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by

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FROM A COMMON MARKET PERSPECTIVE*

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The European Community is a major exporter and importer of agricultural products. In 1983 its total external trade in agricultural products was roughly $69 billion. The largest supplier of such products to the EC is the United States, and we consistently run a net balance of trade surplus with the Community in agricultural products. U.S. exports to the EC are dominated by grains, feeds and oilseeds. Alcoholic beverages are the largest U.S. import item from the Community. In 1983, 19 percent of the Community's agricultural imports were from the U.S. and our net trade surplus in agricultural products with the EC was $4.6 billion. In the light of these statistics, it is clear that the Community's trade policy is of particular importance for international markets and for the United States. In order to understand this policy, it is necessary to understand the EC's agricultural policy as a whole and its importance to the Community.

Trade and the Common Agricultural Policy

EC trade in agricultural products is primarily determined by the operation of the Common Agricultural Policy (CAP). The formation of

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this policy was a major and essential task in founding the original Community of six countries (Belgium, France, Holland, Italy, Luxembourg and West Germany) during the late 1950s. At the time the Community was established, agriculture accounted for over 20 percent of employment in the member countries. A major economic incentive for the formation of the EC was that improved French access to German farm product markets would be exchanged for improved German access to French manufactured product markets. Agriculture in the founding countries had typically been protected from import competition, and it was, therefore, necessary that some degree of protection should be continued. A common policy would also have a number of desirable objectives, including improving agricultural productivity, income support, market stabilization and security of supply, and reasonable consumer prices. To further these objectives, roughly 30,000 national measures had to be modified and transformed into a unified structure to provide price support to Community farmers, and yet guarantee the free movement of agricultural commodities between member countries.

The resulting policy achieved these aims by regulating the price of imports by means of a variable levy. A variable levy is actually as effective as a quota in controlling imports but is easier to administer. After deciding on an internal market price, a corresponding minimum import price is set. A variable levy is imposed as the difference between the minimum import price and the world market price to ensure that imports do not undercut the price of domestic supplies. The variable levy system provides complete price protection for the internal market and also produces substantial domestic stability--one of the major objectives of EC policy. In this system, international trade is clearly a residual which adjusts to make up the difference between domestic supply and demand.

The common agricultural policy involving these mechanisms was simple, but was also based on two fundamental assumptions: first, that the EC was a relatively "small country" whose agricultural and trade policies would not have a noticeable effect upon world markets; second, that the EC would largely remain a net importer of agricultural products. One of the major problems is that even if these assumptions seemed reasonable at the time, they clearly no longer hold.

When the EC was formed, its agriculture was dominated by small farms. Average farm size in 1960 in the Community was less than 25 acres compared to over 100 acres in the United Kingdom, which at that time was a nonmember. Community agriculture was characterized by low productivity. On a per-worker basis, the ratio of agricultural to nonagricultural output was 56 percent in 1960. Also at this time, the EC was a substantial net importer of many agricultural products. During 1956-60, it was 90 percent self-sufficient in wheat, 92 percent self-sufficient in beef and veal and had a rough market balance in sugar and dairy products.

Since the introduction of the Common Agricultural Policy, there has been a major structural change in European agriculture. Farm size has increased considerably, output per worker has risen and the EC is now a major exporter of cereals (especially wheat and barley), sugar, dairy products and beef and veal. Furthermore, this increase in self-sufficiency has occurred with a substantial expansion in membership, from six to ten countries (with the addition of Denmark, Greece, Ireland and the United Kingdom). As the Common Market has expanded, it has clearly lost its status as a small country, particularly with U.K. membership in 1973. Its use of export restitutions (subsidies) has become much more contentious than its levies on imports. The Community is now a major force in world trade and a competitor with the United States. U.S. criticisms of the EC are increasingly directed to its use of subsidies which, it argues, create unfair competition and damage the U.S. position in world markets. The Community acknowledges the fact that there are problems in the international trade of agricultural products, but its own views on the causes of these problems and their solutions are substantially different from those of the United States.

The Community's View on Trade Policy

The Community frequently points out that it continues to be a major market for many U.S. products, especially animal feeds and soybeans. In fact, the Community argues that part of the problem which it is encountering with grain is due to the rapid growth in imports of competing feeds from the U.S. The OECD has estimated that perhaps 30 percent of EC soybean imports directly displace Community produced grain. Since soybeans are not covered by the variable levy system, they introduce an additional distortion into the Community's pattern of trade. Low-cost imported soybeans displace higher-priced domestic grains. These grains must then be disposed of on world markets. The Community argues that it should be allowed to correct the distortions created by existing relative prices through the use of restrictions or taxes on competing feeds. The U.S. opposes this, primarily because it believes that the Common Agricultural Policy and its price levels should be fundamentally modified. The end result of the disagreement is that soybean producers in the U.S. (and also increasingly in Brazil) benefit while U.S. wheat farmers lose.

The U.S. argues that EC policies are disruptive because of their subsidization of exports. The EC points out that for some products, e.g., poultry, much of the apparent export subsidy merely offsets the competitive disadvantage faced by poultry producers because of the higher levels of feed costs in the Community. Furthermore, it argues that many of the components of our agricultural programs essentially are export subsidies. It suggests that the U.S., through a variety of devices, provides hidden subsidies for agricultural exports, e.g., through the target price system, preferential tax treatment, provision of in-land water transportation services at below true cost, PL 480 food aid program and the Food Stamp program. The Community also points to the fact that government expenditure on agricultural support in the United States now substantially exceeds that in the Community. If we consider expenditures on price supports in 1983, these were roughly $12 billion in the EC and almost $19 billion in the U.S.

(fiscal year figures). The Community also points to the fact that its right to dispose of surpluses had been agreed in international negotiations under the General Agreement on Tariffs and Trade (GATT). The Community notes that the U.S. jealously guards the concessions which it has managed to obtain through GATT, most notably the waiver we obtained on the use of import quotas for dairy products and sugar in the early 1950s. The Community believes that the U.S. is far from consistent in its attitude to agricultural trade policy. It criticizes the U.S. for simultaneously calling for freer trade in other countries while tightly controlling its own imports of dairy, sugar and certain other products through the use of quotas.

Finally, and in my view accurately, the Community argues that during the last few years it has been made the scapegoat for failures in U.S. domestic agricultural support programs and economic policies. The effects on our exports of an overvalued dollar created by current fiscal and monetary policies, compounded by sluggish agricultural product demand worldwide, have been considerable. Many in the Community would argue that the real issue is not one of EC protection, but the failure of the United States to change the policies which put our agriculture at a competitive disadvantage.

The Community is making efforts to bring agricultural supply and demand into better balance. For the majority of agricultural products, Community support prices in real terms have declined since the early 1970s, and the European Commission has been attempting to promote reductions in the normal prices of surplus commodities in recent years. Efforts are being made to retire land from the production of some commodities, e.g., certain fruits and vegetables. The Community has also introduced production quotas in an attempt to control the supply of dairy products. It is possible that these could be used in other cases, for example, cereals.

As budgetary pressures have grown, support has been building in the Community to make changes in the CAP to bring supply and demand into closer balance. The U.S. apparently believes that it can accelerate these changes by stimulating a subsidy war. Internal budgetary pressures may force change in the Common Agricultural Policy; U.S. attacks upon the CAP through competitive subsidization of exports are certain to further resistance. Indeed, they will probably serve to weaken the position of those nations such as Germany and the U.K. who have been seeking to reform the CAP. The lesson of history should tell us that the threat of attack from an enemy without is frequently a great unifier for a nation divided internally.

An Agenda for Future Research

In assessing agricultural trade tensions that exist between the EC and the U.S., it is important to bear in mind the fundamental importance of a strong and united Europe for U.S. foreign policy. It is also essential to recognize that the common agricultural policy will not be abandoned because without it there would, in essence, be no European Community. It is vital not to lose sight of the fact that more is at stake in U.S./EC relations than the sale of a few tons of wheat or soybeans. However, there are real problems which need resolution, and many of these are clearly in need of more research. It is in the interests of both the U.S. and the EC to see a stable and orderly development of international markets, and to foster an overall reduction of the distortions which plague international trade. Attention needs to be shifted to the constructive analysis of how this might be achieved. Specific issues which require attention are as follows:

(1) How can a meaningful framework for agricultural trade negotations be developed which takes into account the total effect of agricultural policy, and not just particular trade measures, upon international trade?

(2) What realistic changes might be made in current policies by the United States, European Community and other countries to reduce the distortionary effects of their agricultural policies upon the level and stability of prices, and trade flows in international markets?

(3) What are the linkages between macroeconomic policies in the U.S. and EC and trade? What steps can be taken to modify such policies in order to foster renewed growth in agricultural trade and the stabilization of market shares?

These are elements of a research agenda which are much more relevant than politically abstract discussions of how world markets would be improved if there were no Common Agricultural Policy. It is virtually certain that the policy will survive. At some stage, we will have to learn to live with the CAP even though it is unlikely that we will ever learn to love it.