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Reform of the CAP: Impact on the Third World

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Reform of the CAP

Impact on the Third World

Ulrich Koester and Alberto Valdés

The European Community is under pressure to reform the CAP, mainly due to internal financial reasons. Proposals have been put forward by the EC Commission that reform the CAP with respect to milk, oils and fats, and corngluten and citrus pellets. The authors look at the impact of these proposals on developing countries. They conclude that the effect will be to increase non-tariff barriers to trade and increase the cost of food production both in and outside the EC.

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Ever since the Common Agricultural Policy (CAP) of the European Community (EC) came into existence with the final price agreement in 1964, the CAP has demanded the lion's share of the EC budget. Expenditure on the CAP has accounted for more than 70% of total EC expenditure in most years and has increased at an annual rate of 21% from 1974 to 1982. To avert a near financial crisis, the EC is currently under pressure to reform the CAP, and was given a mandate to present reform proposals. These proposals were included in an EC document and were discussed at the meeting of the Council of Agricultural Ministers in December 1983.

Our purpose is to evaluate the proposals from the Third World's point of view. The underlying premise is that the CAP is not only relevant for the European farming community, the EC taxpayer and the EC consumer, but also to the overall state of the world food economy. This is because the EC plays a dominant role in the markets of most temperate-zone agricultural products. In the early 1980s, the EC was the largest exporter on the following markets: butter, cheese, non-fat milk products, wheat flour, broilers and eggs in shell for consumption. It was the second largest exporter on the sugar, beef and veal markets, and the third largest on the wheat and total grain markets. It is clear that changes in the CAP will have a significant impact on the world food economy and especially on the Third World.

To date, the CAP has been only inward-looking, concerned with solving EC problems without considering its side-effects on trading partners. Ironically, and without conscious determination, the largest beneficiary of the CAP has been the Soviet Union. As the USSR shifted from being a net exporter to becoming a significant importer of agricultural products, it gained from the depressed world markets prices brought about by the CAP. Table 1 presents some rough calculations of the CAP's effects on world markets; Table 2 shows the USSR's income transfer due to the CAP. As a by-product of the CAP, the USSR received a transfer of 300 billion ECU in 1980 alone for the six products presented in Table 2. This is about the same amount which the EC spent on total food aid in 1980 (318.8 billion ECU).

We argue that the EC should accept a moral obligation to minimize the harm it may exert on Third World countries. These countries depend increasingly on world food markets and hence have a vested interest in whatever reforms are instituted in the CAP. The CAP should not only be revised so as to better solve EC problems, but also to take into account the interests of the less developed countries, more than they have done in the past.

The reform proposals submitted by the EC Commission contain some elements which are neutral to the LDCs and which will not be discussed in this essay, such as the proposal to change the decision making process in special cases. Instead, we restrict

Notes:
[a]1980/81; [b]1982/83; [c]Live weight; [d]Carcass weight; [e]Calculated on the basis of producer price for broiler; [f]1982; [g]Calculated on the basis of net export value divided by export quantity; [h]Assumptions: supply elasticities in all countries 0.5; demand elasticities in all countries −0.5. Isoelastic supply and demand functions.

Source: Authors' calculation from *FAO Trade Yearbook, 1980* and *FAO Production Yearbook*, 1981.

Table 1. Increase of world market prices due to a liberalization of the CAP (1980).

Product	EC price (ECU/100kg)	World market prices (ECU/100kg)	World market prices, with liberalized EC trade[h]	World market price Absolute change	World market price Relative change
Common wheat[a]	21.93	15.07	15.77	0.70	4.63
White sugar	32.13[b]	15.90[f]	17.44	1.54	9.70
Beef[a]	160.76[c]	84.75[f]	93.65	8.90	10.50
Poultry	127.46[e]	83.83[g]	89.00	5.18	6.18
Pork meat	150.58[d]	111.21[d]	117.28	6.07	5.45
Butter[a]	319.59	111.73	143.31	31.58	28.27

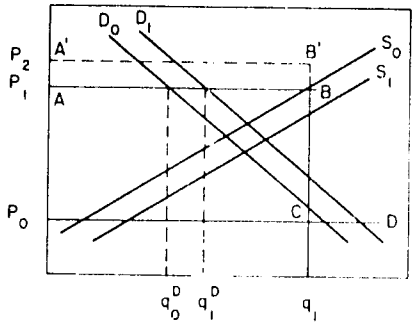

Figure 1. Milk quota system.

Notes: ABCD = price sale function for suppliers of milk; P_1 = price for reference quantity in period 0; P_0 = price for excess supply in period 0 and 1; P_2 = price for reference quantity in period 1; q_0^D = demand in period 0; q_1^D = demand in period 1 with unchanged prices; q_1 = reference quantity; S_0 = supply curve in period 0; S_1 = supply curve in period 1; D_0 = demand curve in period 0; D_1 = demand curve in period 1.

ourselves to those proposals which are likely to affect Third World countries. It might well be that some of these proposals will never materialize either because the necessary agreement is not reached within the Council or because implementation may fail.

However, for our purpose we will assume that the CAP might be reshaped along the lines of the proposals. Occasionally we will analyse how political realities will affect the implementation and what effect this will have on the LDCs.

The most important elements of the package of reform proposals concern the milk market. This is because the future of the CAP on all other markets depends largely on the reform of the milk market organization. The costs of interventions in the EC milk market amounted to 40% of total EC budgetary outlays over the last few years. If these costs can be cut, substantial financial resources could be freed for use in other markets, thereby rendering restrictive price policies as proposed by the Commission for other markets (especially the cereals markets) unnecessary.

The EC Commission proposes to cut surplus milk production by introducing a quota system for production. A reference quantity (quota) would be established for each dairy, based on their actual delivery 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. Thus, the proposal implies a two tier price system, where the lower price for the excess quantity might be only one-third of the present EC producer milk price. Assuming that production above the reference quantity would no longer be profitable, further production increases would be negligible.

Such a system could be managed without further increases in budgetary costs and could nevertheless allow the price for the reference quantity to be increased. The general idea can be clarified with the help of Figure 1. Given the significant differential between the price for the reference quantity and the price for excess supply, it can be taken for granted that shifts in the supply curve due to changes in technology will not affect total supply. Shifts in the demand curve due to increases in nominal income and price increases for substitutes in consumption will either help to reduce expenditure for surplus disposal or it will allow an increase in the price for the reference quantity without increasing budgetary expenditure. The new expected price sale function could be A'B'CD instead of ABCD.

From past experience with quota

Table 2. USSR income transfers[a] in 1980 due to the CAP (ECU × 10^3).

Product	Wheat	Sugar, total raw equivalent	Meat of bovine animals	Pigmeat	Poultry	Butter	All products
Value	102 900	76 800.262	20 737.000	6 903.047	8 236.977	78 637.358	294 214.65

Note: Taking into account the world market price effect of the protectionist EC agricultural policy (see Table 1) and assumed price inelastic import demand of the Soviet Union.

Sources: FAO Trade Yearbook, 1980 and *FAO Production Yearbook, 1981*; Statistiches Amt der Europaeischen Gemeinschaften, Brussels, Luxemburg, *Agrarstatistisches Jahrbuch*, 1982, p 26, and *Monatsbulletin der Aussenhandelsstatistik*, Vol 4, 1983, p 178; Bundesministerium fuer Ernaehrung, *Landwirtschaft und Forsten, Statistisches Jahrbuch ueber Ernaehrung, Landwirtschaft und Forsten der Bundesrepublik Deutschland*, 1982, p 389.

systems and politicians who try to support the income of the farming population, we can be certain that, in order to achieve their agricultural income objectives, price increases for the reference quantity will be likely. These price increases will have a smaller effect on the budget than price increases with the present system; thus they will serve as a more invisible income transfer from consumers to farmers.

If accepted, the proposed reforms would affect LDCs in several ways.

(1) Administrative curtailment of milk production in the EC will lead to a shift of resources to those activities which compete for the same types of resources. Empirical studies show that pork production would be affected the most. A higher growth rate of beef and veal production may be expected as well. First, the quota system will change the relationship between milk production and number of cows. It will pay less to employ purchased inputs as feeding compounds as a substitute for on-farm produced feed. Hence, yields per cow will be lower and more cows will be needed to produce a given quantity of milk. Second, less land and labour will be needed for milk production and will be set free for alternative production. A tendency to take up beef and veal production will follow. However, with a given number of calves and milk cows, calf prices would go up and limit the expansion of this activity. However, thirdly, a change in the type of farming can be expected. Nowadays, mixed farming is dominant; meat and milk is produced jointly. But higher calf prices and more land resources set free from milk production would make monocultural farms which only produce meat more profitable. This would support the expansion of beef and veal production. Summing up, it is likely that the EC's surplus in beef will increase, thereby increasing the EC's already dominant role on the world markets for beef and veal. Further, depressed world market prices will follow. This contradicts the interest of those developing countries which have a relative abundance in land and, hence, a comparative advantage in beef production. Some African and Latin American countries belong to this group and thus, their prospects for development will undoubtedly be curtailed by an EC milk quota system.

'World agriculture might be thrown into greater disarray'

(2) The change in the input mix in EC milk production would lead to a decline in import demand for ingredients of feeding compounds, mainly for soya.

(3) Past experience with quota systems illustrates how governments, in spite of their good intentions, have found themselves unable to suspend such a policy once it has been established. Hence, we would expect not only that the EC milk quota system would continue indefinitely, but also that the EC milk market might be permanently disconnected from the world milk market. World agriculture might be thrown into greater disarray and those developing countries which have a comparative advantage in milk and/or beef production would be permanently harmed.

(4) As the milk quota system would require fewer financial resources, price policy on other markets would be less restrictive, leading to an increase in the degree of overall protection across markets. This may or may not be to the advantage of some developing countries, although it is certain to be to the advantage of the Soviet Union. Generally speaking, developing countries will be harmed.

(5) If the EC does not want to increase surpluses on markets other than the milk market but still wants to achieve some specified agricultural income objectives, further administrative interventions are sure to follow. These could include quota systems for other markets, in particular the beef market, and are bound to lead to increased uncertainty in the world food economy.

The EC Commission proposes to introduce a non-discriminatory internal tax on the consumption of oils and fats other than butter, irrespective of their origin. It is hoped that domestic consumption of vegetable oil will go down, and that butter consumption will increase. At present, the EC is the largest producer of olive oil, but is

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relatively insignificant in production of other vegetable oils. It is fair to assume that EC import demand for these oils will decline.

In analysing the likely effects of an EC tax on oils and fats on LDCs, we have to take into account the fact that the most important vegetable oil, soybean oil, is complementary to soybean meal in production. Soybeans may be traded as a raw product, or separately as meat and oil. The EC imported more than 50% of total world imports of soybean meal in recent years, but only 12–13% of world imports of soybean oil. A decline in the EC's demand for soybean oil will also affect the world market for soybean meal.

It is quite straightforward to derive the effects of the EC tax on oils and fats on the soybean meal market: a decline in soybean oil demand lowers price for this product and soybean production will be less profitable. A reduction in soybean production will follow, leading to a decrease in supply of both soybean meal and soybean oil. Prices for soybean meal will go up, but price changes for soybean oil cannot be predicted. A decrease in demand and a decrease in supply may lead to unchanged, higher or lower prices for soybean oil. In any case, many LDCs will be adversely affected by higher prices for soybean meal, particularly those countries which have to import soybean meal for the purpose of feeding livestock and indirectly those who import livestock to match the growing demand for meat.

The EC also plans to restrict imports of corngluten feed and citrus pellets. Since the USA is the main exporter of these products to the EC, it might be argued that LDCs are not affected by the proposed import restrictions. However, in analysing the historical background of this proposal and its potential effects on the world economy, the overall effect of this proposal will be to increase uncertainty in the world food economy.

The EC Commission considers corngluten feed and citrus pellets as substitutes for grains in feeding livestock. Hence, domestic grain demand for animal consumption can be increased and the EC grain surpluses decreased if cereal substitute imports are restricted. The EC has already succeeded in reaching an agreement with three cassava-exporting countries (Thailand, Indonesia, and Brazil) to restrict their exports voluntarily. However, such an agreement would do little to solve the EC's problems if imports of cereal substitutes other than cassava (and cassava imports from other countries) were not also restricted. The argument can be clarified with the help of Table 3. From 1978 to 1980, the EC imported 12 to 13 million tons of cereal substitutes annually. The share of cassava imports declined from 49.2% in 1978 to 43.5% in 1979 and 37.3% in 1980. The share of corngluten feed in total imports of cereal substitutes increased from

Table 3. Imports of cereal substitutes into the EC–9[a] (tonnes × 10^3).

Nimexe item number	Category	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
07.06–30	Cassava (Tapioca)	1352	1335	1526	1482	2073	2222	2984	3801	5976	5375	4866	6677	8101
07.06–90	Sweet potatoes	12	116	205	224	177	115	55	9	6	81	324	88	55
23.02–01[b]	Bran: maize, rice[f]	81	36	62	134	233	267	417	280	145	205	233	279	222
23.02–09	Bran: maize, rice[g]	–	–	–	–	–	–	–	15	6	3	5	5	6
23.02–21[c]	Bran: other[h]	1073	1168	1194	1079	976	1237	1839	1903	1798	1806	1707	1703	1733
23.02–29	Bran: other[i]	–	–	–	–	–	–	–	4	6	0	5	6	2
23.03–15[d]	Corngluten feed	598	585	733	837	694	930	1147	1486	1685	2021	2596	2837	2842
23.03–81	Dried sugar beet pulp	–	–	214	224	133	176	365	402	256	225	190	284	390
23.03–90	Brewer's and distiller's grains	453	346	82	68	64	57	95	116	161	204	290	365	377
23.04–06	Maize germ oilcake[j]	–	–	–	–	–	465	564	709	790	869	856	790	735
23.04–08	Maize germ oilcake[k]	–	–	–	–	–	60	65	108	181	167	202	242	328
23.06–20	Grape residues	–	–	–	4	13	10	19	17	7	9	38	57	35
23.06–50[e]	Citrus pulp	97	103	185	378	327	480	646	968	1000	1205	1571	1351	1265
23.06–90	Other fruit residues	32	29	10	17	21	56	136	164	117	177	156	103	130
	Total	3698	3718	4211	4447	4717	6075	8332	9982	12134	12347	13039	14787	16220

Notes: [a]from 1970 to 1973 six member European Community, from 1981 ten members; [b]from 1970 to 1976, the Nimexe item number was 23.02–11; [c]from 1970 to 1976, the Nimexe item number was 23.02–13; [d]from 1970 to 1971, the Nimexe item number was 23.03–10; [e]from 1970 to 1972, the Nimexe item number was 23.06–10; [f]≤35% starch; [g]>35% starch; [h]≤28% starch; [i]>28% starch; [j]≤3% fat; [k]3–8% fat.

Source: Statistical Office of the European Communities, *Foreign Trade: Analytical Tables (Nimexe)*, Luxemburg, different volumes and oral account.

13.9% in 1978 to 16.4% in 1979 and 19.9% in 1980. Negotiations over the voluntary export restrictions for cassava led to an unprecedented growth in imports of cereal substitutes, especially between 1981 and 1982.

This clearly illustrates two points. First, EC policy may lead to a significant change in trade flows from year to year. Second, the supply of cereal substitutes seems to be very elastic. Consequently, the EC found it gained little in domestic relief through its rather limited agreements with the above-named cassava exporters. Thus, apparently it seems to the EC Commission to be a logical step in domestic protection to restrict imports of corngluten feed and citrus pellets. However, world trade, and the Third World in particular, might be significantly affected by such a policy.

'The USA is willing to start a trade war with the EC if the EC proposals are carried out'

A US subcommittee of the House Agricultural Committee held a hearing about this issue on 4 October 1983. It is quite clear from this hearing that the USA is willing to start a trade war with the EC if the EC proposals are carried out. Such a trade war would be likely to lead to lower world market prices for some agricultural products, especially grains. This is good news for grain-importing developing countries and the USSR. However, the effects in the long-run are completely uncertain. Instability in world food markets would certainly be increased and a man-made food crisis, such as occurred in 1972 to 1974, might well follow. It is clear that those who would suffer most would be those LDCs who would be unable to afford to import food at high world prices.

As the EC has quantitative import restrictions for corngluten feed and citrus pellets in mind, the implementation of the proposal will, together with the cassava export restriction on Thailand, Brazil and Indonesia, lead to higher prices for cereal substitutes within the EC. This in turn will lead to an inflow of cassava and cereal substitutes from other countries. The export potential seems enormous, as cassava alone is produced in many LDCs, and ten of these were supplying the EC market in 1982. The voluntary export restrictions with Thailand, Indonesia and Brazil were only the first step, and the proposal to restrict imports of corngluten feed and citrus pellets is the logical second step, with further steps to restrict trade sure to follow. Thus, the EC knowingly increases uncertainty in world trade flows which have considerable negative effects on the world food economy and especially on developing countries.

'The proposals imply an increase in non-tariff barriers to trade'

The voluntary export restrictions with Thailand, Indonesia and Brazil deserve a special comment. Perhaps EC policy makers are not able to learn from the experiences of other nations who have applied similar strategies. The US experience with the grain embargo it applied to the USSR should have provided such a lesson. The USA restricted its exports to the USSR voluntarily, but the other trading partners which supplied grain or substitutes – some of which originated from the USA – succeeded in compensating for this decline through their own exports to the Soviet Union. The same will happen with EC imports of cereal substitutes unless further trade restrictions are implemented. Thus, the proposed restriction on corngluten feed and citrus pellets are, to the neutral observer, a logical conclusion of such a protectionist policy. It is likely that other restrictions will follow.

All three proposals discussed in this paper have two end results in common. First, they imply an increase in non-tariff barriers to trade. Such barriers can have a frustrating effect not only on international trade itself, but also on trade liberalization efforts. These additional trade barriers lead to increased uncertainty in the world food economy. Signals for foreign traders are confusing, both about the implicit level of protection and the uncertainty with respect to changes through time. This can deter investment for exports in third countries.

Second, a realization of the three proposals will necessarily increase the costs of food production in the EC and, through further distortions in world trade, outside the EC as well. The choice of administrative measures which increase the factors needed to meet world food needs must take into account the welfare of DCs.