

THE FUTURE OF THE COMMON AGRICULTURAL POLICY

AND ITS IMPLICATIONS FOR NEW ZEALAND

E.A. Attwood

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THE AGRICULTURAL ECONOMICS RESEARCH UNIT  
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## CONTENTS

	Page
LIST OF TABLES	(vii)
PREFACE	(ix)
SUMMARY	(xi)
CHAPTER 1 INTRODUCTION	1
CHAPTER 2 THE ROLE OF THE CAP	3
2.1 CAP as a Political Instrument	3
2.2 Evolution of the CAP	4
2.3 Basic Principles	5
2.4 New Approach to the Managed Market System	7
CHAPTER 3 THE AGRICULTURAL SITUATION IN THE COMMUNITY	9
3.1 Role of Agriculture in the Economy of the Community	9
3.2 Agricultural Situation in the Individual Member States	10
3.3 Revolution in European Agriculture	14
3.4 Farm Structures Policy	15
3.5 A New Farm Structures Policy	17
CHAPTER 4 THE DAIRY SECTOR	21
4.1 The Current Dairying Situation	21
4.2 Production and Consumption of Dairy Products	22
4.2.1 Drinking Milk	22
4.2.2 Butter	22
4.2.3 Skimmed Milk Powder	23
4.2.4 Cheese	24
4.2.5 Other Dairy Products	24

4.3	The Machinery of the Common Organisation of the Market for Milk and Milk Products	24
4.4	Trading Arrangements with Non-Member States	25
4.5	Additional Support and Stabilisation Measures	25
4.6	Causes of the EC Dairy Problem	26
4.7	The Future of Dairying in the Community	28
CHAPTER 5	THE SHEEP SECTOR	29
5.1	The Current Sheepmeat Situation	29
5.2	The Trend in the Community Deficit	30
5.3	The Organisation of the Market for Sheepmeat	31
5.3.1	The Basic Price	32
5.3.2	The Annual Ewe Premium	32
5.3.3	The Variable Premium	32
5.3.4	Intervention Buying-in Scheme	33
5.4	The Effects of the Sheepmeat Regime	33
5.5	The Trade in Sheepmeat	34
5.6	The Future for Sheep Production in the Community	35
CHAPTER 6	THE BEEF SECTOR	37
6.1	The Current Beef Situation	37
6.2	Organisation of the Market for Beef	38
6.3	Trade with Non-Member Countries	38
6.3.1	Imports	38
6.3.2	Exports	39
6.3.3	Prices	39
6.4	The Level of Budgetary Expenditure	40
6.5	The Future for Beef Production in the Community	40
CHAPTER 7	AGRICULTURAL TRADING POLICIES	43
7.1	The Background to the Trade Problem	43
7.2	Mechanisms of Community Trading Policies	43
7.3	The EC and GATT	44

7.4	The Community's Export Situation with Regard to Agricultural Products	45
7.5	Problems of Agricultural Trade - The Case for Non-Member States	46
7.6	The Response of the EC	48
7.7	Trade with the Developing Countries	48
7.8	The Resolution of the Trade Problem	49
CHAPTER 8	THE FARM INCOME SITUATION	53
8.1	Growth of the Farm Income Problem	53
8.2	Farm Income Trends Within Member States	54
8.3	Effects on Price Decisions	55
8.4	Consequences of Inflation for Real Incomes	56
8.5	Measurement of Farm Incomes	57
8.6	The Income Problem and its Political Consequences	57
8.7	The Farm Income Situation Overtaken by the Budgetary Crisis	58
CHAPTER 9	MONETARY PROBLEMS AND THE CAP	59
9.1	The Two Currency Exchange Rate System	59
9.2	Evolution of Monetary Factors in the CAP	59
9.3	Permanence of "Temporary" Solutions	61
9.4	Effects on Trade in Farm Products	62
9.5	Long-Term Solution	64
9.6	Policy Adopted in the 1984-85 Prices Decisions	65
CHAPTER 10	THE BUDGETARY SITUATION AND ITS IMPLICATIONS	67
10.1	Current Budget Crisis of the Community	67
10.2	Basic Financial Understanding in the Community	68
10.3	Underlying Nature of the Budgetary Problem	69
10.4	Position of the Major Net Contributors	70

10.5	Elements in Any Solution	71
10.6	Procedural Difficulties	72
10.7	Current Proposals	73
10.8	Pressures for a Solution	75
CHAPTER 11 FACTORS WHICH WILL DETERMINE THE FUTURE OF THE CAP		77
11.1	Basis of the Commission's Proposals	77
11.2	Farm Income Position	78
11.3	Prospects for Direct Income Aids for Poorer Farmers	79
11.4	Situation and Outlook on Agricultural Markets	81
11.5	Budgetary Factors	82
11.6	Changes in Technology and Resources	83
11.7	Role of Prices	85
CHAPTER 12 THE FUTURE OF THE CAP		87
12.1	Need for Reform	87
12.2	Response of the Member States	87
12.3	Adaptation of Agriculture in the Community	88
12.4	Rationalisation of the Market Organisation	89
12.5	Guidelines for the Principal Sectors	90
12.5.1	Milk	90
12.5.2	Sheepmeat	92
12.5.3	Beef	93
12.5.4	Cereals and Other Products	93
12.6	Agri-Monetary Problems	94
12.7	Complementary Measures	95
12.8	Financial and Other Economic Consequences	95
12.9	Basis of Future Policy	96
CHAPTER 13 NEW ZEALAND'S AGRICULTURE AND THE CAP		99
13.1	Role of Agriculture in the New Zealand Economy	99

13.2	Resources Used in Agriculture and Their Earnings	99
13.3	Farm Incomes in New Zealand and the European Community	100
13.4	Agricultural Trade Situation	102
13.5	Trade Situation for Sheepmeat and Dairy Products	103
13.6	Effects of the CAP on New Zealand's Agriculture	104
13.7	Current EC Proposals for the CAP and New Zealand Agriculture	105

BIBLIOGRAPHY	111
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LIST OF TABLES

Table		Page
1	Market Balance - Sheepmeat: 1981-83	35
2	Farm Incomes in New Zealand 1977-78 to 1981-82	101
3	Incomes on Sheep and Beef and on Factory Supply Dairy Farms 1979-83	102



## PREFACE

This paper provides an authoritative and up to date picture of the State of the European Economic Community's (EC) Common Agricultural Policy (CAP). The paper is largely descriptive and gives an informative account of how the CAP has evolved to the present time and the major dilemma the EC now faces over the CAP.

The paper was written by Dr E.A. Attwood, a distinguished agricultural economist from Europe and Visiting Research Fellow in the AERU for a period of a year.

Dr Attwood has held positions at Cambridge University, and the University of Wales before moving to Ireland to head the Farm Management Department and the Agricultural Economics and Marketing Department at An Foras Taluntais. In 1968 he was seconded to the Irish Department of Agriculture to establish an Economics Unit. He now heads this Unit and holds the position of the Chief Economist in the Department of Agriculture.

Dr Attwood is well qualified to comment on the CAP. He was engaged in the detailed assessment of the economic benefits of Irish entry to the EEC before 1973. Since that time he has been closely involved with the CAP and has been Chairman of a number of EEC Council working parties during the periods of Irish Presidency of the Council.

P.D. Chudleigh  
Director



## SUMMARY

The Common Agricultural Policy of the European Community has its roots in the economic, social and political situation of Europe in the mid 1950's, when over a quarter of the population lived and worked on farms and when the memory of food shortages of the decade earlier was still vivid. The CAP has been constructed on the basis of three fundamental principles:

- (a) Market Unity involving common management and support prices throughout the Community
- (b) Community Preference over external supplies
- (c) Financial Solidarity under which the costs of the CAP are met from the Community budget

These principles have come under increasing pressure as new production technology has fuelled a growth in output far beyond the needs of the internal Community market and commercial export opportunities. This has led to a new approach by the Commission to these problems involving a system of production management to complement the existing market management system. This has been initiated to bring a better balance between supply and demand for the main farm commodities and in order to control the growth in the budgetary costs of the present policies.

The agricultural and economic situation within the Community is one of great diversity and of rapid change. While agriculture now contributes 3.5 per cent of the total Net Domestic Product at factor cost, this involves 7.5 per cent of the total Community labour force. This relationship between the economic product from agriculture (after allowing for the various measure of price supports) and the labour force engaged in its production has deteriorated over the past decade and this is an essential part of the consequent political problems that have arisen. This deterioration has occurred in spite of the 5.7 per cent fall in the number of people on the land in the past 20 years. Furthermore the real terms of trade in agriculture have fallen by 15 per cent since 1973, and this fall has continued into 1984.

France is the biggest single producer of farm products in the Community and agriculture plays a leading part in the economic policy of the French Government even though this sector now contributes only 3.6 per cent to total Net Domestic Product in France. The next largest agricultural country is Italy, which still has two and a half million people working in farming many of them on small non-viable holdings. The main Italian concern in the operation of the CAP is that most of the price support measures help the richer farmers in Northern Europe, while the smaller farmers in the south receive little benefit from the Community. Germany and the U.K. have agricultural sectors that generate less than 2 per cent of the Net Domestic Product of these countries and their attitude towards the CAP has become increasingly concerned with its cost (though both countries have been anxious to get

what they can for their own farmers from that Policy). The smaller European countries represent the wide range in European agriculture, with efficient farming particularly in the Netherlands and Denmark and large numbers of poor non-viable farms in Ireland and Greece, with these latter two countries in particular looking to the CAP to help resolve the economic problems of their farmers.

Although the average size of farm in the Community is only 18 ha with over 40 per cent of farms of less than 5 ha, farming in Europe has undergone a technical and economic revolution in the last 20 years. This has involved increasing specialisation and intensification and an increase in output per man in real terms of over 70 per cent in the last decade (compared with a growth of less than 20 per cent in industry). Even so the average size of individual farm enterprises is still small :7.6 acres in the case of cereals, 1 ha for potatoes, 15 cows in the case of dairy herds, 87 animals in the case of sheep (and only 46 if the U.K. is excluded), and 35 animals in the case of pig enterprises.

The attempts to improve the efficiency of European farming through an effective structures policy has met with great difficulties, both from within the farming sector where modernisation is beyond the reach of the weaker farms and from the external economic environment, which has not provided the off-farm jobs needed to implement action within the farming sector. A new structures policy, involving much more budgetary resources has been proposed, with greater emphasis on the problems of the small farmer, but in the absence of new off-farm employment opportunities, the effectiveness of this new policy will be severely limited.

The paper then considers the current EC situation of the main commodities of concern to New Zealand - Dairying, Sheepmeat and Beef (wool is not a product coming within the ambit of the Common Agricultural Policy but is treated as a raw material for the industrial sector). On the production side, the dairying sector has seen an increase in the rate of growth of output far beyond the available commercial and food aid outlets, even though only 12 per cent of the dairy herds are above the 30 cow minimum required for a viable enterprise by European standards. Over 1.5 m dairy farmers have ceased milk production over the past decade, but cow numbers have been constant and better yields have been the source of output growth. The operation of the organisation of the market for dairy products under the CAP involves a very detailed set of market intervention measures, but these have failed to avoid the growth of an unsaleable surplus of dairy products.

The internal consumption of dairy products including liquid milk has virtually stabilised at 86m tonnes milk equivalent, and the Community has now taken steps to reduce milk production to 97.2m tonnes thus providing around 11m tonnes to meet export outlets. The effects of these measures have yet to be seen, but they are likely to have some adverse effects on dairy farmers' incomes in the Community.

The situation in the sheepmeat sector is very different from that in dairying; much of the production comes from areas where farm incomes are particularly low and where support has been given for social and

conservation reasons. The Community has a net deficit in sheepmeat of around 250,000 tonnes. This is projected by the Commission to fall to around 200,000 tonnes in the latter part of the 1980's, but will require an increase in consumption higher than that over recent years and in production at a rate less than half that which has occurred since 1970. If recent trends in consumption and production are sustained, the Community's sheepmeat deficit could fall to under 100,000 tonnes. The common organisation of the market for sheepmeat was not finally agreed until 1980; the essential dichotomy of a low priced "everyday" sheepmeat market in the UK and the high priced "luxury" market in France still being unresolved. The sheepmeat regime has required a substantial volume of funds from the Community budget and limited steps have been taken to reduce the costs involved. The prospect of further increases in supply, particularly if farmers move resources into sheep production out of enterprises where growth is deliberately curtailed, could lead to problems of disposal similar to those for other farm products already in structural surplus.

Beef production is one of the most common farm enterprises in the EC. Production has been expanding in recent years primarily due to the upward trend in slaughter weights and the higher proportion of total cattle numbers slaughtered. The longer term growth of production of between 0.5 per cent and 1 per cent per annum has led to a surplus of 0.4m tonnes over the static consumption of some 6.6m tonnes. This surplus has been disposed of with the payment of export refunds (subsidies), and these have been reflected in the rapid growth of budgetary expenditure on beef and veal. The problems of production surpluses and the consequential budgetary costs have led to limited steps to reduce the degree of support under the common organisation of the market for beef, but the measures taken so far are likely to have only very little impact on the supply position in the Community. Unless more vigorous steps are taken the surplus problems could become more serious.

The major debate on the CAP outside the Community has been on the effects on world trade in farm products. The instruments to regulate EC farm trade are levies on imports (and occasionally on exports), duties on imports and subsidies on exports. The duties express the degree of Community Preference in farm products, while the export subsidies are paid in order to encourage traders to sell Community products on external markets, and are fixed in relation to the prices prevailing on those markets. A considerable part of the agricultural imports into the EC are bound under the GATT code, but trade is affected by protectionist policies involving non-tariff barriers which limit the effectiveness of trade negotiations.

The concern of non-member states has been expressed most vigorously by the US, which has objected particularly to the effects of the CAP on both internal demand and on the world market for food through subsidised competition and the insulation of the Community producers from the adjustments signalled by the international market mechanism. However the EC Commission has drawn attention to the effects of US policy, especially monetary policy, on the international performance of US agriculture. Trade policy cannot be isolated from the consequences of agricultural policy and the factors which shape that policy. While long-term adjustment policies will help to resolve



the existing social and economic difficulties of smaller farmers in Europe, the current budgetary difficulties may well have a more direct impact.

Within the Community the development of the CAP had, until recently, been dominated by the question of farm incomes. After substantial improvements in the early years of the CAP, the underlying trend in per capita farm incomes in real terms has been downwards, in spite of the very sharp decline in the numbers of farmers. This farm income decline has been particularly evident in France and Germany and this has had a significant effect on their policy decisions in relation to the CAP. One of the problems that has been of particular concern is that of inflation, and the European Parliament has criticised the conclusion of the Commission that member states with high inflation have not suffered from a low rate of increase in agricultural incomes in nominal terms.

It is not easy to explain or justify the concern of the Community with the farm income problem, given the high unemployment in recent years and the associated problems of urban society in Europe. While consumers are a far larger group numerically than farmers, their strength as a pressure group has been of little significance compared with the farmers lobby. The present level of support for agriculture is partly a result of the present parliamentary situation in a number of European countries.

The operation of the CAP has been made difficult by the problems of adjusting to currency exchange rate changes. A policy of full adjustment would create substantial changes in the prices of farm products; to avoid such changes a system of special agricultural (or green) exchange rates has been operated for countries devaluing or revaluing their currencies. This system has involved a special set of monetary charges or payments (monetary compensatory amounts) on trade in farm products of the countries concerned. While these MCA's were originally intended as a short-term temporary arrangement to allow a gradual transition to the new market exchange rates, these temporary solutions have often been of a long-term virtually permanent character. Under these circumstances the system of MCAs has become a factor distorting the operation of the CAP. Considerable efforts have been made to resolve the problem. The most recent attempt was made at the Council meetings to fix the 1984/5 agricultural prices; this will involve the creation of a special green ECU (the basic currency unit of the Community) and a substantial additional cost to the Community budget. Whether this will be the long-term solution to the problem is still far from certain.

The budget situation itself has become the major issue in the current operation and future development of the Community. The current (1984) expenditure programme will not be possible unless additional financial resources can be agreed, or a considerable reduction is made in some of the programmes in operation at present. The provision of additional resources requires the unanimous agreement of all member states; this will be most difficult to achieve in the face of the widely differing interests within the Community. While the Community in theory does not have the power to borrow to meet its current budgetary expenditure, this prohibition could be overcome if some

suitable procedure could be found to which all member states could subscribe.

The underlying cause of the current financial crisis has arisen largely from the rapid increase in expenditure on the CAP, which has grown twice as rapidly as the Community's own resources. Proposals to raise the financial resources of the Community face considerable opposition from the net contributing member states. The Commission has proposed that the financial burden should be 'modulated' according to the level of prosperity of the different countries and to their degree of dependence on agriculture. The difficulties of reaching an agreement are increased by the role of the European Parliament, which has a greater influence in budgetary matters than in the other aspects of Community policy.

The budgetary crisis and the grave imbalance between the supply and market outlets for a number of major farm products has led to a series of attempts to reform the CAP. In addition to these factors, the future of the CAP will depend upon the income situation of farmers, the strength of new production technology and the trends in the resources in agriculture, particularly labour. The fall in farm incomes per head in real terms over the past decade has been accentuated by the growth in off-farm incomes (though this factor has been partially lessened by the growth in unemployment and the likelihood of serious employment difficulties lasting for many years to come). The benefits of a policy of direct income supplements to the poorest farmers led to a strong reaction particularly from the beneficiaries of the present system of aids through price support measures. There is little effective support for a policy that would replace price subsidies by direct income aids, and while some limited income aids are already provided it is unlikely that these would play a major role in the foreseeable future.

The prospects for a better supply balance in the Community's internal market for farm products are handicapped by the likely decline in the growth of food consumption to no more than half the rate that prevailed over the past two decades. The growth of 0.25 per cent in internal consumption to 1990 will only account for a small part of the underlying upward trend in production, which has averaged 1.5 per cent to 2 per cent over recent years. This situation has led to proposals to limit, still further, access to the Community market for external suppliers.

The attempts by the Commission to hold agricultural spending to its 1983 level in order to reduce the pressures in the budget have been over-ruled by the Council of Ministers, which at the 1984/5 Price Agreement raised the costs of the CAP by a further 2b ECU. The funds for this extra expenditure are likely to be very difficult to obtain, even though they amount to a small proportion of the total GDP of the Community.

The forces towards expanding farm output in Europe are still very strong. The effects of new technology, capital investment and structural reform will continue in the future. At the same time the decline in the total number working on farms has been slackening; this decline has been a major factor in improving per capita incomes and its

slowdown will exacerbate the farm income problem.

The key decisions however are those on prices. In fixing prices, Ministers for Agriculture are primarily concerned with the farmers' income problem but prices have other functions, particularly that of market clearing in the short term and the guiding of production decisions in the longer term. It is the low priority given to these two latter roles which is at the root of much of the problems of the CAP today.

The economic pressures for a reform of the CAP have come up against a political reaction which has involved a lengthy list of factors to be taken into account in any future developments. The Commission has put special emphasis on the rationalisation of the market organisation for the main agricultural products, with a series of proposals for guarantee thresholds beyond which producers would be more fully involved in the costs of disposal of surplus production. This system is already in existence in principle, but has had only very limited impact so far. The Council's reaction so far has been cautious, though it has brought in a super levy on surplus milk production which will go a considerable way to reduce the severe imbalance in the EC dairy market. Limitations brought about by guarantee thresholds may, however, result in greater output of the remaining unlimited products; an example is sheepmeat where the present supply deficit from Community sources is regarded as a justification for expansionist production policies. If these policies are accompanied by measures to limit consumer subsidies then there is a real danger of the growing supply of sheepmeat to be accompanied by a declining level of consumption. A comparable situation already exists on the Community beef market, where the increasing production surplus has already given rise to measures to reduce the current budgetary costs of support for beef. For other products, particularly cereals, the large surplus of Community production has led to proposals to reduce the gap between Community prices and those of its main external competitors, but accompanied by greater limitations on the imports of cereal substitutes. More restrictive import policies will however generate very strong opposition, particularly from the US.

The effects that the measures to limit supplies will have on farm incomes should be seen in the context of the Community economy in virtual stagnation and suffering from growing unemployment. Even in this context and given the size of the budgetary burden, there is little evidence of the radical realignment of farm prices called for by the President of the Commission. The need for a new set of positive and realistic guidelines for the CAP has not yet led to any fundamental change in its basic objectives or mechanisms.

The consequences of a continuation of the essential elements of the CAP for New Zealand are very serious. In contrast to the situation in the EC, agriculture has shown a remarkable capacity to maintain its contribution to the New Zealand Gross Domestic Product. However this has involved a decline in the output and inputs of agriculture in New Zealand, and a very slow growth in the Gross Domestic Product itself over the past decade. In spite of all the expenditure on the CAP, average farm incomes in New Zealand remain substantially above those in

the Community, even though New Zealand sheep and dairy farmers have seen their incomes fall sharply over the past five years.

Export earnings from agriculture have remained at close to 70 per cent of total export earnings in recent years in New Zealand, compared with less than 10 per cent in the Community. The EC market for New Zealand sheepmeat will come under increasing pressure from the growth in Community production. In the case of dairy products, the difficulties facing New Zealand in the EC market are primarily a consequence of the extraordinary growth in UK output and the decline in UK consumption. It is likely that this would have occurred to a substantial degree even in the absence of Community membership - though policies under the CAP have certainly exacerbated the difficulties.

Trade difficulties, not only in the dairying sector but for other products, will continue to affect relations between the European Community and other countries. The political and economic pressures which affect these relationships are likely to be of greater benefit to third world countries, the US and non-EC European countries than to advanced agricultural countries such as New Zealand, in spite of the general goodwill that exists towards New Zealand in the Community.

The dominant themes in the CAP today - production constraints, small price increases and greater spending on farm structures - will not resolve the current problems though these measures should prevent the situation becoming much worse. The policy of supply control is unlikely to be implemented with such rigour as to eliminate the present structural surpluses. Small price increases may well have only a limited impact, particularly in the case of products where prices are already high by world standards. The policy of more intensive action on farm structures could make the supply problem even worse and while this may bring social benefits it will not lead to any diminution of demands for higher protectionist measures against imports from outside the Community.

Nothing in the current developments of the CAP holds out any relief for New Zealand at least in the short to medium term. What the longer-term effects may be is impossible to foresee, but the political and economic forces holding the Community together are very strong, and these necessarily involve a continuation of common policies for agriculture. In these circumstances New Zealand faces continued problems in its agricultural exports to the Community, whose own problems may increase the pressures against a more liberal trade policy so far as New Zealand is concerned.



## CHAPTER 1

### INTRODUCTION

The development and continued viability of the New Zealand economy is based on the competitiveness of the agricultural sector and the opportunities for sales of its output on the main world markets for food. This competitiveness of farming has continued to improve, primarily through a more efficient use of inputs rather than through any significant growth in total output, as the growth in output has been constrained by the problems of finding remunerative external markets. This problem has become of increasing complexity with the development of stronger protectionist policies in agricultural products in many areas of the world. This has been most evident in the case of the European Community (EC) where the Common Agricultural Policy has had a substantial impact on New Zealand's agriculture and therefore on the New Zealand economy as a whole.

Agriculture in Europe, however, also faces major difficulties on its own domestic market, as the growth in output has created enormous problems of finding remunerative markets. The present study sets out to explain the underlying forces which have fashioned the evolution of the Common Agricultural Policy; the factors which are dominating the current developments in that policy and which will continue to determine its course over the coming years. The basic horizon for the consideration of future events is the end of the present decade. Even that may be too long a period over which to project the economic social and political factors which shape the decisions taken by the European Commission and the Council of Ministers.

The purpose of the study is to present a reasonably comprehensive, but not too detailed, account of the CAP and an assessment of its current development for New Zealand agriculture, in the hope that a better understanding of the European situation might help to contribute towards a solution of the economic difficulties between New Zealand and the Community.



## CHAPTER 2

### THE ROLE OF THE C.A.P.

#### 2.1 CAP as a Political Instrument

The framework for the Common Agricultural Policy is set out in the basic treaty which set up the European Economic Community. The second section of that part of the Treaty of Rome setting out the 'Foundation of the Community' is concerned with agriculture (the first section deals with the free movement of goods); this section precedes the parts concerned with economic policy, social policy, the financial provisions etc. The high priority accorded to agriculture reflected its importance in the European economy in the mid-fifties, when over a quarter of the population worked directly on farms. Its continued priority in the affairs of the Community, when its farm labour force has fallen to only 7 per cent of total employment, is a remarkable testimony to the political strength of that labour force.

It would be useful at the outset to draw attention to the direct connection between 'policy' and 'political'. Policy has been defined as "political sagacity" and as "course of action adopted by Government, party etc", while political has been defined as "of the State or the Government" and as "of public affairs". The Common Agricultural Policy both in its general formulation, and even more so in its day-to-day operation, is a course of action adopted by Governments as a result of political considerations. While this is entirely appropriate in a democratic society, it does not mean that the actions involved are necessarily well founded or sensible in terms of the needs of European society as a whole.

However, an explanation of the priority given to the agricultural sector in the affairs of the European Community solely in terms of the political strength of the farmers of Europe is clearly inadequate. The appropriation of over 60 per cent of the total EC budget for a sector in which only a small proportion of the population is employed cannot be entirely explained in terms of the political strength of that part of the population, even if it is extremely well organised to use its political muscle. A further reason must underline the decisive role of agriculture in the affairs and development of the European Community. It has been suggested that the reason for this is basically related to the demand for and the supply of farm produce. Farmers produce goods which are a basic human want and, rightly or wrongly, there seems to be an innate concern that without market intervention supplies of a commodity could become erratic and so become scarce. Whether or not this explanation is adequate, agriculture has remained a dominant issue in the affairs of the Community since its inception.



## 2.2 Evolution of the CAP

The need for a common policy in agriculture arises from the very first set of principles in the Treaty of Rome, "by establishing a common market and progressively approximating the economic policies of member States, to promote throughout the Community a harmonious development of economic activities, a continuous and balanced expansion, an increase in stability, an accelerated raising of the standard of living and closer relations between the States belonging to it". This "harmonious development of economic activities" was to be achieved through the elimination, as between Member States, of customs duties and of quantitative restrictions on the import and export of goods, and of all other measures having equivalent effect. For this to be achieved it was essential that the different policies in the agricultural sector would be unified, so that a single market for farm products could be created within the Community.

There were, however, very wide differences between the agricultural sectors of the different member States when the Community was first established, both in the relative importance of the agricultural sector in the respective national economies and in the productivity of agriculture in the different countries. These differences in agricultural conditions were in sharp contrast to the industrial sector, where there was a much greater degree of uniformity. Yet, in spite of these great differences between the agricultural sectors of the six original member states, there was agreement on one cardinal point; without a policy of government subsidies, incomes in agriculture would everywhere lag behind those in industry.

Such a disparity was no longer acceptable. For many years the authorities everywhere in Europe had intervened to ensure adequate incomes in agriculture. They had intervened not only in the field of farm prices and incomes but frequently also in the production and distribution mechanism. In this way each of the six countries had built up its own agricultural system, a development which did not always run on parallel lines. However, the problems inherent in integrating the agricultural policies of the different member States was recognised as early as the late 1950's when Dr Mansholt, then Vice President of the European Commission with responsibility for the agricultural sector, drew attention to the danger of being caught up in a vicious circle. On the one hand there was the economic, social and political need to improve the income of persons engaged in agriculture and therefore to strive for a higher degree of productivity, and on the other hand it was inevitable that by achieving greater productivity, and especially by demanding higher prices, the limit for the sales of foodstuffs would eventually be reached. Unfortunately this warning by Mansholt was insufficiently heeded and the limitations he predicted have become of major concern.

The original objectives of the CAP were set out in detail at a conference of agricultural experts which met in Stresa, in Italy, in 1958. These objectives have been summarised as:

1. to expand trade in agricultural products between member countries and with third countries and to eliminate all internal quantitative restrictions,

2. to maintain a close correlation between structures and market policies,
3. to achieve a balance between supply and demand of farm products avoiding the encouragement of surpluses and giving scope to the principles of comparative advantage of each region,
4. to eliminate all subsidies tending to distort competition between one country or region and another,
5. to improve the rate of return on capital and labour,
6. to preserve the family structure of farming,
7. to encourage rural industrialisation in order to give employment to surplus labour and to give special aid to geographically disadvantaged areas.

So far as the Stresa conference was concerned, the primary objectives of European farm policy were seen as the maintenance of the family character of farming while increasing the efficiency of such enterprises. However, the concept of "the family farm" covers a wide range of farming situations in Europe, from the large scale arable farms of the Paris basin to the small peasant holdings in some of the poorest regions of Southern Europe. These farms while all categorised as "family farms", are so diverse in their basic economic characteristics that they are in reality quite different economic and social units. The major focus on improving the efficiency of European farming, in order to bring reasonable parity between incomes in agriculture and those in other occupations, has not allowed sufficiently for the great diversity of farming within Europe. The rapid growth in the European economy was seen as providing a massive opportunity to move farm labour, especially on the small, low output farms, into more economically productive activities. The expectation was that the output per head in agriculture could be increased by positive action towards increasing total farm output, while simultaneously reducing the amount of labour employed. While it was recognised that a greater output would have to be directed towards new outlet possibilities, there was a general belief that the growth in the European market itself would generate greater sales opportunities and that trade and distribution of farm products could be organised on a larger scale and therefore more efficiently. In the longer run, it was anticipated that the consumer would benefit from all this by lower prices, which would stimulate consumption and in turn boost production. In the short run this proved to be realistic; in the long run the inherent contradictions have become virtually insoluble.

### 2.3 Basic Principles

The three principles which embody the underlying beliefs of the CAP are:

- (a) Market Unity: that there should be a single market for any commodity coming under the CAP, involving a common system of management and pricing throughout the Community.

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- (b) Community Preference: that producers inside the Community should be more favourably placed on the internal market than competing overseas suppliers.
- (c) Financial Solidarity: that there is a commitment by the Community to finance the budgetary requirements of the CAP.

The basic aim in the implementation of the CAP so far as the different farm products are concerned has been to establish a managed market system. This involves the disposal of farm output on the domestic and export markets in a manner that would meet a series of different objectives (i.e. to stabilise markets, particularly the internal market, to provide an adequate level of income to producers, to assure the availability of supplies to consumers at reasonable prices, to limit the demands on the Community's budget etc.). These objectives are not complementary and there has inevitably been a growing measure of conflict between them.

The philosophy of the managed market system has run into enormous problems, particularly those generated by the growth of farm output fuelled by the development of new production technology. The belief in the late 1950's that the consumer would benefit through lower prices, which would in turn stimulate consumption, has proved to be of very limited validity. The consequences of improved technology have not been absorbed by the growth of viable market outlets. Nor has the farm structural reform programme resolved this problem. The managed market approach has come under increasing pressure as the volume of supplies of farm products has grown without a corresponding growth in commercial markets. In the face of the general economic developments of the past decade, the European Community has not been able to achieve a common response to the challenges it has faced. By political pressure, or by practical necessity, the Member States have found themselves assigning priority to widely differing economic objectives - employment, consumer prices, the balance of payments, etc. - and this has necessarily had an impact on the evolution of the CAP.

Now that general economic growth in the Community has slowed down so sharply, there are far fewer opportunities for farmers and farm workers to find jobs outside agriculture. In fact, total employment in industry and services has been declining over recent years. More than 12 m people in Europe are now out of work today, twice as many as there were just five years ago. Four young people in ten have no job. Rationalization of farming by streamlining the agricultural labour force is no longer the obviously desirable policy it was in the past, although the situation varies from member State to member State. Moreover, the member States in which the proportion of the labour force working in farming is highest (Ireland, 19.2 per cent; Italy, 14.2 per cent, (1980)) and where rationalization is therefore most needed are the member States which have the largest reserves of manpower (the unemployment rate is over 16 per cent in Ireland and over 10.4 per cent in Italy). It is just these countries where it is hardest for farmers or farm workers to find alternative employment.

This situation has not only slowed the process of rationalization of agriculture, but has reinforced the pressure to use agricultural

prices policy to support incomes on farms which normally would have disappeared from the market. In consequence, the objective of a prices policy based on a narrowing of the gap between Community prices and prices charged by its main competitors, as proposed by the Commission, has become increasingly difficult to achieve.

#### 2.4 New Approach to the Managed Market System

The basic Commission thinking is now along the lines of a managed production system to complement the existing managed market arrangements. This has involved an attempt to reduce the growth of output by a prudent price policy i.e. a policy of declining real prices for farm products. For the years from 1977 to 1981, real prices (i.e. nominal prices paid to farmers deflated by the changes in prices paid by farmers for their inputs) declined by an average of 3 per cent per year. This had some effects in restraining the growth in farm output, at least enough to give some justification for the more favourable price settlement in 1982. However, this improvement on the supply/demand balance was only a temporary reprieve; with the upsurge in farm output in 1983, the pressure for a restrictive price policy to reduce the disequilibrium in the market for farm products has become far stronger.

This prudent price policy approach has been reinforced by policies of producer coresponsibility levies. The details of how this has been implemented are discussed later but their essential character involves a reduction in the prices paid to farmers when a specified volume of output has been reached. The levy can and has been modified to exempt, wholly or in part, certain categories of producers, and thus tends to be a more flexible policy instrument in supporting farm incomes than direct price reductions. However, the impact of coresponsibility levies on food prices and the Community budget are different to those of straight price cuts; levies do not affect consumer prices while price cuts bring lower prices in the shops.

The purpose of the coresponsibility levies (i.e. to require producers to contribute towards the disposal of surplus production) has been expressed much more forcibly in the Commission's proposals in 1980 to impose a supplementary levy on milk output (or 'super-levy' as it became known) which would fund all the costs of disposal of production in excess of a specific quota. This proposal was the subject of considerable debate in 1981 and again in 1983 but was not agreed by the Council of Ministers at this time; in consequence the output of milk grew very sharply in spite of the absence of any markets for this extra milk. The resurrection of this proposal again in 1984 came only after a large volume of additional dairy products had filled the cold stores of Europe and the pressure for meaningful action had become overwhelming.

The failure to resolve the inherent contradictions in the operation of the managed market policies has resulted in mounting costs to the budget. It is a fundamental feature of the financial policy of the Community that budgetary expenditure must be balanced by actual receipts; the EC does not, at least in principle, have the power to borrow to meet increased levels of expenditure. Furthermore, the

powers to make additional financial demands on member States are severely constrained, such that there is in effect a ceiling on financial resources which can only be raised with considerable difficulty.

In these circumstances, the burgeoning costs of the CAP, together with the rapid growth in other common policies of the Community, have generated a need to find effective solutions to the financial costs of the CAP, which remains the principal charge on the total Community budget. It is this financial pressure which has become the real dynamic behind the moves by the Council of Ministers to reform the CAP. There are of course other issues which have played their part in the proposals for this reform, but it is clear that these do not have the strength that the budgetary constraints now impose on the further development of the CAP and indeed on its current day-to-day operation.

With all its problems, the CAP still plays a central part in the affairs of the Community. Ministers for Agriculture in the Community have powers far in excess of that which they could exercise individually within their own Governments. There is no doubt that this is in part the price which the more industrialised countries (e.g. Germany and the UK) have to pay for the opening up of the domestic markets of the less industrialised member States. This price has now created major problems for the further development of the Community. The European Commission has said that the lack of common policies, or at the very least, the absence of harmonization of the policies determining the economic context in which the common agricultural policy is ever more closely involved, is liable not only to slow down the development of the CAP but also, in the long term, to pose a threat to it.

Thus the future of the EC itself is bound up with the solution of the current problems arising from the CAP. There is an overwhelming view in Europe that these problems will be surmounted and that the Community will continue its progress towards a more unified European economy. This progress will inevitably be slowed by the magnitude of the problems to be overcome; the resolution of these problems, arising directly from the CAP, create their own friction within the Community.

## CHAPTER 3

### THE AGRICULTURAL SITUATION IN THE COMMUNITY

#### 3.1 Role of Agriculture in the Economy of the Community

The EC represents one of the world's largest agricultural producing and food consuming political entities. It is, however, far from homogeneous, either in terms of the physical, economic, and social circumstances of agriculture or in the food consumption patterns in the various parts of the Community. There have been enormous changes in the agricultural sector over the past two decades - changes which are far from over yet.

Take first the main economic factors in relation to agriculture. In total, agriculture contributes about 3.2 per cent of total Net Domestic Product of the Community - varying from 1.3 per cent in Germany to over 17 per cent in Greece. A considerably higher proportion of the labour force is working in farming - about 7.5 per cent for the Community as a whole, varying from 2.5 per cent in the UK to 30 per cent in Greece. Part of the agricultural problem can be seen in these figures; as 7.5 per cent of the population are involved in a sector generating only 3.2 per cent of the production of the Community, there are bound to be large income problems, and especially a substantial gap between farm incomes and those in other sectors of the European economy.

This relationship between people and product has not improved over the past decade. In 1983 some 8.8 per cent of the total population worked on farms and produced 5.5 per cent of total Net Domestic Product. Thus the decline in the proportion of Community G.N.P. coming from the agricultural sector has been faster than the decline in the labour force working in agriculture. This has meant that, in spite of all the support measures under the CAP, the gap between incomes in farming and those in the rest of the economy has widened still further.

Yet at the same time the decline in the labour force has itself been sharp, particularly if a long-term view is taken. Employment in the agricultural sector fell from 19m in 1960 to 12m in 1970 and to 8.2m in 1982 - an average loss of 1 job per minute over a 20 year period. This works out at just under 4 per cent per year over the 20 years from 1960 to 1980, though this has fallen to nearer 3 per cent in recent years. The 8 m people currently employed in farming work on 5 m farms which occupy 102m ha of agricultural land. Of the total area about half is under arable crops, somewhat less under permanent grass and the remainder under permanent crops (mainly vines and fruit trees). The main products are milk (20 per cent), beef (15 per cent), pigmeat (12 per cent), poultry and eggs (8 per cent) and, on the crop side, cereals (13 per cent), fruit and vegetables (11 per cent), wine (6 per cent), sugar beet and potatoes (5 per cent). Thus just over one third of farm output is milk and beef, with 20 per cent from pigs and poultry and about 30 per cent from field crops. There is a wide variation

between member States - milk and beef account for 70 per cent of farm output in Ireland but only 13 per cent in Greece, pigmeat is nearly 30 per cent of output in Denmark but only 7 per cent in Italy and France; cereal production accounts for over 18 per cent of output in both France and the U.K., but only 2 per cent in the Netherlands.

Farm output has been growing at an annual average rate of 1.7 per cent between 1973 and 1981 and nearer 2 per cent if growth in 1982 and 1983 is allowed for. However, this has required a faster rate of growth of purchased inputs, so that value-added in real terms has grown at just under 1.5 per cent a year. Coupled with the decline in the total farm labour force, output per man in volume terms has been growing by almost 6 per cent a year. Yet in spite of this growth, the farm income position has become more acute, not less so.

The underlying reason for this farm income situation has been the adverse movement in the terms of trade for agriculture in the EC i.e. the ratio of agricultural producer prices to prices of purchased inputs. Over the years 1973 to 1982, the overall terms of trade facing European farmers worsened by about 15 per cent. The decline was particularly severe in France, Ireland and to a lesser extent the U.K., due mainly to the relatively high inflation rates in these countries and their effects on the level of input prices. This decline in the real prices paid to European farmers for their products has been an even more serious long-term problem over the period since the 1960's. From 1967/8 to 1980/1 the guaranteed farm prices under the CAP, in real terms (i.e. nominal farm prices deflated by the implicit price index of the G.D.P.) fell by an average of 4.5 per cent per year. This trend is likely to be maintained and possibly even accentuated in the current situation of the CAP. There is little in economic theory that can explain the level of supply response of European farmers in the face of the large price decline in real terms that has occurred; the concept of a backward sloping supply curve would appear to be a reality in the European agricultural situation, but it must be recognised that this has involved a substantial change in technology over the years in question and is not just a response to price changes.

### 3.2 Agricultural Situation in the Individual Member States

The biggest single producer of farm products is France, which accounts for just over a quarter of Community output - and over one third of cereal and wine output and around 30 per cent of beef and poultry output. The former French President, Mr Giscard d'Estaing has referred to agriculture as the "green oil" of France, as agriculture provides a substantial proportion of French export earnings.

With over 1m farms, well over half of them less than 20 ha in size, French farmers have traditionally played a leading part in the agricultural politics of Europe. It has been generally held that part of the basic understanding on which the Community is based is that, in return for opening its frontiers to free trade on industrial products, the French economy would be compensated by way of better market access and price support measures under the Common Agricultural Policy. France is a substantial direct beneficiary from the EC budget and the farming sector has also enjoyed large gains from the system of Community

preference, which maintains internal prices of farm produce sold on the domestic European market well above the levels which would otherwise prevail. Although the contribution of agriculture to the French Net Domestic Product has declined to only 3.6 per cent, over 8 per cent of the population work in the agricultural sector. The French Government has constantly followed a policy of concern for the need to improve the position of these people.

French agriculture has made great strides in improving its arable sector. This is particularly the case in the Paris basin, whose farmers can compete with those of any other region in Europe. In the livestock sector progress has not been so evident; in dairying the average size of the dairy herd is still only 15 cows and nearly 40 per cent of French dairy herds are of less than 10 cows. In the case of pigs nearly two thirds of all producers have less than 10 animals and even in the case of cattle, where the French contribution to total Community output is substantial, the average size of herd is only 35 animals.

The second largest agricultural country in Europe is Italy, which accounts for just under 20 per cent of total Community output but has nearly 40 per cent of the total number of farms. Italian agriculture probably shows a greater range in the economic characteristics of its farms than any other EC member State. Many of the farms in the north are large commercial holdings. With the exception of the UK it has more of its cattle on farms with over 300 head than any other member state; the exception of Greece it also has more of its cattle on farms with no more than two animals. These very small units are to be found particularly in southern Italy, where smallholdings of no more than a few ha provide the main source of livelihood for very large numbers of families. In many cases, however, these small units are devoted to intensive cropping systems - vines, fruit, vegetables, olive oil, etc. - which are run with a relatively high labour input from the farmer and members of his family. Although Italy has two and a half million people working in farming i.e. 50 per cent more than in France, the Italian policy position in the Community has tended to be less dominant than that of France. The Italians have been particularly concerned that the mix of their agricultural output, with its emphasis on fruit and vegetables, wine, olive oil, tobacco, rice etc., has derived less benefit from the agricultural budget than that provided for northern European products. Moreover the lower output per farm in Italy compared with that in other European countries has meant that the absolute level of benefits per farmer from price supports from Brussels have tended to be relatively low.

In recent years the balance of advantage has been partially restored with the introduction of a special Mediterranean package for fruit and vegetables and also a special structural package for improving farm structures which would give particular benefits to Italian producers. These would have their sharpest impact in Southern Italy, where output and income per farm are much lower than in the rest of Italy or in Europe generally. The Italian view has been, therefore, that rather than limit total Community spending, the Community should link its production aims more closely to the economic recovery of its weaker members.



The third biggest agricultural country in Europe is Germany which, like Italy, has an efficient farm sector in the north of the country but a less viable farm sector in the southern region. Agriculture, however, contributes less to total net domestic product in Germany than in any other member State; only 1.3 per cent of the output of the German economy comes from agriculture. German farmers are particularly concerned with producing cereals and sugarbeet in the cropping sector and pigmeat and milk in the livestock sector. The average German farm is of around 15 ha; 33 ha in the north but only about 10 ha in the south. German farming, particularly in the south, is characterised by a substantial number of part-time farmers where the farmer spends most of his working time outside the farm in a job which provides most of his income. The incidence of off-farm earnings has helped to mitigate the problem of low average incomes from farming and the very large gap between farm earnings and those in other sectors.

This problem of the income gap has been seriously exacerbated by German exchange rate policy, where the strength of the Deutsch mark has led to constant revaluations of the currency with consequential downward pressures on German farm prices. These downward pressures have been partly mitigated by the operation of a system of "monetary compensatory amounts" which have maintained German prices above those in the rest of the Community. Even so the increase in producer prices for agricultural products, which has averaged only 2.2 per cent per year for the past decade, is only one quarter of the rate of increase in the Community as a whole. German policy consists of two opposing trends - on the one hand as the main paymaster into the Community budget there has been growing concern at the direct costs to the German economy of the costs of the CAP; on the other hand the very difficult financial circumstances of many German farmers is still an important factor on the German economic and political scene. This dichotomy in the German attitude to the CAP, together with its implicit recognition of the understanding with the French on the basic nature of the economic accord on which the Community is based, has tended to make the German impact on agricultural decisions in Brussels less emphatic than they might otherwise be.

The fourth largest agricultural producer in Europe is the U.K. The U.K. is in some ways comparable to Germany with just over 2 per cent of its total national output coming from agriculture. However, the British have a much smaller proportion of their workforce on farms than in Germany and consequently a much better farm income situation. In general the size of the agricultural enterprises in the U.K. is much larger than in other European countries. For example the average dairy herd is 56 cows or four times the European average and over two thirds of all dairy cows in the U.K. are in herds of over 60 cows. Similarly the average pig herd, at 270 animals, is 8 times larger than the average for the EC as a whole and nearly 80 per cent of the total pigs in the U.K. are in herds of over 400. The 600,000 people working on U.K. farms (farmers and farm workers) represent a little over 7 per cent of the total EC farm labour force but the U.K. accounts for 13.5 per cent of total EC farm output.

The U.K. agricultural sector has grown quite sharply under the stimulus of EC membership. In the last decade Britain has become much more self sufficient in temperate agricultural products. Twenty years

ago Britain imported half the grain it consumed - now it is a net grain exporter. Butter production has quadrupled, in spite of the sharp fall in consumption. The large average size of farm business has meant that the U.K. farmer has enjoyed substantial benefits under the Common Agricultural Policy. The fact that the U.K. is a net contributor to the Community budget has not prevented its agricultural sector from enjoying a considerable boost from EC policies. This has been accentuated by the fact that British farm prices, like the German, have been supported at an artificially high rate in recent years through the operation of the monetary compensatory amounts system. This means that U.K. policy is by no means as concerned with cheap food for its urban population as in the past, as the proportion of disposable income of the overwhelmingly urban society spent on food has declined with the increase in wealth. The major U.K. concern in the operation of the CAP has been and still is the cost to the U.K. exchequer. The pressures of low farm incomes are not especially strong in Britain but the fact that the U.K., with its national income per head below the EC average, is the second largest net contributor to the Community budget has given sharp focus to efforts to reduce expenditure on the CAP. The British farmer is in a better position to earn his income directly from the market place than is the case in most other countries, so that the CAP price support mechanism is less significant to British farm incomes than to those of their European counterparts. Moreover, the British Government has maintained certain aspects of their pre-EC deficiency payments system in operation e.g. in the beef and sheepmeat sectors, but with partial or complete funding from the Community budget, and they have been anxious to preserve these very beneficial arrangements for the British farmer.

The six smaller EC countries account for a little over 20 per cent of total EC output. Here the range of farming situations is just as great as within the larger countries. The Dutch farmers with their emphasis on intensive production systems in both crop and livestock enterprises have achieved relatively high farm incomes by European standards. The Dutch view is that producing enough food is no longer for them a farming problem. The farming objective is to switch over to management methods which will ensure profitability in the future; this involves major decisions regarding the means of production i.e. land, labour and capital and in many cases making a choice between enlargement of the farm or specialization, mechanization or collaboration with others and new investment or giving up.

The position of Belgian farming is similar to that in the Netherlands, except that there is a greater emphasis on beef and pigmeat, largely at the expense of dairying. Average farm size is the same in the two countries at around 15 ha, and these farms are run typically by the farmer and his wife with little or no additional labour. The position in Denmark is broadly similar, except that cereal production is far more important than vegetables and the livestock sector is dominated by milk and pigmeat.

The Netherlands, Belgium and Denmark are among the most prosperous countries of the EC; this has helped their agriculture through providing off-farm jobs, a high price market for quality food products and a relatively large amount of Government funds for farm education, research etc. In the last two years this has changed, with

unemployment growing rapidly in these countries, large fiscal deficits and static or even declining incomes outside agriculture. In spite of this, these countries are perhaps the most Community minded in their approach to agricultural policy and have generally been more concerned with the reasonable development of that policy rather than an exclusive emphasis on the particular needs of their own farmers.

The last two member States to be considered are Ireland and Greece, which are geographically at the two ends of the Community. Both these countries have relatively large agricultural sectors; for them the direct benefits from the CAP have played a major part in their reason for joining and continuing membership of the EC. Both countries have special problem areas of small poor farmers and special regional programmes have been agreed to give additional help, as these farmers otherwise derive relatively little from the general CAP price support measures. In their approach to the decisions taken on the CAP, these two countries, along with France, have been strongest in their demands for the full implementation of the three principles which underline the CAP - common prices, Community financing and Community preference.

### 3.3 Revolution in European Agriculture

The metamorphosis which European agriculture has undergone since the introduction of the Common Agricultural Policy can be regarded in many respects as a 'silent revolution'. The main aspects of this revolution are the rapid decline in the number of persons working on farms, the restructuring of major sectors of production under the pressure of unremitting technical progress, increasingly close links with other economic sectors and, as a consequence of all these aspects, a major improvement in the efficiency of European agriculture. This does not mean that European agriculture is generally as efficient as that in other large developed economies; there are still large areas of small scale farming which have a considerable impact on the overall position.

The rationalization of agricultural production is reflected in the restructuring of the factors of production. This process has affected mainly small farms of less than 20 ha, whose land is being taken over by bigger farms. In consequence, the number of farms with 50 ha and over tends to increase, and average farm size in the Community has grown from 12 ha in 1960 to just under 18 ha in 1980. Even so, over 40 per cent of farms still cover less than 5 ha; these cultivate just under 7 per cent of the utilized agricultural area, while the 6 per cent of farms of over 50 ha work more than 40 per cent of the total farming area.

In parallel with the change of farm structures, the agricultural production process itself has been 'revolutionized' by technical and biological progress. This has involved increasing specialization and intensification of agricultural production, the substantial mechanization of agriculture, an intensive use of fertilizers and pesticides, the use of much higher yielding plant varieties and livestock raised on concentrated feeds.

It is sometimes maintained that, however considerable the

development of European agriculture, it is proceeding much too slowly and that in absolute terms the achievements of agriculture lag behind not only the results attained in some other sectors but also the average growth of the European economy as a whole. For instance, the share of agriculture in total gross value added at market prices in the Community was halved between 1960 and 1980. However, this argument overlooks the starting point for the development of agriculture in some Member States, where it was isolated from the rest of the economy for decades before coming within the orbit of the Common Agricultural Policy. Considering this difficult initial situation with all the associated national and regional problems, the far-reaching changes in European agriculture since the beginning of the Common Agricultural Policy have taken place with surprisingly little social disruption. The common agricultural policy must certainly take much of the credit for this.

#### 3.4 Farm Structures Policy

Much of the agricultural problem in the EC arises from the present farm structural situation. Structure in this context relates to the pattern of farms, and the combination of land, labour and capital in the individual farm business. The structural problem can be seen most clearly in the size of the farm enterprises on European farms.

So far as the size of crop enterprise on European farms is concerned, the average for cereals is 7.6 ha, for sugarbeet 5.4 ha and less than 1 ha for potatoes. The average dairy herd is only 15 cows (ranging from 3 in Greece to 56 in the U.K.), and almost 55 per cent of dairy herds are of less than 10 cows. In the case of sheep the average flock size is 87, but the effect of the U.K. which accounts for over half the total sheep in the Community, is to raise this average substantially (excluding the U.K. the average sheep flock is only 46). Similarly in the case of pigs the average size of pig herds is 35 animals (not just sows, but all pigs), but in Italy and Greece the average is only 10 pigs, while in the Netherlands and U.K. it is over 200. These differences in the size of the main farm enterprises have been the major cause of the wide disparity in farm incomes. This income problem is inevitably far more serious in those regions where the typical farm enterprise is substantially below the average for the Community as a whole.

So far as size of farm is concerned, the average for the EC as a whole of just under 18 ha covers a range from over 65 ha in the U.K. to just over 4 ha in Greece and 7 ha in Italy. Of the total of 5.78 m farms in 1977, (the most recent year for which the data are available) 4.6 m were under 20 ha and only 330,000, i.e. less than 6 per cent, over 50 ha. The 77 per cent of farms less than 20 ha in area occupied no more than 28 per cent of the utilised agricultural area but employed 71 per cent of the active agricultural population.

Part of the underlying philosophy of the Common Agricultural Policy has been that the income problem of the European agricultural sector can be resolved to a considerable extent through the operation of an effective farm structures policy. In their recent proposals to revise the existing structures policy the Commission have said that

"the common policy for agricultural structures is a vital element in the Community's agricultural policy. The long-term development of agricultural production on a sound basis, and satisfactory economic and social conditions for those engaged in agriculture, cannot be assured without common action by the Community and Member States in this domain. By its nature, and unlike the common policies for agricultural prices and markets, the structural policy for agriculture produces its effects mainly in the longer-term; and unlike them, it was developed gradually in successive stages during the first twenty years of the life of the common agricultural policy".

The farm structures policy has been based on the view that a large number of farms could become permanently profitable only by making investments spread out over a number of years, which they could not possibly finance without public aid. For the effect of this investment to be a lasting one, farm structures would have to be improved. This is mainly a matter of farm size. Hence the need to encourage farmers to leave the land and turn over their holdings to others who have realistic prospects of operating profitably. This progress towards an up-to-date type of farming could be achieved only if those remaining in farming are given the opportunity to become more efficient by acquiring further occupational training.

The approach adopted was a logical and valid one in the economic conditions prevailing in the early 1970s, when this policy was formally adopted. Circumstances decided otherwise. To start with, it transpired that the modernization required was beyond the reach of the weaker farms. In the less-favoured regions in particular, the poverty of the farmers and especially the employment, administrative and economic environment proved formidable obstacles to any improvement in agricultural productivity. Secondly, the impact of the general economic recession has severely restricted the application of the common policy on structures. The two factors essential for adjusting farm structures, namely the occupational mobility of farmers and farm workers and the "mobility" of land itself, were severely reduced or lost altogether.

The effect has been that while substantial increases in farm productivity were achieved, these were primarily in good farming regions and came in particular from intensifying production and greater specialisation. Land mobility in the context of the common agricultural structures policy has been minimal - the increase in size of 'development' farms being, on average, less than 5 ha. In these circumstances, the progressive intensification of farm production has been reflected mainly by increasing levels of investment in equipment and livestock. Some 60 per cent of farm development plans provided for investments in cattle and cattle housing and over 66 per cent for investments in machinery. In this sense the policy has contributed to an increase in the output of surplus farm products.

At the same time the "prudent" price policy, conducted against a background of increasing production costs, has exerted an increasing pressure on farm incomes. Farmers with the necessary financial means to participate in the Community's Farm Modernisation Scheme have become fewer in number in recent years. In fact, "modernising" farms represent a maximum of only 15 per cent of all farms in the Netherlands

but less than 2 per cent in Italy.

In spite of a special programme of aids for farms in the poor hill and mountain areas, it remained evident that the less-favoured areas suffered from other drawbacks which prevented normal agricultural development. It is for this reason that a number of "common measures" were adopted, aimed at compensating for these shortcomings. These measures exist both on a general basis and for particular regions e.g. the Mediterranean, Ireland and Northern Ireland.

Quite apart from the factors inherent in the agricultural structures policy itself which individually or collectively have reduced its effect from the original high hopes for the policy, the radical changes which occurred since 1972 in the general economic situation of the Community have been sufficient in themselves to warrant a revision of the totality of the policy.

With the general European economy now in a situation of virtual economic stagnation, unemployment has become a crucial problem. The improvement in agricultural incomes has been reversed while economic disparities have increased among the various regions of the Community. Furthermore, the increasing surpluses on the markets for the main agricultural products no longer allow for the intensification of production, but necessitate the pursuit of a prudent or restrictive price policy more than ever before and require further adjustment of the structures policy.

### 3.5 A New Farm Structures Policy

In the current economic situation, and given the difficulties facing the market for many agricultural products, the view of the European Commission is that the agricultural structures policy must now become a more positive force in the development of agriculture. However, it has to achieve this objective despite the fact that the pressure on the market from many farm products now creates major constraints on structural adaptation.

The aim of the new farm structure policy is, first of all, to promote technical progress and an increase in the competitive position of farms, through productive investments, a more efficient use of production factors and better training of farmers. It is also aimed at promoting the structural development of agricultural processing and marketing. Moreover, the policy has to contribute to the maintenance of agricultural activity in areas where, despite natural handicaps, farming proves necessary in the absence of alternative employment opportunities, and in the interests of environmental conservation.

The Commission therefore proposed to the Council in 1983 that in future greater emphasis be put on long-term structural action, as opposed to market intervention and price support as the means of alleviating social and income problems in agriculture. Expenditure on

the new policy is expected to amount to some 7,500 m ECU<sup>1</sup> in the first five years, as compared with the 3,750m ECU allocated for 1980-84 under the existing policy. To this must be added estimated expenditure of some further 3,000 m ECU for improving agricultural structures under the Integrated Mediterranean Programmes.

The reform of the agricultural structures policy reflects a number of objectives:

- to provide help for a larger number of small-scale farmers who are likely to be the most affected by the current economic difficulties and the lower guaranteed prices for many agricultural products to be expected in the future;
- to improve farm structures and incomes in the mountainous and less-favoured areas of the Community, particularly in those member States where the problems are most acute;
- to ensure that the aid programmes for improving farm structures and incomes take due account of the need to control the output of surplus farm products and for the most efficient use of limited financial resources;
- to stimulate the processing and marketing of agricultural products;
- to develop non-agricultural activities in the rural areas, including forestry.

Under these new measures, it is proposed that all investment aids at both Community and national level be banned if they increase the output of products with market difficulties, particularly milk, with the exception of certain products in some less-favoured areas. By contrast, investment aids for the purpose of qualitative improvement or the conversion of farm production in line with market requirements will be actively encouraged.

These new proposals recognise that the farm modernisation policy in the past has helped farmers who were in the best position to implement development plans. By so doing it is associated with an aggravation of the surplus situation on some Community markets. The new policy involves a change of direction, favouring farmers in lower income brackets who are in greatest need of investment aid. The aim is to help them to improve their income, living and working conditions without, at least in theory, inducing them to increase the production of products which are already in surplus. The Commission anticipates a significant increase in the number of farmers who will benefit from the Community aided investment measure each year up to 1990.

It still remains to be seen how the Council of Ministers will finally resolve the conflicts in the structures policy. The initial reaction to the new proposals has been broadly positive from the

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1. The ECU is the common unit of currency for the Community. It is currently worth approximately NZ\$0.81.

countries with large numbers of small farms (Italy, Ireland and France) but less so from the countries which have a reasonably good agricultural structure at present and which would not be the major beneficiaries under the proposed new policy. In addition, the financial resources required for the new policy will require a satisfactory solution to the present budgetary difficulties.

It is evident that the most effective way of making progress in the area of farm structures could be a growth in the national economies of member States, and in particular the development of new opportunities for off-farm jobs. The present level of unemployment, however, makes this extremely difficult. In the absence of an expanding off-farm sector, the resolution of the farm structures problem is going to be severely handicapped. The further growth of new farm technology will put the existing millions of poor farmers under increasing pressure - a pressure which the current proposals will not even contain, let alone resolve.





## CHAPTER 4

### THE DAIRY SECTOR

#### 4.1 The Current Dairying Situation

Agriculture in the EC has traditionally had a strong bias towards dairy farming. One farm in three (nearly 1.8 m in total) produces milk; virtually all of these are family farms where milk production is the main source of income. The majority of these farms are below the production level needed to provide a reasonable income, by today's standards, to the families involved. The average number of cows is 15. The structure of dairy farming in Europe is, however, very varied, with 55 per cent of all dairy farms having less than 10 cows; this increases to 86 per cent in the case of Italy, which nevertheless has over a quarter of all dairy farms in the Community. If a figure of 30 cows is regarded as the minimum for a viable dairy enterprise by European standards, then 88 per cent of the dairy farms are below this viability threshold. Thus most dairy farmers look towards an intensive use of their very limited acres as a means of achieving a reasonable income, since their small farms are not suitable for more extensive farming systems such as arable cropping or beef production.

The current number of dairy farmers is only just half the number in the early seventies. The loss of over 1.5 m dairy farmers in the past decade represents an extremely high rate of adjustment to the situation of the dairy market and should be seen against the nature of the "structural surplus" problems of the dairy sector. The change has come during years when the economic climate in Europe has been generally unfavourable, and jobs outside farming have been scarce.

In spite of this fall in the number of farmers in dairy production, the number of cows has remained remarkably constant at some 25 m head. Cow numbers are in fact slightly down on the number in the Community some 20 years ago although there has been a small increase in recent years. This recent growth follows the decline experienced between end-1978 and 1981, which reflected the limited impact of the non-marketing of milk and official "conversion" schemes from dairy production; the impact of other economic factors, particularly the "cautious" price policy and costs development (primarily high interest rates), have also been important. In 1982 the price/cost ratio of dairy production improved but the structural development continued, involving a further reduction of the number of smaller dairy herds offset by an increase in the number of bigger and more efficient ones. The rhythm of increase in milk deliveries to dairies continues unabated, with a further 3.5 per cent rise in 1983. This means that, in the two years 1982 and 1983, an extra 8 m tonnes of milk was produced, for which no additional internal or external markets have been found.

The virtually static cow numbers in the past two decades have been accompanied by a steady increase in yields per cow of 1.5 per cent per year. Over the last few years, however, this yield increase has

gathered momentum and since 1975 has averaged some 3 per cent per year. In 1982, average yields per dairy cow increased by 3.8 per cent to 4,332 kgs, an increase considerably above the longer-term trend.

The growth in yields per cow has been ascribed to better stock selection, effective disease control measures, investment in modern accommodation and equipment, better grassland management and especially the more extensive use of purchased feed. The milk producer has in fact at his disposal unlimited quantities of feed from outside the farm. It is estimated that over 20 per cent of milk production originates from imported feed. The milk/purchased feed price relationship has been very favourable and this has inevitably led to steadily increasing feed consumption. It is generally assumed that 1 kg of fodder concentrate produces at least 2 litres of milk, but as the price of 1 kg of fodder concentrate has usually been appreciably lower than the price of 1 litre of milk, the greater use of purchased feed has generated more income for the farmer.

Twenty years ago deliveries to dairies represented only 60 per cent of total milk production. Dairies now receive about 90 per cent of the total milk produced in the Community. This percentage is continuing to rise since, because of the labour involved, processing at the farm (farmhouse butter and cheese) is dying out. The milk products industry, downstream from dairy farming, has become highly concentrated and is now part and parcel of the industrial sector. The process of concentration was particularly rapid in the sixties, the decade of general economic growth. Since 1965 the number of dairies has halved while in the meantime the supply of milk has risen by about 30 per cent. The tendency for units of production to expand and merge applies strongly in the dairy processing industry and has resulted in marked improvements in productivity.

#### 4.2 Production and Consumption of Dairy Products

##### 4.2.1 Drinking Milk

The overall use of milk in the Community for liquid milk and fresh milk products has increased only marginally recently, with the consumption of drinking milk remaining practically unchanged over recent years. However, the picture showed a certain degree of differentiation as to individual products and member States. Thus, the general tendency of the last nine years to consume more semi-skimmed milk and less whole milk has continued. The total share of UHT-milk continues to increase. Consumption of cream and other fresh milk products (yoghurt, etc.) has also increased, but at a significantly lower rate, reflecting the impact of unemployment and other economic/social difficulties.

##### 4.2.2 Butter

Total butter production in the Community increased by 7.8 per cent in 1982 and by a further 10 per cent in 1983. This development resulted from the sharp increase in milk deliveries and the relatively low increase of milk utilization for other dairy products. The

internal consumption of butter at the normal market price has continued to fall and the total consumption increase of 1 per cent in 1982 was due to increased sales at reduced prices to the food industry (bakeries, ice cream) and non-profit making institutions and, finally, to the end-year cheap price sale ("Christmas butter"). However, the increase in consumption in 1982 due to cheap price sales should be considered as purely 'technical' as a high substitution effect occurred at the beginning of 1983, resulting in a decline in consumption in 1983. Commercial exports continued to decline and were 38 per cent lower in 1983 than in 1980; the export figure of 370,000 t was the lowest since 1978.

Because of the large increase in production, the relatively low consumption and the decrease in total exports of butter, the end year stocks for 1982 were more than double the stocks at end 1981. The continued imbalance between supply and demand and the drop in exports resulted in stocks of about 850,000 t by end-1983; this is projected to increase further in 1984, even with the full implementation of the 'super-levy' on all additional milk production.

#### 4.2.3 Skimmed Milk Powder

Skimmed milk powder production has been increasing in recent years to reach 2.5m t in 1983. This increase is partly due to the increase in milk deliveries and in butter production and the consequential relatively limited use of milk in the production of cheese and liquid milk products. The use of liquid skimmed milk for animal feed declined by 35,000 t in 1982 but the introduction in that year of a special aid for skim powder fed to pigs and poultry resulted in sales of more than 500,000 t in 1983. At the same time skimmed milk used for casein production increased in 1982 by 13 per cent, an increase which continued in 1983 but at a lower rate.

The manufacture of skimmed milk powder in the Community far exceeds demand at market prices, which amounts to less than 15 per cent of total production. This is the background to the aid given to skimmed milk powder incorporated in animal feed compounds. In 1982, 1.27 m tonnes (or 58 per cent of production) was sold for calf-milk replacers with a price reduction of 40 per cent.

Both the commercial and food aid exports continued to decline in 1983, when only 240,000 t were exported against 580,000 t in 1980. Exports in 1983 were the lowest since 1976 and the decline over recent years has continued in spite of the substantial export subsidies which have been paid.

The large increase in production, relatively stable consumption and decline in exports has resulted in increased public stocks. The stocks of 279,000 t in 1981 increased to 574,000 t in 1982; by end of year 1983 stocks reached 1.1 m t despite the sales under the pigs and poultry feed disposal scheme. Some decline in stocks to just over 1m tonnes has been projected by end 1984, but the cost of the disposal programme is very large.

#### 4.2.4 Cheese

Community cheese production increased in 1982 by 1.7 per cent (against 3.6 per cent in 1981) while consumption increased by 2 per cent (against 2.5 per cent in 1981). Thus, the upward trend in consumption continued, but at a lower rate. No doubt one of the main reasons for this continued increase is the availability to the Community consumers of a wide range of cheese types and qualities, including imports of about 100,000 t of cheese from third countries. On the other hand, the Community is the world's biggest cheese exporter, exporting 390,000t in 1983. The increase of these exports in recent years, with the aid of export subsidies, has decisively influenced the total level of Community production.

#### 4.2.5 Other Dairy Products

The production of whole milk powder in the Community is traditionally linked to the development on the international market. Having increased by more than 60 per cent from 1978 to 1980, the international market stagnated in 1981 and exports decreased by 15 per cent in 1982 to 450,000 t. Community production decreased by 18 per cent in 1982 compared to 1981 and the decline continued in 1983, although at a lower rate.

Production of condensed milk increased by 1 per cent in 1982, mainly in response to export sales which, for the first time, reached 600,000 t (19,000 t over the 1981 level). Although the EC share of the international market has been falling from 1977 to 1980, a recovery both in quantities exported and market share was recorded in 1981 and 1982. However, a slowdown of production and exports has occurred in 1983.

EC production of casein is based on a system of aids paid for skimmed milk used in its production. These aids compensate for the very low import duties bound under GATT. With higher aid levels, production increased in 1982 by 20,000 tonnes to over 100,000 tonnes and the increase continued in 1983 although again at a slower rate.

### 4.3 The Machinery of the Common Organisation of the Market for Milk and Milk Products

The basic regulations for the dairy sector under the CAP have established a price system, an intervention system (designed to support the initial market) and rules for trade with non-member countries. Additional measures are designed to support and stabilise the milk sector.

To underpin farmgate prices, the Community fixes a target price for milk delivered to dairies. This is the price of milk which Community policy seeks to ensure for all milk sold by farmers during the milk year, either on the Community market or external markets. Thus the target price is an objective but not a guarantee. The achievement of the target price is underpinned by intervention prices for butter and skim milk production. The intervention agencies, operated by each

member State, must buy in all butter and skim milk powder offered to them at the intervention price.

These prices are normally the lower limit of market prices and thus guarantee a minimum income to farmers. The prices obtained for the other products (liquid milk, fresh products, cheeses) on the markets are such that in general the average prices actually paid to milk producers should be close to the target price. They may even exceed this price where demand is heavy for a given product but more often they are a little below it. On a market burdened by permanent over-production, the intervention price eventually determines the market price and, consequently, the farmgate price, i.e. what the farmer actually gets. Threshold prices apply in the dairy sector as a protective mechanism against imports, enabling the prices on the internal market to be brought near to the target price and only allowing imports should there be a shortage on the internal market.

#### 4.4 Trading Arrangements with Non-member States

The threshold price for milk products is set each year; products are divided into groups and for each of these groups a pilot product is chosen for which a threshold price is fixed in the light of:

- the ratio of the fat content of the milk to the protein content;
- the target price of the milk;
- the need to ensure some degree of protection for the Community's processing industry ("the Community preference").

The threshold price represents the lowest price at which the product coming from non-member countries may enter the EC market, and is used in the calculations of a levy on dairy imports. This levy is the difference between the threshold price and the import price for each product matching the most favourable opportunities for purchasing in international trade. In addition a given quantity of butter from New Zealand is imported at a special levy rate. On exports, the Commission pays "refunds" to bridge the gap between prices in the Community and prices obtaining in world trade in milk products. The refund is the same throughout the Community, but may be differentiated according to country of destination to cover any special features of the market. It is reviewed at least once every four weeks.

#### 4.5 Additional Support and Stabilisation Measures

A compulsory coresponsibility levy designed to encourage and broaden the disposal of milk products has been paid by milk producers since 1977, in the form of a percentage of the milk target price. The yield from this levy is used to promote the disposal of milk products, but not the payment of the export refunds.

The Community have also operated special incentive schemes to induce dairy farmers to go out of milk production and into other farming systems, but in view of the difficulties and even fraud that

have been experienced these schemes have been suspended. It is not evident that the schemes have been cost-effective; they have provided substantial payments to producers who in many cases were giving up milk production for other reasons.

#### 4.6 Causes of the EC Dairy Problem

The problems in the dairy sector have arisen from the relentless upward surge in milk production and a virtually static internal demand. The annual increase of domestic human consumption of all dairy products expressed in milk equivalent (fat basis), followed an upward trend in the period 1974-82 of about 0.5 per cent per year, reaching a level of 85.3 m tonnes in 1982. This development covers very different trends for individual dairy products. In particular, the consumption of butter has been falling at an average of 2.8 per cent annually, despite the measures taken by the Community to subsidize sales. For all other milk products the increase in consumption has been of the order of 2.4 per cent annually. If these trends continue unchanged, consumption in 1990 could amount to 88 m tonnes milk equivalent. However, in view of the economic and demographic conditions forecast for the coming years, it seems probable that a lower rate of increase in consumption should be achieved than in the 1970s and that a realistic level of consumption in 1990 is unlikely to exceed 87 m tonnes milk equivalent.

Against this current consumption of 85-86m tonnes of milk, production has continued to grow. By 1983 it had reached a total of 111.6 m tonnes, i.e. some 30 per cent greater than the Community market can absorb. The extrapolation of the trend of milk deliveries in recent years (annual average increase of 2.7 per cent in the period 1973-82) suggests that by 1990 deliveries would be at the level of 121 m tonnes, unless measures are implemented to stop the further development of milk production. It is evident that such a volume of production would be far in excess of the realistic possibilities of disposal within the Community and on external markets. Recently the Director-General for Agriculture in the Commission pointed out that the marginal cost of disposal of milk products in 1984 is, according to his own experts, more than 100 per cent of the target price. As the target price is now considerably above the actual farm-gate price for milk in the Community, this means that the marginal disposal cost is well above the average price of milk currently received by farmers. In other words the returns on additional milk produced in the Community do not pay the manufacturing, storage and selling expenses; when these are met the net sum left to reward the farmers involved is negative, and substantially negative at that.

Outlets on the internal market of the Community are circumscribed by a shortage of finance. In 1982, about 88 per cent of the skimmed milk powder and around 40 per cent of the butter consumed on the domestic market was subsidised. The average cost of disposing of surplus butter internally is still about twice the cost of export (about 3,000 ECU/tonne). The cheapest outlet for surplus output of these two products has always been the export market but, despite increases in 1982 in export refund levels, quantities of most dairy products exported in 1983 were well below those for earlier years. In addition, the existence of high stock levels in other developed

countries, particularly in the United States, are not contributing towards price stability on the world market.

The serious market imbalance in the EC dairy sector is not a new problem but the situation has deteriorated sharply in recent years. World market prospects do not indicate the possibility of further significant increases in the Community's exports. The cost of subsidised disposal on the Community's own markets has reached very high levels. The Community is, therefore, faced with the need for radical action to correct the situation.

It is quite evident that the price decisions taken over the last 10 years have not been sufficient to redress the market imbalance. The Commission has estimated that, in order to avoid the "guarantee threshold" of 97m tonnes delivered to dairies being exceeded in 1983, the milk price for 1984/85 would have to be abated by as much as 12 per cent. A measure of this kind would evidently have grave and immediate effects on the revenues of producers, yet there would be some delay before the full effect on production was achieved. In the light of the gravity of the imbalance in the milk sector and the economic and social aspects of the situation, the Commission has proposed that in future the principle of the guarantee threshold in this sector should be implemented through a quota system, accompanied by a restrictive price policy.

At the meeting of the Council of Ministers at the end of March 1984, it was agreed that a reference quantity (quota), corresponding to the concept of the guarantee threshold, would be established based on deliveries in 1981 plus 1 per cent (but in 1984/5 at 1981 plus 2 per cent). Italy and Luxembourg quotas were set at the level of their 1983 deliveries and for Ireland the quota was 1983 deliveries plus 4.63 per cent. All deliveries in excess of this quantity will be subject to a supplementary levy, calculated in such a way as to cover the full cost of disposal of the additional milk. The dairies in turn would apply the charge to producers. The Commission have argued that such a measure should stabilize milk deliveries without aggravating the problem of the income of small producers. It would have a rapid effect in discouraging additional production. To provide for the possibility of establishing newcomers (such as young farmers) the transfer of quotas from one enterprise to another has been proposed.

An increasing output of milk through purchases of concentrated animal feed is leading to the development of so called 'milk factories'. Where the connection with the land is of little importance, the Commission had suggested the introduction of a special levy on milk from intensive farms (for example, those which deliver more than 15,000 kg per ha of forage), but no agreement has so far been reached in the Council on the introduction of any such system of levies.

In addition, the high cost of disposing of butter on the Community's internal market particularly through general consumer subsidies has led to only a small increase in consumption. This has led to a proposal to eliminate, in two steps, the special subsidy for butter consumption. This would result in some loss of butter sales, but it is argued that compensating increases in disposal of milk fat



can be obtained by more cost-efficient measures (e.g. the extension to other foods of the aid for butter used in pastry and ice-cream and the introduction of a special aid for concentrated whole milk).

#### 4.7 The Future of Dairying in the Community

The enormous problems of the EC dairy sector will almost certainly worsen in 1984. It is unlikely that the steps taken will hold production even to its 1983 level, and some further production increases seems inevitable. This will further aggravate the problems of surplus stocks which, particularly in the case of butter, have grown far beyond the level that can be disposed of by almost any steps that would not totally destroy the precarious balance of the world market. Production of whole milk powder and condensed milk has been falling over the past two years and there is no possibility of these recovering sufficiently to overcome the present surpluses of milk. Skimmed milk powder can be disposed of for animal feed, but the increasing use of liquid skim in the Community is limiting the growth in the consumption of dried skim. In any event, very high subsidies to feed skim either in liquid or dried form to animals can not be justified as an efficient use of resources in agriculture.

Nor is it apparent that the Commission's proposals could halt the expansion of milk production. Their proposals have met with stiff opposition in certain countries which stand to lose substantially from their introduction. The present measures are far from being sufficiently strong to bring about a complete halt to growth in milk output, though they would certainly reduce the rate of growth to only a fraction of its recent level. If however, there is a sharp reduction in the real price of milk, arising from both a low rate of price increases and supplementary measures to reduce the effective price of intervention purchases, then it is possible that the consequential loss of income might induce farmers to reduce output. Such a policy would be a rational response; while some individual farmers may increase output to compensate for the sharp drop in their incomes that would otherwise arise and while European farmers have increased output in spite of falling milk prices in real terms over many years, it seems unlikely that a really sharp fall in prices could continue to give rise to a growth in total output. The Commission estimates that a price reduction of the order of 12 per cent would lead to a static or declining level of total milk output. This price decline could become a reality in real terms, particularly in countries with large increases in production costs. Certainly a drop in real prices of this magnitude might well occur over a two year period and the farmer response could be more significant than has generally been allowed for. Such a development would, of course, have a severe effect on farm incomes, with consequential political problems for the agricultural ministers. What the outcome would then be is very difficult to foresee, but the change in the economic and political climate in which price decisions are made, particularly in the dairying sector, may create a quite different direction for the CAP, with the most immediate impact on dairy production itself.

## CHAPTER 5

### THE SHEEP SECTOR

#### 5.1 The Current Sheepmeat Situation

Sheepmeat and goatmeat account for about 2 per cent by value of the Community's total agricultural production and 4 per cent of total meat production. Sheep are raised on approximately 600,000 farms in the Community, with four member States having 92 per cent of the Community flock (38 per cent in the United Kingdom, 23 per cent in France, 16 per cent in Italy and 15 per cent in Greece). Sheepmeat accounts for about 20 per cent by value of the production of all types of meat in Greece, and about 13 per cent in the United Kingdom, France and Italy.

The Community, with its output of 700,000 t, is the world's second largest producer. The USSR has the highest output (800,000t), then the EC, followed by Australia and New Zealand (600,000t each) and China (400,000 t).

The number of sheep in the Community has risen virtually without interruption since 1972 to reach 59 m head by 1982, including 40 m ewes. The rate of increase, at 3.3 per cent, was slightly higher in 1982 than the 2.9 per cent in 1981, but it varied considerably among Member States. Numbers fell sharply in France by 7.5 per cent, remained steady in the United Kingdom, and increased in the other Member States. A further rise, by 1.7 per cent to 60 m head has been estimated for 1983, coming mainly in the UK, Ireland and Italy.

A large proportion of the sheep production in the Community is concentrated in the mountain and hill farming areas, where farm incomes are considerably below those in agriculture generally. Incomes of sheep producers in these areas are, however, supported by special headage payments paid out of Community and national funds, as well as by the general market support measures for sheepmeat.

Community production of sheepmeat tends to run in cycles, but the underlying trend has been upwards since 1970. Thus, from 1973 to 1981 there was an annual rate of increase of 2.7 per cent. In 1982 production rose to 706,000 tonnes and is estimated to have increased more sharply (by 3.4 per cent) to 730,000 tonnes in 1983. This represents a new record level of production and is 164,000 tonnes (30 per cent) more than the quantity produced ten years earlier.

Consumption of sheepmeat in 1982 at 975,000 tonnes, increased sharply (4.5 per cent) due to a steep rise in the United Kingdom (7.6 per cent) and a somewhat lower one in Greece (5.5 per cent) and France (4.0 per cent). A further increase to 980,000 tonnes is estimated for 1983, which would leave total consumption some 50,000 tonnes higher than in 1973.

## 5.2 The Trend in the Community Deficit

Sheepmeat is the only meat in which the EC is not self-sufficient. By 1983, the level of self-sufficiency had risen to 75 per cent, compared with only 56 per cent back in 1972. The deficit has fallen from around 360,000 tonnes a decade ago to 250,000 tonnes in 1983.

There is surplus production in only two Member States, Ireland and the Netherlands, both of whom export to France. In 1982 the United Kingdom produced only 64 per cent of what is consumed, but it is at one and the same time the Community's biggest producer, importer and exporter, accounting for 37 per cent of Community production, 74 per cent of imports and 46 per cent of exports to other Member States.

Production and consumption forecasts for 1985 and 1990 prepared by the European Commission show:

- (1) Total output should increase. Community production in 1985 and 1990 is likely to be of the order of 770,000 tonnes and 810,000 tonnes respectively, an annual increase of 1.2 per cent over the period 1980-1990. This assumes that the current system of premiums to producers is maintained. (This rate of increase does, however, appear remarkably low when compared with the 2.9 per cent that occurred from 1970 to 1980 and implies a sharp decline in growth in the second half of the 1980s. Given the prospect of resources in other farming enterprises being moved into sheep, this projection of only 1.2 per cent per annum looks even more unlikely).
- (2) Consumption is likely to increase to 980,000 tonnes in 1985 and 1,020,000 tonnes in 1990. This assumes that the current variable premium system in the United Kingdom, which underpins the increase in per capita consumption in the Community, is maintained. It gives an annual rate of increase in total consumption of 0.5 per cent over the period 1980-1990. This, however, seems exceptionally high when compared with the increase of 0.1 per cent from 1970 to 1980, particularly as economic growth generally may be below that in the 70's and the higher prices under the sheep meat regime may deter increased consumption.
- (3) On the basis of the Commission's projections, the common organisation of the market should hold the Community's deficit steady at around 210,000 tonnes in both 1985 and 1990. The Commission's view is that without the common organisation, the shortfall would be smaller - i.e. there would be more opportunities for 3rd country suppliers to export to the EC, on the basis of their assumptions about the rates of change in production and consumption of sheepmeat.

Against this projected deficit of some 200,000 tonnes by the Commission, a projection of the actual trends in production and consumption from 1970 to 1980 from the 1983 actual levels, gives a deficit of less than 100,000 tonnes by 1990. The Commission has not produced any explanation of the rates of increase that they have used in their own projections, and on the face of it they seem to be unlikely.

The current EC deficit is made up mainly by imports of frozen lamb into the United Kingdom from New Zealand. West Germany, Greece and Italy also import significant quantities of sheepmeat from third countries, notably from Argentina, Australia and Eastern Europe. Italy is also the main importer of live sheep from third countries, with smaller quantities of live sheep imported from Eastern Europe into West Germany, France and Greece. Most of the Community's export trade is conducted within the EC itself and only relatively small quantities of sheepmeat or live sheep are exported outside the Community.

### 5.3 The Organisation of the Market for Sheepmeat

While the markets for the major agricultural products in the Community had been brought under a common organisation before the U.K., Ireland, and Denmark joined in 1973, the sheepmeat market was still subject to national rules in each Member State. In the original six member States, sheepmeat output was less than 1 per cent of total farm output and sheepmeat tended to be regarded as a luxury product not widely consumed in ordinary households.

With the entry of the UK and Ireland into the EEC in 1973 the position changed. Lamb consumption is a major element in the everyday diets in these two countries and both of them have a substantial sheep production sector within their agriculture. The need to harmonise the sheepmeat market was quickly acknowledged but early agreement on a common organisation of the market proved impossible. The conflict of interest between the French and the UK was the major problem. The French have a high priced sheepmeat market in order to support the incomes of their own producers, the U.K. a low priced market as part of their general cheap food arrangements. Furthermore, the element of community preference which would have to be incorporated in any EC market regime was limited by the bindings in GATT on the existing customs duties on sheepmeat imports. A more restrictive import regime would involve considerable compensation to existing exporters to the EC if these GATT bindings were to be "deconsolidated". As this might prove very costly, there was a reluctance within the EC to become involved in any steps in this direction.

At the same time the French market offered by far the most profitable outlet for producers in other member States. The operation of the French market arrangements, however, created great difficulties for potential exporters to this market. The French were unwilling to see their market taken over by suppliers from other member States, particularly the U.K. who would then import much of their domestic requirements from outside the Community. This situation obliged the member States to get down to serious negotiations on a sheepmeat regime and by late 1980 a common organisation of the market came into operation.

The structure of the organisation involves a basic price, premiums and an intervention system.

### 5.3.1 The Basic Price

The Council of Ministers fixes for each marketing year a basic price for fresh sheep carcasses. This price takes into account the situation on the EC market, the prospects for development, and sheepmeat production costs in the Community; it is related to the normal seasonal price variations on the Community sheepmeat market.

Member States can choose either an intervention buying-in scheme or a variable slaughter premium scheme, in conjunction with an annual ewe premium scheme. Alternatively a member State may operate the annual ewe premium scheme only. It is this combination of intervention, variable slaughter premium and ewe premium which provides the basic support for sheep farmers' incomes. France has opted for intervention and the United Kingdom for variable premium, both in connection with the annual ewe premium. All the other member States operate the annual ewe premium scheme only.

### 5.3.2 The Annual Ewe Premium

In order to maintain producer's incomes, any gap between the basic price and the actual market price for the marketing year is estimated annually at the beginning of the marketing season. This difference (or loss of income) is multiplied by the tonnage of sheepmeat produced in each region concerned during the previous calendar year. The total is divided for each region by the number of ewes, to give the estimated amount of the premium payable per ewe in each region. The premium paid corresponds to the "effective loss of income" for the producers resulting from actual level of market prices.

In the first two marketing years (1980/81 and 1981/82) the market prices in Ireland and the United Kingdom were such that this annual ewe premium was paid only in these countries. By the 1982/83 marketing year the situation had changed; not only Ireland and the U.K. fulfilled the conditions required for receiving the ewe premium but also France, Benelux, Denmark and Federal Republic of Germany. These premiums reached 18.85 ECUs per ewe in Belgium and ranged downwards to 0.5 ECUs in France. Total expenditure on ewe premiums in 1982/83 amounted to 100m ECUs.

### 5.3.3 The Variable Premium

Variable slaughter premium measures are in operation in Britain, and provide for a direct payment to producers when market prices are below a "guide level" i.e. 85 per cent of the basic price. This guide level is adjusted weekly in the same way as the basic and the intervention prices.

When the average market price is below the weekly guide level, a variable slaughter premium equal to the difference is paid out on sheep marketed either live-weight (the most common practice in Britain) or dead-weight in that week. Whenever live sheep or carcasses on which the variable slaughter premium has been paid are exported from the UK to another part of the Community, a charge equivalent to the variable

premium is made ("clawback") so as to prevent any disturbance of the smooth operation of the market in the region of destination. However, exemption of the variable premium "clawback" is allowed on British sheepmeat exports to traditional non-Community markets.

#### 5.3.4 Intervention Buying-in Scheme

Intervention buying-in measures can be applied to a Member State, provided that it is operating a national carcass classification system which makes it possible to identify the qualities which will give best support to the market and a representative survey of prices paid for those qualities. Weekly intervention prices have also been fixed for France, but no buying-in has actually taken place.

There is also provision for aids for private storage to be operated when the EEC market price falls below 90 per cent of the basic price. Although these conditions have arisen on a number of occasions, this system of aids for private storage of sheepmeat has not been introduced and no budgetary provision has been made for its operation.

#### 5.4 The Effects of the Sheepmeat Regime

Expenditure on the sheepmeat regime has grown very rapidly. Total expenditure on the ewe premium and on the variable premium rose from 53.5 m ECUs in 1980 to 360 m ECUs in 1983 (although the 1984 budget provides for expenditure to drop slightly to 350 m ECUs). In 1983, however, it was found necessary to delay payment of the first instalment of the ewe premium until 1984 and it is likely that the original 1984 provision will prove to be inadequate. Much of this expenditure has been in the U.K. and Ireland, which have seen sheep prices increase very sharply under the stimulus of the sheepmeat regime.

Price movements at farm level reflect market conditions and Community actions. As in the case of other farm products, the real market price for sheep (adjusted for inflation) had been falling since 1960/61 over the Community as a whole. Since the common organisation of the market in sheepmeat was set up however the situation has been largely reversed. Even so, the average market price in each marketing year has been below the basic price in Ireland and the United Kingdom, and above it in Italy and Greece. In the other regions the average market price fell below the basic price for the first time in 1982/83 and will probably remain below in 1983/84, with the exception of France.

The United Kingdom market price is consistently around 70 per cent of the French price. The advent of the common organisation has thus not led to the price upsets so much feared by certain sectoral interests (i.e. collapse of prices in France, steep rise in the United Kingdom).

The development of prices under the sheepmeat market regime, as for other products, has been influenced by the operation of the Community's monetary policies in the agricultural sector. Unlike other

major farm products, however, the system of special "green" exchange rates, with the consequential monetary compensatory amounts, does not apply to trade in sheepmeat. However, in working out the ewe premium it is necessary to compare basic prices with market prices, which involves a conversion of the latter into ECU; the conversion rate applied is the special 'green' rate. The application of the green rate rather than the market rate means that Member States whose market rates are higher than their green rates may be attributed a somewhat higher income loss and therefore a higher Ewe Premium than countries whose market rates are lower than their green rates. In spite of this, the Commission has proposed to continue the use of "green" rates, without the introduction of MCAs in this sector.

The basic sheepmeat Regulation provided for an advance on the ewe premium to be paid in any region or regions in which the forecast market prices are lower than the basic prices. This has proved to be a somewhat hazardous exercise; the practical implications of inaccuracy in forecasting the market price level and the variable slaughter premium of the marketing year are that member States that enjoy over-payments can and do profit for a large part of the marketing period from the interest they receive by using these funds. However, at producer level there can be some injustice involved, since in a given marketing year in which over-payment has taken place, sheepmeat producers are over-compensated for their loss of income at the expense of other producers whose flock is expanding during the next marketing year. In the light of experience of the problems involved and as a means of saving money the Commission has proposed that advance premiums be deleted and that payments be made in arrears, when the national market prices are known. The Council has broadly accepted this proposal, with the qualification that an advance payment of 30 per cent of the premium be made in the hill and mountain areas of the Community.

The Commission has become concerned at the costs of the sheepmeat regime, particularly in the UK. Sheepmeat output in the UK fluctuates much more than that of other meats and since the common organisation of the market was set up the degree of variation has increased. The Commission have proposed that a ceiling of 25 per cent of the guide price be put on the variable premium in the UK, in the expectation that as soon as this ceiling is reached some producers will decide not to send their animals for slaughter, in the hope of profiting a few weeks later, from a higher guide level and a variable premium with no ceiling. This proposal has however met with considerable resistance from the UK.

#### 5.5 The Trade in Sheepmeat

The Community's main suppliers are New Zealand, Australia, Hungary, Argentina and Yugoslavia. In 1982 New Zealand accounted for 83 per cent of total imports, and together with the other four countries accounted for 96 per cent of the Community's imports (280,000 tonnes). The United Kingdom is by far the Community's main importer. In 1982 it accounted for three-quarters of imports from outside the Community i.e. 207,000 tonnes carcass weight, including 201,000 tonnes of frozen meat from New Zealand. The remaining quarter was divided between the Federal Republic of Germany, Italy, Greece, France and

others. The Community's exports on the other hand are tiny: about 5,000 tonnes going mainly to Switzerland and some Arab countries.

So far as the European Commission is concerned, their view is that the trade mechanisms worked well in 1981 and 1982, as none of the countries concerned exceeded the limits laid down under the voluntary restraint agreements negotiated with the main suppliers. However, the Community's actual imports have been less than the total possible imports negotiated under the voluntary restraint agreements of about 320,000 tonnes carcass weight (Table 1). In 1981 imports of 226,000 tonnes were well below the limits laid down and the Community market was maintained without any major interference with normal market price formation. This was not the case in 1982, when imports amounted to 281,000 tonnes carcass weight, which led to an increase in stocks in the Community of about 8,000 tonnes. It is worth noting that in 1982 the market price in the Community increased by about 5 per cent on average as against 14 per cent in 1981. In view of these developments, the Commission wants to reduce the current quantities of about 320,000 tonnes allowed under the voluntary restraint agreements and the introduction of a minimum import price.

TABLE 1

Market Balance - Sheepmeat: 1981-83

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(000 Tonnes)

	Consumption	Production	Production Balance	Imports	Exports	Trade Balance	Change in Stocks
1981	933	701	-232	226	6	220	-12
1982	975	706	-269	281	4	277	+8
1983*	980	730	-250	255	5	250	0

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\* estimated

5.6 The Future for Sheep Production in the Community

The Commission have proposed a lengthy series of adjustments in the way the system operates, in order to keep down budget expenditure. One of their main proposals, a reduction in quantities of imports under the voluntary restraint agreements, combined with the introduction of a minimum import price could have a substantial effect on costs to the budget, and of course on the trade in sheepmeat. Other proposals include a different manner of calculating the ewe premium (which has been accepted by the Council), a revision of the seasonal adjustment of the basic price, and a change in the date of the marketing year. These



proposals are aimed at tightening up the management of the market, but they would not make any fundamental difference to the operation of the sheepmeat regime.

While the detailed changes which have been adopted will no doubt provide some savings to the budget, the basic problem of market balance still remains. The two sheepmeat market philosophies (i.e. a luxury high priced meat in France and a regular part of the ordinary family diet in the U.K.) have not been reconciled. The EC system tries to embrace both approaches - but this gives rise to considerable problems in the operation of the regime. The proposal for further limiting imports coupled with higher prices, is likely to have a serious impact on consumption levels, especially in the U.K. where price elasticity of demand is particularly high. Such a step, in reducing total consumption, might sharply reduce the total sheepmeat deficit and eventually lead to the same serious disposal problems which have arisen for other products. This may be more acute if the system of quotas or other limits are imposed on production in other farming sectors and producers then turn to sheep production as a means of maintaining their incomes. It is clear that, while the sheepmeat regime has its own special characteristics, it is basically subject to the same longer-term constraints that underline the CAP generally and therefore to the same longer-term problems.

## CHAPTER 6

### THE BEEF SECTOR

#### 6.1 The Current Beef Situation

Raising cattle is one of the most important farm enterprises in the EC. Beef production accounts for about 15 per cent of the value of total farm output. Over 2.5 m farmers, or one in every two in the Community, are involved. The average size of cattle enterprise is just over 30 animals per farm. The total cattle herd in the EEC is fairly constant at around 78 m head, of which 31 m are cows. About 80 per cent of beef production comes from herds which also produce milk, so that specialised beef cow herds are the source of only a minority of beef output in the Community. In recent years, the structure of cattle-raising has undergone far-reaching changes. The number of cattle farmers has declined by almost 4 per cent per year, mainly through the fall in the number of small farms involved and consequently some increase in the average number of animals per farm.

Production of beef depends on the size of the total cattle herd, the proportion of the herd that is slaughtered and the average slaughter weight. The static character of the cattle herd has been offset in the most recent years by the recovery, from the trough in 1982, in the slaughtering coefficient (the ratio of slaughterings to cattle numbers) and the upward trend in average slaughter weight of both cattle and calves. The changes in the slaughtering coefficient have been one of the major factors in the cyclical nature of beef production over recent years. It seems possible that 1984 may be a peak year in this cycle and that some fall might occur in subsequent years. The trend in slaughter weight is influenced by the level of cattle feed prices and may decline as feed prices increase but the evidence on this is still very uncertain.

Beef production in the Community has been subject to cyclical change, with an underlying long-term trend of an annual increase of between 0.5 per cent and 1 per cent. The most recent trough in the cycle was in 1982, when total beef and veal production was 6.65 m tonnes. This was only slightly above total consumption, with an excess of some 50,000 tonnes. However the upward phase of the beef cycle will bring production to 7 m tonnes in 1984 while consumption has remained constant at 6.6m tonnes. In these circumstances the surplus has risen to 400,000 tonnes - or some 6 per cent above the level of consumption.

Consumption has been static for the past 3 years, but the medium-term trend is downwards. The current consumption of just over 24 kgs per head, is some 7-8 per cent below the level of the late seventies. Competition from alternative lower priced meats, the low level of economic growth in the Community, the rapid increase in the number of unemployed and the slow rate of population growth have all contributed to the static level of total beef consumption. It would seem unlikely that these factors will change sufficiently to reverse

the medium-term trend of some decline in total beef consumption.

The degree of self sufficiency has grown from 90 per cent in 1970, when there was a significant opportunity for external suppliers to sell on the Community market, to 106 per cent in 1984. Since 1974 imports of beef have been running at about 400,000 tonnes. Exports have shown greater fluctuation, growing from 160,000 tonnes in 1978 to around 650,000 tonnes in 1980/81 and then falling to just under 500,000 tonnes in 1982. Third country producers now face sharp competition from EC suppliers on world markets.

## 6.2 Organisation of the Market for Beef

Like most of the common market organisations, that for beef/veal involves detailed price arrangements which hinge on the guide price i.e. the price applying to all categories of adult cattle marketed on representative markets of the Community. It is the price which is aimed at in normal market conditions and is fixed annually at the price negotiations, in theory to operate during the following marketing year. The Community also fix an intervention price, which for some years now has been 90 per cent of the guide price. The intervention price is a determining factor for the calculation of the buying-in price where quantities of beef/veal are taken off the market by the intervention agencies of the member states.

The main support measure is the intervention system. The intervention agencies must, on certain conditions, buy in specified categories of beef/veal at a given price. The beef is subsequently sold usually at prices well below the buying-in price, the loss being born on the Community budget. Certain limited measures have been introduced to stimulate consumption, including the sale of frozen meat from intervention stocks to any taker (wholesalers, processors, exporters), the supply to processors of a quantity of frozen meat from intervention stocks for processing within the Community and sale of intervention meat at reduced prices to welfare institutions.

Private storage aids may be paid when the market is weak, covering various products (carcasses and quarters). In the United Kingdom variable premiums are paid; this is similar to the system of deficiency payments that was operated in the UK prior to EC entry.

A suckler cow retention premium has been paid from the beginning of the 1980/81 marketing year; it is an income supplement for producers and is paid to farms which do not deliver milk and keep only cows producing calves for fattening. A calf premium is also paid in some of the poorer member states.

## 6.3 Trade with Non-Member Countries

### 6.3.1 Imports

All categories of cattle, beef/veal and preparations are normally subject to customs duties when imported into the Community from non-member countries. In addition to import duties there are also

variable levies on imports. The levy is calculated by stages:

- (a) the basic levy is the difference between the guide price and the import price or, for certain non-member countries, the market price. Customs duties are added.
- (b) the levy actually applied is calculated by multiplying the basic levy by a coefficient which is derived on a weekly basis from the ratio of the EC market price to the guide price.

The import levies may be applied differently depending on the type of meat, the country of origin, and the basis of bilateral or multilateral arrangements. Because sea transport takes so long, the Community operates a scheme for the advance fixing of levies in respect of certain origins. For all imports into the Community, a 90-day licence is compulsory.

### 6.3.2 Exports

To limit the need to purchase beef by the intervention agencies, store it for some months and then dispose of it often on export markets, a system of direct export subsidies - the export refund - is operated to encourage the direct disposal by traders of beef and live cattle for which there is no market within the Community. The refunds are not fixed automatically, but take account of:

- the present and future situation on the world market.
- the state of the market in the Community and expected developments.
- the competitive position on the markets of non-member countries.

Generally, the refunds are fixed on a quarterly basis, although they can be adapted between quarterly dates to allow for changes affecting market conditions. Refunds may be varied according to the destination of the products. Most of the refunds can be fixed in advance. All exports must be covered by a 90-day export licence.

### 6.3.3 Prices

Market prices of beef have tended to remain some 15 per cent to 20 per cent below the guide price, in spite of the intervention in the market to try to maintain the returns to producers. Meanwhile consumer prices expressed in national currencies have shown an average increase of more than 10 per cent per year in recent years. The Commission have projected some recovery in the market prices of adult cattle in the medium term but, in the face of the problems facing the EC both on the consumption and production side, the basis of this projection is not clear.

The level of intervention purchasing over recent years has been related to the level of total output. Years of high output, such as 1979 and 1980 and again forecast in 1984, have led to substantial increases in direct buying-in by the public intervention agencies of around 400,000 tonnes a year. Years of lower output such as 1982 have

seen intervention buying falling to just over 250,000 tonnes.

#### 6.4 The Level of Budgetary Expenditure

Budgetary expenditure on beef/veal was 1,160 m ECU in 1982; it is estimated at 1,283 m ECU in 1983 and to increase to 1,400 m ECU in 1984, i.e. just under 10 per cent of total farm price support payments. The 1983 figure of 1,283 m ECU breaks down into 753 m ECU in export refunds, 289 m ECU in intervention expenditure for public and private storage and 241 m ECU in premiums, mainly the calf premium and the suckler cow premium.

Although there has not been the same problems of market surplus in the beef sector as in the dairy sector, the European Commission has expressed concern about the risk of these problems arising in the future. It has therefore made proposals to adapt the intervention measures more to market realities, through reducing the operation of intervention at certain times of the year, by operating a uniform classification system for the Community to bring a greater degree of cohesion into the system and by withdrawing certain national exemptions which give additional support in some EEC countries. They have also proposed to end the UK variable premium system and special aids for calf production paid in some of the poorer EC countries. They have also proposed to adapt the import concessions in beef, clearly with the intention of reducing the present volume of beef imports. Not all of these proposals have been accepted by the Council, but some limitations of the UK variable premium and the calf premium in Italy, Greece and Ireland have been adopted for the 1984/5 marketing year.

#### 6.5 The Future for Beef Production in the Community

The Commission medium-term forecasts of beef production at 7.5 m tonnes by 1990, with consumption at between 6.5 m and 7.0 m tonnes, show that the current Community surplus of 0.4 m tonnes could be doubled, or more than doubled, by the end of this decade. This would mean that Community production may exceed the realistic possibilities of disposal on the internal and export markets of the Community. The present proposals for changing the intervention rules seem unlikely to have any major impact, but the more restricted pricing policy now being followed could have a somewhat greater effect. Furthermore policies followed in the dairy sector would almost certainly have an effect in the beef sector; there are however two opposing possibilities:

- (a) a fall in beef production from the dairy herd, if the squeeze on the dairy sector results in any appreciable fall in cow numbers;
- (b) a substitution of beef cows for dairy cows by farmers seeking to maintain their farm business in the face of pressure on dairy cow numbers.

In the light of present knowledge it is uncertain as to what the net effect of dairy sector policy on beef production will be but it is possible that there will be some curtailment of growth in production.

It is unlikely that EC market prices or those in the rest of the world will be strong enough to resolve any of the EC budgetary problems in so far as these arise in the beef sector. Clearly the beef sector is not in the same disarray as the dairy sector, and the trends towards a growing surplus are not as sharp. However, as expenditure arising from the beef sector represents 10 per cent of total expenditure on the CAP, any limit on the funds for the CAP as a whole could well have serious consequences for beef producers.



## CHAPTER 7

### AGRICULTURAL TRADING POLICIES

#### 7.1 The Background to the Trade Problem

Within the Community the major issues of debate on agricultural policy are farm incomes and the budgetary problems to which income support measures have given rise. Outside the Community the major debate on its agricultural policy has been on the effects on world trade in farm products. This debate is itself largely a consequence of the effects of EC farm policies on farmers incomes in non-EC countries and of the subsequent consequences for the economic situation in these countries.

These issues should be seen against the wider background in which the major decisions are made - in particular the economic problems within the Community, the effects of technological change on the level of farm output, the political strength of the agricultural producers within the Community and the general constraints on agricultural trade in virtually every country in the world. The Community's agricultural trading policies have evolved in response to the changes in the internal level of output and consumption of farm products and the evolution of international trade policies under the General Agreement on Tariffs and Trade.

#### 7.2 Mechanisms of Community Trading Policies

The aim of the trading policies of the Community is to protect internal agricultural prices against cheaper imports, while enabling it to export to the rest of the world through the provision of export refunds. The instruments used to regulate trade between the Community and non-member countries are essentially only three in number: levies, customs duties, and refunds. Levies are chargeable either on imports, or (less frequently) on exports; duties are chargeable on imports; and refunds are paid on exports.

The import levies, related to the prices within the Community, are designed to negate the impact of price fluctuations on world markets and thus to help stabilize the domestic market. The levy is therefore a variable charge. Its role is not directly comparable to that of a customs duty: when the world price of a product is running at or above the Community threshold price, the levy is zero. Moreover, when world prices are higher than threshold prices, the Community can charge levies on its own exports so as to limit European agricultural products being sold on world markets and thus to ensure reasonable prices for the goods supplied to consumers at home. While this has been done in the past for several products, it was only for limited periods of time and has been of small extent in comparison with levies on imports.

The agricultural import duties are based on the principle of



'Community preference'. This principle is a rule of almost universal application defended even by the countries producing and exporting agricultural products on a large scale. The usual way of operating preferential arrangements for home-produced products consists of protection at the frontier in one form or another. Non-EC countries which are major net exporters of farm products operate protective arrangements at frontiers such as customs duties, quantitative restrictions and even the actual prohibition of such imports. Cases in point are Australia with regard to sugar and the United States and Canada for certain milk products. The principle of Community preference is implemented by the charging, at varying levels according to product, of certain customs duties vis-a-vis non-member countries or by the establishment of threshold prices serving as a reference for the calculation of a levy so as to ensure a trading advantage for Community producers.

The export refunds are normally the counterpart of the import levies. They are designed to bridge the gap between the internal price of a product and its world market price, so that the Community's agricultural products can be exported.

### 7.3 The EC and GATT

The creation of a single market in the Community has encouraged an expansion of internal Community trade which has encroached on imports of some products from non-member countries. These changes in trade flows are the logical - and indeed the inevitable - outcome of the creation of a customs union. Despite these developments, the Community has remained the largest world importer of agricultural products. The arrangements for Community trade with non-member countries in agricultural products have taken into account the international obligations assumed by the various member countries and by the Community as such, including the requirements of the General Agreement on Tariffs and Trade (GATT).

The Common Customs Tariff, which is the legislative instrument applying to imports into the Community of any product entering into international trade, reflects the picture of EC commitments to its GATT partners. The 'conventional' duties in the Tariff - i.e. duties that are covered by agreements or conventions - express the concessions granted by the EC in the form of 'bindings'. For a number of 'unbound' agricultural products, the EC is free to apply any import arrangements it deems fit. The Common Customs Tariff as it now stands is the cumulative result of the various negotiations conducted by the EC from its inception. The freedom the Community enjoys in respect of certain products, for example the products subject to levies, has often been "paid for" in full by concessions in respect of other products of special interest to non-member countries.

The Community's policy on trade in agricultural products is thus designed to achieve, in relations with developed countries, a trade-off of mutual advantages; the economies of the various countries complement each other in some respects at international level and, in general, Community policy turns this to good account. As for relations with the developing countries, the Community's policy on trade in agricultural

products encourages as fully as possible trade on the basis of complementary needs, but generally the principle of reciprocity is ignored.

In the various multilateral negotiations in GATT in recent decades the main objective has been the reduction of customs tariffs and other barriers to trade; agricultural products have always been included in these negotiations along with manufactured goods. During these negotiations, the Community has entered into major commitments 'binding' the arrangements for imports of important agricultural products, in particular oils and fats and cereal substitutes: either the duties applied are minimal or the products incur no duty at all. Agricultural policies pursued by the various countries however seldom rely on customs duties as the only, or even the main, instrument of defence. Governments operate a wide range of schemes which, not being open to negotiation, continue to underpin the expansion of the home agricultural industry by sheltering it from the impact of free competition at world level. The protectionist policies generally followed towards agriculture, and in particular the non-tariff barriers that have been built up, do not make trade negotiations very meaningful in many instances.

#### 7.4 The Community's Export Situation with Regard to Agricultural Products

The EC countries have a long tradition of exports of agricultural products and make a major contribution to supplies on world markets. As world requirements develop and as the Community has achieved self-sufficiency in regard to a number of agricultural items, exports of agricultural products have become an important factor in ensuring the continuity of the common agricultural policy. The Community's trade in agricultural products with the rest of the world has grown steadily over the years, but there has been an overall deficit on the agricultural trade balance, which was 24.9b ECU in 1979 and 22.7b ECU in 1980.

The deficit on trade with the developing countries in 1980 was 9.6 b ECU in 1980, of which 5.8 b ECU were accounted for by Latin America and 3.6 b ECU by the Lomé Convention Countries (i.e. the countries which signed a special agreement on trade and development with the EC; they are the countries in Africa, the Caribbean and the Pacific which were formerly associated with individual member states of the Community). The deficit with industrialised countries was somewhat larger at 12.3 b ECU, of which 6.1 b ECU was on trade with the United States of America, 1.3 b ECU on trade with Canada and 0.5 b ECU on trade with Australia. The deficit on agricultural trade with the State-trading countries was 0.8 b ECU.

EEC agricultural imports from non-member countries rose from 24.4 b ECU in 1973 to 42.2 b ECU in 1980, an increase in value terms of 73 per cent. The largest increase was from developing countries, though the volume from these countries was still somewhat smaller than from the industrialised countries.

### 7.5 Problems of Agricultural Trade - The Case for Non-Member States-

In spite of the lengthy negotiations in GATT and all the efforts they have required, the EC's trading policies in agricultural products have given rise to serious concern from non-member states who are substantial exporters of these products. This concern has been voiced most vigorously by the United States but other agricultural exporting nations have joined in these sentiments. The view of the U.S. has been that when EC policy, implemented in pursuit of the internal objectives for the agricultural sector, becomes detrimental to the well being of U.S. farmers, it becomes imperative that the U.S. Government act to protect the interest of its own farmers.

Their objections to the CAP centre around three issues:

- (1) the effect of the CAP on the level of internal demand for food products;
- (2) subsidised competition from the EC with other agricultural exporters on the world market for food;
- (3) the instability that the EC transmits into world markets by maintaining stable internal prices and thus insulating the EC from adjustments signalled by international market developments.

The USDA have quoted a number of studies that showed the effects of the CAP on the internal demand for food within the Community. These were, however, primarily concerned with the cost to consumers and the welfare transfers to producers rather than with the effects on the level of demand for food as such. While it is true that the average per capita levels of various food products in the EC are different from those in the U.S. and in other developed countries, the EC average itself involves wider differences as between different member States. Differences in per capita consumption are far more than just a reflection of the effects of the CAP on food prices and of the demand for food within the EC, as they reflect long established patterns of dietary preferences. The low elasticity of demand for most foodstuffs and the small proportion of expenditure in the Community that is now spent on food make it unlikely that the price levels under the CAP have had any substantial effects on the level of total food consumption.

It is the second aspect of the CAP criticised in the U.S. study i.e. the subsidised competition on third markets, which has given rise to the strongest adverse reactions. The study stated that "since its inception the Common Agricultural Policy has operated to maintain high and stable internal prices without any mechanism to limit the extra production elicited by these high and riskless price support measures. This excess and growing production has first displaced EC imports and then, as it grew larger, has been disposed largely through subsidised

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2. This section is based on a paper on "U.S. Views of the Common Agricultural Policy" prepared by the Foreign Agricultural Services the USDA. Washington. February 1982.

prices onto the international markets, thus further displacing our and other countries more efficient exports. During the period of the operation of the CAP the EC has moved from a substantial importer to a significant exporter of a large number of major agricultural exports."

Thus the complaint is that the first stage of expansion of farm output on the basis of high support prices reduced the market opportunities for traditional exporters to the Community; the second stage "spilled over onto international markets through subsidised EC exports that compete unfairly with traditional exporters in third markets". This latter state was illustrated by the growth of grain exports such that the EC has now become a net grain exporter, the growth of sugar exports to 4.5m tonnes in 1980/81, the transition from the world's largest importer of poultry to the world's largest exporter, the transition from a net importer of beef and veal to the world's second largest exporter (after Australia) and the effects of EC fruit processing subsidies on U.S. producers. (It is, however, of significance that the U.S. study does not quote the effects of EC policies in the dairy sector in the developments on the world market for dairy products).

The third issue raised by the U.S. is the effects of the CAP on the stability of world markets for agricultural products and specifically that "by maintaining a rigid internal price structure under the CAP and insulating the EC agricultural sector from the international market, the EC forces other countries to bear the brunt of international stability. Although some of the less developed countries are least able to cope with these distortions, the U.S. also must adjust production and consumption to accommodate EC market distorting forces". The USDA refers to the 'political difficulty' arising from the 40 per cent decline in U.S. farm incomes in 1981, which in real terms constitutes the lowest level of net farm income since the Depression, arising in part from the decline in exports.

This study concludes that "EC subsidised exports are hurting the U.S. High internal EC prices stifle food demand by consumers... subsidised exports and supplies onto the world markets" and results in "higher farm programme costs for both the EC and the U.S. EC consumers bear the burden. U.S. producers bear the burden and the tax payers on both sides of the Atlantic bear the burden".

In practice of course the burden is borne by other agricultural exporting countries as well as the U.S. and it is not only on both sides of the Atlantic that the problem arises. The smaller developed economies which have a large part of their total exports coming from the agricultural sector have to bear a relatively larger proportional burden than that borne by the U.S. The economic and political difficulties to which this burden gives rise in these countries is equal to if not greater than those experienced in the U.S. but the strength of the U.S., and the resources they have for expounding their views, have led to this view being the most clearly set out in the current debate.

## 7.6 The Response of the EC

It is of course in the very nature of the CAP that it is based on a high level of direct market management, designed to sustain internal farm prices and incomes. Inevitably it involves a considerable measure of protection and the control of imports from third countries. The CAP system could not operate, and the budgetary costs would become intolerable, if imports were allowed when market prices were low or when a substantial measure of intervention was in operation.

So far as the U.S. complaints are concerned, the EC Director-General for Agriculture has argued that it is a myth that the EC and its agricultural policy is responsible for the difficult situation in which American farmers find themselves. The EC remains the world's major importer of agricultural products; the EC's deficit with the U.S. in farm trade grew from \$5.8 b in 1979 to \$6.8 b in 1980. U.S. farm exports to the EC had grown much faster than farm and food exports in the other direction. In his speech the Director-General denied that the EC was responsible for the decline in world coarse grain prices in 1980. The EC imported nearly 10 m tonnes of maize, almost 12 m tonnes of soyabean and over 7 m tonnes of soya cakes, while EC exports of barley were only 4.3 m tonnes. He commented that the main problem with wheat exports was the size of the U.S. crop itself which has increased from 58 m tonnes in 1979/80 to 76 m in 1981/82. This increase of 18 m tonnes was more than double total EC wheat exports. The Director-General has also drawn attention to a study by the U.S. Department of Agriculture on the effects of U.S. monetary policy on the demand for U.S. farm exports which concluded that the price competitiveness of the U.S. agricultural export sector in the 1970's was brought about by relatively loose monetary policy, and this policy was one of the main reasons for the boom in U.S. farm exports in that period, a boom which was cut off by much tighter monetary policy in the early 1980's.

In putting forward the point of view of the EC the Director-General reiterated the Community's desire to avoid a trade war over farm policy and acknowledged that, in response to the current economic recession, the natural reaction of some governments has been to look for scapegoats outside their frontiers. Most governments are trying to escape from this crisis by boosting exports and sometimes, also, by slowing imports. He has expressed concern at the plans of the U.S. Agriculture Secretary John Block for working aggressively to stimulate long-term growth in exports of U.S. farm products. The resources available in both the European Community and the U.S. to engage in "dynamic" export policies for farm products is however of major concern to other agricultural exporters, who do not have the same economic and political leverage at their disposal.

## 7.7 Trade with the Developing Countries

The discussion of agricultural trade so far has not taken into account the particular issues of trade with the less developed world. The developing countries have always had important trade relations with the Community in which agricultural products have played a major role. The Community's agricultural imports from the developing countries rose

during the period 1973-80 from 10,000 m ECU to 19,000 m ECUs, an increase of about 90 per cent in nominal terms. These imports increased more rapidly than the Community's total imports of agricultural products, which, over the same period, rose by 75 per cent in nominal terms.

Almost half the Community's total agricultural imports come from the developing countries (45 per cent in 1980), taking approximately one-third of their total exports of agricultural products. An analysis of the tariff arrangements applicable to agricultural imports from the developing countries shows that in terms of their total value, 60 per cent enter the Community duty-free, over 30 per cent face only a relatively low level of duty and 7 per cent are in fact subject to levies. Since these trade arrangements are much more favourable than the national provisions of the member States before the introduction of the CAP, one might have expected a greater volume of agricultural imports from the developing countries.

This has not been the case. The introduction of the CAP has had some small effect on the developing countries' share of the Community's agricultural imports.

The proportion of the EC's total imports of agricultural products coming from the developing countries was only slightly higher in 1980 (45 per cent) than in 1962 (43 per cent), the year the CAP came into being. Nor does the CAP seem to have had any substantial effect on the composition of agricultural imports from the developing countries. Those products for which the developing countries are net exporters and which are imported into the EC subject to rules adopted under the CAP (primarily beef and sugar) only account for some 17 per cent of their agricultural exports to the Community.

There are cases, however, where Community exports do compete with developing countries' exports. Some 20 per cent of the EEC's agricultural exports to the world comprise products, largely sugar and beef and veal, of which the developing countries taken as a whole are net exporters. Present trends suggest that, in the medium term, sugar from developing countries is likely to be faced with ever-increasing competition on the world and EC markets alike.

Just as the Community is an important market for the developing countries, they are an important market for the Community, taking 47 per cent of its agricultural exports. This percentage is on the increase, even though the EC's share in world trade in agricultural products has remained constant, at around 10 per cent, after a slight increase when the CAP machinery was set up.

#### 7.8 The Resolution of the Trade Problem

The basic point at the centre of the problem of the agricultural trading policies is the economic situation of the producers within the EC and in other food exporting countries and the social and political consequences which arise from this situation. While there are good economic grounds for developing a more liberalised policy in regard to world trade in agricultural products, this would result, both in the

short and the long-term, in significant resource flows. In particular such a policy would benefit farmers with favourable ratios of land to labour and who are in a position to exploit new production technologies. Conversely such a policy would hurt farmers with poor and inadequate land resources, who tend to have least opportunities for developing their farm business and farm incomes.

The longer term answer to such a transfer of resources is that smaller and more disadvantaged farmers should be encouraged to cease farming altogether and to take up alternative employment. However, such alternative employment is becoming increasingly difficult to find. The level of unemployment within the Community has grown very sharply in recent years and shows no sign of any decline. Indeed, the possibility now has to be faced that the economies of the EC may experience unemployment rates of 10 per cent or more for many years to come. In these circumstances the pressure to maintain small farmers on the land and the implications for external trade policies, become stronger and stronger.

Nor are the traditional outlets of emigration to the "new world" countries now open on any scale. These traditional opportunities of emigration were of major importance for countries like Ireland and Italy and also of considerable significance to the development in other European countries over the past century. To some extent the growth in agricultural exports from EC member States can be seen as a response to the decline in alternative outlets for the resources involved, particularly the labour resources. The very strong protectionist policy in regard to agricultural products can be seen as, in part, a response to the protectionist policies towards the movement of the resources, particularly labour, by countries which previously had been the "safety valve" for countries with severe population pressures.

Nevertheless it has to be accepted that the consequences of the present international trading policies in agricultural products of the EC give rise to a very serious cost burden. This is now clearly evident within the EC itself, where the cost of export refunds on agricultural products is a major factor in the budgetary difficulties of the Community. It is not only a budgetary issue, for the costs to domestic consumers are also very substantial.

It is unlikely that there will be a full solution to these problems in the foreseeable future. The further growth of these difficulties is, however, likely to be curtailed and may be reversed in the longer term by the measures that the EC is obliged to take in the light of its current financial situation. These new policies are likely to involve two aspects of immediate importance to the agricultural trade situation. The first aspect is the measures taken to curtail the growth in output, through sharper cuts in the real support prices for farm products and through effective quota limitations on production with consequent curtailment of the 'structural' surpluses. The second aspect is the more restricted application of the market support measures, such that farmers and merchants will be encouraged to find outlets for their produce without the benefit of aid from Community financial sources.

At the same time, there will be even greater pressure for stronger

protection from external supplies on the EC's domestic food market. Such action can help to sustain farm incomes without direct demands on the Community budget. The Commission has said that in its various applications, the policy on trade in agricultural products must respect the objectives and the need for the proper operation of the Common Agricultural Policy, particularly Community preference. It is difficult to see how, in the current economic circumstances of farmers in Europe, the need for the "proper operation of the CAP" can but involve a greater restriction of imports of farm products into the Community. It is clear that the member States are not prepared to face the depopulation and the social and economic consequences of policies that would abandon those sectors of their agriculture which are inefficient in economic and commercial terms. To the extent that the position of these farmers can be protected by measures which restrict access of third country suppliers to the Community market, then these measures will be taken. Indeed such policies are virtually inevitable given the political pressures for their adoption.





## CHAPTER 8

### THE FARM INCOME SITUATION

#### 8.1 Growth of the Farm Income Problem

The evolution of the CAP has in recent years been dominated by two issues: the income situation of farmers and the Community's budget problem. The changes in the level of farm incomes are an essential aspect of agricultural policy decisions both at Community as well as national level. This is most important in connection with the annual decisions on the common agricultural prices; while the farm income situation is not the only criterion, it has been the main one until recently. This is only what is to be expected in view of the objective of "increasing the individual earnings of persons engaged in agriculture", under Article 39 of the Treaty of Rome, as one of the main aims of the Common Agricultural Policy.

Concern over farm income changes has grown sharply in recent years in the Community, especially since increases in farm incomes began to fall behind the rate of inflation and behind increases in incomes for the economy as a whole. Political and economic considerations relating to income improvements have consequently become even stronger than in the past.

Since the full implementation of the common agricultural policy in 1968 the trend in farm incomes in the EC was one of substantial improvement in the first five years (i.e. 1968-73) when average farm incomes in real terms grew by over 40 per cent. From 1973 onwards, however, the underlying trend has not been maintained in an upwards direction and indeed has been downwards. The fall in 1974 was partially restored over the years 1975-78 but even so in the peak year of 1978 farm incomes were 5 per cent lower than in the earlier 1973 peak. Incomes have fallen again since 1978 and, in spite of the good recovery in 1982, average incomes in real terms were still somewhat lower than in 1973. A further decline of 7 per cent for the EC as a whole has occurred in 1983.

It is necessary to consider how the changes in average real incomes in farming actually occur. While the focus is usually on changes in total net farm income, changes in the labour force amongst whom this income is shared is equally important. Much of the improvements in per capita incomes has occurred through the sharp decline in the agricultural labour force. Generally speaking this decline is concentrated among those with the lowest incomes. If no other changes in the income situation occurred over a given time period other than the decline in the numbers of those with very low incomes, then the per capita incomes of those remaining would tend to rise. Given that over the past decade the per capita incomes of those remaining in farming in the EC has tended to fall, while those with the poorest incomes have fallen out of the equation altogether, those now farming in Europe have seen their real incomes falling by much more

than the decline shown in the official statistics. This group would by definition have had incomes above the average for farming as a whole, but not necessarily as good as those in the non-farm sectors.

## 8.2 Farm Income Trends Within Member States

While reliable income distribution data for European farming are not available, the Commission have published figures which show that in 1977/78 80 per cent of "market-oriented" farms in the Community had farm incomes that were below the average incomes in off-farm jobs. This was the position in spite of the sharp drop in the total farm labour force in Europe; in the decade of the seventies alone the total number on farms fell by about 40 per cent. Even with this sharp fall in the numbers working on farms, average incomes of farmers have not even been maintained in real terms, let alone kept pace with improvements in the rest of the economy. These changes are by no means uniform. German farmers for example experienced a strong decline in incomes from 1976 through to 1980 and the recovery in 1981-82 has been eroded by the further sharp decline in 1983. This has occurred in spite of the benefits which German farmers derive from the special exchange rate policy operated under the Common Agricultural Policy. These incomes and trends, particularly when contrasted with the considerable improvements in real incomes of people at work in the other sectors of the German economy, have been a very significant factor in the German policy stance in Brussels, as their aim of constraining expenditure on the CAP has had to be tempered by the very large problems faced by their own farmers over recent years.

French farmers have found themselves faced with very similar income problems except that, in their case, real incomes have been falling since the early 1970's. Farmers incomes fell continuously from 1973 down to 1978 and, after some fluctuations around the 1978 level, have again declined in 1983 to around 75 per cent of the level prevailing a decade earlier. Over these years the rest of the French economy has also experienced a steady improvement in incomes, so the gap between urban and rural incomes has widened very substantially over the past decade. Again this has happened in spite of the very large benefits accruing to French farmers from participation in the CAP. As France is a beneficiary under the CAP, there has not been the same pressures to contain expenditures as in the case of Germany. The French policy position has been dominated by the need to achieve effective action at Community level that would be of direct help to their agricultural sector in improving its income situation.

The income trends in Germany and France are in considerable contrast to those in Italy. Italian farmers are in general much poorer than those in the Northern European countries but their incomes over the past decade have tended to increase, though not in any consistent fashion. However, these increases have not brought Italian farm incomes generally up to the level of the average of the rest of the EC, primarily because of the serious structural problems of Italian agriculture. Furthermore Italian farmers have not enjoyed the same degree of price support for their particular mix of farm output, so that the Italian policy stance on income and price supports has not been motivated by the same factors as those of northern Member States.

The farmers in Denmark, Netherlands, Belgium and Luxembourg have not suffered the same downward income trend of German and French farmers, but neither have they tended to improve their farm income position over the past decade. Farmers in these countries are among those with the highest levels of per capita incomes, and they have in general been able to maintain these in real terms - though they have experienced some very sharp year-to-year changes. Except for Luxembourg, there has been an appreciable improvement in real incomes in the non-farm sectors of these countries, so that while on average farmers have been able to maintain their real incomes (but subject to the proviso about the nature of the income trends within the farming sector set out above) they have not been able to keep up with the improvements in incomes of people in other sectors.

The income experience of farmers in Ireland and the U.K. has been different again. Irish farmers have traditionally been much poorer than those in most other European countries; in the years immediately preceding EC membership they enjoyed a very rapid income boost which, after a sharp set back in 1974, was continued up to 1978. By 1978 the CAP had been implemented in full in Ireland and farmers found that the promise of a major transformation in their economic situation, which had been held out as the carrot to EC membership, had in fact become a reality. However, the reality was very short lived. The following year, 1979, saw a very sharp fall in incomes, a fall which was continued into 1980 and then, at a much lower rate, on into 1981. By 1981 Irish farmers were considerably worse off than they had been in 1973, when Ireland first joined the Community. There has been some small improvement in the following two years, but this has still left farmers far worse off than they were in 1978 and no better off than in 1973.

U.K. farmers found their incomes falling in the first couple of years of EEC membership; a fall that continued after a temporary improvement in 1976. By 1980 this income fall had left the U.K. farmers over 25 per cent worse off in real terms than in 1973. However, the next two years, and particularly 1982 saw considerable recovery - not enough to restore real incomes to their 1973 levels, but at least sufficient to bring some measures of relief to British farmers.

These many different trends in income have tended to cancel each other out at Community level, so that by 1982 real farm incomes were almost back to their 1973-75 average, but the fall in 1983 has left farmers 10 per cent worse off than a decade earlier.

### 8.3 Effects on Price Decisions

The year to year fluctuations have been much smaller at Community level than at the level of the individual member State. However, decisions on price supports and other measures affecting farm incomes are taken by the Council of Ministers with regard to the position of the farmers in their own country rather than with great concern for average income trends in the EC as a whole.

There is therefore, a greater pressure for price increases than

might be the case if the decisions were taken with regard to the situation of Community farmers generally. This is reflected in the fact that the original price proposals put forward by the Commission in any year tend to be somewhat more restrictive than the decisions on prices finally taken by the Council of Ministers of Agriculture - although the size of this gap should not be exaggerated.

The income problems of European farmers have, therefore, remained substantial in spite of all the benefits conferred on them by the CAP. While the decisions on the CAP over the past decade have been strongly criticised, the nature of the underlying problem, particularly in terms of the social needs of maintaining and protecting the fabric of rural society in Europe, should not be under-estimated. The fact that, in spite of so much that has been spent, so little has been achieved in terms of income improvement is a very real measure of the size of the problem.

#### 8.4 Consequences of Inflation for Real Incomes

One of the major issues in recent years was the position of real farm incomes in member countries with high rates of inflation. This was the subject of a detailed report by the European Commission, which concluded that it does not appear that a higher than average rate of inflation has been associated with a lower than average rate of increase in agricultural incomes.

The European Parliament found this conclusion hard to swallow and said that it seemed so contradictory to the reality experienced by farmers in member States with high rates of inflation that a Motion for a Resolution was signed by members of the Parliament expressing serious reservations and requesting the Commission to re-examine its conclusions. The contention of Parliament was that the study of the Commission can be considered coherent only if the underlying concept and the means chosen to estimate farm incomes are accepted.

It was the underlying concept that Parliament did not accept. It argued that the Commission based its conclusion on averages over long time spans, for all products, costs and producer prices calculated in European currency (ECU) and not in terms of national currencies. Parliament therefore said that this approach camouflaged completely the harsh economic reality faced by farmers in member States with high rates of inflation. The second criticism by Parliament was that the Commission looked at the value-added of agriculture as a whole and that in attempting to deal with the incomes of all engaged in agriculture it measured the income of none, since the resultant index was an average of large and small, full-time and part-time, intensive and extensive, arable and poultry etc. In other words, no attempt was made to take account of the diversity that is to be found in the agricultural structure in all Member States.

According to the European Parliament, while the Treaty of Rome provides an obligation to ensure a fair standard of living for the agricultural community, in particular by increasing the individual earnings of persons engaged in agriculture, the Commission's study refused to look at farmers as individuals with very different economic

situations and problems.

#### 8.5 Measurement of Farm Income

The European Community in spite of all of its efforts, is still a long way from achieving an agreed measure of the income problem of farmers. Different groups clearly have a vested interest in the way the data are analysed and presented, and this is both a horizontal problem (i.e. it applies to farmers throughout the Community), and vertical problem, (i.e. different analyses can have different outcomes for farmers in different member States).

An approach to the assessment of the farm income situation through a detailed statistical exercise which measures the income requirements of farmers to maintain existing parities with incomes in off-farm jobs - the "objective method" - was abandoned by the Commission in the late 1970's when this approach showed clearly the growing divergence between farm and off-farm incomes. The Commission argued that the method encountered "fundamental difficulties" in its application to the situation in 1980/81, particularly arising from the effects of monetary exchange rate changes and the effects of technological change in the levels of incomes earned by farmers. While these problems were real, it is difficult not to conclude that this method was abandoned because of the embarrassment caused by the results that the method generated, rather than from the inherent weaknesses of the method itself.

#### 8.6 The Income Problem and the Political Consequences

The Community policy of support for incomes (which is only one of the objectives laid down for the CAP in the Treaty of Rome), is a consequence of a political decision by the member governments. At a time of the most serious unemployment and other problems of urban society, particularly among younger people, it is not easy to explain or understand the rationale for devoting so much of the total Community budget to farm price supports, much of which goes to the prosperous farmers for production which at the margin has only a very low, or in the case of milk a negative, value. The explanation would seem to lie in the ability of farmers to use their political strength in influencing Government, many of which hold office by only slender parliamentary majorities, to spend very large sums (in 1984 some 18,000,000,000 ECUs from the Community budget plus further large sums from national budgets) to support the farm sector. The other groups in European society affected by farm policy decisions, for example the European consumers though numerically much larger have had little success in using their influence on food prices, and their opinions play virtually no part in the annual price decisions taken by the Council of Ministers for Agriculture. Nor has the sharp decline of the contribution of the agricultural sector to the Gross Domestic Product of the Community, or to the total level of employment, had any serious effect on the political strength of the farm lobby. It would seem unlikely that if the European Community was to be established in the economic social and political climate of the 1980's, the role of agriculture would be so dominant, but the system was a consequence of the situation in the mid 1950's and having been established on that

basis, it has proved virtually impregnable to subsequent economic and political change.

### 8.7 The Farm Income Situation Overtaken by the Budgetary Crisis

The income problem of European farmers has, however, now become overwhelmed by the wider budgetary problems of the Community. The future policies taken to support incomes - either through farm prices or by other support methods - will depend upon the solution of the budgetary difficulties. This is so fundamental to the whole question of the future of the European Community itself - not necessarily as to whether it will break up altogether but at least as to the fundamental character of the Community - that the farm income problem itself is no longer at the centre of the European stage. But this problem has not been resolved, indeed is more serious now than ever before. The farm income issue has, however, brought the EC to a crisis in its development and is likely to remain of major concern for years to come.

## CHAPTER 9

### MONETARY PROBLEMS AND THE CAP

#### 9.1 The Two Currency Exchange Rates System

The operation of the CAP has been made extremely complex by the changes in market exchange rates in the major European currencies that have occurred with great regularity over the past 15 years. These have led to a system involving special exchange rates for agricultural purposes for the currencies of most major States of the European Community. The two currency exchange rates that operate within the Community - the normal market rate for non-agricultural purposes and the "representative" rate for the purposes of the Common Agricultural Policy - are inter-related, but not in a uniform or consistent fashion. The two rates are subject to quite different influences, although there have in the past been strong pressures to bring the agricultural rates back into line with the prevailing market rates (though it is not clear what affects the recent agreement on agricultural exchange rates in the 1984 price agreement of the Council of Ministers will have in the longer term).

The problem of special agricultural exchange rates (often called "green" rates) arose from the farm income and other economic consequences that would otherwise follow in the operation of the Common Agricultural Policy from changes in the market rates for the currencies of the individual member States in the Community. Maintaining the exchange rates used for purposes of the Common Agricultural Policy at whatever the prevailing market rate happened to be during periods of sharply fluctuating exchange rates would have a major repercussion on the prices received by agricultural producers. The policy of insulating, at least in part, the prices of agricultural products from the effects of changes in the market rates of individual currencies of the EC is however an unprecedented development in market policy. Its effects have led to widespread representations on behalf of those groups who have been adversely affected, particularly farmers whose prices and incomes are very directly affected by decisions on the exchange rates actually used in the day-to-day implementation of the Common Agricultural Policy.

#### 9.2 Evolution of Monetary Factors in the CAP

The Treaty establishing the European Economic Community lays down (in Article 38) that "the operation and development of the common market for agricultural products must be accompanied by the establishment of a Common Agricultural Policy among member States" and that the common organisation of agricultural markets may include "regulation of prices, aids for the production and marketing of the various products, storage and carry over arrangements and common machinery for stabilising imports or exports", with any common price policy being based on "common criteria and uniform methods of



calculation" (Article 40). The implementation of the Common Agricultural Policy has involved fixing of common price arrangements and the joint financing of expenditure on market price supports and farm structural improvements. The common price arrangements determine the level of prices at which agricultural imports may enter the Community as well as the level of internal market support.

In order for the common agricultural policy to function, some common denominator is required for the currencies of the member States. The original 'unit of account' (u.a.) was the notional unit used for official transactions between the European Community itself and the member States, with a value of 35 u.a.'s equal to 1 ounce of gold (i.e. gold value of the U.S. dollar in 1962 when the unit of account was first established). It was the obvious choice as the basic accounting unit; all the member States at that time had a declared par value of their currencies with gold and, of course, the parity with the U.S. dollar was appropriate, for it was then, and still is, by far the most dominant currency in international affairs.

In 1962, it was decided that the exchange rate to be used for the conversion of "units of account" into the domestic currencies of the member States for the operation of the Common Agricultural Policy would correspond to the official par value of the currency declared to the International Monetary Fund. As long as currencies of the member States remained at fixed parities against gold - and therefore, against each other under the Bretton Woods monetary system - the operation of the common agricultural policy involved no monetary difficulties. This was the position throughout the sixties right up until 1969, when the French franc was devalued in August and the German mark was revalued in October. Although this occurred many years ago, it led to consequences that have been a major problem virtually ever since that time.

The devaluation of the franc by 11 per cent in 1969 should, under the operation of the system of fixing prices in units of account, have led to an equivalent increase in the prices for farm products and all the monetary factors (e.g. import levies and charges, export refunds, intervention prices etc.). Under this system, any devaluation of a currency of a member State carried through to its full conclusion would automatically lead to an equivalent upward change in support prices for farm products in the country concerned. Conversely any country revaluing its currency upwards against its gold parity and, therefore, against the unit of account, would automatically result in a fall in the support prices paid to its farmers.

The prospect of an 11 per cent increase in the prices of the farm products produced in France for which a common organisation of the market existed was of serious concern to the French Government. Such a change would add to the problem of inflation, which was a major cause of the devaluation in the first place. Furthermore an increase in farm prices would have changed the distribution of income in favour of farmers and against the other social and professional groups in society. If, on the other hand, prices for farm products were left unchanged in terms of French francs, this would have created great difficulties for the operation of the CAP, for it would have given French producers an exchange rate advantage and distorted competition in agricultural trade both inside and outside the Community.

In this situation there were, in practical terms, only two realistic policies which could have been adopted. The full consequences of a currency devaluation under the system of common organisation of the market, on prices paid to French farmers could have been introduced immediately or could be delayed through steps to offset the "exchange rate advantages" which would otherwise accrue to French farmers and traders. The Council of Ministers, with the agreement of the French government, decided on the latter course as a temporary measure.

The French Government's aim was to align prices at the new parity for the franc within 18 months or so. In the meanwhile, a system of monetary compensatory amounts was introduced which, in effect, made up the difference between French farm prices at the pre-devaluation parity of the French franc and the prices which were paid for French farm produce in trade, both within and outside the European Community, which were paid at the current market exchange rates. Under this system a charge was made on exports of those French farm products covered by the Common Agricultural Policy; at the same time a payment was made on equivalent imports in order to reduce their price. As the alignment of French farm prices to those appropriate to the new parity of the franc took place, so these monetary charges were phased out and the full effects of the devaluation then took effect in prices to farmers, and of course in the prices paid by consumers.

The devaluation of the franc in 1969 was followed very rapidly by the revaluation of the German mark. As in the case of the change in the parity of the French franc, this change in the value of the deutsch mark should have led to a revision in the prices for farm products in Germany. In this case, however, the revision would have meant that prices paid to farmers would have fallen by almost 10 per cent. This was unacceptable to the German government because of the inevitable reaction that would have followed from their farmers to a fall on this scale in the prices paid for their products.

The solution to this problem created in the agricultural sector by the German revaluation was to follow the principle already established in the case of the French devaluation. The prices paid in German marks for farm products in Germany was left unchanged and, again a temporary system of payments and charges on trade in farm products was instituted in order to compensate for the difference in the changes in the value of the mark in external trade. The Council of Ministers agreed to a programme for phasing out the monetary compensatory amounts in order to restore the unity of the Community market for the main farm products.

### 9.3 Permanence of "Temporary" Solutions

Thus the system of monetary compensatory amounts had been put into effect before the end of 1969 for both devaluing and revaluing currencies. This created a new phase and a new problem in the development of agricultural policy within the Community. In the case of both France and Germany these compensatory amounts were a temporary measure to enable the prices of farm products in the two countries to be brought back gradually into line with those appropriate to the new official parities.

However, while on these particular occasions the arrangements were in fact temporary, they represented the beginning of an entirely new set of difficulties for the CAP. This has resulted in a whole new dimension in the trade in farm products of individual member States, not just for trade with other countries inside the Community but equally for trade with third countries. This has meant that the unified price system of the Common Agricultural Policy has in effect been disrupted by the division of the Community into separate markets for farm products, differentiated according to the strength of the national currencies involved.

Monetary compensatory amounts (MCAs) were introduced in order to maintain the system of "common prices" for farm products within the European Community. Changes in the parities of currencies of individual member States would, unless some action were taken, lead to a change in prices received by farmers and thus, it has been held, a change in the levels of "common prices" in national currencies. However, this interpretation of "common prices" involves an underlying concept of constant exchange rates at the representative or declared exchange parities. These cannot be regarded as unalterable during periods of substantial changes in market rates of exchange. The monetary compensatory amounts originally introduced as a temporary transitional measure, have subsequently been applied without any really effective time limit, or indeed any specific limitation on the levels of charges or subsidies which are paid. In practice the periodic adjustment of representative (i.e. agricultural) rates does create such a limitation and it is the declared policy of the Commission to phase them out as rapidly as possible. Nevertheless MCAs have become a major feature of the day-to-day operation of the CAP.

The agricultural products which are covered by the MCA system are primarily those for which a common organisation of the market exists and for which intervention measures are laid down within the framework of the Common Agricultural Policy, i.e. cereals, rice, pigmeat, beef and veal (but not sheepmeat), eggs and poultry, milk and dairy products, wine, sugar, tobacco and olive oil together with the main processed agricultural products which have undergone a relatively simple degree of transformation. In the latter case the distinction between those products where the cost of raw agricultural material represents a significant proportion of the final value of the product, and therefore subject to monetary compensatory amounts, and those where the raw material costs are not a significant proportion and not subject to MCAs, is an arbitrary one. For example trade in chocolates and chocolate confectionery are subject to monetary compensatory amounts while bread and flour confectionery is not. Boiled sweets are subject to monetary compensatory amounts but not chewing gum. Processed fruit and vegetables (including jam) are not covered because the raw fruit and vegetable ingredients are themselves not subject to monetary compensatory amounts.

#### 9.4 Effects on Trade in Farm Products

Trade in farm products accounts for a very substantial part of total EC trade, both within the Community and with third countries. Total agricultural imports and exports of the member States of the EC

were valued at some 150 billion ECUs in 1983. Much of this trade was subject to monetary compensatory amounts - the main exceptions during 1983 being trade to and from Italy, Ireland and Belgium whose agricultural rate has been aligned with its market exchange rate, and those farm products not covered by the common agricultural policy. The problems that this system has generated are both of an immediate character, which affect the current level and direction of trade in agricultural products, and of a longer term nature which affect the whole development of agricultural trade not only within the Community but also between individual member States and third countries.

On the whole, the monetary compensatory amounts have so far made it possible to preserve the single market, at least in principle, in spite of different prices in national currencies (i.e. different when translated at the central rate), thus ensuring the survival of the CAP. However, this itself is not without defects.

Firstly, it has cost a lot of money. Some 14.5 per cent of total agricultural expenditure from the EC budget was accounted for by monetary compensation in 1977, though by 1983 this had fallen to just under 3 per cent. Secondly, the system has imposed a new set of burdens on the administration of the member States and on the problems of traders in their day-to-day trading activities. It must be recognised that changes in the market rates of currencies of member States is bound to cause very great problems for the administration and trade of the CAP; the system of monetary compensatory amounts is, however, no simple solution in administrative terms. It is not only the national administrations which are involved; the present system means that European traders in farm products on international markets have to cope both with the normal trading problems and also with the complex changes in market exchange rates and the consequential adjustment to monetary compensatory amounts. The efforts to reduce the economic disadvantages have added to the administrative complexities of the system.

Thirdly, the long-term effects have, however, been the most important. Persistent differences between the central and green rates of exchange may distort competition, impede structural change in agriculture and prevent the most efficient utilization of the resources available in the Community. The MCA system artificially ensures that trade between the various domestic markets and with third country markets takes place at the common level while in reality domestic prices remain either above the common level in the case of strong currencies or below the common level in the case of weak currencies.

By the application of the green rates in a country which has revalued, agricultural prices in that country, expressed in national currency, at first remain at the pre-revaluation level instead of falling. However, some imported agricultural raw materials are paid for at the official (revalued) central rate of exchange and thus become cheaper. A devaluation has the opposite effect. The unequal treatment of raw materials imports and agricultural produce may have important effects in certain sectors of production (e.g. pigmeat, poultry, eggs and to some extent also milk and beef and veal). Hence if the differences between the central and green rates remain fixed for too long or are even increased over the years owing to frequent

revaluations, this may give rise to serious distortions which may in turn call the CAP itself into question.

#### 9.5 Long-Term Solution

The nub of the problem is that as long as full economic and monetary union has not been achieved in the Community, differences in economic trends (in particular differing inflation rates) in the Member States will necessitate market exchange rate adjustments. Since the central rates change but farm prices in the member countries are not always fully adjusted immediately, "green" exchange rates are necessary. Differences between central and green rates would give rise to total distortion of trade flows in agricultural products and make monetary compensatory amounts unavoidable.

If the problem is to be tackled at its root, there is only one solution: European economic and monetary union. The introduction of the European Monetary System (EMS) in 1979 was a step in that direction. In spite of all the difficulties, the EMS has worked reasonably satisfactorily, even if it has not yet been possible to integrate sterling fully within the system. It has actually proved possible to create a European area of some stability in an otherwise turbulent monetary world. However the EMS, even when it involves all the members of the Community, is still a long way from full economic and monetary union.

In the meanwhile the political problems arising from MCAs have become of major concern. Countries with high positive MCAs (i.e. strong currency countries) face substantial cuts in farm prices - and consequently even bigger cuts in farm incomes - in the event of the withdrawal of MCAs. The Commission have over the past decade repeatedly pressed for the elimination of these MCAs, on the grounds that agriculture in the Community has been suffering from the consequences of the lack of monetary union between member States. The single market originally achieved by means of common prices in units of account has subsequently disintegrated because of the changes in exchange parities which have been made.

The recent proposals by the Commission for the rationalisation of the CAP include the dismantling of existing MCAs in two identical stages at the beginning of the next two marketing years, with any new MCAs being dealt with in three stages i.e. when the exchange rate realignment occurs and at the beginning of the two following marketing years. The Commission have also proposed to amend the rules for calculating MCAs so that they are restricted to the amount strictly necessary to ensure that the market organisation functions properly and trade distortions are prevented.

For countries which had substantial current positive MCAs, such as Germany with over 10 per cent and the Netherlands and the U.K. with around 7 per cent, reduction of half these levels would have a severe repercussion on farm income. Reductions in the past have been implemented at times of general support price increases, so that any decline in MCAs has not led to an actual fall in prices in countries with revalued currencies. At present, however, the scope for higher EEC

support prices is minimal and proposals for no change, or for just 1 per cent or 2 per cent for some products, would not alleviate the burden of a sharp decline in positive MCAs. It is, therefore, clear that the political problem of MCA reductions has now become of major concern in the Community.

At the same time, the pressure from countries which are exporters of agricultural products within the Community with low or negative MCAs to have the entire system phased out have become increasingly strong. Protection through the MCA system for countries with strong currencies has a most serious effect on the prosperity of other countries who find market access for their farm exports severely restricted by high MCAs. Moreover, positive MCAs can have a major impact on Community farm output, for example in the field of dairy production, and their continued existence in some member States has added substantially to current surpluses of farm products (particularly dairy products).

#### 9.6 Policy Adopted in the 1984-85 Prices Decisions

The MCA problem has, therefore, become a substantial element in the discussions on the rationalisation of the Common Agricultural Policy. The 1984/5 Farm Price decisions taken by the Council of Ministers represent a major step towards phasing out MCAs, but whether this plan will work in the longer term still remains to be seen. The new system involves the creation of an "agricultural ECU", some 3 per cent above the market ECU, and the reduction in MCAs in Germany and Netherlands to this new agricultural ECU. In return, the German government will provide special assistance to its farmers to offset the reduction in farm prices brought about by the reduction in MCAs, the cost to be met in part from the Community budget. The increase in the value of the ECU for agricultural purposes has meant an increase in prices for farm products in national currencies for most member states, and this will add substantially to the total bill for farm price supports to be met out of the EC budget in 1984/5 and subsequent years. Whether the new system in fact represents a permanent solution to the problem will depend on currency developments in the coming years; certainly the proposal to index the green currency system to the strongest national currency (i.e. the German mark) would have further very serious consequences for the Community budget. It could also have significant repercussions on the trading developments in farm products between the Community and the rest of the world.



## CHAPTER 10

### THE BUDGETARY SITUATION AND ITS IMPLICATIONS

#### 10.1 Current Budget Crisis of the Community

In recent years the budgetary question has moved into the forefront of discussions concerning the future of the European Community. In its most direct form the possibility has arisen, at least in theory though hardly in practice, that the Community may go bankrupt in the sense that agreed common policies and common activities cannot be pursued or implemented for lack of cash.

The budget has now become the most important instrument in the integration process between the individual European nations into a cohesive Community. This concern over budget matters is based on two fundamental issues. First there has been a detailed debate on the level of net contributions; this has focussed on the economic costs and benefits that arise directly in the budget related to those parts of the Community system which lead to financial flows between Member States. The UK in particular has felt that its net contribution to the Community budget involves an economic cost out of proportion to the benefits to them and consequently they have demanded a fundamental budget reform covering expenditure as well as receipts. Most other member States, however have rejected this approach on the grounds that the budget considered in isolation does not properly reflect the true costs and benefits associated with membership. These members would hold that the notion of the "juste retour" - the principle of payments and receipts being equal for each country - is against the very spirit of the EC.

Second there is the very real possibility that the Community will run out of funds in a very short time. It would, indeed, be a most serious breakdown of the EC as it now operates if the Community could not pay for the activities approved by the Council of Ministers. There is no doubt that, in the event of financial resources being exhausted, the Community would come to a virtual standstill and would then find itself in a major crisis. Those countries who favour radical reform of the budget are likely to use the prospects of such an outcome to impose their own conditions for agreeing to any further additional finances for the Community to meet existing commitments.

The crucial element in the budgetary crisis is that the Community is now living, to quote the Budget Commissioner, "within the shadow of the exhaustion of its own resources". To understand the nature of this crisis it is necessary to consider briefly how the financing arrangements of the EEC actually operate.



## 10.2 Basic Financial Understanding in the Community

When it was first set up, the Community was financed by direct contributions from the Member States. However the Treaty of Rome made provisions for the Commission to examine ways in which these financial contributions could be replaced by the Community's "own resources" - i.e. by sources of finance which were the Community's automatically and independent of decisions by the individual Member States or by the Council of Ministers.

The Community's revenue under the system of own resources was introduced by a Treaty of 1970. This provided that the Community should receive all customs duties, agricultural levies and an amount equivalent to a 1 per cent VAT rate on an agreed base of sales and services. VAT is the only flexible element among these sources of funds. By 1975 all customs duties and agricultural levies had been fully transferred to the Community. For the VAT resources to be brought into effect, a harmonised VAT base had first to be established and this came into effect in 1979. This Community VAT rate is independent of the rate or rates levied by the Member States under their own national system.

The original VAT rate required to replace the remaining financial contributions from the Member States was about 0.7 per cent so that, even from its beginning, the own resources system had already used up a considerable part of the maximum 1 per cent VAT rate provided for in the new system. A 1 per cent VAT rate yields at present about 15 b ECU, equal to about 60 per cent of the current (1984) budget total, which is of the order of 25 b ECU. The difference is accounted for by customs duties and levies.

The EC Commission had warned in 1978 that the 1 per cent VAT rate could well be fully utilised in a relatively short time span and had put forward a variety of alternatives for supplementing the Community's own resources. In fact, the 1 per cent VAT ceiling took rather longer to reach than the Commission had originally expected, as the world prices for farm products remained relatively high until 1982 and agricultural intervention expenditure consequently grew more modestly than had been originally forecast. In 1983, however, a radical change in the agricultural situation, with a corresponding increase in farm price support payments occurred. A record supplementary budget of about 1,700 m ECUs for agricultural expenditure was necessary and the increase in total farm price support spending over 1982 approached 30 per cent. This increase in expenditure, coupled with a poor economic performance generally and a consequential lack of buoyancy in the Community receipts, led to a very tight financial situation. The budgetary problem was highlighted in the most dramatic manner at the end of 1983 when the European Commission suspended the advance payments of certain export refunds and aids because the funds were not available to meet these costs. This had the effect of deferring until 1984 some 600 m ECUs of payments due in 1983.

It is perhaps useful to explain that one of the major differences between the Community Budget and that of a typical Member State is that the Community does not in theory have the power to borrow in order to finance its expenditure. On the contrary, it is a fundamental Treaty

obligation that budgetary expenditure must be balanced by Community receipts. Until additional own resources are approved and made available to the Community, the existing limit is one within which the Community has to live. In these circumstances there is a very real possibility that the present Community policies may become unsupportable and that policy changes will be implemented for purely budgetary reasons. However, in the dire financial situation of 1984, various measures are being considered to circumvent the restrictions on borrowing; it is quite possible that some device may be adopted which will overcome the limitation which hitherto has been regarded as an absolute prohibition on borrowing to meet the Community's expenditure programme.

A further complicating and important factor in the situation is the role of the European Parliament. Although the Parliament's powers generally are limited, they are strongest in the budgetary field, where the Parliament can reject - and indeed has in the past rejected - the entire budget. It is inevitable that the elected Parliament should seek to influence the policies operated by the Community and, in doing so, should use whatever means it finds at its disposal.

### 10.3 Underlying Nature of the Budget Problem

The fundamental causes of the present budgetary crisis are simple enough in themselves, but very difficult to resolve. The problem can be seen quite clearly from the course of the 1983 budget. The original budget was twice amended, first in the spring to provide funds for UK and German compensation for 1982 and later in the year to cover the sharp rise in farm price support expenditure.

In total, 1983 spending was just over 25 b ECU. This total virtually exhausted the financial resources available, including the full 1 per cent VAT rate. Of the total, about 15.8 b ECU, or just under two thirds, was budgeted for farm price supports. By comparison, agricultural expenditure on farm structural improvement was some 650m ECU i.e. less than 3 per cent of the total.

The budgetary crisis has arisen primarily because the measures to increase the proportion of expenditure on the non-agricultural policies has not been matched either by the growth in total financial resources or the diminution of the proportion spent on agricultural support. This problem has been exacerbated by the fact that the benefits of agricultural expenditure accrue unequally in different regions of the Community, which has created a considerable measure of instability in the budgetary situation.

The scale of the problem can be assessed from the experience of the 10 years 1974-83. Over that period, expenditure on agricultural price supports grew more than five-fold, from about 3b ECU to almost 16b ECU. Over the same period, 'own resources' increased by only two and a half times, from about 9b ECU to some 24b ECU. This unequal growth has occurred in spite of the attempts to contain the volume of spending on agriculture price supports. The Commission's proposal in 1980, that such expenditure should grow at a slower pace than the growth in the Community's own resources, has been totally unsuccessful.

It should moreover be recognised that the existing financing arrangements do provide for a steady growth in the income of the EC both in nominal terms and in real terms as long as the total economy is growing in real terms.

From 1974 to 1979, the annual increase in the cost of supporting agricultural markets and guaranteed prices averaged 23 per cent; there was then relative stability in 1980-82, largely because of a favourable situation on world markets, which reduced the cost to the Community budget of export refunds. This favourable situation postponed the day of reckoning; now, after years in which agricultural production has increased faster than consumption and the rate of increase in overall budgetary expenditure has outpaced the growth in own resources (customs duties, agricultural levies and up to 1 per cent of VAT), the irresistible force of the Community's agricultural expenditure has come up against the (at least temporarily) immovable object of the Community's budget.

The Commission has made proposals to increase "own resources" by raising the VAT ceiling to 1.4 per cent, with provision for further adjustments in later years, and these proposals were subsequently revised upwards to a 2 per cent ceiling on the direct VAT related contribution. This proposal for increasing the member states direct budgetary contributions has been put forward to avoid the need for frequent smaller increases (particularly as it has become clear that the likely 1984 CAP expenditure and the costs of enlargement of the Community to include Spain and Portugal would largely exhaust the original proposal of an extra 0.4 per cent VAT contribution). However, because of the large share of agricultural expenditure in the overall budget spending, it is clear that adaptation of the CAP is an integral part of budgetary reform and has become a matter of great urgency.

#### 10.4 Position of the Major Net Contributors

The financial problems of the Community have been made far more difficult to solve by the strength and nature of the U.K. budgetary problem. This problem is itself to a considerable extent a consequence of the agricultural problem. The United Kingdom, whose GDP per head is close to the Community average, contributed in 1982 almost a quarter of total Community finances and received in return just over half of this sum back from Community expenditures. This resulted in 1982 in a net United Kingdom contribution of more than 2 b ECU. This was almost the same net contribution as that of Germany, whose level of economic wealth is substantially greater than the U.K. While the idea of the 'just return' is an anathema in EC circles, it is not so among the major net contributors to the financial burden (and particularly to the U.K.).

The problem of the other major net contributor, Germany, differs from that of the United Kingdom in that the Germans accept in principle the obligation of making a substantial net contribution to the Community. However, they are understandably concerned that, as the richest Community country, the expansion of the Community budget could result in very large additional demands on them. In recent years the

German domestic economic policy has been concerned particularly with the need to contain their own budgetary situation and it would be quite unrealistic to expect that a member State would swallow the politically unpopular consequences of severe budgetary restraint at home while contributing substantially more funds to the European Community for the benefit of other countries.

At the same time a number of member States, particularly those who have large agricultural sectors and are major beneficiaries of payments under the CAP, are concerned that budget reform should not imply a dismantling of the present agricultural policy. This concern is readily understandable in the case of countries with a large agricultural sector and whose GDP per head is relatively low. The benefits from the CAP have become a major part of the incomes of farmers in these countries and both economic and political forces require these member States to support the fundamental objectives and mechanisms of the CAP.

The problem of the U.K. and German position has been accentuated by the attitude of the European Parliament, which has pressed for the solution to be found in the development of general Community policies rather than in the form of cash repayments. Parliament's position on this point was made clear at the end of 1983, when it rejected the supplementary budget which would have authorised refunds to Germany and to the United Kingdom, even though these refunds were agreed by the European Council. As the European Parliament has no direct governing responsibility, as is the case of national parliaments, the pressure to swallow difficult and unpopular decisions is far less strong. The fact that an agreement to the budget has to be found not only to the satisfaction of all ten member Governments but also to that of the European Parliament clearly renders the situation even more complex and delicate.

#### 10.5 Elements in Any Solution

The solution to the EEC budgetary problem therefore has to take account of the following elements:-

1. The Commission's view that a limit must be placed upon agricultural guarantee spending, both in relation to its share of the total budget and in relation to its future growth relative to the growth of own resources.
2. Structural surpluses in agriculture will over time have to be eliminated, either directly through budgetary constraints themselves or by some other mechanism.
3. The United Kingdom will only be satisfied when its net contribution is held to the level which has been achieved in recent years by refunding part of its contribution directly to the U.K.
4. Germany requires some guarantee that its own contributions to Community spending will not be an open ended commitment and that such spending will be cost effective.

5. The European Parliament is keen that the operation of the new budgetary system will result in the growth of Community policies, particularly those in the non-agricultural sector.
6. Those member States heavily dependent on agriculture will seek to ensure that any limits on agricultural spending and the reform of the Common Agricultural Policy will not fundamentally alter the basis on which their own partnership in the Community is based.
7. The problem is complicated still further by the forthcoming enlargement of the Community to include Portugal and Spain, which is forecast to impose an additional net cost of about 5 per cent to 7 per cent on the current budget.

The list of difficulties in the way of solving the Community's present financial crises illustrates just how difficult it will be to reach a solution. These difficulties are compounded by the basic legal framework of the Community which governs the procedure to be followed for increasing the financial contribution by the member States. The basic procedure as laid down in the Rome Treaty requires not only the unanimous agreement of all the member States, but also the ratification by all ten national parliaments. In other words, not only can any one member State effectively veto any agreement between the other nine, but each government must be sure that its own national parliament will endorse any new agreement. A member State government with uncertain parliamentary support could therefore find its negotiating position, in what is already an extremely complex and delicate issue, further circumscribed by the need to ensure parliamentary approval at home.

This process of negotiating a new level of financial resources for the Community and then securing the agreement of all ten member State parliaments is bound to be a lengthy procedure. The general expectation is that it is likely to take up to two years to complete, even given a genuinely positive approach by all of the different parties concerned. As this is a political question of a fundamental character, it is inevitable that political issues in the different member States will play a major part in the negotiations, as well as in the ratification procedure involving national parliaments. These negotiations could well lead to major changes not only in the way the Community operates its different policies but also in the orientation of the policies themselves. Indeed, even in the interim period before any additional financial resources became available, it is clear that there are going to be substantial modifications both to the operations of the Community policies and to the development of both these policies and to those new policies currently under consideration.

#### 10.6 Procedural Difficulties

These modifications will be influenced to a considerable degree by the procedural arrangements under which EC policies are operated. In the first place, most of the day to day operations are within the "competence" of the Commission (i.e. the Commission can take the decisions affecting the management of the policies, with only limited scope for individual member States to affect these decisions). It is evident that whenever changes affecting expenditure can be effected,

they will be taken in order to conserve the funds now available. Where, however, decisions involve the Council of Ministers and where the national interests of member States are much more to the forefront in the decision, then policy changes which adversely affect the payments to the different sectors of the member State concerned will be much more difficult to achieve.

A second factor complicating the way in which the Community's financial policy will be managed in the interregnum before any revised level of resources actually materialises, is the categorisation of expenditure into 'obligatory' and 'optional'. These two categories are not simply a reflection of the degree of importance or inherent benefits from the expenditures involved, but rather reflect the nature of the legal basis for them. Expenditures which are in the 'optional' category are considerably more at risk to severe cuts in the event of total expenditure being likely to exceed total revenues. Most of the expenditure on the CAP is, however, in the 'obligatory' category and to that extent is a priority in budgetary allocations. Thus if it becomes necessary for the Community to prune its expenditure severely, in order to live within its means, the pruning would be of an uneven nature and have regard to a substantial degree to factors other than the social and economic consequences of the particular cuts that were made.

#### 10.7 Current Proposals

In 1984 the European Community's budget will use practically all the money available under the present system of 'own resources'. A new financial basis will be needed if the Community is to finance current policies, including the CAP. The European Commission has submitted proposals for increasing the Community's income. This was the major subject for discussion at the European Council in Stuttgart in June and again in Athens in December 1983.

The Commission believes that its proposals will not only provide a more diversified form of finance for the Community, but will also help to resolve the problems set out earlier. In the face of the strongly voiced views of the U.K. Government on the existing budgetary arrangements and the emphasis on the need to find a solution acceptable to all member States, the Commission has set out proposals under which the U.K. share of budget financing would be reduced as long as agricultural spending remained the dominant element of expenditure.

The Commission's principle proposals are:-

- that the present 1 per cent ceiling on VAT should be abolished;
- that a special decision-making procedure, involving unanimity in the Council and a qualified majority in the Parliament, should be introduced for the approval of each further tranche of 0.4 per cent of VAT in excess of the proposed 1.4 per cent (but this has now been superseded by the proposal for a 2 per cent VAT contribution);
- that part of the Community's VAT revenues should be paid in the form of a "modulated" VAT, with variable rates applying to the

different member States;

- that customs duties on imports of European Coal and Steel Community (ECSC) products should henceforth accrue to the Community rather than to the member States;
- and that the reimbursement to member States of 10 per cent for the cost of collecting customs duties and agricultural levies should no longer be automatic.

One of the most interesting features of the Commission's proposal is the "modulated" VAT rates. These would be determined on the basis of three indicators:

- the share of member countries in final agricultural production of products falling within the common agricultural policy;
- gross domestic product per head in each country;
- member countries' shares in the Community's net operating surplus.

The choice of agricultural production as one of the factors determining the level of contribution reflects directly the need to ensure a better relationship between the revenue side of the budget and its expenditure side. As agricultural expenditure occupies such a prominent role in the budget it is argued that there should be some agricultural-based element in the Community's revenue system.

The other two indicators reflect the relative prosperity of member States and the dynamism and profitability of their economies. The Commission has said that taken together the use of the three indicators produces a balanced result which provides a substantial element of diversification in the Community's revenues and which makes a realistic contribution to the resolution of the problems of budgetary imbalances in a way which is equitable for all member States.

The aim of these proposals is basically to provide a greater total income while at the same time overcoming objections to the present burden of the budget borne by the U.K., without seriously increasing the net contributions of those countries with a relatively large agricultural sector. These proposals are also intended to ensure that the growth in farm price supports is lower than the growth in the total income of the Community.

These proposals have run into the two major hurdles. First the Council of Ministers, and especially the meeting of heads of governments (the European Council) have considered not only the Commission's ideas but additional ideas put forward by a number of member States themselves. There has been, however, no general concessions by the member States, so that there has been little progress made in the negotiations.

Secondly the Commission's proposals have also been considered by the European Parliament (whose role on budgetary matters is much stronger than in other policy areas generally). The reaction of Parliament was to make the conditions for any increase in funds far

more restrictive than that proposed by the Commission; in particular it wanted any VAT increase to be conditional (a) on measures to reduce surplus production in agriculture due to 'structural' factors and (b) on the annual growth in agricultural expenditure being held below the growth in resources generated within the present 1 per cent VAT ceiling, rather than by reference to any higher VAT ceiling.

#### 10.8 Pressures for a Solution

It would appear inevitable that the negotiations on the budget will involve the most profound reconsideration of the nature and objectives of the Community since it was first established. The debate is likely to go to the very heart of the "acquis communautaire" i.e. the basic understanding on which the EC rests.

The negotiations are of an overwhelmingly political nature; they are not just a matter of bookkeeping or even of economic and social policy generally. There is no doubt that the individual member States recognise the need to succeed in these negotiations, as failure would reverse the integration of European countries into a unique Community. Every member State has more to lose from a failure to agree on a new budgetary system than on the concessions that will be needed to bring agreement. Nevertheless the conflict of interests between the different member States is very large and the negotiations are bound to be extremely tough. What the eventual outcome will be is impossible to foresee, but the future of the Community will be largely decided by the solution that is eventually reached.





## CHAPTER 11

### FACTORS WHICH WILL DETERMINE THE FUTURE OF THE

#### CAP

##### 11.1 Basis of the Commission's Proposals

In a 1980 document on 'Reflections on the CAP', the European Commission concluded that the Common Agricultural Policy has broadly achieved its main goals; free trade in agricultural commodities, security of supply of basic foodstuffs at stable prices for the Community's 260 m consumers, growth in productivity and protection of the incomes of 8 m farmers, fair share of agriculture in world trade and in the contribution of the agricultural sector to the Community trade balance.

The Commission recognised, however, that the CAP has met with serious difficulties:-

- (a) the open-ended guarantee system has led to major imbalances between supply and demand in several major agricultural markets, milk being the main problem;
- (b) price guarantees or product subsidies have worked out in an indiscriminate manner between producers and have been of greater assistance to the richer regions than to the least-favoured areas of the Community;
- (c) although the financial impact of the CAP is not excessive in relation to the GDP of the Community, it has tended to increase too rapidly in real terms and the way in which the money is spent, for instance on milk surpluses, has been justifiably criticized.

The adjustments to be made to the CAP must reconcile three main objectives:-

- (a) to maintain its three fundamental principles; unity of the market (through common prices); Community preference (mainly through variable levies); financial solidarity (through the agricultural budget);
- (b) to set up mechanisms whereby the financial consequences of production surpluses may be held in check;
- (c) to concentrate financial resources on the least-favoured farms and regions.

The Commission in 1980 proposed to overhaul the CAP along three lines:

- (a) the adjustment of the common market organisations by the introduction of a new basic principle; coresponsibility or producer participation in the form of either a levy (as already existing for sugar and milk) or other mechanisms;
- (b) a new approach to the Community's external agricultural trade policy, both on the import and the export side;
- (c) a readjustment of structural policy.

For over three years now, the reform of the CAP has been to the forefront of discussions on the evolution of European agricultural policy. In its most recent set of proposals on the fixing of prices for agricultural products and related measures for 1984/85, the Commission has warned that every week's delay in reaching agreement on this makes the market problems of the CAP more difficult to solve. In so far as the final decisions on the 1984/5 prices went only part of the way to meet the criteria set out by the Commission, the solution of the market problems still remains to be settled.

The factors which will primarily determine the future development of the CAP are:

- (a) farm income position;
- (b) the state of the markets for agricultural products;
- (c) the budgetary situation;
- (d) the strength of production technology;
- (e) the trends in resources, particularly labour.

These will in turn be reflected in the decisions on prices which have a major effect on the first three of these factors. The decisions on prices are, however, also affected by the general economic climate of the economy of the Community as a whole, as the relative income situation of farmers and of those in other occupations is of major importance in the fixing of prices for farm products by the Council of Ministers.

## 11.2 Farm Income Position

The farm income position has become over recent years the most important single determinant of the operation of the CAP and only the present budgetary problems have moved it from the very centre of the stage. The farm income problem involves the trend in farm incomes over time, particularly in real rather than nominal terms, the distribution of those incomes between the farmers of the Community, the trends in incomes in the non-agricultural sector and the alternative ways in which farm incomes can be maintained.

Over the past decade the overall trend in farm income per head in real terms has been static. Relatively good years, such as 1973, 1978 and 1982 have been followed by much poorer ones 1974, 1980 and 1983, so that the average European farmer has seen no improvement in his living standards for many years. The 1983 average farm income, as measured by the "sectoral income index" was about 4 per cent below the 1973-5 average in real terms. Furthermore as this index of farm incomes makes

no allowance for the growing burden of debt servicing which has built up over these years, the underlying trend in real net farm incomes is downwards rather than just static. This contrasts sharply with the earlier years of the Community when real incomes in agriculture increased rapidly.

At the same time, the trend in the real incomes of people at work in other sectors in Europe has continued upwards over the past decade. It is true that this concept of income development makes no allowance for the increasing number of people in Europe who are unemployed, but for those who are at work there has been a significant improvement in living standards, amounting to around 2 per cent per annum over most of the past decade. Thus, although it is difficult to make direct comparisons between farm and non-farm incomes in Europe, it is clear that the trends in incomes since 1973 have been clearly in favour of the non-farm sectors. Even, for example, in Ireland, which had expected farm incomes to benefit substantially from participation in the CAP but incomes in manufacturing industry to be in some jeopardy, the gap between farm and non-farm incomes has grown wider, to the disadvantage of the farmer.

Trends in average farm incomes for the whole of the Community conceal enormous variations both geographically and between different categories of farm. The efficient medium to large farms of northern Europe, particularly in Denmark, England and the Netherlands have much larger incomes than those in the southern countries, particularly Italy and Greece. This income distribution pattern within Europe can be found within some of the larger member States. The present system, whereby farm incomes are supported primarily by action on prices, has been criticised as a source of social inequality, under the cloak of economic equality. This is an extension of the criticism that the Common Agricultural Policy itself has been of greater assistance to the regions which were already rich than it has been to the least-favoured areas of the Community. This latter criticism is clearly a consequence of the differences in natural resources and the structural disparities which already existed when the Community was set up. However the large differences in income and productivity between the Community's agricultural regions have if anything widened during the '70s. There are two basic reasons for this. Firstly, the richer Community regions produce commodities (cereals, milk and sugar) which receive more substantial support than those produced in the less-favoured regions, which are largely in the Mediterranean area and mainly produce fruit and vegetables and wine. Secondly, it should be borne in mind that the nature of the system of 'organisation of the market' for the individual farm products is such as to favour the more well-to-do producers, who are mainly concentrated in the richer regions.

### 11.3 Prospects for Direct Income Aids for Poorer Farmers

In a Europe facing a long slowdown in its economic growth, voices have been raised in protest against Community funds being used, for the most part, to support the incomes of the richest farmers. There has, therefore, been a recurrent discussion on systems of farm income support which would be more directly aimed at those most in need. There is indeed a clear lack of consistency in providing income support for

the agricultural sector on the grounds that average farm incomes are below those in other sectors, and then providing this support through a system which totally ignores this principle and gives a great deal more assistance to those who are already the best endowed and most wealthy in the sector, and very little to the genuinely poorer farmers. In the discussions on the most appropriate policy that should be pursued, it is acknowledged that the most appropriate form of aid for the poorest farmers would be that provided in the form of direct income supplements. These have the advantage that:-

- (1) they can be geared to provide help to those most immediately in need;
- (2) they can be organised so that, as distinct from price support payments, less is paid to the larger, and more to the smaller, farmers;
- (3) they are not tied in any way to production and therefore do not generate an additional volume of output for which there may be no commercial markets;
- (4) they could be paid in some member States from Community funds without necessarily generating an irresistible demand that they be paid in other member States.

At the same time serious objections have been raised against them, primarily from farmers themselves who tend to be strongly opposed to direct income support payments because:-

- (1) the level of assistance will be directly known to society at large and, if they are at a level that would substantially remedy the current farm income problem, then they are likely to give rise to very strong demands for equivalent support from other sectors who are in real financial difficulty,
- (2) a redistribution of support via direct income supplements rather than through higher farm prices would hit larger farmers in particular; it is generally these farmers who hold the dominant positions among those who speak on behalf of farmers and they have considerable direct influence with Governments and Ministers for Agriculture,
- (3) farmers may be opposed to direct income supplements because they are associated with "dole" payments and argue that they should be in a position "to earn a decent living in the market place and not through charity",
- (4) income supplements could prove to be transitory; they might easily be withdrawn if the pressures on the Community budget were strong enough.

So far there is little concerted support for direct farm income supports in the Community. There has been a strong feeling that the right way to support agriculture is not through a system of income aids of this kind. In the present budgetary situation, any significant measure of this nature would have to be financed by savings elsewhere

in the agricultural budget, i.e. by reductions in other support measures of an equivalent cost. Such reductions might well be politically unacceptable; failure to provide something not previously available is generally less politically damaging than taking away some support that previously has been paid to farmers.

#### 11.4 Situation and Outlook on Agricultural Markets

In considering market prospects for Community farmers, it is necessary to examine the situation on the domestic markets, those on external commercial markets and those of the developing world. On its domestic market, the Commission has estimated that the total population of the Community of Ten will only increase from 270.9 m in 1982 to 274 m in 1990, an annual rate of increase of only 0.14 per cent; the rate was 0.35 per cent during the period from 1971 to 1981. The level of total private consumption per head is projected to increase between 1983 and 1990 at an annual rate of 1.9 per cent; this rate was 2.9 per cent during the period from 1970 to 1980.

During the past two decades, food consumption in the Community has increased by about 0.5 per cent per annum. Of this, some two-thirds was accounted for by population growth, so that per capita consumption was growing by only about 0.15 per cent per year. This trend is likely to fall even further in face of the slowing down of economic growth generally and the high levels of per capita consumption already achieved. Thus the level of growth in total internal food consumption in the future is likely to be of the order of 0.25 per cent per year, of which 0.14 per cent would be generated by population growth and 0.10 per cent in consumption per head. This would mean that internal total food consumption will grow over the coming years at only half the rate of recent decades.

With the growth of production at 1.5 per cent to 2 per cent a year, the Community has gone well beyond the point of self-sufficiency for most of the main agricultural products. It has therefore become more and more dependent on world markets to dispose of production in excess of its own domestic requirements. In the last ten years, agricultural exports of the Community have increased twice as rapidly as agricultural imports. It is however no longer financially possible nor economically sound to expand EEC farm exports. The Commissioner for Agriculture Mr Dalsager has recognised that the problem of surplus production is unhealthy on the grounds that it is bad for the Community, because of the high costs involved. Moreover intervention and public subsidies are not the market. A policy which removes the market and removes risk is a policy which cannot last.

Faced with difficulties of disposal on its own markets and increased competition on external markets, the official policy of the Community is to base its agricultural trade policy on a combination of three elements:

- international co-operation with the principal exporting countries, to prevent the further deterioration of world prices;
- the development of a policy at the Community level for promoting

exports of farm products on an economic basis;

- the exercise of the Community's international rights, particularly in GATT, for the revision of the external protection system in those cases where the Community is taking measures to limit its own production.

The Commission have argued that the introduction of measures involving guarantee thresholds on Community farmers, particularly the participation of producers wholly or partly in the cost of disposal, should permit agricultural exports from the Community to develop on a sound basis. This policy should create the necessary conditions for concluding long-term contracts for the supply of agricultural produce to third countries, including certain developing countries, in the framework of their policies for food security.

As regards agricultural imports, the Community will undoubtedly re-examine the regimes applicable for the different products, with a view to "adapting" them to the market situation. In some cases, where the Community has contracted international commitments concerning agricultural imports in exchange for reciprocal concessions in these cases, an adjustment of the import regime must take account of the possibilities of negotiation and of the reactions of the Community's trading partners. In other cases, autonomous concessions have been granted for reasons of general commercial policy and foreign policy. However, the Commission has maintained that if the Community is to demand greater discipline of its own agricultural producers, it must take parallel action in respect of imports to ensure a satisfactory observance of Community preference. This approach is likely to be pressed even more strongly by a number of Ministers when this issue is before the Council.

In addition, in the light of experience, the Commission considers that the rational management of the agricultural markets has encountered difficulties because the automatic nature of certain instruments (intervention, etc.) does not allow a flexible reaction to the development of the market situation. It is evident that decisions at the level of the Council for the management of the agricultural markets can lead to linkage with other questions, which is detrimental to the proper execution of the CAP. The Commission have proposed to take further powers in the context of agricultural management, with the objective of making the management of the policy more flexible and less automatic, so as to make the most efficient use of the existing instruments and financial resources.

### 11.5 Budgetary Factors

The budgetary problems of the Community have been the subject of concern for some years. The level of expenditure on agriculture doubled between 1976 and 1979, and a financial crisis was anticipated as the total Community budget rapidly approached the limit provided under the Treaty. The improvement on world markets and the opportunity this gave to a more effective policy of market management in 1980 and 1981 gave a purely temporary reprieve. In fact 1981 saw a fall in budget expenditure in farm price supports and this, together with a

reduction of expenditure on export subsidies and on net monetary compensatory amounts, meant that over the two years 1979-81, total CAP expenditure rose by only 6.6 per cent, in spite of the fact that the latter year expenditure included that on Greece for the first time. However, the sharp upward trend was resumed in 1982, and accelerated in 1983 with a growth of over 40 per cent over these two years. In the light of this increase, the budget was not sufficient to meet all the expenditure commitments, and this has precipitated the current crisis.

In their price and CAP reform proposals for 1984-5, the Commission has estimated that there would be savings of 875m ECUs from the implementation in full of their various proposals (including savings achieved from adjustments in the day-to-day operation of the CAP). However, these savings will be required to offset the over-runs on the funds provided in the 1984 budget - in particular the additional costs of supports in the dairy sector - together with the costs of payments that were deliberately delayed from the end of 1983 into 1984. The Commission's aim is to contain the increase in agricultural expenditure at a level below the growth of total financial resources. Given the nature of the support systems under the CAP, it is accepted that regard must be had to the trend in expenditure over a period of years, rather than in any one year. Taking the three year period 1983-85, the Commission has estimated that the growth in the average rate of agricultural expenditure would be 11 per cent, compared with a projected growth of financial resources of 6.6 per cent. However, the 1983-85 period is heavily influenced by the 1983 year, when agricultural expenditure went up by 29 per cent. It is now evident that the out-turn for 1984 will not be as favourable as the Commission has anticipated; their projection is based on the assumption that the Council would adopt all the proposals that have been put to them - and this has now proved to be far from the case. The revised estimate of CAP expenditure in 1984 of 18.6b ECUs is 13 per cent above the original provision of 16.5b ECU, and it is far from certain that expenditure will in fact be contained within the revised figure.

The Commission has had strong support for its policy from the European Parliament, which in November 1983 declared that "reform of the CAP can no longer be postponed, both to ensure the possibility of financing the policy, and also if the aims set out in Article 39 of the Treaty are to be attained". A month later in its resolution on the 1984 budget, Parliament again demanded that "the Council should decide, at the latest by 31 March 1984, on the improvement of the CAP, so as to eliminate the expenditures due to production of structural surpluses, expenditures which the Community budget can no longer assume".

#### 11.6 Changes in Technology and Resources

The Community's agricultural problems have stemmed basically from the inability of the agricultural sector to adjust to the changes in its technology and resource environment. During the last two decades, since the CAP was developed, the advance of technical progress and productivity in agriculture has been rapid. This, of course, is not just an European phenomenon; it is part of the world wide technological impetus arising from large investments in research and development. The long-term trend in the volume of agricultural production in the



Community has been between 1.5 per cent and 2 per cent per annum. Not all of this is due to new technology; part of it has arisen from the substantial capital investment that has been made on modernising farms in Europe, farms which were often very backward in terms of the level of their production systems. Part has also come from the structural developments in European agriculture, in particular the transfer of land from smaller and often traditional farmers to larger units run by better educated farmers able to utilise more up-to-date production methods.

These three factors making for growing agricultural output are still very strong. In spite of cut backs in research budgets, there is a large volume of new technology being developed that will continue to increase the production potential of resources in agriculture. While there have been significant steps to cut the level of state or Community aid to new investment in certain areas of agricultural production and the general investment climate in European agriculture is far less buoyant than a few years ago, there is still a considerable volume of new investment being undertaken. Again, while the structural reform programme may slow down, particularly in face of the general and economic difficulties in Europe, the transfer of land to more efficient farmers will continue for many years to come.

Thus the underlying factors making for increased farm output will continue to exist even in the face of a restrictive implementation of the Common Agricultural Policy. While there may be some slowing down in the rate of expansion under these circumstances, it would be quite unrealistic to expect the problems arising from the creation of substantial surpluses in a number of important sectors to resolve themselves.

It would of course be possible to offset this upward trend in output by reducing the level of resources involved in European agriculture. In this context, the most significant input is labour. However, over the past two decades, the total number of persons employed in agriculture in the ten member States has fallen by 60 per cent from over 20m to less than 8m and there has been an increase in part-time farming as farmers have sought to supplement their incomes from off-farm jobs. The exodus from farms has, however, slowed down in the face of growing unemployment in other sectors and the greater difficulties of finding off-farm jobs. It is now about 1 per cent per year; the rate of decline has been somewhat lower in the more industrialised countries but higher in the more agricultural ones. It would be unrealistic to expect this exodus to grow again in the near future; it is more likely to remain at the most recent rate of a decline of only 1 per cent or so per annum.

The decline in the agricultural labour force has been of particular consequence for the trends in per capita farm incomes. Without it, per capita farm incomes would have fallen very sharply in real terms over the past decade. However, it is evident that this decline has not seriously hampered the growth in production, as the substitution of capital for labour has facilitated the continued growth in total farm output. The slowing down of the exodus of labour from agriculture will however exacerbate the decline in per capita farm incomes and this in turn will increase the pressures for a more

protected and heavily supported agricultural sector.

### 11.7 Role of Prices

The most immediate key decisions on agricultural policy are those on prices. These decisions in the past have been taken by the Council of Agricultural Ministers with particular regard to the current needs of the farmers of the Community. However, prices play an economic role that extends considerably beyond the requirements of farmers for income support. They have the major function of bringing about an equilibrium between the supplies on the market at any particular time and the demand for those supplies. Prices also have the longer-term function of guiding the decisions of producers on their future production programmes, both the mix of products which they produce and the level of output in terms of the intensity of their production systems. Prices also have an impact on the distribution of income between producers of the different agricultural commodities.

The free market function of market clearing can tend to create wide short-term fluctuations that can obscure the longer-term function of guiding production decisions. The CAP system of target prices supported by intervention is intended to avoid the instability of the short-term market situation. Unfortunately, the use of the price mechanisms as a means of farm income support has overshadowed the resource allocation function; this is at the root of much of the problems that have arisen with the CAP. Yet in spite of the considerable volume of resources that have been devoted to price support mechanisms, the level of farm incomes has not been maintained in real terms, particularly when compared with the trends in the non-farm sectors. Thus, even with all the budgetary and other resource costs involved in maintaining farm prices, the income problem has remained a serious one for the farmers of Europe. Unfortunately the pressures to increase prices for income reasons have swamped any realistic regard to the other economic functions of the price mechanism and there is little if any evidence of a willingness to allow prices to play their role in bringing an equilibrium in the supply and demand situation. Certainly the Commission has expressed their concern that prices should be such as to prevent the continuation of "structural (i.e. long-term) surpluses", but there is no evidence that the Council of Ministers would regard this as a factor of the first priority.

The factors which have determined the development of the CAP over the past two decades - the need for high output and improved incomes, the availability of financial resources and the trends in resources and technology - have all had a basically positive character. In the prevailing conditions today, particularly the lack of commercial external markets and the severe budgetary limitations, the determinants of the agricultural policy followed by the Community have become of a much more negative nature. How the Community will respond to this is far from certain; initially there can be a belt tightening exercise as the Community adapts to the factors which now shape the course of agricultural development. Whether this exercise will really meet the needs of today, or whether some more fundamental change will have to take place, remains to be considered.



## CHAPTER 12

### THE FUTURE OF THE CAP

#### 12.1 Need for Reform

The Common Agricultural Policy is generally regarded by the European Community as one of its major achievements. There is however agreement that Europe must adapt its agricultural policy, but changes in policies which themselves were adopted only after difficult political compromises will require a firm political resolve.

The reform of the CAP is not a technical affair but a political challenge which can be successfully accomplished only if the costs involved are distributed equitably between the different Member States, the different market organisations and in general between the various interested parties. At the same time the agricultural policy, like other policies, must respond to the need for the efficient use of the Community's financial resources.

The budgetary costs of the CAP are a consequence of the measures adopted to implement its social and economic objectives. Those objectives, which include the assurance of a fair standard of living for the agricultural community and the availability of supplies to consumers at reasonable prices, are common to agricultural policies in all developed countries of the world. The European Commission now accepts that these objectives should be pursued at a cost which is reasonable and not disproportionate to the costs experienced in other countries.

The Commission has for a number of years advocated the reform of the agricultural policy. In 1981, in a memorandum on "Guidelines for European Agriculture" it outlined a programme for adapting the CAP to the "new realities" both of general economic conditions and of the agricultural sector itself. This programme included in particular the establishment of "guarantee thresholds" to which the price guarantees would apply. These would take account of the long-term prospects for production, consumption and trade for individual agricultural products.

Subsequently in June 1983, the Commission presented a further statement of its views in its communication "Further guidelines for the development of the CAP" which developed further this concept of supply management to complement the existing market management system, which has been a fundamental feature of the CAP as it has operated up to now.

#### 12.2 Response of the Member States

In reply, the Heads of Government set out a long list of factors taken into account in deciding on the future CAP policy:

- price policy
- guarantee thresholds, in relation to objectives for production
- coresponsibility of producers
- intervention arrangements
- export refund arrangements
- substitutes and Community preferences
- monetary compensatory amounts
- aids and premium arrangements
- internal barriers
- type and size of farms and particular situations of various categories of farmers
- the need for strict financial guidelines
- external agricultural policy
- special problems arising in certain regions such as in the Mediterranean regions, in mountain areas or other regions at a disadvantage because of natural or economic features.

It is of note that the list makes no specific reference to farm incomes, although the income position is no doubt implied in the reference to the "particular situation of various categories of farmers".

The Commission's detailed reply underlined the fact that the situation cannot be remedied by short-term palliatives, or economies of an ad hoc nature and went on to say that "determined action to adapt the CAP in a rational long-term framework will be necessary to place the agricultural policy in a sound economic and financial context for the coming years".

### 12.3 Adaptation of Agriculture in the Community

The adaptation necessary in European agriculture is part of the general adaptation of its society, faced with rapid technological progress but a rate of economic growth lower than in earlier years. The diverse structure of agriculture in the Member States is the inheritance of many generations, and its well-being is regarded as essential to the fabric of rural life. But this well-being can be ensured only by a better integration into the economy as a whole, not by its isolation from the underlying factors which are affecting modern society.

Two factors of particular importance are the following:

- (a) overall demand for food will increase less rapidly than in the past. On world markets the capacity to pay - i.e. effective demand - will depend on economic growth and on credit possibilities which are uncertain. While the Community will continue to play an important part in food aid, it must at the same time encourage the developing countries to satisfy more of their food requirements from their own resources.
- (b) scientific research and development generates a constant improvement of crops and breeds of animals, machinery and techniques which mean that the factors of production can be combined more and more efficiently and at lower real cost. These

trends are expected to continue and may even accelerate in the coming years.

The Commission has promised suggestions on the relationship between agricultural policy and fundamental research. For this purpose it accepts the need for a system of forecasting the fundamental changes which may take place in the medium and long-term and also an examination of the possibilities for new outlets for agricultural production, particularly for products in surplus. In view of the earlier problems with medium to long-term forecasts in the agricultural sector, it is not clear what the Commission intends to do in terms of a new set of forecasts. Nor are the medium-term forecasts that have been published by the Commission at all convincing. The basis of the projections has not been given and the results that have been published show quite unrealistic changes in the current trends of supply and consumption of some of the major farm products. Even so in view of the future perspectives, it is clear that the Community has no choice but to revise its policy of guarantees for production. If Community agriculture is to expand its exports and maintain its share of world markets, it must increasingly accept the market disciplines to which other sectors of the Community's economy are subject. In this approach, the Commission now put more and more emphasis on production at a competitive price. Hitherto, the price guarantees for most products have been unlimited in nature, but this situation cannot continue if the CAP is to develop on a rational basis.

#### 12.4 Rationalization of the Market Organization

The stagnation or decline in demand, both in the Community and on external markets, for products such as milk, wheat and beef shows that it is no longer reasonable to provide unlimited guarantees of price and intervention where there is considerable doubt about the possibility of outlets in the coming years. The current proposals from the Commission would involve farmers more fully in the cost of disposing of production beyond a certain threshold. Measures in respect of such guarantee thresholds constitute the centrepiece of the Commission's philosophy for the reform of the CAP.

Guarantee thresholds can be applied by different producers according to the product concerned. For example, thresholds can be applied by:

- (a) lowering the increase in the target price or intervention price if production exceeds a global quantum;
- (b) limiting the aids paid under the market regulation to a global quantum;
- (c) participation of producers, by means of a levy, in the cost of disposing additional production;
- (d) quotas at national level, or at the level of the enterprise.

All these various approaches have in fact been used, in differing degrees, in the context of the existing market organisations. For

example, the approach to (a) was followed in the decisions concerning the common prices for cereals and milk for 1983/84; approach (b) exists in the market organisation for cotton (and has been proposed for dried raisins); the coresponsibility levy introduced for milk in 1977 goes in the direction of (c); and quotas on the model of (d) have existed for sugar since the inception of the market organisation. However, these proposals for a system of supply management have had only limited success in the past and it is not clear that the agreement of the Council of Ministers would be forthcoming for a really effective system that would resolve the present imbalance on the markets for the major European farm products. The likely outcome of qualified agreement could stem the growth of this problem without really resolving it.

### 12.5 Guidelines for the Principal Sectors

In order that the agricultural policy be brought more into line with the market conditions prevailing in each product sector, the Commission has proposed that expenditure be streamlined in such a way that the available financial resources are concentrated on the areas where there is the greatest need, where the interest of Community action is most clearly demonstrated and where budgetary intervention can be most cost-effective.

The economic context of each market organisation for which adaptations are required has been examined; this has taken account of all market organisations with a share of more than 2.0 per cent of the expenditure of the agricultural budget (Milk, Cereals and Rice, Beef, Sheepmeat, Fruit and Vegetables, Oilseeds, Olive Oil, Tobacco and Wine).

#### 12.5.1 Milk.

Milk production presents the most urgent problem. In this sector the trend of annual increase of milk deliveries of about 2.5 per cent in the period 1973-1981, has accelerated to about 3.5 per cent in 1982 and 1983. Meanwhile domestic consumption of milk products in all forms, which showed an annual increase of the order of 0.5 per cent in the 1970s, is now tending to stagnate though there is some change in the product mix. The milk sector is different from other agricultural sectors because of the unremitting and even accelerating divergence of the trends of production and consumption. The volume of milk produced in the Community now exceeds all realistic possibilities for additional disposal, even at rates of subsidy which are themselves no longer acceptable for the Community taxpayer.

The market imbalance was already very serious when the principle of a guarantee threshold was first introduced in 1982 and has deteriorated further since then. World market prospects indicate that further significant increases in the Community's exports are no longer possible. The cost of subsidized disposal on the Community's own market has reached very high levels indeed. The Community is therefore faced with the need for urgent and radical action to correct the situation.

It is quite clear that the price decisions taken over the last 10 years have done little to redress the market imbalance. Although the guarantee threshold has been applied in such a way as to limit severely the 1983/84 milk price increase, this did not have any significant effect so far in restraining production. Nor are the 'ordinary' price decisions the only factors affecting prices, as changes in 'green' exchange rates can give substantial price increases in national currencies when there are only small 'ordinary' price increases. The production threshold fixed for 1983 was exceeded by at least 6 per cent. It has been estimated that, in order to offset the additional expenditure likely to arise from the guarantee threshold being exceeded, the milk price for 1984/85 would have to be cut by as much as 12 per cent. A measure of this kind would evidently have grave and immediate effects on the incomes of producers yet at the same time there would be some delay before the full effect on production was achieved.

One alternative that has been proposed is an increase in the existing co-responsibility levy in the milk sector (currently applied at the rate of 2 per cent) but differentiated according to the volume produced so as to alleviate the effect on the incomes of small producers. This measure has, however, been rejected as a solution to the problem because to be financially effective it would involve a differentiation so great as to result in inequalities between Member States and thus run into severe political difficulties. This does not rule out some adjustment in the co-responsibility levy as a part of any revision of the support price for milk.

The Commission therefore proposed that in future the principle of the guarantee threshold in this sector should be implemented through a quota system accompanied by a restrictive price policy. A reference quantity (quota) would be established for each dairy, based on deliveries in 1981. All deliveries in excess of this quantity would be subject to a supplementary levy, calculated in such a way as to cover the full cost of disposal of the additional milk. The dairies in turn would apply the charge to producers. The charge would be so large as to leave the producers with little or no income from milk delivered above their quota. The Council, in its 1984/5 agricultural price decisions broadly accepted these proposals subject to an extra 1 m tonne quota for 1984/5 and for additional quantities for Ireland, Italy and Luxembourg.

Such a measure should stabilize milk deliveries. It would have a rapid effect in discouraging additional production; if production did increase the levy would give sufficient income to cover the cost of disposing of milk in excess of the threshold. At the same time the levy will be so large that no rational farm production system would expand beyond its quota level.

There is considerable concern that increasing output through purchased imported concentrated animal feed is leading to the development of 'milk factories' where the connection with the land is becoming less and less important. The Commission proposed that a special levy on milk from intensive farms be introduced for those which deliver more than 15,000 kg of milk per ha of forage, but this has not been accepted by the Council of Ministers.



The problems in the milk sector have been aggravated by the availability of intervention as a more or less permanent outlet for production. The Commission has proposed that intervention be suspended for skimmed milk powder during the winter months, but even this very limited step towards restraining the volumes being put into store was not accepted by the Council.

The present cost of disposing of some of the quantities of surplus butter on the Community's internal market through general consumer subsidies is high because the price elasticity of butter is such that the volume of extra butter consumed as a result of the subsidy (paid on all butter consumed) is relatively small. The Commission has taken the view that the cost does not seem to be fully justified and it is the consumer, in his capacity as taxpayer, who finally has to bear the cost. It has therefore proposed the elimination of this special subsidy for butter consumption. This would result in some limited loss of butter sales but the Commission has suggested that compensating increases in disposal of milk fat can be obtained by more cost efficient measures, including an increase in the fat content of whole milk for human consumption. In practice, the butter subsidy from Community funds has been cut back, not eliminated altogether.

The problem in the milk sector is not just to restrain the present growth in output, but to cut production back to the level which current consumption (including subsidised disposal on both internal and external markets) would justify. This requires a reduction of over 6 per cent of the 1983 output level. This is equivalent to almost 6m tonnes of milk, which for all interests and purposes would give a zero or negative return to the farmers having regard to the net earnings on the marginal sales outlets. The consequences of policies that will actually achieve this position, both on farmers' incomes and the position of the dairy processors has not been made clear, but these could well have serious repercussions over the next few years.

#### 12.5.2 Sheepmeat.

The principal expenditure on sheep production, where a market organisation was introduced in 1980, arises from the payment of premiums to producers. The Community's level of self-sufficiency in sheepmeat is relatively low. To curtail further increases in expenditure, the Commission has proposed that the system of premiums should be modified without, however, radically changing the market conditions. The main modification proposed was to limit the payment of the variable premium in the United Kingdom to 25 per cent of the basic price. This should result in an increase in market prices, which would hopefully be sufficient to maintain producers' revenue. In addition changes in the ewe premium including the withdrawal of advance payments have also been put forward. The Council accepted the proposal to withdraw the advance payments of the ewe premium except in the hill and mountain areas, where an advance payment of 30 per cent of the premium will be made, and the method of calculation of the premium will be revised, otherwise the system of market support for the sheepmeat sector will remain basically unaltered.

The Commission has also proposed negotiations on a reduction in

the quantities of sheepmeat imported in the framework of the voluntary restraint arrangements with third countries and, at the same time, the introduction of a minimum import price. Such an adaptation could lead to a reduction of Community expenditure in this sector as a result of the strengthening of the marketplace, while in theory maintaining the receipts enjoyed on the EC market by third country suppliers. The effects on consumption have not been articulated, but the UK market in particular could be seriously affected by higher sheepmeat prices.

The Community has not faced up to the prospect of a rapid increase in supply of sheepmeat from domestic production and a reduction of consumption, which the present policies will generate. The present net import situation is generally regarded as a justification for expansionist production policies while the need to sustain consumption has been given much less consideration.

### 12.5.3 Beef.

Although the Community's beef production tends to follow a cyclical pattern, the long-term trend is for an increase of between 0.5 per cent and 1 per cent a year; meanwhile consumption of beef is expected to stagnate because of competition from lower-priced meats and the limited growth in purchasing power of consumers. The Community has passed during the last decade from a situation of deficit to a position as a net exporter of beef. The Commission's proposals for avoiding market surpluses in the future include a further restriction on the availability of intervention buying and the termination of calf premiums paid in Italy, Ireland and Greece and the special variable premium system operated in the U.K. These proposals were only partially accepted by the Council and the present system will remain in operation though on a considerably reduced scale. These measures would help the budget problem but would do little to restore greater market equilibrium. There is, however, concern at the current situation on the Community beef market; the most likely solution could come from a restrictive dairy policy that would result in a significant reduction in the Community's total cow herd.

### 12.5.4 Cereals and other products.

A guarantee threshold was first fixed for cereals for 1982/83 at the level of 119.5m tonnes. The Council of Ministers decided that if average production of cereals (excluding Durum wheat) in the three most recent seasons exceeded the threshold, the intervention price would be cut. However, it also decided that if imports of cereal substitutes exceeded 15m tonnes, the guarantee threshold would be increased accordingly. Since the threshold for 1982/83 was exceeded, the increase in the intervention price for 1983/84 was cut by 1 per cent. In practice a 1 per cent cut in the intervention price is of very little consequence in the prices paid to farmers for cereals.

The Commission has, therefore, proposed that the objective in its future proposals for common prices for cereals should be the reduction of the gap between EC prices and those applied by its main competitors. A prerequisite for implementing the guarantee threshold in future is a

rapid and effective limitation of imports of substitutes. The Community has already limited the import of manioc and bran; and the import of molasses is subject to a threshold price fixed in the framework of the sugar market organisation. As regards corn gluten feed and citrus pellets, it is proposed that limitation should be achieved by negotiations under GATT, but this will certainly run into stiff opposition from the U.S. as well as from some member countries within the Community.

Changes designed to cut the cost of present policies are also under consideration for other farm products. In the case of fruit and vegetables, a restrictive price policy is advocated by the Commission to avoid the development of excessive intervention, withdrawals and other expenditure. For oilseeds the system of guarantee thresholds has led to some reduction in the target prices; this system will be continued to limit the level of budgetary expenditure in the support payments for olive oil.

The development of the market in oils and fats in the Community is giving rise to increasing concern. Supplies imported free of duty have added to the imbalance in the market situation as between olive oil and other vegetable oils on the one hand and butter and other fats on the other. This has had two consequences for the Common Agricultural Policy:

- (a) the consumption of butter and olive oil has fallen;
- (b) it has pushed up budgetary costs in the oils and fats sector.

In order to restore balance on the market the Community is already operating a coresponsibility levy on milk and a guarantee threshold for milk and oilseeds. The Commission has proposed to introduce an internal tax on the consumption of oils and fats other than butter, irrespective of their origin. Again this has been strongly opposed by the U.S. which has a substantial trade in these products and also by member States with a high consumption of oils and fats other than butter.

#### 12.6 Agri-Monetary Problems

For many years, the Commission has pressed for a system of automatic dismantling of the special exchange rate levels for agricultural products (the 'green' rates) and the associated monetary compensatory amounts that are charged on agricultural trade by individual Member States. The negative MCAs that arise from a devaluation of the market rates of the currency of any member State can be dismantled by bringing the green rate of that currency back into line with its market rate, with a corresponding increase in the support prices for farm products in the country in question. In spite of the effect of this on consumer food prices, it has not proved difficult to bring green and market rates into line in the case of devaluing currencies. However, in the case of revaluing currencies, where bringing green rates up to the new market rates involves a reduction in farm support prices, the problems of alignment have in the past proved virtually insoluble.

The system of an automatic phasing out of MCAs proposed by the Commission would create great difficulties in countries with positive MCAs even though arrangements agreed at the 1984/5 Agricultural Prices meetings to create an artificial "green ECU" have partially overcome the problem but at very substantial costs, particularly when these are applied to a full financial year. The fact that the resources necessary to meet these costs have not yet been agreed is an example of the procedures of the Community, in which new expenditures are agreed that are way in excess of the available financial resources, and the financing problem is left to be solved subsequently.

#### 12.7 Complementary Measures

The present crisis in the financial situation has given the Commission the opportunity to press for the solution of other long standing problems. One of the special features of the administration of the agricultural regulations is that it is undertaken by member States, who in many cases have a strong incentive to be less than diligent in the proper and effective use of market regulations. Opportunities also exist for deliberate fraud and unlawful expenditure to which the complex managed market system gives rise. The Commission has therefore pressed the member States to take steps to achieve greater rigour in spending the Community's money. It is also pressing for full harmonisation in veterinary plant health and other areas to reduce the current proliferation of barriers to trade within the Community. Whether these proposals will have any effective result is not at all certain; some of them reflect long standing efforts by the Commission that so far have produced few results.

#### 12.8 Financial and Other Economic Consequences

The aim of the Commission, so far as financial management of the CAP is concerned, is that the rate of growth in agricultural expenditure should be kept below that of the total available financial resources. The Commission has estimated that their present proposals should cut agricultural expenditure by 2,500 m ECUs in 1984/85, rising to 3,200 m ECUs in 1986/87, below what it otherwise would be. However, the outcome of the Council meeting on prices and related matters has totally reversed this projection; expenditure in 1984 on the CAP is projected to rise by 2.13 b ECU and the consequences of these decisions in 1985 will raise this figure still further.

The reform of the CAP should be seen in the general context of the general economic situation in the Community and in the narrower context of the problems of the agricultural sector itself. So far as the economic position of the Community is concerned the current recovery is still quite modest and even uncertain. This is mainly due to the fact that, despite the relative reduction in oil prices since 1982, there has been no change in two other external factors which have contributed to the creation of the present crisis in the Community, and to its unusual duration: that is, the exceptionally high rates of interest in real terms in the United States and the weakness of world demand and trade. In these circumstances and in view of the shaky basis of the first signs of recovery in the Community, it is necessary to be

cautious as regards forecasts of the economic prospects, at least in the short term. In 1983 the gross domestic product of the Community increased only by 0.5 per cent in volume, only very slightly better than in 1982. In fact 1983 saw a reduction in the volume of gross domestic product in several Member States and, in certain cases, this was for the second year in succession. As for the prospects for 1984, despite the fact that some degree of economic recovery is expected in almost all Member States, the gross domestic product of the Community is projected to increase by only 1.5 per cent in volume, which is half the average rate of increase experienced in the period 1971-80. Nor are the prospects for employment more encouraging. Although there has been a slowing-down in the rate of increase of unemployment in 1983, the number of jobless could still increase over that in 1983, when the unemployment rate in the Community was 10.4 per cent.

One of the most worrying aspects of the present recession is the decline in world demand and thus in international trade in recent years. World trade in goods, which increased in volume at an annual rate of 4-5 per cent in 1977-80, remained stationary in 1981 and declined by 2 per cent in 1982. In the short-term, a gradual increase in internal demand in Europe and the United States should result in an acceleration of world trade in 1984, but two factors will continue to limit the expansion of world trade: the exceptionally high level of debt of many developing countries and the fall in income which is affecting many of the oil-producing countries.

Thus the improvement in the general economic situation which so facilitated the evolution of the CAP in its early years no longer holds out the same prospect in terms of alternative employment, higher food consumption and additional financial resources. The consequences of this are that the factors which contributed to the support of farmers' incomes in the European Community over the past two decades are likely to be much less effective in the years immediately ahead. Apart from the political problems to which this will undoubtedly give rise, it will greatly strengthen the demands for further protection against supplies of farm products from outside the Community. This will affect some products more sharply than others but will have a series of repercussions throughout the agricultural sector.

As the various measures for restricting output began to take full effect in one sector - e.g. milk, there will be a movement of farm resources into sectors where such severe restrictive policies are not applied e.g. sheepmeat. This could well lead to an even more rapid expansion of production in these sectors, to a point where they in turn become subject to quotas or similar output reducing measures. This will, however, only intensify the farm income problem and in turn the pressure for relief from the economic difficulties of farmers and their families.

### 12.9 Basis of Future Policy

It is evident that the adaptation of the CAP in a long-term framework will require difficult decisions on the part of the Community institutions and a readiness by all parties to make concessions and sacrifices. There is little evidence so far of any readiness to make

real sacrifice. Such a policy would require transfers in costs and benefits between the different social and political groups concerned; taxpayers, farmers, consumers, processors, member States and third countries. To make adjustments of this kind is not a technical matter; it is a question of political choice for the CAP is essentially a political instrument. To rationalise and streamline a policy for the agriculture of ten Member States, after more than 20 years of development, requires imagination and great political will. A number of the major proposals for change hit various interest groups very hard and the political and economic position of Governments in the Community make it very difficult to get agreement.

It is evident however, that the underlying philosophy of the long and detailed series of proposals has been to save money. It is the budgetary situation which has brought the reform of all CAP to a head, for all the repeated assertions by the Commission that it is the problems of market imbalance which has brought on the present crisis. Recently the President of the Commission reminded the European Parliament that the Commission had warned the Council as far back as 1980 that the Common Agricultural Policy would become unmanageable unless prices were radically realigned and some limitation placed on the guarantees given to producers of surpluses, which today cannot even be given away. He went on to say that because of the illusionary respite provided by the favourable trend of world prices in 1981/82 precious time was lost during which the imbalance on the agricultural markets grew even worse. Unresolved problems piled up making the necessary decisions even more difficult. This call for a "radical realignment" of farm prices is not likely to be heeded; the steps in this direction will not be at all "radical" but simply some extension of the prudent price policy that the Commission has been advocating for more than five years now.

What is not at all clear in the present debate on the reform of the CAP is any underlying economic, rather than purely financial philosophy on future policy. There is now an urgent need for a positive approach to the evolution of the CAP, if the policy is not to decline into a series of ad hoc measures. The Commission has rightly said that a cost cutting exercise, conducted without regard to the social and economic consequences, would render no service to the development of the European Community and that their aim is to rationalise the CAP. At the same time no coherent strategy for the future has been established. The view of the Commission is that the production of surpluses must be contained at all costs since their disposal jeopardises the guarantees which the Common Agricultural Policy can and must provide for other more marketable products. This is a quite inadequate basis for the future strategy for the development of the CAP.

Rationalising the CAP must involve a basic set of new objectives that are more than just a set of pious aspirations. The operation of the first decade of the CAP involved a substantial measure of integration of the agricultural sector within the rest of the economy of the member States and an increasing food output, which was widely regarded as a welcome phenomena in an uncertain world. From 1973 onwards, a greater emphasis was given to the income situation of farmers and the need to achieve a greater measure of parity between

farmers' incomes and those in other occupations.

The Community now needs to develop a set of positive and realistic guidelines for the future of its CAP - to provide European agriculture with new horizons, going beyond long overdue reform. This is likely to take some time to evolve. The pressures of modern technology have entirely overshadowed the improvements that are being achieved by structural change. The development of a "dynamic export policy" has come up hard against the realities of the current world market situation for farm products. The growing problems in other sectors of the economy particularly unemployment, and the consequential growth in problems of urban societies, has lessened the degree of concern for the plight of the farmer, even for that of the farmers on small non-viable holdings. While the need for reform of the CAP has been brought to a head by the budgetary situation, a solution to that situation would not of itself solve the underlying problems. The 1980s are a totally different world for agricultural policy than that of the 60s and the 70s. Unfortunately the most likely prospect is that the present restrictive price policy, the further development of more stringent production controls and the general tightening of the detailed administration of the CAP will be continued for some years to come. Whether, on the face of these essentially negative policies, a more constructive policy can be found is yet to be seen. There are no immediate prospects of such a solution in sight at the present time.

## CHAPTER 13

### NEW ZEALAND'S AGRICULTURE AND THE CAP

#### 13.1 Role of Agriculture in the New Zealand Economy

Among the advanced economies of the world, New Zealand is unique in its high degree of dependence for its export earnings on a small number of agricultural products - in particular products from the ewe and the cow. In a world of surplus agricultural products on commercial markets and in the face of large export subsidies on supplies from less efficient agricultures, New Zealand's economic situation in recent years has been one of increasing difficulty. The entry of the U.K. to the European Community in 1973 coincided with a fall in real incomes per head in New Zealand of 11.5 per cent over the period 1973-77 (this was the biggest drop in any OECD country). GDP growth since the mid seventies has averaged no more than 1 per cent annually. The reorientation of export markets for the traditional meat and dairy products has met with great difficulties, created in considerable measure by the trading policies of other advanced economies, notably the European Community.

While it has been said that the agricultural sector plays only a minor and fluctuating role in New Zealand's GDP, looked at in a wider context the agricultural sector has shown a remarkable capacity to maintain its contribution to the Gross Domestic Product over the past decade. This is in contrast to the agricultural sectors of most other developed economies, which have contributed a smaller and smaller proportion to GDP over these years. This decline can be seen for example in the case of the European Community where the percentage contribution of agriculture to the Community's GDP has fallen by one third since 1973; in the case of member States dependent on agriculture, such as France and Ireland, the decline has been even greater. The New Zealand situation moreover has undoubtedly been influenced by the problems in 1974/75, a very poor year for agriculture due to the collapse in commodity prices and by the rapid growth in total real GDP in the three preceding years.

#### 13.2 Resources Used in Agriculture and Their Earnings

The contribution of agriculture to GDP in any economy is largely determined by four factors - the volume and price of farm output and the volume and price of the 'non-factor' inputs used in the production of that output. During the years 1973/4 to 1982/3, gross agricultural output in New Zealand has grown in nominal terms by over 153 per cent; the increase in the prices paid to farmers was over 166 per cent; this would imply a decline in the volume of output by just over 9 per cent. At the same time, however, the volume of inputs, which grew by 195 per cent in nominal terms, was subject to even sharper increases in price of over 248 per cent so that the volume of inputs declined by 15 per cent - a faster rate than that of output. These changes in the volume



of output and inputs imply a growth in the agricultural gross product in real terms, in spite of some fall in the gross product of the agricultural sector as a proportion of total GDP (this decline in the contribution could arise from the changes in the terms of trade in the agricultural sector which has taken place, even if the gross product of agriculture itself rose in real terms). It would appear that farmers have made strong efforts to sustain their incomes by reducing the volume of purchased inputs, and while there has been some decline in the volume of output, the improvement in the efficiency (in terms of purchased inputs per unit of output) has to some extent mitigated the effects of the adverse movement in the terms of trade of agriculture, which declined by over 30 per cent over these years.

Agriculture provides employment for 9.7 per cent of the total New Zealand work force (1981 Census), compared with some 7.6 per cent in the European Community. The relationship between the proportion of population employed in agriculture and its contribution to GDP at 9.7 per cent and 8.8 per cent respectively in New Zealand is much better than the situation in the EC, where the figures in 1981 were some 7.6 per cent and 3.6 per cent respectively. This is due in considerable measure to the far more favourable ratio of land to labour in New Zealand and the consequential higher level of labour productivity than in the European Community.

This much better land/labour ratio in New Zealand than in the EC can be seen in the average size of farm - 293 ha and 18 ha respectively. While the figure for New Zealand includes a higher proportion of hill and other disadvantaged land, the difference in average farm size, even allowing for this factor, is still very large indeed. The total area under agriculture and the number of holdings in New Zealand has been growing slowly over recent years, while the trend in the agricultural area, and more so in the number of farms, has been downwards in the Community. This better resource combination and the consequential higher labour productivity in New Zealand has led to higher incomes per farm than in the EC.

### 13.3 Farm Incomes in New Zealand and the European Community

While it is a dangerous exercise to make direct comparisons of farm incomes between countries, the available data shows that average net farm incomes for dairying in the European Community were around 11,000 NZ\$ in 1982 compared with 20,000 NZ\$ in New Zealand, while average net farm incomes from cattle and sheep farming in the EC were 9,300 NZ\$, compared with 22,000 NZ\$ from sheep farming in New Zealand. Mixed cropping farms in the EC had farm incomes of less than 6,000 NZ\$ compared with 13,750 NZ\$ from equivalent New Zealand farms. The EC figures probably contain a much greater degree of variation within these averages - for there are considerable differences between the averages for individual member States. There is, therefore, likely to be a proportion of EC farmers with incomes around the New Zealand level. At the same time there is, by definition, a large number of European farmers with incomes much below the equivalent New Zealand incomes and it is the problems of these farmers which have loomed large in the agricultural policy decisions of the EC.

The decline in real incomes of New Zealand farmers since 1977/8 has involved a period of some stability, apart from the very good out-turn in 1979/80. The most recent published data for farm incomes as a whole, in terms of changes in the Agricultural Operating Surplus, do not give an adequate indication of the changes in net farm income, as the Operating Surplus does not take account of the level of interest charges paid by farmers or of the fluctuating price supports paid to farmers by the producer boards.

TABLE 2

Farm Incomes in New Zealand 1977/78 to 1981/82

	1977/78	1978/79	1979/80	1980/81	1981/82
Agricultural operating surplus (m \$)	866	965	1,534	1,444	1,662
G.D.P. Price Index (1977/78 = 1,000)	1,000	1,131	1,332	1,528	1,755
Ag. Op. Surplus in real terms (1977/78 = 1,000)	1,000	985	1,330	1,091	1,093

Source: Department of Statistics Monthly Abstract of Statistics February 1984 and Information Service 29 March 1984.

The very severe fall in incomes of sheep farmers over the period 1980-84 has been the primary cause of the decline in farm incomes generally as dairy incomes have been less affected by the very difficult external trading situation which New Zealand farmers have faced in recent years. More recent data are available for sheep and beef farms and for factory supply dairy farms, which are set out in Table 3.

TABLE 3

Incomes On Sheep and Beef Factory Supply Dairy  
Farms 1979-83

	1979	1980	1981	1982	1983	1984
Net Income per Sheep Farm (\$)	19,494	24,772	21,698	21,401	23,500	19,800
Index in real terms (1975/6 = 1,000)	982	1,066	806	686	666	534
Net Income per Dairy Farm (\$)	13,341	13,742	14,188	18,190	20,900	18,900
Index in real terms (1975/6 = 1,000)	943	839	797	826	823	711

Source: M.A.F., New Zealand Agricultural Statistics 1983 and 1984

In these circumstances, the reversal of growth in farm investment in real terms over recent years is readily understandable. Total capital expenditure fell in nominal terms by some 9.4 per cent (and by over 17 per cent in real terms) in 1982/83 over the previous year. This decline, which has come after a period of steady growth, has affected all the main categories of investment, and is likely to affect the capacity of New Zealand to maintain its production levels, particularly as the decline is expected to continue into 1983/84.

#### 13.4 Agricultural Trade Situation

The entry of the UK into the EC has been generally regarded as the cause of the severe international trade problems that New Zealand agriculture has faced during the past decade and the principal cause of New Zealand's external terms of trade being 25 per cent lower in the years since 1975 than they were in the previous decade. In these circumstances, it is remarkable that the proportion of total agricultural output which is exported has not only remained high, but has apparently been increasing in recent years. The value of total receipts from the export of agricultural products as a proportion of agricultural output has been well over 90 per cent for the years 1981-83, compared with 81 per cent in 1980. This comparison is not entirely a valid one because the values of exports are at f.o.b. prices and those of output are at farm gate prices, but the relationship between the two sets of values is nevertheless unusual. The contribution of agricultural exports to total exports has been slowly declining, from just over 71 per cent in 1980 to 69.3 per cent in 1983, while the ability to provide export earnings from

alternative sources has grown correspondingly slowly. It is interesting to compare this export performance of around 70 per cent from the agriculture sector with that of the EC, where agricultural exports provide less than 10 per cent of the total export earnings of the Community as a whole (i.e. excluding the intra Community trade). This EC figure has also been declining slowly, in spite of the substantial export support payments from the Community budget.

New Zealand exports of meat, wool and dairy products to the EC provide a quarter of total export earnings. Exports of dairy products have, however, been seriously affected by the operation of the CAP. In the case of sheepmeat the voluntary restraint agreement, with its guarantee of access for 234,000 tonnes per annum, has been regarded by the EC authorities as having "effectively settled" the preoccupation of New Zealand with this issue. Whether this will in fact be the case seems extremely doubtful, in view of the Commission's new proposals to review the operation of these arrangements with third countries as part of the current reform of the CAP. As set out earlier, the effect of the common organisation of the sheepmeat market under the CAP has been to give substantial incentives to expansion of production in the Community, particularly in the U.K. and Ireland. This had had the effect of increasing pressure of supplies in the U.K. market, with a consequential sharp rise in support expenditure from the Community budget. Whether this growth of output tends to displace New Zealand sales on the UK market directly, or has the effect of competing on world markets for sheepmeat, is of lesser significance than the more immediate point that the effects of the common organisation of the market for sheepmeat in the EC has a real impact on the incomes of New Zealand sheep farmers.

### 13.5 Trade Situation for Sheepmeat and Dairy Products

Sheep production is one of the few areas in the agricultural sector of the Community where the present relatively low degree of self-sufficiency provides an opportunity for expansion in Community output. This expansion is now being generated not only by the direct effect of various very large support payments in recent years to sheep producers in the Community but also by the policies towards other farm enterprises, where pressure is directed towards reducing output and therefore to shifting resources to alternative activities as a means of maintaining farm incomes.

The farm sector where this policy of output limitation and even reduction is most important is dairying. The growth of dairy output and the ineffectiveness of "producer coresponsibility" policies as a means of bringing a reasonable balance between supply and commercial demand has led to direct action in order to limit future dairy output.

Consideration by the EC authorities of access to the Community market for dairy products, notably butter, from New Zealand has meant that the Commission has "had to take into account both the Community's surpluses in this sector and also New Zealand's dependence on adequate outlets for its butter" in the belief that "to close the community's frontiers to New Zealand dairy imports could not solve the problem of the Ten's dairy surpluses", and "aware of New Zealand's dependence on

outlets for its butter on the Community Market, the European Commission has regularly sought a more lasting and balanced solution taking into account the preoccupations of Community producers and consumers alike". However, the "balanced solution" sought by the Commission is subject to the decisions taken by the Council of Ministers of Agriculture, where incomes for their own producers are at the forefront of their preoccupations and concern for New Zealand producers is inevitably relegated to a less immediate position.

Prior to entry of the U.K. to the EC in 1973, imports of butter from New Zealand were some 170,000 tonnes, together with 70,000 tonnes of cheese and smaller amounts of milk powders and casein. The Treaty of Accession of UK to the Community provided for continued access for butter from New Zealand, on a declining scale to 1977, and thereafter subject to an arrangement by the Council of Ministers, and for access on a decreasing scale for cheese. Subsequently, in 1975, the Community's Heads of Government declared that the Community after 1977 "should not deprive New Zealand of outlets which are essential for it". The problems on the U.K. butter market have arisen from two major sources - the extraordinary growth of butter production in the U.K. itself and the sharp fall in consumption in that country. UK output has grown from a level of between 50,000 and 100,000 tonnes in the years 1973-76 to 250,000 tonnes by 1983. At the same time the level of U.K. consumption has declined from between 450,000 and 500,000 tonnes in 1973-76 to less than 300,000 tonnes in 1983. Thus while the UK was producing only 10 per cent to 20 per cent of its requirements of butter in the early to mid '70s, by 1983 it was producing equivalent to 85 per cent. Both the growth in output and the fall in consumption of butter in the UK would have occurred if the UK had remained outside the EC, but membership of the Community almost certainly exacerbated this underlying trend.

The UK butter imports in the 1973-76 period involved purchases of butter from other Community countries of between 200,000 and 350,000 tonnes. This has now fallen to 85,000 tonnes. Thus the changes on the U.K. butter market have been most evident in the fall in supplies from other member States; this has been even more evident than the consequences for New Zealand. Of course, the other member States have had the benefit of intervention aids from the EC budget (to which they all contribute) to support their surpluses of dairy products and are thus under less direct pressure than is the New Zealand economy, whereas the problems on the U.K. market for dairy products translate into immediate problems for the New Zealand dairy farmer and the national exchequer.

### 13.6 Effects of the CAP on New Zealand's Agriculture

It is evident that the operation of the Common Agricultural Policy on the economy of New Zealand, and in particular in the agricultural sector are extremely serious. The CAP is not however, of itself, entirely responsible for the decline in the sales of New Zealand dairy products on the U.K. market. For any realistic estimate of the effects of the CAP itself, it would be necessary to estimate the likely trend in U.K. purchases of New Zealand butter and other dairy products in the absence of EC membership. This would involve the likely evolution

of UK agricultural policy, particularly in relation to the level of UK production of dairy products, the pricing policy on the UK market and the operation of any system of restricted access to the UK market. Since the analysis of the alternative possible developments on the UK market over the past decade would be of a largely academic nature, it is not proposed to explore this in any detail. Suffice to say that, while it is quite evident that the policies followed by the EC have contributed to the economic difficulties of New Zealand's dairy sector, these problems cannot be entirely laid at the door of that policy. A continuation of the policies being followed by the UK Government prior to 1973 would have led to a considerable reduction in access for New Zealand dairy exports to the UK markets and to some of the problems now being experienced by New Zealand dairy farmers.

In the case of the sheepmeat market, similar underlying factors are also relevant, though these would not have had the same impact as those in the dairy sector. The trend in consumption of lamb might well have been lower in the absence of the effects of the CAP in raising the price of beef on the UK market. At the same time the growth in continental European markets for sheepmeat supplies, from both the UK and Ireland, has had some effect in reducing supplies from producers in these countries on the UK market itself. Furthermore, the benefits of the variable levy on returns to UK producers has enabled the government to regard the low prices of lamb on the UK market with considerable equanimity. If the effects of these low prices had impacted directly on the incomes of their sheep producers, the UK government would have been obliged to take some more direct support measures. It is likely that, in the face of greater supplies of sheepmeat on the UK market, the government would have instituted arrangements that would have limited access to the UK market; these might well have been at least as restrictive as the current voluntary restraint agreements of third countries with the European Community.

The effect of the current EC sheepmeat policy in generating a substantial increase in supplies is minimised, so far as New Zealand is concerned, by the undertaking in GATT from the Community not to impose import restrictions greater than a 20 per cent tariff and to provide an acceptable level of compensation to external suppliers in the event of any more restrictive regime being implemented. This limitation in the sheepmeat sector has led to the view, particularly from the French Government, that the question of access for New Zealand's butter should be linked to agreement on a more restrictive policy in regard to sheepmeat.

### 13.7 Current EC Proposals for the CAP and New Zealand Agriculture

The CAP now faces a period when the major forms of support (first through increasing domestic prices behind a tariff wall and then through increasing budget expenditure on export surpluses in order to support farm incomes as the Community reached self sufficiency in most agricultural products) have become less and less effective.

Faced with the immediate problem of the budget, the basic need of the Community is to save expenditure wherever this can be done. The impact of this on the incomes of European farmers is immediate and is

giving rise to a strong reaction by those producers most affected. One of these reactions is a demand for more stringent barriers to the entry of farm products from outside the Community. The countries which are affected by the CAP import regime can be categorised into four separate groups:

- (1) third world countries, particularly those which have some degree of commitment from the European Community directly under the Lomé agreement, and more generally from the recognition in Europe of the need to provide the opportunities for trade with these countries as a means of helping their economic development.
- (2) the U.S., which is a major supplier to the Community and which has the economic and political strength to negotiate a solution to its agricultural trade problems.
- (3) countries, particularly those neighbouring the Community in Europe, with whom the member states are most anxious to preserve good relations, primarily for political reasons.
- (4) the remaining countries, including New Zealand, Canada, Australia, which have well developed economies and for which there is only limited political will in the EC to resolve the trading problems which have arisen.

There is no doubt that a measure of general goodwill towards these latter countries, and particularly to a small one like New Zealand, exists within the Community. How much this goodwill is worth in the face of the economic and political problems now facing EC Ministers for Agriculture is problematical. Moreover the claims of the first three groups set out above are likely to be given greater priority than those in the fourth group; it may well be that much of the scope for trade negotiation would be largely used up by the Community in meeting the needs of these countries. This is especially the case of the US whose strength in negotiations gives it considerable opportunities to overcome the protectionist measures of the CAP.

Furthermore, negotiations with New Zealand on access to the EC market for meat and dairy products would only cover part of the conflict arising from the operation of the CAP. The effects on New Zealand producers of the expansion of European farm exports to non-EC markets are equally serious. While these have been recognised in the efforts made by the Community and New Zealand to work together to stabilise the international dairy trade, these efforts are subject in the last resort on the EC side to those political considerations which influence decisions in the Council of Ministers. The political considerations take greater precedence at times when other pressures on the CAP mean that European farmers face severe reductions in their incomes in real terms.

In the light of the present situation of European agriculture, it is of great importance to the interests of New Zealand that reasonable agreement on trade with the rest of the world should be achieved. In the case of dairy products and sheepmeat the amount of total world production entering international trade is relatively small, and a diversion of a small part of EC output of these products on to the

limited world market can and does have the most serious consequences.

One of the most fundamental questions in the current situation is whether the fall in real prices of farm products (i.e. in the terms of trade of agriculture) will result in a limitation of the upward trend in total agricultural output in the Community. The substantial fall in farm prices in real terms over recent years and the even larger fall in 1984, still leaves little prospects of any significant reversal in the years immediately following. Over the past two decades it is evident that the fall of around 4 per cent in the prices paid to farmers in real terms has not led to any reduction in output, as farm output has continued to grow in the face of these price developments. It is possible however that a much sharper rate of fall in real prices could generate a more conventional supply response, leading to an actual fall in the volume of output, particularly if the price policy was reinforced by more direct policies affecting the level of output of some of the major farm products (and particularly milk output).

Such policies will be bound to have a very severe effect on farm incomes and, coming after the decline of 7 per cent in 1983, a further decline of this magnitude would create a major crisis in the Community. In the face of such a crisis, it is unlikely that the obligations to a small geographically isolated country, 18,000 miles from Europe on the other side of the world, would be to the forefront of the issues on which decisions would be taken. Given that the Commission has warned the Council of Ministers that the problems of the CAP are putting the whole of the Community in peril, the complexity and politically divisive nature of the solutions put forward by the Commission have created a very real crisis in Europe, a crisis that is much more than just a budgetary one.

The three major elements in future Community agricultural policy are:

- (a) the adoption of more extensive and more stringent production constraints,
- (b) the continuation and possible strengthening of the prudent price policy and
- (c) the development of more extensive measures on farm structures.

These policies will not solve the present problem of the CAP, though they are likely to stop the situation deteriorating further and may bring some measure of relief. The extension of production controls will contain the supply of the major farm products but as in some cases, particularly milk, the current supply is substantially greater than the level of disposal on internal and external markets, this constraint may do little towards re-establishing a reasonable balance on the world market for these products. Nothing in the proposal from the Commission, or even less so from the decisions of the Council of Ministers, would indicate direct supply management of such rigour that the present structural surpluses will be entirely eliminated. It would therefore be unrealistic for the New Zealand dairy industry to see any prospects for substantial improvement in its external markets arising from the EC policies in the dairy sector.



The continuation of the prudent price policy, both as a means of limiting the costs to the Community budget and as a route to better supply balance, could be a more effective means of achieving an improvement in the world market situation for the products involved. This is likely to be more the case in the cereals and beef sectors, where the Commission policy of achieving a more competitive European agriculture would seem to have a greater chance of success, than in some of the other major agricultural sectors. The rapid growth of expenditure on sheepmeat over recent years could lead to a more stringent price policy now that the final step in the alignment of prices in the sheepmeat regime has been undertaken. However, the attractiveness of present prices in the lower production cost member states of the Community, particularly the UK and Ireland, should not be underestimated. If production cost increases are effectively contained by successful policies against inflation, then the lack of any significant price increases may not be a major constraint to further expansion in production. This is not therefore a development that is likely to improve significantly the trade position of New Zealand's agriculture, as the UK market may see greater Community supplies, or alternatively, EC exports to non-member countries may expand appreciably.

The third strand of CAP policy in the immediate future is the reform of farm structures. This includes various forms of direct income supplements (for example those currently paid to farmers in the mountain and less favoured areas under Directive 75/268), but these supplements account for only a very small proportion of the total expenditure on the CAP. Even if the Commission's proposals on structures are implemented in full, and the consequential additional budgetary requirements are met from whatever sources may be available, it is doubtful if this is a route to a more market oriented agricultural policy for the Community. In so far as a policy in farm structures involves upgrading small non-viable farm businesses into economically viable operations, this is likely to result in a larger volume of output from the farms concerned and consequently a greater demand on Community funds for farm price supports. It would be entirely unrealistic to envisage any such development leading to a diminution in the demands for higher farm prices, demands which have been and still are led by farm organisations in the Community representing larger farmers just as strongly as smaller ones. Furthermore the present unemployment problems in Europe effectively rule out policies to reduce the numbers of people on the land as a route to raising per capita incomes of those remaining. Certainly an effective farm structures policy can improve the economic and social circumstances of farmers in the poorer regions of Europe, but this is unlikely to reduce any of the pressures for greater protection against imports from third countries or mitigate the demands for higher prices to support larger Community farm production.

There is therefore no apparent reason for forecasting any amelioration of New Zealand's difficulties in the trade in agricultural products with the European Community arising from the current developments in the CAP. Whether the internal difficulties of that policy will eventually lead to a total change in its direction and what effect that might have in New Zealand is impossible to foresee. The economic and political forces holding the Community together are very

strong and the CAP is an essential part of the present basis of the Community. The current budgetary problems could well lead to an increasing demand for protection ("Community preference") as a means of improving the incomes of European farmers; the external trading policies of the EC may become even more responsive to the demands of the large trading powers, particularly the US with the commitment to the less developed countries taking much of whatever scope is left for negotiations on trade in farm products. In these circumstances New Zealand will have to fight to hold on to as much of its export trade as it can, against a much larger Economic Community facing political economic and social problems proportionally every bit as large as those in New Zealand itself.



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