	0.7
Spain	5700.0	5.3	367.0	12.8	6.4
France	23503.0	22.0	732.8	25.5	3.1
Ireland	5230.5	4.9	15.2	0.5	0.3
Italy	9212.2	8.6	717.9	25.0	7.8
Netherlands	10984.2	10.3	102.3	3.6	0.9
Portugal	1794.4	1.7	67.6	2.4	3.8
UK	14197.2	13.3	392.7	13.7	2.8
EC total	106634.9	100.0	2875.1	100.0	2.7

Source: Revision according to ZMP, Marktbericht 22, 3.6.1993, and (AEL 4.6. 1993, M6).

Table 8: Supply and demand of milk in the European Community (EC-12, 1000 tonnes)

Item		1988 (A)	1989 (A)	1990 p	1991 p	1992 e
Dairy cows (1000 head)	a)	23,564	23,312	24,281	22,964	22,589
Yield per cow (kg)		4,538	4,627	4,722	4,758	4,878
Total milk production	b)	112,280	111,687	122,622	117,899	116,609
Dairy cows only		109,733	109,140	119,042	114,276	112,969
Cow milk deliveries		99,163	98,649	107,945	103,933	102,617
in % of production		90.4	90.4	90.7	90.9	90.9
Imports	c)	2,223	1,957	2,200	2,098	2,300
of which from NZ	c) d)	1,624	1,355	1,305	1,214	1,155
Exports	c)	19,177	15,125	10,900	14,709	14,500
Change in stocks	c) e)	-15,039	-1,574	4,226	-2,200	-1,800
Domestic demand	c) f)	88,695	87,055	95,019	92,522	92,217
Butter						
Production		1,689	1,715	20,260	1,792	1,686
Domestic consumption		1,900	1,530	1,654	1,641	1,566
of which						
at market prices	g)	1,226	1,171	1,283	1,203	1,126
Closing stocks	e)	212	124	335	302	250
Skim Milk Powder						
Production		1,353	1,488	1,775	1,526	1,338
domestic consumption		1,243	1,000	1,027	1,121	1,035
of which						
at market prices	g)	260	280	260	265	265
Closing stock	e)	7	5	333	421	50

(A) EC-12 excluding East Germany; p = preliminary; e = estimated.
a) December census; b) Total cow, sheep, goat milk; c) Whole milk equivalent; d) Butter only; e) Intervention stocks only; f) Cow milk products processed in dairy plants; g) Non-subsidized human consumption.

Source: Agrarbericht (1993, p. 106)

markets for butter and skimmed milk powder. Production of these two main intervention products (the others being some Italian cheese varieties) was reduced and thereby alleviated intervention. Stocks continued to decrease and smaller quantities of produce needed to be subsidized for consumption.

2.5 Beef

With an annual production of 8.71m tonnes (carcase weight) of beef and veal the EC's cattle industry had reached a cyclical high in 1991 (cf. Table 9). Production subsequently declined and, due to the

Table 9: Supply and demand of beef and veal in the European Community (EC-12, '000 tonnes slaughter weight)

Item	1988 (A)	1989 (A)	1990 p	1991 p	1992 e
Gross indig. production	7,618	7,336	8,247	8,710	8,350
Livestock imports	21	20	80	85	90
Livestock exports	92	144	144	110	100
Net indig. production	7,689	7,460	8,301	8,735	8,370
Meat imports	429	427	390	420	400
Meat exports	834	942	841	1,345	1,070
Change in stocks	-42	-300	322	266	250
Domestic consumption	7,326	7,245	7,528	7,544	7,450

(A) EC-12 excluding East Germany; p = preliminary; e = estimated.
Source: Agrarbericht (1993, p. 108)

prevalence of dual purpose cattle breeds in all EC member countries, this downward trend was further reinforced by decreasing cow numbers, a consequence of production limits and increasing yields in the dairy sector. In 1992, beef production was 4.1 per cent lower than in the previous year but measured against slightly reduced consumption it still remained about 12 per cent above domestic disappearance. Meanwhile, the process of restructuring the cattle herds to the benefit of more specialized beef production continued. Restructuring was generally stimulated by the financial incentives (suckler cow payments) granted under the CAP. The shift was especially strong in member countries utilizing large areas of extensive grassland (e.g. Ireland, France, Spain and, partly, the UK).

As in previous years almost two-thirds of total EC beef imports were covered by quota, some of which were more country-specific (granted to Yugoslavia, certain African or Alpine countries) while others were more product-specific (live calves or store cattle; high-quality beef or processing meat). These quotas are not always fully used. Beef imports therefore fluctuate according to availabilities in exporting countries rather than in accordance with EC requirements. Thus, between 500,000 and 550,000 tonnes of beef (carcase weight) are normally imported every year almost irrespective of domestic supplies. Since access to the EC's beef market is regarded by the Commission as a sensitive issue in international trade policy, it has seldom tried to regulate imports according to EC internal needs. Even a specially designed provision for determining the quantity of manufacturing beef to be imported by means of annual balance sheets has rarely been applied in the originally intended way (as to balance supply and demand by annual variation of imports).

Thus, at the same time when beef imports amounted to more than 500,000 tonnes, large quantities of beef had to be either exported or purchased for intervention. In 1991 for example, exports culminated in an all-time record of 1.45m tonnes of beef although intervention agencies purchased about 1.03m tonnes and carried-over some 0.86m tonnes into the next year. Over supplies have since not diminished. In 1992, beef exports and intervention purchases still amounted to 1.17m tonnes and 0.89m tonnes, respectively. Non-availability of appropriate international market outlets kept intervention stocks rising and December 1992 stocks set a new record: 1.09m tonnes of beef were in intervention stores and bound to rapidly deteriorate both in quality and in value.

In spite of current over production and continuously weakened price support, beef and cattle prices in 1992 recovered from the previous year's low, but without reaching the heights achieved in 1989. Looking at medium-term price developments, however, one has to take into account that market receipts have increasingly been supplemented by direct payments (special beef subsidy, suckler cow subsidy).

Throughout the second half of 1992 many farmers tried to expand their basis for legal subsidy claims. Not surprisingly, the number of suckler cows increased substantially during the last months of 1992, the year specified as the reference period for individual holdings. Bull calves were retained to provide the basis for claiming the 90 ECU beef special premium at ten months and the reduction of supplies began to pass higher price demands for store cattle to specialized veal finishers and beef fatteners. The new winter beef slaughter premium was reported to have deferred Irish steer slaughterings from the last quarter of 1992 into 1993 (an effect which had originally been aimed at by the Commission but nevertheless required some reorientation on the markets when it occurred for the first time).

2.6 Sheepmeat

Following the changes made in the regulation of the common market in sheepmeat, Irish sheep farmers complained about having lost half of their incomes in 1992 (due to the new method of calculating the headage premium based on a single price average for all EC member countries as against averages on seven regions previously). Contrary to the previous year when Ireland still formed a price averaging region of its own, with the ewe premium consequently making up all the difference between the EC basic price and the national average market price, the subsidies for 1992 were reduced by the overall price situation in other member countries. The abnormally high slaughter lamb prices realized in the southern parts of the Community raised the EC average price and pulled down the ewe headage payment. This was to the detriment of all those countries (e.g. Ireland) where market prices fell short of the EC average. In October 1992 the gap in average national lamb prices between Ireland on the one hand (1.67 £Stg per kilogram deadweight) and Spain (4.11 £/kg), Portugal (3.66 £/kg), Greece (2.94 £/kg) and Italy (2.80 £/kg) on the other was so large that the ewe premium had lost its effectiveness to the Irish as a compensatory payment making up lower market returns by higher headage subsidies.

Compared to the Irish sheep farmers the British faced even lower market prices (1.52 £/kg) but here the prices were viewed as more acceptable since they were higher than in 1991. Moreover, while British lamb exports to the continent were stimulated by the devaluation of the Pound Sterling and the removal of the clawback (cf. Manegold 1992, p. 128), the competitive situation of Irish exporters had been aggravated by the relative revaluation of the Irish Punt against the British Pound. But the increased competitiveness of British lambs depressed market prices in France so that the farmers there called for practical application of the aid package already announced by the government[4] to ease the effect of CAP reform and for anticipated handout of the instalment on the ewe payment for 1992. Claims were also raised in France and Ireland for another change in the ewe premium calculation and for provision of at least two separate price regions — one comprising the dairy sheep producing (Mediterranean) countries and the other one grouping together the meat lamb producing countries.

Whether or not the latter suggestions will be given further consideration by the Commission is not clear. Within the Council's comprehensive compromise deal from 18 December 1992, however, Ireland gained concessions on the calculation of the ewe payment by a one-year extension of the transition period towards EC-wide application of a uniform headage payment (originally to be applied

[4] The aid program was designed to relieve French agriculture from production charges of about 1,900m FF (288m ECU) in 1993. The main measure, estimated to be worth 800m FF, covers tax relief on land not built on. The tax reduction (worth 2,800m FF in all) was originally intended to be phased over four years (1993-96) instead of three as it is now. In addition, the national "extensive grassland subsidy" for areas with stocking density of less than 1.4 livestock units per hectare will be raised by 80 FF to 200 FF per hectare. Installation grants to young farmers and more favourable conditions for investment loans are also part of the aid package (*BIMA* No. 1406, p.4).

from 1993 on). By virtue of this change the Irish sheep farmers are now able to collect higher payments. In conjunction with the increase of the "Rural World" premium payable on ewes in Less Favoured Areas, the overall gain was estimated to be in the region of 4 ECU per head (AEL 18.12.1992, P2).

3. Farm Price Decisions for 1993/94

With the decisions on the CAP reform taken in 1992 and the implementation of reform measures well underway there was some justification for assuming that this year's farm price negotiations in the Council would be easily and quickly achieved. Farm Commissioner René Steichen, in office since 1 January 1993, even expressed hopes that it might be possible to put an end to the Council's "masochistic ritual of annual price negotiations" and to develop some kind of five-year farm acts as practised in the United States (US). Neither assumption was true. When the price package, however unpretentious it really was, came under discussion at the Council, the Commission was unable to arrange for a timely decision. Some farm ministers were new in office, the end of the French election campaign had to be waited for and the newly elected government needed some time to settle its attitude on the most controversial issue of French farm policy: the US-EC compromise on the agricultural aspect of the Uruguay Round. Thus, the EC price negotiations were not only delayed by months but increasingly burdened with ministers' demands for appeasing the various groups of the irrespective home constituencies. Finally, a comprehensive compromise deal was needed to reconcile all the national claims put forward and, as usual in EC farm policy, this compromise fell heavily on the European Agricultural Guarantee and Guidance Fund (EAGGF).

The price decisions themselves were broadly consistent with the current CAP reform measures AEL 28.5.1993, E1). The monthly price increments applied on top of the cereals prices were however reduced from 1.50 to 1.425 ECU/tonne per month rather than accepting the 10 per cent reduction proposed by the Commission. In view of the forthcoming general price cut triggered by the agrimonetary mechanism (cf. section 6 below), the reduction of the intervention price for butter by 5 per cent on 1 July 1993, planned as part of the CAP reform, appeared no longer acceptable to the German farm minister. It was therefore decided to make the necessary adjustments in two steps and to cut the butter price by 3 per cent in 1993/94 and by another 2 per cent in 1994/95.

Contrary to their own ambitions under the CAP reform, namely to cut the milk quota, the farm ministers agreed to increase the national milk quota by 0.6 per cent for all member countries except Spain, Greece and Italy (for which specific provisions had already been made in the context of CAP reform) and except Portugal and the new German Länder (which got their delivery quota increased at the expense of the sales quota). The new quota was formally intended for allocation to farmers who were illegally denied quota by the Council after they had bought or inherited land covered by a 5-year non-marketing contract in the late 1970s. This problem was however unknown to countries like Denmark, Belgium, Luxemburg and Portugal which nevertheless all participated in the augmentation of quota. In France the newly won quota was used for nullifying the seizure of hitherto suspended quota in the Less Favoured Areas, a measure which the government had unsuccessfully applied for at the Commission. The dairy industry will however take pleasure in such alleviation only for a limited period of time. Today's generosity on the quota issue will mean even greater hardship once the export volume reductions and minimum access restrictions of the Blair House accord are written into a GATT agreement and actually come into effect.

In addition to the quota, a sum of 40m ECU was made available for quota restructuring measures (buying-up schemes) which resulted from Irish demands for such funding. Although the Irish had asked for 2m ECU only, the Council was unable to agree unless all member countries were proportionately funded so that an amount twenty times the required one was finally spent.

The existing EC regime for sugar which was exempt from the reform in 1992 was further maintained but the Commission was called upon to make a reform proposal before 1 October 1993. The new regulation shall then be applicable in

1994/95. The aid for linseed was set at 85 ECU/ tonne (instead of 87 ECU as originally proposed) to be multiplied by the regional cereals yield. But the amount of aid will be reduced proportionately if the area planted exceeds an overall limit of 266,000 hectares in the Community.

Perhaps the most important changes to the price compromise were made with regard to the set-aside programme. On the request of the French farm minister who had asked for a 50 per cent increase, the Council unanimously agreed to raise the set-aside compensatory payment from 45 to 57 ECU/ tonne (to be multiplied by the regional cereals yield) and to apply this higher payment from 1994 onwards. This concession was made in order to buy off French resistance against the 10 per cent minimum set-aside rate for oilseeds which was agreed as part of the US-EC Blair House deal - yet without getting a clear commitment from the French side for approval of that deal. The rate for non-rotational set-aside which had been left open in the CAP reform decision was fixed at 20 per cent of the base area under normal circumstances. The rate will, however, be reduced to 18 per cent (1) for nitrate sensitive areas where a significant reduction in the use of fertilizers is required (at the request of Denmark), and (2) for countries where more than 13 per cent of the total base area was expected[5] to be set aside in the first year of the scheme (at the request of the UK). It is revealing for the new style of "à la carte" policy under Single Market conditions that in both cases the qualifications were aptly formulated in a very general but at the same time so specific way that all member countries were excluded except the two requesting ones.

Finally, from 1994/95 onwards, linseeds will be subject to the set-aside obligation, too, and sugar beet production for industrial (non-food) purposes will be permitted on set-aside land but the land under sugar beet will then not be eligible for set-aside payments.

Following the Commission's own estimate, the additional cost of the compromise on farm prices and related measures would amount to only 53m ECU in 1993 but increase to 313m ECU in 1994 and 577m ECU in 1995 (AEL 28.5.1993, P2). It was maintained that the budget guideline would still cover the cost until next year. For 1995, the Commission pretended to be unable to make such a qualifying statement because of non-availability of the respective guideline figure. Even assuming that the Commission's assessment is correct, there will certainly be no room for flexibility on major CAP issues over the next years. The visibly precarious budgetary situation has obviously not prevented the ministers from offering each other favours although they should have remembered the consequences of such behaviour from the experience of the 1980s.

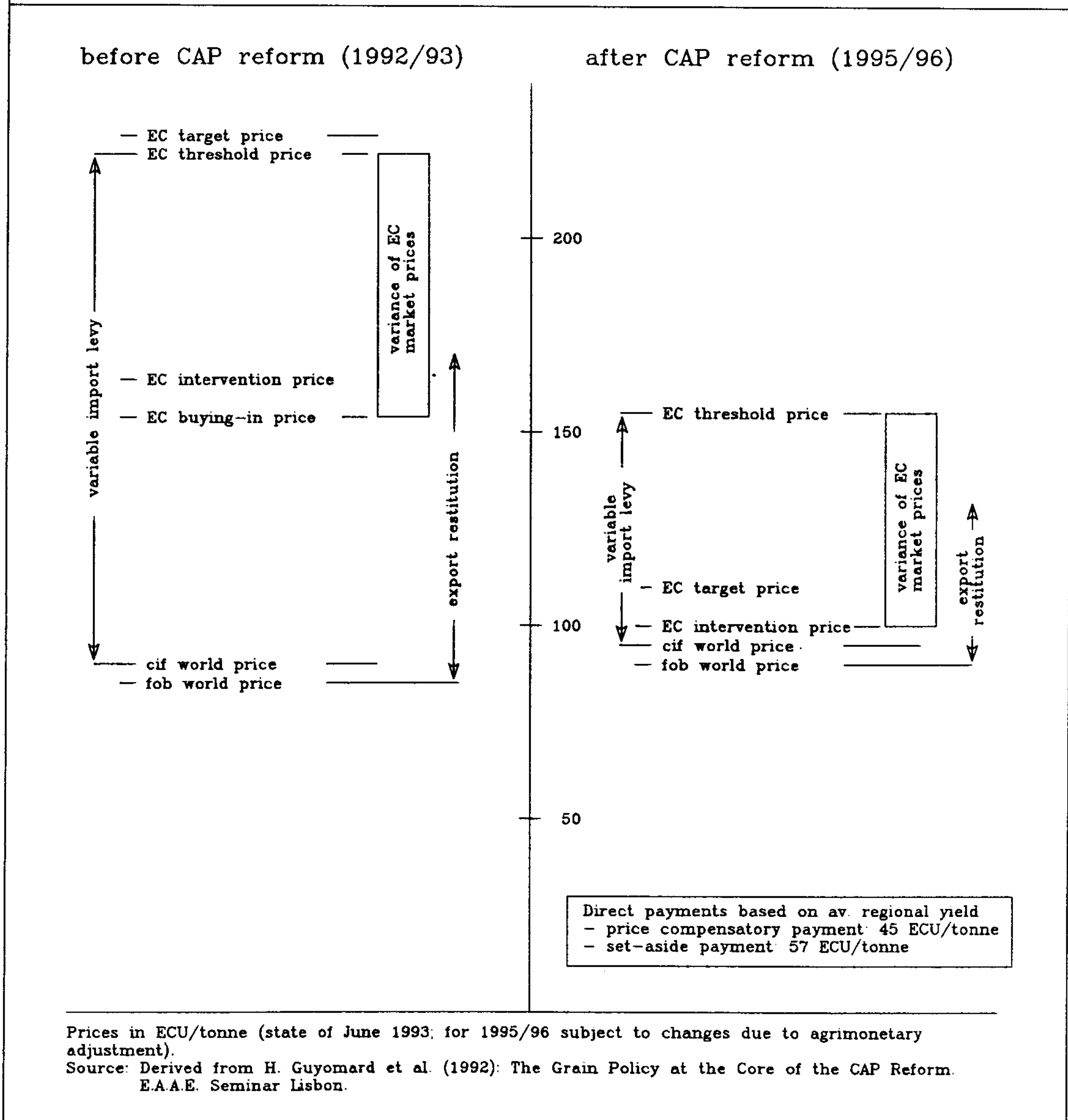
4. CAP Reform and Aftermath

The reform of the CAP (for details see Manegold 1992, p. 129) becomes effective from the beginning of the marketing year 1993/94. Overall, it is a modification rather than a fundamental reform of existing market regulations. EC cereals prices are drastically reduced but are maintained at above world levels. Larger farms will be forced by financial incentives to participate in the annual set-aside program (since non-participants cannot apply for price compensatory payments in excess of 92 tonnes of cereals). Beef and sheep farmers are supported more extensively by direct payments. The principle of competition has further been disregarded by granting direct payments but also by extended application of quota (on base areas, suckler cows, beef cattle reference herds, sheep flocks etc.). Current measures in the fields of social and structural (environmental) policy will also be extended. The basic principles of the CAP, however - preference of EC producers, common market and common financial responsibility - remain formally unaltered.

Market regulations have changed for cereals (c.f. Figure 1), oilseeds, tobacco, beef and sheepmeat. For milk the confirmation of the ruling quota system for another 10 years was overall more significant than the cosmetic price cut or the announcement of an intended (though limited) reduction of quota. Other products such as sugar, fruit and

[5] Ironically, it is not the percentage of land really set aside which matters in this respect but the expected percentage quoted in a Commission paper. The xlatter was much higher (14.2 per cent) than the former (presently estimated at 12.4 per cent).

Figure 1. Systems of Price Support for Cereal Under EC Agricultural Policy



Prices in ECU/tonne (state of June 1993; for 1995/96 subject to changes due to agrimonetary adjustment).
Source: Derived from H. Guyomard et al. (1992): The Grain Policy at the Core of the CAP Reform. E.A.A.E. Seminar Lisbon.

vegetables, olive oil - and the less regulated markets in pig meat, poultry meat and eggs - remained totally unchanged.

4.1 Speculation on likely effects of the CAP reform

Soon after the decision on CAP reform was taken speculation began on what the combined medium-term effects of the new policy measures would be. A few examples taken from an international conference in London may, in this respect, throw some light on contemporary experts' opinions (AEL 17.7.1993, E3).

Rudolf Stöhr of COCERAL suggested that the EC grain harvest could stabilize at around 170m tonnes by 1996, 20m tonnes below the likely result under

an unreformed CAP. Assuming that around 3.7m hectares of arable land will be idled (as against 0.5m hectares in 1992) the set-aside impact on production was estimated to be 14 to 15m tonnes. Sharply reduced support prices would lower the intensity of grain production and contribute at least 5m tonnes to the overall change. At the same time, the price effect would stimulate consumption of cereals in the form of both compound feed and on-farm utilization adding another 5m tonnes each to alleviate the EC grain balance. Thus, with total supplies (including required imports of 5m tonnes) amounting to 175m tonnes and consumption rising to 150m tonnes an exportable surplus of around 25m tonnes would be left. Since this quantity was considered still to be too much under any prospective GATT agreement and normal world market conditions, Stöhr predicted that the level of set-aside would have to be increased from 15 to 20 per cent of the base area.

Although the EC dairy sector had been in the background of the CAP reform negotiations, it was seen likely by Philippe Jachnik of the French dairy trade organizations (FNCL/ATLA) that unresolved problems would soon come to the surface and require new quota cuts. It was also realized that the continued subsidization of about 20 per cent of EC butter output (as it has been the case in the decade of 1980 to 1990) posed potential threats to the whole sector. While the triggering of this time bomb was thought to depend on availability of financial resources, any conceivable GATT agreement would sharply increase direct pressure on the output of the EC dairy industry. Moreover, producers and processors alike would be facing increased competition, first, from countries joining the Community in the near future and, second, from newly emerging market economies in Eastern Europe some of which (Poland being a likely candidate) have the potential to become important milk producers. With regard to an eventual quota cut (as freely envisaged under the CAP reform) other speakers questioned whether a reduction by 2 or 3 per cent would be sufficient in the medium term. The question was also raised about the economic wisdom of applying equal cuts to all member countries irrespective of their efficiency. Using the UK as an example, the often-heard argument was that one of the most efficient milk producing countries was, in view of its low self sufficiency, not to be made responsible for EC milk surpluses.

The British sheep farmers were widely believed to be the main beneficiaries of the decisions concerning the reform of the EC sheepmeat market. First, the flock size structure and the retention of the old size limits, in this market, give British farmers a comparative advantage over other member countries in exploiting the EAGGF. Further there is the redefinition of an ewe eligible for payment which will divert more money into the pockets of British producers. This definition had hitherto been an ewe being at least one year old before the last day of the application period. In conjunction with the typical age structure depending on the replacement cycle the final date (23 February) was said to effectively bar an estimated 3 million specialist replacement sheep in Britain from earning a total of around 55m ECU in ewe payments. This amount is now expected to be released by the new definition of eligibility, admitting ewe lambs for subsidy that become one year old during the 100-day retention period (AEL 16.10.1992, M6).

With regard to farm incomes, arable farms tend to lose income from the reforms, mainly for two reasons. Firstly, although the amounts of compensatory payments are calculated, on average, to exactly balance the effects of price reduction, farms with above average yields are disadvantaged compared with those operating at lower yield levels. This disadvantage will be the greater the higher the share of cereals and oilseeds is in the farm's arable area. Secondly, farms which have to comply with the set-aside program and cannot efficiently opt for the small-farmers' provision are particularly hit because the set-aside payment does not normally compensate for the income foregone. However, the regulations worked out in 1992 give reason to assume that depending on the future stability of the required set-aside rate, farm incomes could stabilize around the level adopted in 1993/94. Taking into consideration the massive increase in the rate of set-aside payments (+26 per cent), the arable farms affected by this program will see their potential loss in income considerably diminished.

Although it is certainly correct to say that, by the reform package, farms with lower yield levels have

generally gained a relative advantage over those with higher yields, this effect is mainly an intra-regional one. The relative competitiveness of whole regions, however, has changed in favour of the better ones rather than the worse ones. Moreover, since more fertile regions tend to be better structured and to have more alternatives for earning an income (on and off the farm), they also have much better opportunities for adjustment. The consequence will be that, in the medium term, structural adjustment will not increase evenly but at different rates. The more favourable regions will show a tendency towards farm growth coupled with intensified co-operation between individual farms. The less favourable regions will experience more and more (marginal) arable land being left idle. Death of the present farm operator or depreciation of existent capital equipment will require critical decisions to be made and in many cases it will turn out that the farm cannot continue to be operated efficiently (unless farm growth and basic investment would be financed by the public). The likely result of such divergent trends will be that EC cereals production will increasingly concentrate on more fertile soils. The speed of this change may well be higher than the biological increase in yield. If this is the case, the reduction in cereals production caused by the CAP reform could be greater than presently anticipated.

Moreover, a general decrease of agricultural producer prices makes farm income more susceptible to fixed cost. Prices and quantities of variable inputs will adjust and in the long run land rents and farm equipment values will also reflect the lower output price levels. But legal prescriptions affecting construction cost, maintenance and repair as well as general production conditions will need some attention. The relevance of these general factors was stressed by Breulmann (1992) who hinted at the large differences within the Community. According to his calculations, two arable farms of around 100 hectares operating under CAP reform conditions at a gross margin of about 120-125,000 DM each, provide for a net income (before tax) of 75,000 DM in France but only 42,500 DM in Germany, with the difference being due to land rents and fixed cost.

While the above figures obviously do not take into account different levels of national subsidies, it is often questioned how long, or up to which levels, direct payments to prop up farm incomes will be acceptable to the public. Weinschenck (1992) is certainly not alone in fearing that acceptable limits will be exceeded when, after the CAP reform, direct payments make up more than 80 per cent of farm income (a level which he assumes to be realistic for an average family farm) or when payments of more than, say, 50,000 DM (or even 500,000 DM in cases of very large east German farm companies) are handed out annually to "wealthy" farmers.

4.2 Early criticisms of the agreed policy measures

It was no surprise that the CAP reform was heavily criticised by all affected, especially by the farmers and the merchants in farm commodities. But the intensity and the targets of criticism varied among member states depending on their main fields of economic interest.

According to an EC-wide opinion poll (the reliability of which cannot be assessed) 85 per cent of all replies were reported to be opposed to CAP reform (AEL 16.4.1993, E6). At least in the eyes of those directly concerned, the expected increase in direct subsidies and other advantages is far outweighed by price reductions, obligatory set-aside and increased bureaucracy. The most extreme views were held in France with 93 per cent of farmers voting against and just 4 per cent in favour. In Germany the corresponding figures were quite similar (92 and 6 per cent, respectively). The most moderate opinions seem to prevail in Great Britain with 61 per cent being against and 31 per cent agreeing with the direction of reform. Italian farmers also appeared to be somewhat positively minded, of whom 76 percent opposed but 23 per cent supported the changes. Although the result from the poll seems to be consistent with common expectations, it should not mislead observers to believe that the above figures reflect purely economic expectations based on sober judgement. In many cases political over reaction, anger about bureaucratic requirements or, on the contrary, opportunities to circumvent administrative restrictions may have guided the farmers' votes.

In Denmark the general obligation to set aside considerable parts of the arable land was strongly objected to (AEL 17.7.1992, E7). It was seen as an intolerable impediment to the country's pig industry. Under the Danish Farm Pollution Laws introduced in 1987, pig farmers must have one hectare of arable land available for every 20 pigs that are slaughtered so as to avoid slurry disposal problems. It was therefore argued that the new requirement of setting aside 15 per cent of that land would, at the same time, seriously affect the volume of pig production and impair flourishing pigmeat exports to Japan. The Danish government therefore called on the Commission to provide for farmers to grow cereals for non-food uses instead of setting-aside the land. Such demands were later seen to be met by the Commission's proposal on the unexpectedly generous admission of non-food production on set-aside land (cf. section 4.3 below).

In addition to the concerns regarding the special situation of pig farms, fundamental objections were raised in Denmark against the setting aside of sandy-soil arable land, a resource the country seems to be sufficiently equipped with. The objections were based on experimental studies which demonstrated that setting aside those environmental sensitive areas promotes enhanced leaching of nitrates to ground water supplies. Extensive farming practices which did not show the same effects (or did but to a much lesser extent) were consequently to be preferred from an environmental point of view. Since this argument was endorsed by major parts of the population, the government took the initiative on the eve of a critical second referendum on the Maastricht treaty (on the European Political Union and the Economic and Monetary Union) to call upon the Commission to generally exempt Danish farmers from all set-aside obligations in return for their commitment to reduce fertilizer applications and be subject to levies on chemical inputs. Extensive farming and organic agriculture should be subsidized by specific payments to put these forms of production on an equal footing with conventional farming (AEL 12.2.1993, E4). This initiative was later embodied in the 1993 compromise on farm prices.

4.3 Implementation of the CAP reform

Feed wheat excluded from intervention support

One part of the provisions to implement the CAP reform in the cereals sector was the decision by the EC cereals management committee to bar feed wheat from intervention support. Thus, the single intervention price will only apply to soft wheat of bread making quality and to feed barley. Feed wheat will profit only indirectly from the support granted to bread wheat. But (according to a "safety-net clause") the Commission has also given assurances it will take appropriate actions "if the price of feed wheat were to fall to a level which risks disturbing the market for bread making wheat or feed barley" (AEL 7.8.1992, E1). An indication of the risk of such disturbance would be (on present knowledge and perhaps subject to change) a price gap between feed wheat and bread wheat or barley exceeding 5 per cent at a time when intervention for wheat or barley was open and the market price for bread wheat or feed barley was at or below the intervention price.

Set up of an Integrated Control System

In order to prevent possible fraud the Commission had its proposal of an integrated agricultural control system (IACS) accepted by the Council (EC Reg. 3887/92), a system which was immediately denounced by national Farmers' Unions as being perverse and showing that "Big Brother (the Commission) had gone mad" (AEL 13.11.92, E5). The IACS is intended to be supported by computerized information as well as by remote sensing. It makes obligatory in situ controls of 10 per cent of all applications submitted for headage payments and of 5 per cent of the applications for acreage payments. It also stipulates severe sanctions to be applied in cases of irregularities.

As the administrative requirements necessary to back up the political decisions taken by the Council of Ministers on CAP reform became apparent, prospects of unprecedented administrative upheaval gained ground. The new regulations concerning price compensation, set-aside and livestock subsidies were soon identified as extremely difficult tasks. The information necessary to provide a coordinated, integrated statement of claims included not only the authenticated proof of the location,

size and utilization of any plot of land agriculturally used by a farmer. It also necessitated a final assessment of every livestock farmer's forage area, a decision of how to deal with agistment and the determination of the size of reference herds as well as of stocking rates. Male bovine animals for which special beef subsidies are applied have to be identified by ear marks and on-farm livestock registers.

Set-aside to be used for non-food production

A special regulation proposed by the Commission provided detailed arrangements for the production of non-food products on set-aside land. This regulation (EC Reg. 334/93) allows for the unregulated production of almost any product except fruit and vegetables, herbs, medical plants and vines provided that the crops are put to broadly defined non-food, non-seed uses and that adequate compliance controls are carried out. While production for starch and, at that time, sugar was excluded on grounds of these products being eligible for special subsidies (so-called production restitutions), the production of oils, fibres, fuels and general biomass for energy was permissible. Even oilseeds were originally not restricted as long as "the economic valuation of the non-food products obtained by any processing of the raw materials is higher than that of all other products derived for human or animal consumption".

The regulation further required that growers and processors of set-aside non-food crops have to conclude contracts on the kind and quantity of raw material and its utilization. Growers have also to submit annually a cultivation declaration to the supervising authority in addition to the normally required set-aside statement. In that declaration they have to make evident: the type of raw material and its variety to be cultivated on set-aside land; the variety of the same material eventually to be grown on non-set-aside land; and the areas of set-aside land devoted to non-food crops and the forecast yields for every species and variety to be grown.

Another important provision contained in the regulation was initially seen to jeopardize the basic intentions of the whole project. According to the regulation, the processor has to lodge a deposit equal to 120 per cent of the set-aside payment (at that time 45 ECU/tonne times the regional cereals yield in tonnes/hectare; the rate has been changed in conjunction with the farm price decision, cf. above) for each hectare contracted. This deposit will only be released when the supervising authority has received proof that the crop has been harvested, delivered and processed. The quantity produced and processed must be within a stated margin of the originally expected yield to ensure a complete refund of the deposit. Likewise, the grower will not receive set-aside compensation until evidence has been provided by the processor that the crop has been delivered and processed.

Contrary to initial suspicions regarding the deterrent effect of administrative impediments, non-food production on set-aside land has frequently stimulated the interest of European farmers and of processing industries. According to provisional records some 50,000 hectares of set-aside land planted to rape seeds were put under contract in Germany for 1993 although the wording of the regulation was then not known to the applicants.

4.4 Later correction of CAP reform decisions

Shortly after the CAP reform was agreed some unintended discrepancies were recognized.

Initially, the regulation on the winter slaughter subsidy (60 ECU per head payable on steers slaughtered in January to April instead of during the peak slaughtering season immediately after summer grazing) was almost exclusively to the advantage of Irish steer fatteners. French and German farmers specialized in the same product under very similar conditions were ignored. By amending the relevant EC regulation these minority groups also were made eligible for such aid.

Eligibility for suckler cow subsidies was extended to dairy producers with a quota of between 60,000kg (the originally proposed limit) and 120,000kg. It was further believed necessary to put a ceiling on this subsidy. The overall limit was fixed by the Council at 806,920 head (AEL 22.1.93, E1). When it was allocated to the individual member countries, Luxemburg and Portugal complained they were treated too harshly (by allocation of only 760 and 5,760 head, respectively); they were promised that

their problems would be looked at later.

France wanted an extension of its area eligible for durum wheat acreage payments. This demand was fulfilled by an additional allotment of 63,355 hectares on top of the 432,000 hectares average area of the last three years (1990-92; not all of which may have been eligible for the regional aid).

Apart from those early amendments which had been initiated by the Commission, there were many other suggestions for modification of particular details concerning the CAP reform. These suggestions arose when national authorities started to consider how the reform was to be put into practice, what such action would mean administratively and how farmers would be likely to react. Although each member state found some "absurdities" which it wanted changed, only the German farm minister came up with a whole "shopping list" to the Council. Highlights in the German memorandum on amending the CAP reform were as follows (AEL30.4.1993, E2):

(a) The six-year period of rotation applied on set-aside was suggested to be reduced to three years (so that every individual plot of arable land had to be cultivated only two years before it could be set aside again and assuming a 15 per cent set-aside rate only half of the base area had to be idled periodically). Regional authorities instead of the national administrations should be responsible for the management of the set-aside program in order to better deal with regional characteristics. Newly rented land should be exempt from the general requirement to cultivate land for two years before setting it aside;

(b) Direct payments on oilseeds should be made in one single tranche (instead of two) and irrespective of the quality of produce;

(c) The beef special subsidy should be made only once in the animal's life rather than twice. It should be paid either on live animals (method requiring earmarks for identification of individual animals) or at slaughter (procedure to be applied in Germany) and should be handed out within one week rather than within 30 days. The 90-head limit (which does not apply to East German agriculture anyway) should be removed. In calculating the stocking density all livestock on a farm should be taken into account rather than only those receiving aid. The upper limit of stocking density should be reduced over a longer transition period. It should be confirmed that the 350,000 tonne ceiling put on beef intervention is meant to include safety net purchases; and

(d) Exaggerated instructions contained in the payment application forms, for instance the one which requires dykes, hedges and solitary trees to be accounted for when measuring land, should be abolished.

Although the Commission took notice of the memorandum, there was no immediate reaction to it since the Commission did not want "to give wrong signals" to the farmers with regard to opportunities for continually modifying the regulations of CAP reform according to the wishes of individual member countries. Moreover, the Commission feared endangering the complicated compromise by giving in to immediate demands for changing individual aspects of the reform package. On the other hand, however, it was already clear that the Commission would comply with similar French and Danish demands to buy off national concerns either on CAP reform and GATT compromise or on EC policy altogether (Maastricht referendum).

5. Towards an Overall GATT Compromise

By its May 1992 decision on CAP reform, the EC Council of farm ministers seemed to have prepared the ground for also overcoming the paralysing situation in the multilateral trade negotiations of the six-years long Uruguay Round of the GATT. It was, however, soon realized that because the farm ministers had watered down the Commission's original reform strategy so much (which had aimed at, among others, making efficient EC cereals producers competitive at world prices), that even the reformed CAP remained a major stumbling-block to the GATT conference. Consequently, the only opportunity to reach a breakthrough was to get at least two of the main antagonists at the conference, the US and the EC, to end their open hostility in

agricultural trade matters and to conclude a tentative bilateral agreement which could serve as a reference for a general GATT agreement.

Although the interests and strategies within the Community continued to diverge, talks between the US administration and the EC Commission were intensified. Finally, after about six months of extremely difficult negotiations and several crises[6] a three-issue understanding was signed by US Secretary of Agriculture Madigan and EC Farm Commissioner MacSharry on 20 November 1992. Besides arranging a bilateral solution to the agricultural dossier of the Uruguay Round, the so-called "Blair House agreement", also provided solutions to the US-EC trade conflicts on oilseeds and corn gluten.

5.1 The Blair House agreement

With regard to the first issue, the US-EC agreement loosely follows the lines of the compromise proposal tabled early in 1993 by GATT Director-General Dunkel. Its main points are (AEL 27.11.1992, E1):

Market access

Border protection measures will be changed into customs tariffs. The tariffs will be reduced, on average, by 36 per cent over six years but each individual tariff has to be reduced by at least 15 per cent over the same period[7].

For the Community, the tariffs will be, at the beginning of the six years, equal to the difference between the world market price (fob) of the product and its intervention price, increased by 10 per cent and by any monthly increments applicable to the intervention price. A variable element ("special safeguard clause") is automatically added to the tariff, when the import price into the EC falls by more than 10 per cent below its 1986-88 average. The amount added to the basic tariff grows proportionately to the difference between the real import price and the 1986-88 average. Protection against fluctuations in the dollar exchange rate is ensured by the fact that import prices are measured in national currencies, that is in ECU for the EC.

A clause on minimum access postulates that import opportunities are to be opened, equal at the beginning to 3 per cent of internal consumption increasing to 5 per cent at the end of the six years. Minimum access is understood not to be an obligation to buy but rather a possibility to do so. A further obligation is that of maintaining existing access opportunities (from which, upon EC's insistence, bananas are exempt) which concern special agreements (e.g. the New Zealand butter and sheepmeat agreements) which will be adjusted to take account of tariffication but without any deterioration in terms of quantities.

Internal support

Overall internal agricultural support (AMS, calculated according to the global method requested by the EC) is to be reduced by 20 per cent as compared with the 1986-88 average. Credit is given for the reduction in support achieved since 1986. Direct payments as those adopted under CAP reform are excluded from calculating the annual AMS values and are not subject to any commitment to reduce internal support. To qualify for being exempt, these aids must be granted within the framework of production-limiting programs (decoupled from actual production). In addition, aids in the green box (as defined in the Dunkel paper; cf. Manegold 1992, p.138) are all exempt from any reduction.

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6 At the time of the US presidential elections talks broke down after, on French insistence, the EC refused US demands for a quantitative limitation of EC oilseeds production (9m tonnes) and the US rejected EC requests for negotiating on the level of subsidy payments instead. The US then resorted to calls for the imposition of trade sanctions against EC food imports, and announced punitive tariffs on EC wines. But while the French government (supported by Belgium, Spain, Portugal and Greece) still favoured a vigorous response to the US announcement, the Community (Commission and Council of foreign ministers) decided against counter-sanctions. Some leading EC politicians had recognized that, inevitably, the negotiations had to go beyond national interests, especially sectoral ones, and they consequently urged both sides to resume negotiations. A few days later, however, EC Farm Commissioner MacSharry temporarily resigned as GATT negotiator in protest at what appeared to be President Delor's pro-French, anti-GATT stance in the talks. Again, UK Prime Minister Major and German Chancellor Kohl intervened in favour of MacSharry and pushed the Commission hard to finally reach an accord with the Americans.

7 The base used for the calculations of market access is always the average of 1986-88.

Export commitments

With regard to subsidized exports, two commitments are foreseen. Direct export subsidies are to be reduced, product by product, by 36 per cent over six years starting from the average outlay of 1986-90. During the same period, the volume of subsidized exports has to be reduced by 21 per cent, also on a product by product basis and starting from the 1986-90 average. Non-subsidized exports and food aid do not fall under this obligation.

The two negotiating parties further agreed to take up bilateral consultation with a view to finding a mutually acceptable solution should EC imports of non-grain feed ingredients increase to a level which, in comparison with the average level of imports in 1986-90, undermined the implementation of CAP reform. In order to reduce the risk of later GATT panels a special peace clause was worded to be inserted into the final act on agriculture to be passed at the Uruguay conference.

5.2 US-EC dispute on oilseeds and corn gluten settled?

In order to finally settle the US-EC conflict on oilseeds, the Blair House accord made the following arrangements (later published by the Commission as a "memorandum of understanding"; AEL 5.2.1993, E4). The EC accepted creation of a separate base area for the production of oilseeds benefiting from the specific aids regime. This base is 5,128,000 hectares from the 1995/96 marketing year[8]. Special provisions apply for 1994/95 to take account of the transitory regimes valid for Spain and Portugal. The oilseeds base area remains subject to the EC's annual set-aside program but with the additional restriction that the rate of set-aside cannot be less than 10 per cent. If the area calculated as indicated above is exceeded, the area payments will be reduced proportionally. The areas placed under the set-aside program but planted with oilseeds for non-food purposes will not be included in the area defined above. However, the Commission committed itself to take corrective action within the framework of the CAP, if the production of by-products resulting from the cultivation of non-food oilseeds exceeds 1 million tonnes expressed in soya meal equivalents. In the event of enlargement of the Community the oilseeds base area will be varied accordingly.

The EC-US corn gluten controversy dated back to spring 1991 when Dutch customs authorities rejected US deliveries of corn gluten containing more germ meal than could be explained by wet-milling processes. Scrupulous application of the EC tariff regulations resulted in fixing a levy higher than the value of delivery and consequently prevented further imports. Throughout the year, there was permanent disagreement as to the justification of the "new" import barrier and the corn gluten issue increased the number of US-EC trade controversies.

By the end of 1991, a mutual understanding seemed to have been reached that corn gluten feed imports into the EC should contain certain maximum contents of starch, fat and protein (22, 4.5 and 40 per cent, respectively, on a dry matter basis). But these limits have reportedly not always been observed by the traders so that fines and import duties continued to be imposed on irregular imports.

By allowing for a maximum content of screenings of 15 per cent the Blair House accord was supposed to have settled the controversy. But interested parties within the EC nevertheless continued to maintain that although imports of pure corn gluten and of pure distillers dried grain into the EC were not leviable, any mixture of both was to be regarded as mixed feed subject to levy. Such argumentation appeared to the Americans and others to be attempting to achieve the old EC objective of "rebalancing" by the back door (AEL 12.3.1993, E2).

Finally, a tariff quota of 500,000 tonnes of corn imports into Portugal was opened and the US declared it would give up any claims for further compensation concerning the consolidation by the Community of the oilseeds at zero duty.

[8] The figure of 5,128,000 hectares corresponds to the average area planted in oilseeds for the years 1989-91 and was also referred to in the CAP reform.

5.3 EC remains divided on the Blair House accord

The opposition of France to any GATT compromise on the basis of the Blair House agreement continued through 1992/93. It is based on a popular resentment against American bullying but more fundamentally it also stems from fears of losing profitable market outlets if EC export volumes and export subsidies were to be cut. Immediately after the Blair House deal, the French farm minister called for the talks in Geneva on the farm sector to be frozen until all other areas were settled, but he did not find enough support in the Council. Ministers generally endorsed the Commission's view that such a stance would effectively mean the end of negotiations. But France was not isolated in its opposition to the accord. Belgium, Ireland and all Mediterranean countries expressed fears about whether the deal was compatible with CAP reform. Only Germany, the UK and the Netherlands supported the EC-US agreement from the beginning and warned against endangering the best possible compromise.

The question of compatibility of CAP reform and the EC-US accord became a highly controversial political issue. The Commission tried to prove that the deal did not go beyond those adjustments which - by virtue of the CAP reform or by financial restrictions (as in the beef and milk sectors) - were to be made anyway. But the paper in which the Commission tried to set out its view (AEL 27.11.1992, P1) was disparaged by almost all critics. The assumption by the Commission of zero productivity in the cereals sector over the medium term was one of those most heavily criticised.

In this respect, however, the analysis presented by COPA, the association of EC Farmers' Unions, fared similarly. Based upon a completely static investigation into the effects of the restrictions agreed in the Blair House compromise, and also on the assumption that EC agricultural labour force will be cut by about 4-5 per cent annually during the rest of the decade (or by about 900,000 full time labour units over and above past trends), COPA claimed that by 1999 EC agriculture needed additional subsidies of about 32,000m ECU in order to maintain real farm income per farmer at present levels. The study also showed that a GATT agreement following the lines of the Blair House compromise would require: a cut in milk quota of at least 4.5 per cent as compared with 2 per cent envisaged under the CAP reform; a cut in overall meat production of some 4.5 per cent; and withdrawal of at least 11.5m hectares of land (still excluding the former GDR) compared with some 4.6m hectares under CAP reform.

COPA therefore bluntly rejected the Blair House compromise as being incompatible with CAP reform. However, the magnitude of the income deficit projected by COPA, together with the threat of increased cuts in production and utilization of land, directly resulted from the assumptions underlying the COPA model. These assumptions included stable world commodity prices, stability of demand, productivity and non-substitutability of cereals against imported substitutes. Moreover, the reference situation was a simple extrapolation rather than a detailed investigation into the effects of agreed CAP reform and into possible further restrictions which will be required to manage imbalances likely to persist on EC agricultural markets. Thus, the COPA study was rightly criticised by the Commission as a conglomeration of unduly pessimistic assumptions. Meanwhile, the opposition of farmers' unions against the Blair House deal has lost governmental support (if there ever was any). Even the French government seems to be preparing a slow retreat after having gained much of what it had demanded for agreeing to the US-EC compromise.

Yet it was not until June 1993 that the EC Council of foreign ministers agreed to a formula which allowed the French government to (partially) drop its opposition to the US-EC accord on oilseeds and permitted the Council to formally ratify the agreement (AEL 11.6.1993, E1). France was assured that: the oilseeds deal was considered by the Community to be "totally separate" from the Uruguay Round; a Uruguay Round agreement must be judged as a global package rather than assessed on an individual sector basis; and any excess planting for oilseeds (beyond the 5.128m hectare base limit agreed to at Blair House) should be dealt with on a country-by-country basis, rather than EC-wide.

While the first two points of the above formula did not provoke much criticism (in fact, it was realized that the oilseeds deal was unexpectedly favourable to EC producers given the two adverse GATT panel rulings before), the last one immediately unleashed a controversial discussion about the consequent need to allot the oilseeds base area to individual member countries and about how that would be done. Although the Commission would certainly have preferred to keep the reference area EC-wide, it was clear that the foundations of another quota regime had been laid. This regime would consist of an additional distinction between the arable crops base area applying to oilseeds on the one hand and all other (specified) arable crops on the other. It was also likely that the oilseeds area had to be allotted to regions, so that future regional shifts in production would also be impeded.

A few days after the promising Council meeting, however, it became clear that the French government was nevertheless determined to maintain most of its former objections. In particular, it was requested that either agriculture should be generally exempt from the GATT code of subsidies or the "peace clause" from the Blair House accord should be permanent. Moreover, the French wanted the safeguard against currency fluctuations (dollar/ECU) to be strengthened, the minimum access to be unambiguously defined and the restrictions imposed on agricultural exports to be lifted. All this had to be done "in the interest of the CAP reform working properly and EC presence at world markets being guaranteed" (*BIMA* No 1406, p.7). In view of these renewed demands and the likely French obstruction in all EC decision making bodies, the Uruguay Round seemed again to be far away from any final agreement.

6. The New Agrimonetary System

A new agrimonetary system was agreed to by the Council on 18 December 1992 for application from 1 January 1993. The new system retains the principle of green rates and, contrary to the Commission's original proposal, the so-called switch-over mechanism[9]. Its main difference compared to the former regime is its lack of monetary compensation amounts (MCA) levied or granted at the EC's internal borders. The MCAs had to be abolished because with the advent of the Single Market the border controls within the EC have been removed. But at the same time several farm ministers were not prepared to give up all opportunities for applying special exchange rates in the agricultural sectors. For two years the switch-over mechanism will now further provide the means for switching any newly created revaluation margin of green rates over to an additional devaluation of partner green currencies[10]. During that period the Commission will review the system and make proposals to the Council for arrangements thereafter.

A direct consequence of avoiding the eventual rise of MCAs was, however, that regulations had to be established for currently adjusting the green rates to the fluctuations of exchange rates of the member states' currencies and at the same time keeping the system clear. Two principles were to be observed. First, for each country there is a single green rate applying to all commodities and to all CAP policies funded from the Guarantee section of the EAGGF. The former "à la carte" differentiation of commodity specific green rates has been abandoned. Second, both the deviations of the green rates from their respective (adjusted, cf. below) official exchange rates have to be kept within tolerable limits. This implies some strict rules for monitoring and for making the necessary adjustments.

6.1 The rules[11]

The green rates for member states with currencies in the narrow band[12] of the Exchange Rate Mecha-

[9] The switch-over mechanism was introduced in April 1984 as part of the then new agrimonetary system. It consists of (1) a factor always taking up (in a cumulative way) the revaluation of the strongest fixed currency, and (2) the factor's application on the ECU. Thereby, the positive monetary gaps are abolished at the expense of increased negative gaps. The switch-over coefficient always represents the difference in value between the green ECU and the market ECU.

[10] The ECU being a basket currency unit has the effect that a devaluation of any member currency will cause all other member currencies to revalue with the respective margins of devaluation and revaluation being proportional to the currencies' shares in the basket.

[11] The rules were established by EC regulation 3819/92 but have meanwhile been amended. The outline of the new agrimonetary system is well documented by Agra Europe *CAP Monitor*, chapter 2, from 18.5.1993.

[12] Countries with narrow band currencies are Belgium, Denmark, Germany, France, Ireland, Luxemburg, and the Netherlands.

nism (ERM) of the European Monetary System (EMS) are aligned with the central rates multiplied by the switch-over coefficient[13]. The green rates for member states with "floating" currencies, i.e. currencies either in the wide band of the ERM or outside it[14], are kept close to the prevailing market exchange rate, again multiplied by the switch-over coefficient[15]. The market rates of these floating currencies are monitored during three 10-day periods each month (running from the first to the 10th, the 11th to the 20th and the 21st to the last day).

A member state's green rate is adjusted whenever there is either: a monetary gap of more than 2 percentage points between green and agricultural market rates during the final period in a month ("two point rule"); or a difference between the monetary gaps for any two currencies of more than 4 percentage points in any of the three monitoring periods of a month ("four point rule"); or a difference between the monetary gaps for any two currencies of more than 6 percentage points over any three consecutive working days ("six point rule").

In addition to the three cases distinguished above, there are, of course, changes in the green rates after a realignment of EMS currencies. For member states with currencies in the narrow band, any revaluation of central rates will lead to an increase in the switch-over coefficient but allow for stable green rates. For the same group of countries, a devaluation of central rates by other countries will create a monetary gap which has to be reduced either immediately or by the end of the current crop year at the latest.

When the switch-over coefficient increases, the value of ECU prices and similar amounts increases by the same proportion. The increase also affects the budgetary outlays under the CAP. In order to offset at least part of this increase, 25 per cent of the rise in the coefficient during the previous 12 months will be compensated each year by a general reduction in the price levels. This cut will be made at the beginning of the respective marketing year. The direct aids, e.g. those established by the CAP reform, however, do not fall under this restriction.

EC Regulation 3813/92 further contains certain provisions to compensate for reductions in national currency amounts caused by agrimonetary developments. Such compensation is however not automatic.

6.2 First experiences with the new system

Basically, the new system will keep farmers isolated from economic reality and continue to stimulate production above "normal" levels. It also continues to provoke inflationary green rate devaluations by weak currency countries. Assuming that without the switch-over mechanism the ECU prices would be at the same nominal level as they presently are, the inflationary impact can be read from the switch-over coefficient. A contemporary coefficient of 1.207509 represents a 20.8 per cent gap in the values of the green and the market rates of the ECU and at the same time indicates a disguised price rise of the same magnitude over the whole period (April 1984 - June 1993). The relative increase allows maintenance of nominal prices in the revaluing countries where otherwise the prices expressed in national currency would have fallen. Correspondingly, the relative increase superimposes all those increases which in the devaluing countries directly result from monetary changes. In addition to the price effect, the budgetary cost of intervention as well as of export subsidisation and direct aid also remain artificially inflated.

All those inflationary effects have obviously not played a major role when the farm ministers, contrary to the Commission's original proposal, not only retained the switch-over but even implemented new compensatory aids which go beyond those previously applicable. The farm ministers took these decisions irrespective of the medium-term financial plans agreed a few weeks before, at the Edinburgh summit, and uncontrolled by the ministers of Finance. According to provisional calcula-

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[13] The official central rate multiplied by the switch-over coefficient is the "agricultural central rate" in agrimonetary terminology.

[14] Countries with wide band currencies are Spain and Potugal while Greece, Italy and the United Kingdom have at present freely floating currencies.

[15] The market rate multiplied by the switch-over coefficient is referred to as "agricultural market rate".

tions released by the Commission the retention of the switch-over alone will result in additional budgetary outlays of at least 1,000m ECU in 1993 (AEL 26.2.1993, E7).

Green rate changes under the new agrimonetary regime continue not only to have inflationary effects but also to distort the relative profitability of individual products. Depending on the degree and rigidity of support granted to the products in question there is a considerable bias between, for instance, sugar beet, cereals, oilseeds and protein crops on the one hand, and less supported vegetables or even potatoes for human consumption on the other. This can be seen in the EC potato market where as a consequence of set-aside restrictions applied on cereals, potato plantings have been extended. Producers would be expected to react to the consequent depressed prices by reducing potato plantings. However there seems to be a marked difference in behaviour across different countries. In the strong currency countries there appears to be less incentive for such behaviour compared with devaluing countries where cereals prices have risen due to monetary effects.

Under the new rules the monetary fluctuations have, in the first half of 1993, triggered a recalculation of green rates on 16 separate dates. Over the same period, farmers in Portugal and Spain saw their prices increased by about 6 and 10 per cent, respectively. For the British and the Italian farmers, however, the change in the monetary situation of the country implied several devaluations of the green Pound (1 January to 1 March) and of the green Lira (1 January to 1 April), respectively, followed by consecutive revaluations. National administered farm prices consequently rose during the first months (by 4 and 10 per cent, respectively), remained constant for a few months, and decreased thereafter (by 2 and 4 per cent, respectively). If the new trend continues, the British government could use these changes as an excuse to later apply for income aids for its farmers - an action presently unlikely, however.

The stipulation that the ECU prices determined by common market regulations have to be decreased at the beginning of a new marketing year by one-fourth of the increase in the switch-over coefficient measured over the previous 12 months has already resulted in the calculation of specific reduction coefficients and their publication after being changed in the course of a realignment of ERM currencies. Due to the different dates at which the marketing years of the various commodities begin and depending on the size of eventual adjustments already made, there are now always several reduction coefficients ready for application. The coefficient to be applied on cereals and sugar at the beginning of marketing year 1993/94 was 1.013088. It implied that the ECU prices of products concerned would be divided by 1.013088 (or cut by 1.31 per cent).

In spite of the accuracy in the above adjustment coefficients the economic value of the price reduction provision in the agrimonetary system must not be regarded too highly. Although one may expect that it will be applied as long as the regulation is in force, the farm ministers will get used to taking its effects into consideration when they determine their strategies for the annual farm price negotiations. Thus, any farm price reduction proposed in the Commission's price package or even a proposed roll-over of prices from one year to the next is likely to encounter resistance from national delegations if there are price reductions to be made on the basis of this provision. The resistance will be stronger the bigger the calculated price reduction attributable to the monetary changes.

While such behaviour seems to be natural and (perhaps) understandable under EC conditions, it has to be kept in mind that the automatic price reductions are only a small fraction of the reductions which would result from monetary effects if there was no switch-over mechanism in operation. Since the latter ought to be abolished on grounds of its inflationary and production stimulating effects, there should be good reason for the Council to let pass unaltered this small and delayed "negative" influence on an agricultural sector badly isolated from general economic influences. Moreover, in view of the CAP reform with its decreased intervention prices and supplementary direct payments which will make the agricultural producer prices more market oriented, the politicians should not be too hesitant in allowing macro economic factors to play a greater role. Traders in agricultural products

have to face greater risks under the new agrimonetary system compared with the old one but it is also true that such risk is not unusual for international trade.

7. EAGGF Budget Close to its Guideline

In 1992, EC total farm spending amounted to 31,114m ECU compared with initial appropriations of some 35,039m ECU (AEL 18.12.1992, E7). Market developments in the cereals and dairy sectors had allowed for the biggest savings by about 13 and 30 per cent (870m ECU and 1,690m ECU, respectively). Sugar, fruit and vegetables, wine and tobacco as well as the meat sectors also all required less financial support than originally expected. On the whole, a more favourable dollar/ECU exchange rate had been the most important single factor to assist the budget. Lower than expected intervention (in the dairy sector) caused by regional drought and erroneous national production estimates (fruit and vegetables in Italy) were found responsible in other cases. Oilseeds and fibre crops were the only sectors to exceed the budget plans (by together less than 10 per cent or 442m ECU).

In the 1993 EC budget, guarantee expenditures had originally been assessed at 34,052m ECU leaving a margin of 2,605m ECU to the Agricultural Guideline (cf. Manegold 1988, p.176). At a later date (in March 1993), however, the Commission saw the necessity of proposing an increase of the EAGGF Guarantee budget by 1,884m ECU. This increase, which has already been ratified by EC ministers and the European Parliament took the financial resources provided for CAP market support to 35,936m ECU, an increase of almost 5,000m ECU, or 15.5 per cent, on actual spending in 1992. While the main cause of increase was the estimated 1,000 to 1,500m ECU cost of the retention of the switch-over by the Council in December 1992, some prospective budgetary effects of the 1993/94 price package had also been taken into account.

The Commission's estimates for the extra cost of the farm ministers not sticking to the proposed price package were 53m ECU in 1993, 313m ECU in 1994 and 577m ECU in 1995. These figures seem to be too modest. Given that the intended quota cut in milk actually resulted in a real increase in output, coupled with a less marked price reduction, the lack of any limitation on beef sector expenditure, the steep increase in the set-aside rate of payment and critical developments in the cereals market, where a weak dollar continued to cause high export restitutions, there exists the potential for large cost increases. Under these circumstances the Commission will be forced to save money on current export restitutions as well as on intervention which will have depressing effects on EC market prices. On the other hand, there is still the opportunity that the Commission might revert to activating the emergency financial arrangements also agreed by EC heads of state and governments at the Edinburgh summit.

According to the Edinburgh agreement, the 1,000m ECU monetary reserve, set up in 1988 as a contingency against fluctuations in the ECU/dollar rate, can now also be activated by currency difficulties within the Community. The Commission may consequently argue that the impending budget crisis is due largely to the recent ERM realignments and the impact of the switch-over mechanism. But since this tranche would not fill the budget hole, the finance ministers would also have to find additional resources from member state finances to prevent exhaustion of the CAP budget (AEL 4.6.1993, E1).

More fundamentally, the Edinburgh summit agreed on raising the EC's "own resources" ceiling from 1.20 to 1.27 per cent of Community Gross National Product over seven years to 1999. This compares with the original proposal of 1.37 per cent after only five years and another one revised downwards after strong protests from several member countries to 1.32 per cent after seven years. According to the final compromise and the underlying estimates of economic growth, estimates at the time of decision were that the Agricultural Guideline would first decrease to 35,095m ECU in 1994 but continuously rise thereafter to reach 38,389m ECU in 1999. Meanwhile however, these estimates may need to be revised downwards due to recession.

Postscript of 9 August 1993

The Community's arduously conceived

agrimonetary system was endangered when during late July 1993 the EMS, on which plans for the Economic and Monetary Union are based, faced its greatest test. Confronted with huge waves of speculative funds the monetary authorities were, after several days of desperate defence, finally forced to make some fundamental adjustments to the EMS. Three possible options seemed to be open, but each contained a clear monetary or political disadvantage. The three options were: (1) a general realignment of central rates. This was ruled out because however the new rates were defined, they were seen to only provide new targets for speculators; (2) a suspension of individual weak currencies from the ERM of the EMS. However this would probably lead to overshooting depreciations of the currencies concerned and concentrate all necessary adjustment on these few currencies; and (3) a suspension of the EMS altogether. This was regarded as politically unacceptable in view of the importance of the Monetary Union envisaged in the Maastricht Treaty.

On Sunday 1 August the EC Council of Finance ministers and governors of national central banks finally agreed to drastically increase the margin of tolerable exchange rate fluctuations from 2.25 per cent to 15 per cent. This decision, which allowed bilateral gaps between two currencies of up to 30 per cent without requiring central bank intervention, formally maintained the EMS but at the same time let the market find the new exchange rates. On request of the Dutch government it was also agreed that the Dutch Guilder/Deutsche Mark exchange rate continue to be kept within the old 2.25 per cent margin. Thus the Guilder and the D-Mark together with the Swiss Franc and the Austrian Shilling, which are associates, not members, of the EMS, now form the hard currency block of the EMS.

In principle, the monetary decision of 1 August did not create a fundamentally new agrimonetary situation since any realignment of central rates was avoided. But, there is a difference of opinion as far as impacts on the existing agrimonetary rules are concerned. The German government wanted to continue to apply the existing rules without any changes and thereby maintain the level of national farm prices. The EC Commission and the French government, however, argued that the three rules applicable for regularly adjusting the green rates (the "two-point-rule", "four-point-rule", and "six-point-rule", cf p.47 above), were to be applied not only to currencies with floating exchange rates or with exchange rates subject to a 6 per cent margin but also to the currencies with the new 15 per cent margin. Realisation of this interpretation would expose German farmers to more volatile farm prices since the green rate of the D-Mark was no longer stabilised by the switch-over mechanism.

The problem was not resolved at the time of writing, but a solution along the lines of the Commission's argument seemed more likely than one following the German "business-as-usual" attitude. On the other hand, however, the effective changes in the market rates of currencies have so far been remarkably small. All central banks seem to be interested in stabilising the exchange rates and even the Deutsche Bundesbank further reduced its discount rate, a measure totally denied a few days before. Thus the agrimonetary situation is presently not threatening nor does EC internal trade in agricultural commodities require any immediate change in existing agrimonetary rules. With regard to the Economic and Monetary Union, however, the EMS and most of the fiscal and monetary policies of the member states need thorough reassessment if not revised and reliable rules.

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