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No799 The Heritage Foundation 214 Massachusetts Avenue N.E. Washington, D.C. 20002 (202) 546-4400

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# THE EUROPEAN COMMUNITY'S COMMON AGRICULTURAL POLICY: CONTINUED PROBLEMS FOR THE U.S.

## INTRODUCTION

As the current round of General Agreement on Tariffs and Trade (GATT) negotiations to open world markets nears its scheduled conclusion this month, the most important unsolved issue concerns trade in agricultural products. The United States would like all barriers to agricultural trade removed, all export subsidies eliminated, and all production subsidies substantially reduced. Opposition to this is led by the twelve-nation European Community (EC). It strongly defends one of the EC's main economic pillars, the Common Agricultural Policy or CAP. This is often described as a key symbol of European unity and integration – the glue that holds together the diverse nationalistic tendencies of the various member countries.

The CAP consists of high tariffs on agricultural commodities imported by the EC and subsidies for production and export of farm goods produced by EC nations. The CAP has made the EC self-sufficient in food and propelled it into the top ranks of world agricultural producers and exporters. At the same time, the cost of the CAP has brought the EC close to bankruptcy, sparked a trans-Atlantic trade war, and led to major distortions in patterns of global agricultural trade.

**Well Entrenched.** The current GATT round, along with budget crises in many nations, global environmental concerns, and political developments, are all exerting pressures for changes in the CAP. Yet as Europe moves toward further economic integration in 1992, the CAP appears well entrenched. Much like Depression-era farm policies in the U.S., European farm policies have spawned a huge bureaucracy and a powerful, well-organized coalition of interest groups dedicated to preserving the special benefits which emanate from the CAP.

Further, the complicated mechanisms that have evolved to translate CAP rules into national agricultural policies make reform even more difficult.

**Reforms Difficult.** The GATT round early on promised significant reform in world agricultural trade, and with it changes in the CAP. But these changes now appear less likely since the prospect of a meaningful GATT agreement has dimmed. Many European politicians are determined to preserve the CAP, seeing it as a way to keep farmers on the land. This has serious implications for American farmers.

The CAP excludes many American exports and floods the world market with cheap, subsidized commodities. Whatever the outcome of the GATT round, EC agriculture will remain an important concern for U.S. trade officials. If an agreement is reached, it will be necessary to insure the EC complies and does not substitute other forms of trade protection or production support. If the GATT round fails, the U.S. will have to develop a new strategy to deal with the CAP.

## ORIGINS OF THE COMMON AGRICULTURAL POLICY

The European Community, originally called the European Economic Community (or EEC), now simply known as the EC, was created in 1957 by Belgium, France, Italy, Luxembourg, the Netherlands, and West Germany. Over the years, Britain, Denmark, Greece, Ireland, Portugal, and Spain joined, bringing the membership to twelve. The original purpose of the Community was to strengthen the economies of the member countries through free trade and liberal investment laws. It was hoped that the Community would become a completely unified market. Article 39 of the Treaty of Rome, which established the Community, provided the CAP's foundation. It was to increase agricultural production, raise incomes for farmers, stabilize the agricultural market, and guarantee food supplies for consumers at reasonable prices.

Given the conditions prevailing in Europe at that time, these objectives were not surprising. For centuries the problem of food security had been a major strategic concern of most European countries. Periodic famines took the lives of millions of people since the Middle Ages. With the coming of the Industrial Revolution and population explosion in the last century, access to imported food became even more crucial. The food shortages of World War II were fresh in many minds. The agricultural sector in Europe, meanwhile, was not particularly efficient: It employed one-fifth of the work force in the six original EC members, but contributed less than one-tenth of their combined national product.

The Treaty of Rome did not specify precise methods or policies for achieving the objectives of the CAP, but rather instructed the Commission, the

EC's executive body, to craft policies in accordance with guidelines. The Commission's recommendations were finalized in 1960. Its provisions were phased in between 1962 and 1968.

The CAP seeks to achieve its goals by giving a preference to agricultural commodities produced by EC members, and by erecting barriers to products from non-EC countries. The result has been a stifling of agricultural trade with other countries. Australia has labeled the CAP as "the most comprehensive example of the management of agricultural markets in the Western world. It reflects a fundamental lack of confidence in unconstrained market forces to achieve the kinds of objectives that EC members would like to see."[1]

## HOW THE CAP WORKS

The CAP relies heavily on high price supports and extensive EC control and management of agricultural markets. Although a number of policy devices are employed, there are three main instruments for major commodities:

1) **EC readiness to purchase commodities** from farmers to prevent prices from falling below a specified intervention price. This keeps prices substantially above the world level for the commodity.

2) **Variable levies on imports** of foreign commodities to raise the prices of these goods so that they do not undercut EC farmers.

3) **Export "restitutions" or subsidies** paid to EC farmers selling their products overseas to close the gap between the high EC internal price and the lower world price. High-priced EC commodities could not compete in the world market with lower-priced products from the U.S., Canada, Argentina, Australia, and other countries. With the EC subsidy, European farmers can cut their prices on the world market to match their competitors. Without export subsidies Europe would be unable to compete in the world market to dispose of surplus products generated by the high internally supported prices.

These market support mechanisms cover more than 70 percent of EC production, including most grains, sugar, milk, beef and veal, pork, certain fruits and vegetables, table wine, and fishery products. They have led to overproduction and vast surpluses of commodities that cannot be consumed by EC nations.

Typical of CAP's mechanism is that regarding grain, one of the EC's most heavily subsidized products. If market prices fall to the intervention price,

1 Australian Bureau of Agricultural Economics, *Agricultural Policies in the European Community, Their origins, nature and effects on production and trade*. Policy monograph no. 2, Commonwealth of Australia, 1985.

government agencies buy the grain, and store it. The intervention price is set at the beginning of each year based on grain prices at Ormes, France, in the heart of Europe's grain producing region, comparable to the U.S. corn belt.

**Constantly Changing Levy.** Though the intervention price is the underlying support price, the EC Commissioners in Brussels attempt to keep prices above the intervention price. They do this first by calculating a target price. The target price is the intervention price plus the cost of transporting grain from Ormes to Duisburg, Germany, which is a region that must import most of its grain. Then, to prevent lower-priced non-EC grain from undercutting the domestic market, EC actions make it impossible for imported grain to enter below a "threshold" price. The threshold price is the target price minus transport, handling, and other costs from Duisburg to the major Dutch port of Rotterdam. The goal is to guarantee that foreign grain unloaded at Rotterdam and transported to Duisburg will end up costing no less than the target price.

Whenever the price of imported grain is less than the threshold price, a tax is levied on the imported grain to bring it up to this price. Since world grain prices move up and down continually the import tax, or variable levy, is changed on a daily basis.

## EFFECTS OF THE CAP ON WORLD MARKETS

The CAP's high grain prices have encouraged increased EC production and led to accumulation of surplus stocks. In the 1960s, the EC was the world's largest importer of grains, purchasing about 20 million metric tons annually. Today it is a major exporter, shipping out about 30 million metric tons annually. Export restitution payments made to EC grain exporters bridge the gap between the high internal price and the lower world price.

The CAP has propelled Europe into the major league of agricultural exporters, not only for grains but also for other products. Once the world's biggest importer of several commodities, the EC now is an aggressive exporter. During CAP's early years, dairy products were the only significant exports. Wheat and sugar joined the list in the 1970s, followed by beef and veal in the 1980s. Today the EC is the world's second largest exporter of wheat behind only the U.S., and the world's second largest exporter of sugar behind Cuba.

EC exports have displaced worldwide sales of agricultural products by other countries, leading to charges of unfair competition. Political tensions have been heightened and numerous disputes have erupted. Example: the North African wheat market once was dominated by America, Canada, and Australia; through export subsidies, the EC increased its share of the market in Algeria, Egypt, Morocco, and Tunisia from 2 percent in 1977 to 42 percent by 1980. The EC has used export subsidies to dispose of a range of surplus commodities including poultry, beef, dairy products, grains, and sugar in markets traditionally served by other countries. In the case of poultry, which the U.S. sells for about $1,200 per metric ton, EC subsidies amount to over $550 per ton.

## CAP EFFECTS ON THE EC ECONOMY

The CAP penalizes EC citizens. In effect, they pay twice for the CAP. First, they are taxed to pay for storage of intervention stocks and export subsidies. Then they pay higher prices for food at the grocery checkout. In recent years tax expenditures have exceeded $30 billion (see table). Food in the EC is estimated to cost 10 percent to 20 percent more than without the CAP, or about $50 billion annually. European consumers spend on average 18 percent of their incomes on food, with a low of 13 percent in Britain and Germany, and a high of 33 percent in Greece and Portugal. Americans, by contrast, spend about 15 percent on food while the Japanese, with import restrictions on some commodities even tighter than those imposed by the EC, pay around 25 percent. While EC citizens pay higher prices because of the CAP, they generally consider themselves better fed today than in the past. Therefore, there is little popular opposition to the CAP.

In truth, however, the CAP harms other EC industries by diverting resources from more efficient uses into agriculture. Some parts of agriculture itself have been affected. The early architects of the CAP realized that high grain prices would be detrimental to the livestock industry. During GATT trade liberalization talks in the early 1960s, U.S. negotiators sought a "zero binding," that is, no tax on oilseeds, used for feeding livestock, imported by the Community. The European Commission made this concession to animal feeders, granting duty-free or low duty access to soybeans, soybean meal, grain by-products such as corn gluten feed, manioc root, citrus pulp, and

**EC Spending on Agricultural Support**

**Million ECUs***

| | 1985 | 1986 | 1987 | 1988 | 1989 |
|---|---|---|---|---|---|
| Daily | 5,993 | 5,406 | 6,022 | 5,910 | 4,720 |
| Meat, Poultry, & Eggs | 3,477 | 4,348 | 3,902 | 4,180 | 4,507 |
| Grains | 2,361 | 3,486 | 5,110 | 4,337 | 4,086 |
| Oils and Fats | 1,803 | 2,632 | 4,595 | 3,915 | 4,709 |
| Sugar | 1,805 | 1,725 | 2,452 | 2,082 | 2,051 |
| Fruits and Vegetables | 1,231 | 986 | 1,121 | 708 | 1,221 |
| Total Agricultural | 19,843 | 22,193 | 27,723 | 26,395 | 26,741 |
| Exchange Rate ($/ECU) | 0.76 | 0.98 | 1.15 | 1.18 | 1.13 |
| **Total ($millions)** | **15,142** | **21,831** | **32,000** | **31,246** | **30,116** |

Source: U.S. Department of Agriculture.

* The European Currency Unit (ECU) is a monetary measure used by the EC equal to a weighted average of the various EC currencies. An ECU is worth about $1.40.

other non-grain products.[2] Today livestock rations in the EC are dominated by these non-grain substitutes, which comprise about 50 percent of total feed. In the U.S., by contrast, grains account for 80 percent of livestock rations.

One of the biggest problems of administering the CAP results from fluctuations between the currencies of the member nations. In an attempt to offset the effect of currency fluctuations on national agricultural markets a complicated system of border taxes or subsidies, known as monetary compensatory amounts (MCAs), was devised. This in turn has led to a divergence between exchange rates for agricultural products and exchange rates for other traded goods and services. The rates for agricultural products have become known as "green" rates. This agri-monetary regime has enabled member nations to partially insulate themselves from cuts in EC support prices.

## ENVIRONMENTAL HARM

A serious consequence of the CAP is its effect on the environment. Attractive product prices encouraged intensive farming practices, relying on heavy use of chemicals such as fertilizers, weed killers, and pesticides. These chemicals have seeped in high concentrations into groundwater supplies. Contaminated drinking water is prompting some municipalities to seek restrictions of agricultural use.

Marginal land has been plowed, hedgerows cut, and wildlife habitats destroyed to make room for more agricultural use. As a result, environmental activists are mounting increasingly vigorous attacks on agricultural practices. The environment ministries of EC member states find themselves in the public spotlight, and many are proposing taxes or incentives to encourage "environmentally-friendly" behavior. For instance, The Netherlands and Italy now are considering taxes on fertilizers, pesticides, and manure.

## AMERICAN LEGISLATION COSTLY FOR EUROPE

The American share of world grain trade slumped from approximately 50 percent in the late 1970s to 35 percent in 1985. Several factors were responsible for this drop, including a strong dollar and high U.S. price supports in the mid-1980s. But EC export subsidies were a major part of the problem.

The remedy, enacted in the U.S. Food Security Act of 1985, was a drastic cut in price supports paid by the U.S. government to American farmers and the use of explicit export subsidies to counteract the effects of EC subsidies. In effect, Washington decided to fight fire with fire. The result has been a recovery in the U.S. share of the world grain market from 35 percent in 1985 to 46 percent today. The effect of this policy has been to push down grain

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2 John A. Schnittker and A.P. van Stolk, "GATT Negotiations and Agricultural Policy Reform." *Choices*, The Magazine of Food, Farm, and Resource Issues, Herndon, Va, Second Qtr. 1989.

prices world-wide, a trend magnified by the depreciation of the dollar from 1985 until 1988.

The lower world prices have been expensive for the EC. Since the CAP devours about two-thirds of the EC budget, escalating costs of export subsidies and commodity storage triggered a 1988 budget crisis at EC headquarters in Brussels. British Prime Minister Margaret Thatcher focused world attention on the budget problem in the spring of 1988 when she temporarily blocked Britain's contribution to the Community.

Since that time budget discipline has helped bring about changes in the CAP. A number of measures were introduced to slow the growth of production; for example, quotas were set to limit dairy production. Land was withdrawn from production. So-called "budget stabilizers" were introduced, which cut prices when grain production exceeds a certain threshold level. These measures have had some success. Dairy surpluses and beef stocks have largely been brought under control, although agricultural output overall continues to grow.

## THE GATT STRATEGY

The current round of trade negotiations offers a forum for agricultural reform. Though this is the eighth round of GATT trade talks, it is the first at which agricultural trade problems have been given such priority. When the talks started in Punta de Este, Uruguay, in September 1986, participants agreed that a leading goal of the negotiations was "to achieve greater liberalization of trade in agriculture and bring all measures affecting import access and export competition under strengthened and more operationally effective GATT rules and disciplines."

The U.S. proposal submitted by the Reagan Administration in 1987 called for eventual total elimination of all trade distorting subsidies. This position was rejected by the Europeans and thus has been modified somewhat by the Bush Administration. The language now being used is "substantial and progressive reductions in agricultural support and protection," but the goal of eliminating trade distortions remains.

The U.S. also has proposed "tariffication." This means converting trade restrictions, like variable levies and import quotas, into tariffs. A tariff is easier to measure than quotas and other forms of protection. Further, tariffs gradually can be lowered, as has happened with manufactured products.

**Plugging the Hole.** The Europeans seek major concessions before negotiating away their variable levy. They demand that the zero binding on oilseeds and corn by-products be relaxed, allowing taxes to be imposed on imports of those non-grain feedstuffs. The Europeans refer to this as "rebalancing." What it really means is plugging the hole in an otherwise impenetrable wall built to stop exports.

As the December 7 deadline for the conclusion of the GATT round approaches, satisfactory agreement on agricultural trade appears increasingly remote. The GATT members have the option of extending negotiations for another month if more time is needed. If no agreement can be made, the U.S. will have to seek another strategy to deal with the CAP.

## THE IMPLICATIONS OF 1992

The Single European Act, ratified in 1987 by each of the EC's twelve member states, calls for the complete economic integration of the EC, including the removal of all remaining internal trade and investment barriers, by the end of 1992.

The prospect of a market with 340 million citizens and an aggregate gross national product of over $4 trillion has been a powerful inducement to the EC's national governments to move ahead in support of Community-wide integration.

This integration will affect the CAP in several ways. Currently, the CAP is administered to some extent by each nation. Production quotas, for example, are assigned to the various member countries. Further, certain countries benefit more from the CAP than others. French and German farmers are the major recipients of subsidies, while Britain loses money. As the EC seeks the most efficient use of resources to become internationally more competitive, it becomes more difficult to justify the system of "green currencies," MCAs, and national quotas inherent in today's CAP. Would border posts be maintained solely to monitor movements of farm products and administer border tax adjustments? Would customs officials stay on to handle agricultural trade between members?

**Impediment to Integration.** The sheer complexity of the CAP actually may serve to delay the full economic integration of Europe. Two French economists, Leon and Mahe, see a "creeping renationalization of the policies in European agriculture" and a refusal to "play the game of a frontier-free Europe for agricultural products."[3] There is some irony in the fact that the CAP, so often described as a unifying force in Europe, has become an impediment to full integration.

Another factor affecting the CAP will be the transformation of Eastern European countries from communist dictatorships into free market democracies. Several of these countries, notably Poland, could be efficient producers and exporters of agricultural products. The EC claims to want to aid Eastern Europe through the transition period. Yet better than offers of aid would be open markets for agricultural products. The East European countries will put additional pressure on the EC to reform the CAP, or at least to provide preferential access.

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3 Y. Leon and L.P. Mahe, "The CAP After 1992: A Fairly Common Agricultural Policy." Paper presented at the AAEA 1989 Annual Meeting, Baton Rouge, Louisiana.

## CONCLUSION

As one of the world's major producers of agricultural products, America has a strong interest in eliminating the subsidies and import restrictions of the CAP. The U.S. federal government also subsidizes American farmers and keeps its markets closed to many foreign imports. Yet American farms are inherently productive and able to compete in a world unfettered by trade distortion. Both the Reagan and Bush Administrations have said that they will eliminate U.S. import barriers and subsidies if other countries, especially those in the EC, do the same.

**Pushing for Reform.** At a time when former communist countries as well as other less developed countries are attempting to reform their own economic systems, the CAP stands in the way of a free and unsubsidized flow of agricultural goods. West European concerns of the past about food security are no longer relevant since they now produce far more food than they need. But the surplus agricultural products which the EC dumps on the world market have become a global issue of great concern to all agricultural producing nations. So long as the EC persists with its costly and economically irrational agricultural policy, U.S. policy makers must continue pushing for reform.

Prepared for The Heritage Foundation by
Ewen M. Wilson, Ph.D.
Former U.S. Assistant Secretary
of Agriculture for Economics.