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COSTS AND BENEFITS OF THE CAP REFORM

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Abstract

This working paper presents a cost-benefit analysis of the reform of the **Common Agricultural policy (CAP)** considering both its effects on farmers in the **European Community (EC)** and on farmers in third countries. The new questions raised by the Uruguay round of the **GATT (General Agreement on Tariffs and Tax)** and the start up of the **Single Market** in Europe are considered in order to examine the possible effects on agricultural income with special reference to family farms in the south of Europe. In the case of Spain, data are presented for possible effects of restructuring work occasioned by the reform.

Key words:

CAP, EC, GATT, cost-benefit, agricultural economics.

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INTRODUCTION

Spain's - and Portugal's- late entries to the ECC, at the outset of 1986, come about when the process of Common Agricultural Policy (CAP) reform had already made some progress.

The transition period agreed upon during the negotiations will last for twelve years for those products which were deemed to be conflictive. Real integration will not take place until 1989, in fact, but the agreements signed that year, on order to have the single market ready for the beginning of 1993, may eventually render unnecessary any subtleties introduced by the negotiators. Basically, they based their analysis on the differences between Spanish and Community prices, and on the time these would take to disappear.

Spain joined and Economic Community (EC) in which a CAP had already been designed to fit the agricultures of the founding member Countries and (given the scarce efficiency of the Italian intervention and Greece's late entry, in 1981), it was formulated with the central European countries in mind. But Spain also enters a CAP which, as of 1973, had been in crisis. It joins a game whose rules do not specially favour it, with the exception of the important detail that agricultural prices are, in general, higher in the EC than in Spain. In any case, it wished to

participate, from within, in the decision making leading to the reform of the CAP, among other issues.

Nevertheless, the main decision of the Agrarian Council is to freeze most agricultural prices, thus drying up the source of hope for all Spanish farmers, the very year in which they joined the Community. They have not yet experienced this fact in their pocketbooks, since financial magic (the revaluation of the Peseta and the price approach system by yearly steps until the EC price is reached) allows the ECU price to rise while the Peseta price continues growing for a significant amount of products. This, however, will not last much longer.

Farmers with problems, therefore, have no other possibility at present than to wait and see how far the strengthening of structure policy will go. Dynamic farmers, and specially the traditional exporters (citrus, olive oil, table olives and wine with origin designation) are hoping that their comparative advantages will prove effective, in a progressively wider manner, as the transition period obstacles are removed. Other producers, specially those of fruits and vegetables, may improve their exporting position to the rest of the EC under conditions of greater exchange freedom.

Some processed products, such as pork derivatives, sausages or "cold cuts", and processed fruit and vegetables have possibilities of expansion in European markets, which are already becoming evident.

However, the development of these and other products, such as vegetable oils, are conditioned by the general context of large food multinational dominance, whose strategies strongly influence the market.

In the course of the last few years, the multinationals, specially European ones, have taken few positions in generally smaller Spanish companies, as a part of their strategies vis-a-vis the Single Market. Some non-Community financial groups, for instance KIO (Kuwait Investment Office) have also invested heavily in the Spanish agricultural industry, but in this case it is more as part of a financial strategy than an industrial strategy, as in the case of the European food multinationals. At any rate, what has happened is that foreign investments in agriculture and food have reached a very important volume (Soria and Rodríguez-Zuñiga, 1990), (Langreo, 1990). Production by the agriculture and food industry represents 4.77% of the Spanish GAV. (INE, 1989).

STRUCTURAL DIFFERENCES: A Large, Mediterranean Agriculture.

In order to fix the starting point of a cost-benefit evaluation, it is necessary to remember the deep structural differences between Spanish agriculture and that of the EC-10.

Arable land is oriented towards a dominance of Mediterranean crops (grapes, olives, citrus, fruits and vegetables), and towards products such as sunflowers and rye, while the EC-10

specializes in continental agriculture (soft and hard wheat, tobacco, sugar beet and colza).

As far as livestock is concerned, Spain specializes in grazing sheep and goats for meat, as opposed to the greater dominance of stabled milk and meat cattle in the EC-10.

In terms of production value, Spain specializes in Mediterranean crops (except for wine), livestock in mountain and lesser favoured areas (sheep and goats), and intensive stockbreeding (poultry meat and eggs), while the EC-10 specializes in continental agriculture (cereals) and expensive livestock breeding, dependent on cereal crops and meadows (meat and milk cattle) (Barceló and García Alvarez-Coque, 1987).

Differences also derive from the structures of agricultural operations, due to the greater polarization of property structures in Spain, where intermediate-size operations carry less weight than in the EC-10.

The weight of the agricultural sector in the Spanish economy is noticeably higher than the Community average, both as a percentage of population working in agriculture concerns (16.1% as opposed to 7% in the EC-10) and as its participation in the GNP of the economy (5.8% against 3.3% EC-10) EUROSTAT (1990).

FARMERS FACED WITH THE CAP REFORM

The first difficulty for agricultural policies in general, and for the CAP in particular, when trying to establish measures to protect family farming, is to identify beneficiaries.

This problem may not be handled as a methodological subtlety, since the suspicion exists that a large part of the measures adopted to protect family farming have benefitted the more competitive farmers, sometimes in a nearly exclusive manner. The evolution of agricultural trade unions and the "farming front" concept for all farmers is at the root of this situation (Moyano, 1989).

Another, even larger, part of the legislation is formed by foreign trade protection measures, and by price maintenance which, under a justification cover of levelling family incomes, noticeably benefits all remaining farming enterprises. Prices may be the same, but costs differ and, thus, benefits will also be different.

Crowds arrived to feed from the fields of family farming aids so many that costs to the Community have eventually been too great. With the arrival of the taxation crisis, family farming now risks being abandoned in future budgetary cut-backs.

THE PERSPECTIVE FOR THIRD COUNTRIES

From the viewpoint of third countries, European agriculture has turned into a source of instability for world markets dealing in farming raw materials, due to the high levels reached by EC's exports.

Economic crisis, even though its origin lies in energy price increases and the subsequent need to re-structure industrial offerings, manifests itself in the appearance of strong macroeconomic unbalances.

The main unbalances in the Spanish economy during the crisis may be summarized as fiscal and balance of payment deficits, inflation and unemployment. With greater or lesser intensity, these features were also prevalent in all other Community countries. Fiscal crisis and inflation stagnation, in particular, have eventually questioned the CAP model, where contradictions between the policies of various farming subsectors would be solved by increasing the EAOGF expenditure (specially the EAOGF-Guarantee).

Increased VAT income - from 1% to 1.4% - was not sufficient to eliminate the Community budget deficit. Surplus accumulation of several products (butter, cereals and beef meat), together with financial problems in many agricultural operations, in spite of costly price-maintenance programs, has underlined the weakness of these policies for efficient resource distribution (Tracy,

1989). The most serious accusation levelled claimed that the CAP was generating a production whose only outlet against them was to be purchased by intervention organizations (Barceló and García Alvarez-Coque, 1987).

Monetary instability has followed the second energy crisis in 1979, after the mirage of a crisis in raw materials had vanished (high agricultural prices in world markets), a situation that has seriously questioned dumping surplus from intervention in these markets. Instability of rates of exchange joined instability of international agricultural prices, generating violent fluctuations. These negative aspects of supranational agricultural policies in third countries have added to extremely negative indirect effects on income distribution, employment and the growth capacity of the economies which apply these programs (Miller, 1987).

Japan and the United States, the former with very high protection levels, and the latter with high ones in agricultural matters, also bear an important responsibility in the effects caused by this fact over the economies of less industrialized countries (Kaneda, 1986). On the other hand, no solution may exist to the problem of External Debt of developing countries unless solutions are offered to their trade deficits (Baker, 1984). The reduction of agricultural protectionism plays an important role in these solutions.

From the point of view of Spanish agriculture, reduction of

protectionism may mean improvements in an efficient distribution of resources, if it is replaced by a selective income policy, even if adjustment of the agricultural sector may have to be performed now under less propitious conditions than those of the EC-10 countries (García-Delgado and Muñoz, 1989). A regional crop rearrangement accompanied by the introduction of advanced technologies, a reorganization of trade structures and support to the agriculture and food industry may allow the Spanish sector to face with optimism the consequences of gradual trade deregulization within the European framework (Tió, 1989).

In spite of the recent failures experienced by the GATT to reach agreements, both the United States and de EC had already started a reform of their agricultural policies. In the case of the Community, the general reform policy has been collected in the last version of the Commission Communication (1988), which clearly expresses the intention of abandoning the CAP based on a price and market policy in favour of a reformed CAP, whose axis is the sum of its political and regional policies:

"From 1984, CAP reform has been accompanied by measures tending to diversity supports to farmers (price aids and interventions in markets are being partly replaced with more objective measures) and by a greater modulation of agricultural support in favour of economically weaker small family farms, and in favour of areas with natural and structural constraints" (Commission, 1988).

This line of action also addresses forest policy and tries to find suitable financial solutions; to this end, the Commission has proposed a forest action program (doc. COM(88) 255). This policy may have an important positive effect from the environmental viewpoint, since deforestation and when the land turn in to desert are indeed threatening some very large areas.

The shift in policy from considerations of price and markets to a concern for structure, on the other hand, means that an important restructuring must be faced by the agricultural sector. Its consequences are still difficult to forecast, since they depend on the manner in which the European economies emerge from the present industrial crisis; some of these possible consequences, however, are listed in this paper.

COSTS AND BENEFITS OF THE CAP REFORM

Some reports are pessimistic about the possibilities of compensating purchasing power losses derived from the freezing of agricultural prices through the structure policy (Sumpsi, 1989; Etxezarreta et al., 1989). But others authors estimate that many of the transformations taking place in the Spanish agriculture are related to long-term processes which are largely independent of the CAP reform, specially those having to do with intersectorial re-structuring and the technical changes induced by economic growth (García Alvarez-Coque, 1989; San Juan, 1990). Therefore, and although social costs of these processes are

underlined, including even the ecologic risks of productivist options, these reports would be in line with the recent papers by Syrquin (1986), who also recognizes the trend towards incorrect agricultural infrastructure in the reading of the "stylized facts" deduced from the development pattern of his first works.

The last purpose of the CAP reform is to narrow down once more the differences between world market prices and internal EC prices. Along this same line, it would be necessary to prevent price distortions due to different levels of protection within the EC itself (Koester and Terwitte, 1988). The key objective, however, is to reduce protectionism and to improve resource allocation.

It should be remembered that the majority of theoretical models assume the existence of full employment when they deal with optimum resource allocation. This hypothesis is hardly realistic nowadays.

The deterioration of farm incomes may create greater pressure in the offer side of the employment market, added to demographic factors (San Juan, 1990).

If agricultural price growth is frozen or delayed with respect to the growth of the general price level, some realistic ways to safeguard (at least partially) producers, incomes are:

- 1) improvement of the farms productivity.
- 2) to achieve that the prices of input and machinery purchased by the sector brake its growth in an equivalent manner, thus preventing a degradation of the true relation of the agricultural sector exchange.
- 3) increasing direct subsidies (or tax rebates) to family farmers and establishing other transfers, specially of a financial nature (New Community Instruments and subsidies to interest rates) to guarantee suitable financing formulas.
- 4) increasing the value-added proportion for farmers, on the total value added of the final food product.
- 5) generation of internal economies to improve living conditions of rural areas.

The first option, that is, to improve production efficiency, is the one which, being more important, will bear the most important part of the reform and of its consequences, if it is done in a rational manner. Nevertheless, as Sumpsi (1989) has observed the rise in productivity may prevent the disappearance of surpluses, even with fewer farmers, thus returning to the root of the problem.

Spanish family farming has an ambivalent position within this alternative. Still, it is true that its production is very often

below the operational level of the rest of the "old" members of the EC (due mostly to the fact that their farms were capitalized under the CAP with high prices and protection for all, to promote self-supply of food).

But it is also true that Spanish agriculture, due to its natural characteristics, is more productive than that of northern countries in a wide range of products (from traditional operations such as olives and citrus to vegetables and horticultural products). In this area, the CAP reform is not compatible with maintaining restrictions of exports of these products, agreed upon for the transition period. These hindrances reduce a general increase in the system's productivity, since to prevents localization of production in the areas of comparative advantages.

For these same reasons, if it becomes necessary to decrease wine production, for instance, the areas of the country which have a less efficient production will be the ones to bear the brunt of these reductions. In this context, the bargaining process of "historical quotas" to lessen unfavourable social effects of productivist measures runs the serious risk of checking the benefits of these policies as far as a better allocation of resources is concerned (Tió, 1989), and a promoting bureaucratic interventionism, which might eventually make the remedy worse than the disease.

It must be remembered that one of the basic goals of the present

CAP reform is to eliminate surpluses. However, measures to improve the productivity of the Community agriculture may lead to production increases, even with a smaller number of farmers. It is, therefore, fundamental that any measures implemented to stabilize excess productions include sufficient corrective factors to prevent family farms from being those mainly hurt by this process.

The fact that family farming is a significant part of the Mediterranean countries' production must also be taken into account, and that the purpose of this production is to satisfy the needs of the local market itself, not exporting. This part of agriculture is not, therefore, the cause of surpluses, we have another problem, namely family farming which focuses on production "for intervention purposes" generated in some productions and which normally co-exists with non-family farming (which, supposedly, produces for the market only) but which, in fact, is producing for intervention purposes and which, no doubt, is an aberration generated by indiscriminate use of interventionism policy itself).

Structure policy is the suitable framework to complete system productivity improvement measures in an equitable manner. It would be necessary to follow this course of action. A single market would not be admissible unless it is preceded by mechanisms to set productive structures of Mediterranean countries at competitiveness levels similar to those of the rest of the Community.

Before EC membership, Spain's agricultural input price level was, in general terms, higher than the EC average¹, while the opposite was true for agricultural product prices; for the time being, therefore, there is a margin to prevent a deterioration of the real relation of exchange in the sector. The Fertilizer Reconversion Plan, among others, has had a positive effect on price adjustment, bringing it closer to the lower levels that exist in the EC.

The third option, that is, to increase direct subsidies (or tax rebates) to family farmers and to establish other direct transfers, may prosper under the present conditions of expense reduction if it shows more efficiency than did the price policy.

The main risk to the development of these policies (as well as structure policies) is that they eventually lead to an inefficient bureaucratic muddle, and eventually are too costly for rational application.

Here, and for both efficiency and equity reasons, it would be preferable to have a system based on tax exemptions. It would then be possible to greatly reduce subsidies; but this would demand a high level of harmonization between fiscal systems of the different countries in matters of direct taxation. And this, nowadays, seems a difficult thing to achieve.

¹ The most important exception were livestock inputs (fodder) imported by Spain from third countries at a lower price. Zoosanitary and phytosanitary products, in general, had prices similar to those in the EC-9.

In matters of equity, the main advantage of a direct system of income maintenance is that it would be more effective in preventing public expenditure from benefiting other farm operations (non family), specially those with a legal status. Politically, however, support for this sector may be more restricted, even though it is a less expensive and more equitable protection system.

Subsidies to interest rates of specific credits to family farms and to the effective implementation of a sort of NCI (New Community Instruments) may be one of the most interesting formulas.

The fourth proposal (to increase the value proportion added by the farmer on the value of the end product) has, in theory, a wide field of potential action, specially in Mediterranean countries. In these countries, organization levels have been traditionally low for farmers, and marketing channels are rather opaque. The greater ease of penetration enjoyed by food and distribution multinationals (large surfaces) may bring some distribution efficiency improvements in this sector.

By contrast, the scarce "de facto" effectiveness of competition defense legislations and the lack of bargaining power by the offering side may bring about very important equity losses. It would, thus, be very desirable to prepare some measures to facilitate and promote better and stronger agricultural trade organizations (Agricultural Producers Organizations and Family

Farming Trade Unions). This is going to become a field where it will be easier to see clearly whether a single market really means a Europe of the People, or whether, in fact, it will become a Europe of Multinationals.

The fifth proposal, to generate external economies that improve living conditions in rural areas, encompasses both structural and regional policies (and transport policy, specially). Defense measures to protect the natural ecosystem will not be effective without a policy which moderates the system's trend towards rural area depopulation and towards concentration of activities in economic centers of gravity.

In this context, it is important to achieve formulas to allow the interests of rural inhabitants to be linked to the preservation of the natural environment around them, and to prevent, whenever possible, a proliferation of interventions administrative organizations. This way, less by costly and more efficient interventions may be achieved, allowing the other members of society to enjoy the benefits generated by the preservation of free natural spaces, which could then be used for tourism, leisure or environmental educational activities; in any case, their value as reserves is essential for industrialized countries.

To sum up, under the present conditions of the EC countries, external economies generated to benefit rural areas, generate, in turn, external economies for all other parts of society. In

this sense, family farming is a strategically important agent since the very survival of its environment, as opposed to the alternative of irreversible depopulation, depends, in great measure, on the survival of a sufficient number of these families. (COMMISSION, 1985; known as "Green Book").

The document L'avenir du monde rural already introduces the need to replace the policy of marginal family farm operations removal with the promotion of pluriactivity², but, in some cases, this may mean a new version of work at home or other variables relevant to hidden economies. The need to join structural policy to regional development plans is also admitted. The obvious risk of a single market generating areas of high industrial congestion as opposed to marginal and depopulated areas lurks in the background of these proposals.

A REFORMED CAP AND THE SINGLE MARKET

The creation of a single market implies reallocating activities as a consequence of a greater mobility of productive factors.

The scheme of priorities varies in different EC countries, with regard to growth and resource relocation models, since the starting situations, development levels and productive structures are also different.

² Pluriactivity is no news to Spanish agriculture: 1.34 million agricultural entrepreneurs practice it, as against only one million with a single agricultural activity (INE, 1985: "1982 Spanish Agrarian Census"). INE, Madrid).

In Spain's case, basic priorities are determined by the high level of unemployment (1989 unemployment rate: 16.9%). The base of the pyramid is very wide for the Spanish population. This means that the population able to work is rapidly growing, and is a pressure factor in the work market offer. This is clearly different from what happens in most of the other member Countries, where the aging of the population determines a narrow base for the population pyramid.

Over one fourth of the active population of the large farms (latifundia) regions, with a greater number of agrarian workers and where unemployment is higher (Andalucía and Extremadura, in the Southeast) is now unemployed, and concentrate 24% of the total unemployed. In other regions, where small farms are prevalent, (Galicia, in the Northwest), the relatively low unemployment rates are related for part-time agriculture. Hidden pockets of unemployment are suspected, as well as underemployment in rural areas.

These peculiar conditions of job offer in Spain mean that, just to maintain the present high rate of unemployment, around one hundred and thirty thousand net jobs should be created between 1991 and 1996.

The agricultural sector will lose some five hundred and seventy thousand jobs. Only a small portion of them will be caused by aging of the population (Escudero, 1988); therefore, even though an important part of rural young people prefer to find jobs in

non-agricultural activities, it is evident that the CAP reform cannot be admitted as another element to strain even more stressful situations in the labour market. It is also necessary to remember that a significant part of industrial and service activities in rural areas are linked to agriculture and, therefore, income losses of farmers would have a negative effect on employment of these connected activities.

Rural employment is very sensitive to the CAP reform. From 1986, agricultural jobs have lost one hundred thousand people, although integration effects were deemed to be beneficial in the short term.

From this perspective, the structural policy also has a large scope of action, both to protect existing jobs and to generate new activities, complementary to purely agricultural ones. New Community financing instruments (NCI), which have shown their usefulness in the field of small and medium size enterprises, may also have a wide margin of action in this context.

PERSPECTIVES

In no case does the re-nationalizing of agricultural policy seem to improve perspectives and the CAP rationalizing will, thus, be preferable, since many of its present contradictions may be solved within the framework of the single market and of the European Monetary System.

In short, the challenge faced by the reformed CAP is to prevent the reduction of the EC's agricultural protection levels vis a vis external conditions from generation depressed regions or layers of population. These measures, therefore, should have sufficient size and flexibility to counteract those undesirable effects from market mechanisms. The industrial crisis opening a period of stable energy prices is a specially suitable occasion to intensify the investments required by the new structures of agricultural offerings. The rural world should be given the chance to integrate in the path of "green growth". The failure of food supply policies in eastern European countries as well as in developing countries, open a door to short-term improvement in global markets, although European export possibilities are very much conditioned by these countries possibilities of obtaining international means of payment. What this really demands is to seek new ways of cooperation with third countries within the framework of the CAP reform.

BENEFITS

- Regulated prices and food supply security.
- Restitutions of exports.
- Funds for agricultural structure reform.
- A larger market for Mediterranean products.
- Increased offer of prepared food.

COSTS

- Resource allocation distortions chargeable to the CAP.
- The possible disappearance of farms in continental agricultural areas (continental product surplus).
- Guarantee price freezing.
- Higher prices for imported livestock fodder.

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