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GOVERNMENT POLICY IN SUPPORT OF DOMESTIC AGRICULTURE: COSTS AND BENEFITS

The European Community

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Two quotations from Corden (1974) express well opinions widely held among economists belonging to the broad neoclassical tradition about European agricultural policy, particularly the Common Agricultural Policy (CAP) of the European Economic Community (EEC).

It is protectionist: "Historically, one of the main reasons for the imposition of protective tariffs in the now-advanced countries has been to prevent changes in internal income distribution that would otherwise have taken place as a result of market forces."

It is outdated and should be revised: "The two outstanding cases (of the senescent industry argument) are the protection of continental European agriculture since the late nineteenth century and the worldwide protection of the textile industry in recent years."

In this perspective it is legitimate to ask: how was such a policy orientation chosen and maintained since the latter 19th century? And, what are the implications of such a choice, particularly what are the costs associated with this policy? These are the questions, which as I understand, the organizers of the workshop have addressed to me. I have been asked to concentrate on the domestic aspects, since other contributors will discuss the international, trade and aid issues raised by EEC agricultural policies. But, the decision to protect European agriculture has been a strategic choice which has dominated all other aspects of domestic agricultural policies. Thus, I interpret my task as assessing the domestic implications, and particularly the domestic costs, of this general, agricultural policy orientation.

As I have reservations with the concept of cost applied to policy analysis, the thrust of my paper will be devoted, first, to a restatement of the problem which leads economists to elaborate analyses in terms of costs. Thereby, I hope to show the limits of the concept of cost applied to policy analysis. Then, I attempt to derive and to compare the various implications of possible changes in current policies. It may then be appropriate to speak in terms of cost, and, thus, to show how the concept can be useful in shedding light on policy choices.

Restating the problem will imply, first, a sketch of the historical background in which policies were elaborated and evolved, and, second, a brief description of the essential features of these policies. These two tasks will be undertaken in the first and second part of this paper before turning, in the third part, to the discussion in terms of costs.

Historical Background

European agricultural policy has a long history. It is essential to take this history into account if one wants to understand the current setting. A key period was the 1870's and 1880's when European countries reacted differently to the competition resulting from progress in transportation techniques which brought grains from new countries of North and South America and from Russia at prices well-below levels deemed acceptable for European producers. Policy

orientations decided at that time have had a long-lasting influence. One has to wait until the fifties and sixties, when the European Common Market was established, to witness another turning point of potentially the same historical importance. As is well known, some countries chose to protect their agriculture, such is the case of Germany and France. Others chose to keep their frontiers open, the best known example, and probably the most extreme one as well, of that orientation is the United Kingdom (UK). Other countries such as Denmark and the Netherlands followed suit. The United Kingdom appears to have totally sacrificed its agriculture at that time 1/, whereas Denmark and the Netherlands purposively increased their cereal imports in order to feed a considerably expanded livestock population. It is, of course, well beyond the scope of this paper--and beyond the competence of this writer--to review historical developments in the 10 countries, presently members of the EEC. But, for our purpose here it will probably be sufficient to review the main developments in France, Germany, and the United Kingdom. These three sharply contrasting cases cover a wide range of problems which continue to weigh.

France. Most observers agree that the decisive choice in favor of agricultural protectionism was made in the late 1870's in order to secure an alliance between the peasants and the bourgeoisie against the workers (8). It must be remembered that just after the Franco-Prussian War, the Commune of Paris uprising--the fourth attempt at revolution in less than a century--was bloodily crushed. Fighting the socialist ideas was to be, for the next decades, a constant objective and an essential task of the dominant social groups and of the successive governments.

In this perspective, the first role of agricultural policy was ideological. In order to ensure social peace, private property ownership by small farm operators was viewed as critical. Their ruin would have been seen as a socio-political catastrophe; a major migration out of agriculture could only have swollen the ranks of the troublesome and feared urban proletariat. Political stability rested on an electoral system heavily biased in favor of the rural areas. In addition to protection from outside competition, the implicit social compact provided farm operators with a liberation from the old exploitative economic and social relationships in which they were involved.

Accordingly, cooperative and mutual credit institutions were encouraged to fight the local monopoly power of merchants; primary education was made mandatory to reduce the influence of the royalist clergy, and efforts were made to promote technical progress in agriculture. Because the latter were not successful, the protectionist policy was strongly criticized by, among others (1), who accused protectionism of having fossilized an antiquated structure. He felt that many small peasant farms incapable of adapting to modern techniques had survived, at the expense of the general economy and of

1/ Kirk (16) reports that the President of the Board of Agriculture is said to have remarked (in about 1908): "The business of the Board is to preside over the demise of British agriculture, and to make sure that it gets a decent funeral." Whether this was actually said or not does not matter much here. The mere fact that it is plausible is itself very revealing.

the peasants themselves, who were the victims of too interested protectors, eager to keep their own dominating role. But such a point of view, even though it was widely shared during the expansionist period of the fifties and sixties, is probably much too simplistic.

Ruttan, in a short but very perceptive article, has emphasized that the technical stagnation of French agriculture and the relatively high proportion of the working population kept in that sector until World War II could very well be explained by the sluggish consumer demand related to the demographic stagnation and the modest rate of industrial growth. Gervais and Tavernier (8) have emphasized additional factors which must be taken into account if one is to fully understand the logic behind the policy orientation chosen in the latter 19th century. The savings function performed by the farmers and the level of protection provided by the Meline Tariff of 1892 was not very high. It is indeed particularly significant that agriculture was a net supplier of financial resources to the rest of the economy. Thus, agricultural policy appears, during that period, as the result of a difficult compromise among many diverse objectives, of both a political and an economic nature. Contrary to the naive liberal doctrine, it is not certain that agricultural protection over more than 60 years led to a serious misallocation of resources. Undoubtedly it would have been possible to produce more, with a more widespread use of modern techniques. But, was there a market for such increased production? How much capital would this have required? Where would the labor thus liberated have gone? What would have been the social and political "costs" of such a change in policy?

After World War II, economic conditions changed drastically; the general policy orientation was seriously shifted, even if protectionism remained a major feature of the new policy. With the needs of, first, reconstruction and, then, general economic growth, agricultural production was encouraged, technical progress was promoted, credit developed. The demand for labor in industry and other sectors accelerated the movement of people out of agriculture, and this, as well as farm consolidation, was supported by various structural policies. It is true that soon farm surpluses occurred. Thus Government intervention on domestic markets, which had started for wheat in 1936, was expanded to several products, such as other grains, meat, milk, and fruits. Again, it was deemed necessary to protect farmers first from market instability and, soon, also from the general tendency of agriculture to over supply--the famous treadmill of Cochrane. The order of the day was not a restoration of free international trade for agricultural products; and the sad experience of the United Kingdom during the war did not render such a proposition very attractive either.

United Kingdom. As Kirk has emphasized, the situation in the late 19th century was unique (16). The severe fall in grain prices, which occurred in 1873, and which was not followed by a recovery as the general economic depression wore off, did not lead to a major policy decision. In a way it can be argued that the case for free trade had been decisively won earlier with the repeal of the Corn Law. Nevertheless, it must be recognized that whatever was decided, or not decided, was so done in the teeth of the farming interest in the Lower House of Parliament, and of the even stronger landlord interest in the House of Lords. A more powerful interest prevailed. This was the interest of the industrial urban population in cheap food, and its evident intention--made manifest at more than one general election--of furthering that interest by its voting power. For the same author this laissez-faire attitude essentially ended however with World War I.

The Corn Production Act (1917) provided high prices for cereals, supported by Government grants. This support continued until 1921 when the Act was repealed. This, of course, was a reduction in the degree of protection and was viewed as a "betrayal" by farmers. But, it did not signal the end of Government intervention in agriculture. Support to sugarbeets was introduced in 1924, an Agricultural Credits Act was passed in 1923, and agricultural wages were regulated in 1924. Rural infrastructure (roads, electricity, and public water) was developed earlier than in other European countries and this certainly favored the later development of milk production.

The crisis of the thirties led, in spite of considerable ideological opposition 2/, to a growing degree of Government intervention: promotion of collective market power by farmers through "agricultural marketing schemes" and quantitative regulation of imports through negotiations with supplying countries by the Market Supply Committee. This pragmatic device had the advantage of permitting liberal terms to the Dominions, in line with the "imperial preference," and harder ones for a country such as Denmark. For wheat a levy-subsidy system was introduced to support prices near a target level. All these measures set the stage for a major achievement of British agriculture during World War II. It managed to provide the population with enough food to survive and fight the war. It is true that large quantities were imported, but, in 6 years, the domestic food production, measured in calories, almost doubled, thanks in particular to a major shift from animal to vegetable products. It is not surprising that after such a performance, administered by a Government working in close collaboration with farmers' representatives, the leading farm organization, the National Farmers Union, emerged as a powerful pressure group. Thus, farmers were able to avoid the "betrayal" they had faced after World War I when the Corn Production Act was repealed. As reported by Tracy, the "Labor Government passed the Agriculture Act in 1947, and undertook to buy at fixed prices the whole domestic output of grains, potatoes, sugar beets and fatstock. The Conservative Government which returned to power in 1951 changed the method, dismantling food controls and substituting deficiency payments, but maintained the aims." 3/

Concern with the cost of such support, which was continuously growing as domestic production expanded and world prices declined in real terms, was permanent, and the case for support to agriculture always questioned by economists. In 1961, the Minister of Agriculture stated that the system of support would have to be changed whether or not the United Kingdom joined the European Community. Under such pressure, the position of agriculture regressed constantly. In spite of the Annual Price Reviews, "farm prices were on the whole held down in the U.K. by successive Governments: between 1956 and 1970, the overall agricultural price index rose only 10 percent, while the retail price index (all commodities) rose 65 percent." 4/ After having peaked at 340 million pounds in 1961, the cost of support never exceeded 300 million after 1964.

Germany. The protectionist choice was also very much the result of the particular political situation. The movement toward German unity had been favored by the establishment of a German customs union, the "Zollverein" in 1834. Tariffs on grain were lifted in 1865. But, German producers lost their British export market, and the trend toward free trade was reversed by the

2/ Kirk writes of an "ideology of financial rectitude" (16, p. 16).
3/ (23), p. 10.
4/ The agricultural price crisis of the last quarter of the 19th century had been overcome.

Tariff Acts of 1989-80. As explained by Cecil (1979), this "brought both heavy industry and the great estates into line behind Bismark. The effect was to affirm the political power of the Junkers, as well as to preserve a substantial agricultural sector within the economy." Forging the alliance between "rye and iron" Bismark was thus able to fight the socialists of the Social Democratic Party (SPD) who took more to heart the interests of the urban masses than those of the peasants, who were assumed to disappear soon into the ranks of the urban proletariat. 5/ The establishment of a Federal tariff had the added advantage of providing the "Reich" with much needed finance as German unity was not yet very solid. When he replaced Bismark as chancellor, Caprivi had to renegotiate the expiring trade agreements. He maintained the industrial tariffs, but in an effort to appease trading partners he made concessions on agricultural duties. This led to opposition from farmers who got organized in the "Bund der Landwirte--BdL," this organization was instrumental in bringing about the fall of Caprivi in 1894. Eight years later when the treaties negotiated by Caprivi expired, Bulow, who was then chancellor, was eager to cement the alliance between heavy industry and the great estates in order to get the solid political support of the Conservative and National-Liberal Parties. Duties were then increased and extended to cover livestock products. Domestic agricultural prices increased significantly: for instance, "the average price of German wheat over the period 1891-1910 was RM 17.60 per 100 kilos; the equivalent free market price in London was 12.90."

But, in 1914, Germany imported large quantities of food and fodder, particularly barley and maize, from Russia. During the war, food supplies declined drastically because of the blockade and declines in domestic yields. By the end of the 1916-17 winter, the daily diet of many was only about 1,000 calories. This had a major impact on the collective mentality regarding agricultural affairs. Food security became a major policy objective and this lasted for at least half a century. This concern may still be alive today. After the war agricultural reconstruction proceeded fairly rapidly. Prices were fairly stable until 1924 but they fell afterwards. In 1925, the rightist coalition in power reestablished tariffs against the opposition of the SPD, which continued to defend only the interests of urban workers. Most economists were then in favor of free trade (16).

Continued price declines stirred up peasant agitation in the late twenties, leading to the establishment of a "Green Front" and the adoption of flexible tariffs in 1929. Surpluses, particularly of rye, accumulated, which led to further Government intervention, this time on the domestic market. These measures did not suffice, given the sluggish demand resulting from the general economic crisis. As a result, the Nazis, in the thirties, easily succeeded in securing the peasants' support as they appeared to take the bull by the horns, cutting off German agriculture from the outside world. This was in line both with the preparation of the war, which required food self-sufficiency, and with the Nazi ideology giving the peasant an essential role in maintaining the purity of the "Nordic race." In the same perspective, support was given to small family farms in the form of debt repayment and security of tenure. According to Cecil: "By 1938 impressive results were being registered; the country was self-sufficient in bread grains. Evidently the price paid by

5/ It is precisely the failure of this prediction which led Kautsky to his masterful study of the "agrarian question" (15).

farmers, in terms of subordination to a powerful bureaucracy, was a high one but they could feel that they had regained a place of respect in the community and would not again be left at the mercy of harsh economic forces." This success of the Nazi Government had a lasting impact after the war. The new regime could not have afforded to bear the same negative image as the Weimar Republic. Support to peasants has continued.

The main impact of World War II on future agricultural policy was to strengthen the concern for security of food supply in the public-at-large and among politicians. The sense of urgency was greater after the war as partition had in effect cutoff the western zones, which formed the Federal Republic, from its traditional eastern supplies. This and the tensions of the cold war probably explain the decision to heavily protect domestic agriculture from free-market forces. With industrial and general economic growth, the standard of living in the population-at-large increased rapidly, and, thus, farmers continued to appear relatively disadvantaged and deserving special treatment. It is true that economists have argued for a long time that it would be more efficient to promote structural changes in order to make agriculture competitive. Indeed they had an influence in the national debate, which produced the famous agricultural law in 1955; measures to increase the size of holdings were taken and had a positive impact. But, these were not a substitute for high prices, as appeared clearly when prices were to be harmonized with those of neighboring countries in order to set up a European Common Market.

Historical Lessons

This brief review of the historical developments of agricultural policies in France, the U.K., and Germany should be sufficient to illustrate several points which were very influential in the debates about the establishment of the CAP almost 20 years ago, about the admission of Britain 10 years ago, and about the maintenance or the reform of the CAP today:

- Government intervention is general and pervasive; its legitimacy is not questioned by any significant segment of society. It is widely accepted that the farm sector should not be left to free-market economic forces. In this regard, it should perhaps be stressed that interventions actually affect many domains, much more numerous than those which have been touched upon in this paper.

- The degree of protection from world markets has varied in time and space. Historically, France and Germany have been much more insulated than the U.K. These three examples suggest that the degree of protection depends upon the economic, social, and political place of farmers in society. But, in all three countries the extreme diversity of farmers' situations does not seem to have had a significant impact on domestic price and market policies.

The Common Agricultural Policy

As Pompidou, then Prime Minister of France, explained clearly in 1965 in an interview to Le Monde: "The Rome Treaty, as it had been conceived actually created only an industrial common market. But such a common market put French industry in direct competition with the outside, particularly with the powerful German industry. It was acceptable only if it was offset by an agricultural Common Market providing our agriculture with important outlets at

remunerative prices thus permitting the Government, unburdened of the necessity to support agriculture, to diminish the costs born by industry." This candid statement of the French position was never questioned. It was essentially accepted by France's most powerful new partner, as the German Government soon imposed, at great political risk, to its farmers the principle of common European prices, which meant a reduction of German prices. This particular treatment of agriculture led to the paradoxical situation where agricultural policy became the most important element of Community affairs. Thus, debates about agriculture have in a way become the testing ground for Europeanism, a situation which has probably helped to maintain the principles of the CAP but which in the long run may be damaging both to agriculture and to the European ideal. Before drawing the implications of this situation for our analysis in terms of costs, it is, however, necessary to recall briefly the main features of the CAP and to point out the elements which remain under national control.

Common Features. Numerous descriptions of the CAP are available.6/ Thus, only the essential elements will be briefly recalled here. The first objective was to achieve a common market for agricultural products. This objective is to be related to the general objectives of the Treaty of Rome: to achieve the union of the people of Europe, to increase the standard of living of all Europeans, and to promote the accelerated development of the poorest regions.

More specifically, the famous Article 39 of the treaty spells out the following objectives for agricultural policy:

a. Increase agricultural productivity through technical progress and the promotion of an optimal use of resources, particularly labor;
b. Ensure an equitable standard of living to the agricultural population, in particular by an increase of the income of those who work in agriculture;
c. Stabilize markets;
d. Guarantee the security of supply;
e. Ensure reasonable prices to consumers.

Of course the world has changed since 1958; new objectives, concerning for instance the protection of the environment, the welfare of the consumers, or regional development, would occupy a more prominent place if the treaty was rewritten today. However, it is important to keep in mind the objectives pursued by a policy when one assesses its costs. We will come back to this later.

Price and Market Policy. The establishment of a common market led directly to a price and market policy, which was supplemented only about 10 years later by a structural policy. The pursuit of the objectives spelled out in Article 39 was undertaken through the adoption of three principles guiding the elaboration of market intervention mechanisms suited to every category of products:

a. Unicity of the market, that is, creation of a single domestic market in which each national market, for example, the French or the Dutch market, is a regional one, as, for instance, the California market in

6/ See as an example (14).

the United States. This means that Community institutions alone are responsible for the day-to-day management of policy instruments.

b. Community preference, that is, market intervention mechanisms, must be such that for the same product all buyers within the Community are incited to satisfy their needs from within the Community rather than from outside.

c. Common financial responsibility, that is, the intervention costs, are supported by the Community as a whole. This has been achieved through the creation of a common fund, best known by its French acronym, FEOGA. Accordingly, levies collected in Rotterdam, Rouen, Hamburg, or Liverpool go into FEOGA, even if they go through the Dutch, French, German, or British Treasury.

The specifics of the intervention mechanisms vary from one category of products to another, and this has important consequences as it leads to great variations in the degree of protection. But, since this section is devoted to common features, it is sufficient to concentrate here on the similarities rather than on the differences among products.

For all products which have the benefit of an intervention, the Community, through its Council of Ministers, fixes a target or indicative price every year. From this level are derived both an intervention price, (that is, a price level such that if the market price falls below it, intervention buying by official intervention agencies becomes mandatory), and a threshold price (that is, a price level where if the world-market is below it, the difference between the two levels is collected as a levy on imports and paid as a subsidy to exporters, called a "restitution" . This "variable levy-restitution" scheme applies directly to cereals, and indirectly to poultry and pork. It is often and, rather justly, taken as the basic structure of the CAP market-intervention mechanisms. Actually, the instruments used are extremely numerous and diverse: Oilseeds are subsidized; sugarbeets have the benefit of a price-support scheme, but within three types of quotas; milk has the added feature of a coresponsibility levy on producers; durum wheat has a deficiency-payment scheme; cut flowers are protected only through a customs duty.

In spite of this diversity of policy instruments, the respect of the three principles led to the establishment of a truly common market. It is probably of historical significance that this major objective was reached in less than 10 years. The first proposals were officially put forth by the Commission on June 30, 1960, and all major agricultural markets were unified by the summer of 1968, while the customs union was achieved on July 1, 1968. Soon, however, the invention of the Monetary Compensatory Amounts (MCA's) dealt a very serious blow to this achievement, as we will see in more.detail below.

One result of the diversity of market-intervention measures is that, if the degree of protection from the world market is high for some products, it is at the same time quite low for others. This has led to considerable debate within Europe and also with its trading partners, as exemplified in the various rounds of trade negotiations in the GATT. It has also led to significant domestic-market stability and to large surpluses for some products, particularly cereals and dairy, and, consequently, contributed to world-market instability.

Structural Policies

Price support policies have long been criticized as inefficient and inequitable. They are not equitable because they provide the largest income support to the largest, that is, the richest, producers. They are not efficient because they slow down the necessary adjustment in farm structure which would bring about a better allocation of resources. We shall discuss below the limits of these arguments but they are sufficient for our present purpose, as they provide the theoretical basis of the structural policies to be discussed here.

The debate about the most efficient farm structure has a long history and is still open today. Numerous authors have believed that industrialization was the keyword characterizing the transformation of agriculture. The brief historical sketch presented above has only alluded to some of the debates and policy measures regarding agricultural structure in the three countries reviewed. In France, the Gaullist Government brought about a major change in agricultural policy emphasis. The price-escalation-with-inflation mechanism was abandoned and the passing of the Agricultural Orientation Act of 1960 and the Complementary Act of 1962 launched major structural programs promoting the early retirement of old farmers, the migration and training for nonagricultural jobs of farmers or of their children willing to leave agriculture, and the establishment of institutions intervening on the land market to facilitate farm consolidation. But, at the Community level, the structural question had not really been publicly discussed before the spectacular presentation of the famous "Mansholt Plan" in 1968. This candid presentation of a policy designed to shrink the agricultural sector, in terms of production, labor employed, and land use, faced a tremendous public outcry. Farmers were in an uproar and many politicians were upset with Mansholt for saying publicly what everybody knew but would not admit. In addition, the accelerated rhythm of change, which was thus suggested, was deemed socially unacceptable and therefore politically infeasible. Thus, it is not surprising that the plan was not adopted but that a few years later a watered-down version of the same ideas was embodied in the so-called structural directives which constitute the essential structural component of the CAP.

As emphasized by Fennell (7), the corresponding measures, financed out of the Guidance Section of FEOGA, are more flexible than the market regulations presented above. They leave a wider margin of maneuver to national governments for their application. In addition, they provide only partial financing, the balance being met by the national government and, also, even the recipient farmer. Two measures stem directly from the spirit of the Mansholt Plan: The aid to farm modernization (directive 72/159) and the early retirement scheme (directive 72/160). The former essentially provides farmers, satisfying specific conditions, with investment aid, mainly subsidized credit. The latter provides older farmers, willing to retire and to let their land serve for farm consolidation, with monetary incentives. In several countries this early retirement scheme works as a supplement or, sometimes, a substitute to similar national programs which existed earlier. Elsewhere it does not seem to have had a very great impact. The former, which is much more selective in terms of its target group, has had an impact on the distribution of subsidized credit. Paradoxically, it has often had, as a consequence, an increase in milk production, already a surplus commodity in the EEC. This results from the eligibility criteria. Farmers must elaborate a development plan. They are eligible for help if, at the beginning of the

plan, their labor income is less than a regional reference, and if it can be reasonably anticipated that at the end of the plan it will be at least equal to that reference. In many instances, only dairy farmers who are considerably expanding their enterprises will meet these criteria. In addition, these farmers must meet some minimum requirements in terms of level of agricultural education, and they must keep farm accounts of a standard type.

There are many other measures aiming at the general uplift of poorly skilled farmers or at the support of farmers in various types of situations. Most of these measures are applicable either for specific products, such as wine, or in special regions. Such is the case for the measures in support of mountain and hill farming. On the whole, these specific measures have been agreed upon by the Council of Ministers, in a very ad hoc fashion, as part of a global deal in one annual price-fixing negotiation or another. The expression "the Mediterranean package" used a few years ago in Brussels is very revealing in this respect.

The pejorative tone of these comments should not, however, be taken as derogatory. These measures reflect the nature of the Community decisionmaking process. As a result, is it conceivable that an added emphasis on "integrated regional development," as apparently contemplated at the present time in at least some circles of the Commission, may be a politically feasible way out of the current situation where agricultural market support eats up about 70 percent of the total Community budget.

The Movement Towards Renationalization

As the CAP has mainly been a market policy and as government intervention has touched for many decades, in all countries, a great array of domains, it is clear that the CAP has only been one, albeit important, aspect of agricultural policies within the EEC. As to other policies affecting long-term adjustments of agriculture to changes in economic and social conditions, we will touch upon them here. But, another element of national variation stems from the exceptions, begun as early as 1969--the year following the completion of the common market--to the principle of unicity of price.

Policies Influencing Long-Term Adjustments. The fact that various national governments have pursued for many years specific structural policies was already mentioned. In addition, emphasis should be placed on the various policies regarding the promotion of knowledge and technology. Strangely enough, these policies, which are more and more recognized as critical for the agricultural development of less developed countries (LDCs), have received very little attention in Community debates. Yet, the range of policies in this general area is very wide and their possible long-term impact significant. Twenty or thirty years ago cane sugar appeared much more economical to produce than beet sugar; thanks to differential rates of technical progress, this is much less obvious today.

The range of these policies cover initial education, continuing education, and research. In all these areas the national differences are very great, so much so that it is even very difficult to assess them. The Community has attempted to launch a program of cooperation in agricultural research. But, even though this is an area of obvious common interest, not much has been achieved for lack of sufficient funds but, also, perhaps, because the agricultural research institutions in member countries are very diverse. In the fields of extension

and promotion of technical progress, national authorities spend large amounts of money in very diverse forms and probably with very unequal effectiveness at the national as well as regional levels.

Other important domains of intervention include infrastructural public investments, investment support to farmers, and help to marketing organizations. About these we know that they are also important and diverse; but the truth of the matter is that, to this writer's knowledge at least, there is no publication that systematically describes and compares these measures, not to speak of any comprehensive analysis of their impact on agriculture in the various countries.

The Monetary Compensatory Amounts (MCA's). To recall briefly, in 1969 when the French franc was devalued and a few months later the Mark revalued, the respective Governments decided that they could not respect the principle of the common price for agricultural products, expressed in the common unit of account. The reason was inflation, which would follow the devaluation, and the interest of the German farmers who would have had to accept a reduction of the prices expressed in marks, that is, the prices which they received. It was felt that temporary levies and subsidies would permit countries to weather the monetary storm. Thus, the famous MCAs and "green currencies" were born.

Actually the successive devaluations and revaluations have been such that MCAs have ever since constituted a quasi-permanent feature of the European agricultural scene. This means that there is not one single price and that farmers in strong currency countries have had a competitive advantage over their colleagues in weaker countries (19).

The decision process regarding each country's MCAs has been such that a great degree of flexibility is kept by each national government. Thus, as argued by many authors (11, 21, 22), the decisions regarding agricultural price levels have been, to a great extent, renationalized. Whether this is to be regretted or not is a question on which economists differ. Ironically, for those who advocate the objective neutrality of the social scientists, one cannot but be struck by the fact that French economists lament this breach in one supposedly fundamental principle of the CAP, whereas German and British economists admire the MCA system because it is flexible and "remarkably well suited" to meeting the requirements arising out of "the great disparities between member states in terms of economic performance and farm structure" (11).

The establishment of a European common market for agriculture in the sixties was undoubtedly a great achievement of historical significance. But it has not been possible to develop a full-fledged, comprehensive agricultural full-fledged, policy. The structural component is still very weak and, more importantly, many policies affecting the long-term evolution of agriculture remain within the sphere of national decisions. In addition, the introduction and the performance of the MCAs has given back to national governments a great degree of freedom in decisions regarding the domestic level of agricultural prices. These developments may be interpreted as reflecting deep divergences of view among member countries regarding the long-term future of their agricultures and the policies needed to bring about the necessary adjustments. In this perspective the well-known annual disputes regarding agricultural prices and budget contributions could be taken as other illustrations of these divergences. It is against this background that we can come at last to the main topic of this paper; the question of policy costs.

Policy Costs

Concepts and Approaches. A commonly accepted definition of policy costs is implied by the following quotation: "Certainly it is not difficult to show that the CAP makes economic nonsense, in that there are alternative policies which could yield efficiency gains relative to the existing policy, but which need not involve any deterioration in the extent to which the policy achieves what usually regarded as its major objectives" (19). Furthermore, the present policy costs more than alternative policies would; without sacrificing any major objective it would be possible to achieve efficiency gains, that is, to save costs. In the same paper Ritson cogently argues that this situation can easily be explained if one recognizes that the Community policy decisionmaking process does not operate as a search for the optimum of a Community welfare function, but it is the result of a compromise among national governments seeking to maximize their gains and minimize their losses. This view has led to a surge of interest, particularly in the United Kingdom, for the question of the benefits and costs of EEC membership. Precisely such is the title of a workshop which was held at Wye College in 1979. In the first sentence of the first paper of the workshop, Reid emphasized: "The cost of membership of the European Community has in recent months become a highly political topic" (25). This is particularly true in the United Kingdom and has led the British Government to insist that its contribution to the Community budget be diminished. One may wonder whether or not this particular point of view on policy costs has not unduly attracted the economists' attention and excluded other aspects which are also very important for policy analysis.7/ But, assessing all the transfers among countries resulting from a given policy is already very difficult. An effort to simplify the problem has been presented by Godley, of the Cambridge Economic Policy Group, which has done influential work on the cost for the United Kingdom of EEC membership (19).

Godley writes, "In this paper we are not discussing the so-called 'direct' costs to Britains of EEC membership in which comparison is being made with a hypothetical position in which we are not members. What we are doing is examining how the present system of financial transfers between member countries is working...that is, examining the patterns of transfers." The objective appears straightforward and useful but, as explained on the next page, the financial effects ("in principle quite easy to calculate") fall in two categories: the net cash payment to the Community Budget and "the costs incurred by countries which import food for the rest of the Community at prices higher than they would otherwise have to pay"(9). In other words, a reference situation has to be defined as a basis for comparison. In her review of the workshop, Loseby (18) emphasizes this point: "Numerous methodological difficulties were encountered, which can probably be reduced to the basic problem of defining a reference situation against which to measure the effects of the CAP."

7/ Having pleaded elsewhere for the development of an "analytical political economy" (20), I do not want to imply here that political considerations can be excluded from economic analysis. My point is that they should not blind the analysts or completely distort the conception of the tasks which they have to perform.

The fundamental problem encountered in calculating national costs and benefits was very well described by Koester during the same Wye workshop: "Estimation of the cost of the CAP to member countries is virtually impossible without making strong value judgments. If costs are defined as opportunity costs, the identification of positive costs indicates that the nation would be better off with a different policy. Such a statement could only be established if the objective function for that society was known and the alternative policy (the reference system) must be acceptable in every respect; that is, politically, socially, and administratively"(17).

The purpose of these comments is to emphasize that economists must not forget the limitations of the hypotheses which they accept implicitly or explicitly. But, this does not imply that the exercise of calculating national costs is useless. Researchers have identified four types of costs: the net budget costs, balance of payments costs, costs to consumers in the form of higher prices, and the effect on total real income in different member states. But, these do not really capture the changes in the welfare of consumers, producers, and taxpayers arising from policy changes, which must, of course, be included in a comprehensive assessment of policy costs. As explained by Buckwell and others, "The political debate of the last two years has focused almost entirely on the net budgetary costs to particular member states. This ignores the cost to consumers throughout the Community who pay more for their food than they might do under a different policy. It also ignores the cost of the misallocation of resources resulting from the over-expansion of agricultural output. Within the neoclassical economics tradition these welfare impacts are approached through the Marshallian concept of producers' and consumers' surpluses. For agricultural policy, this approach was first used in the field of international trade to estimate the welfare cost of protection (5, 6). Following this lead, Josling has proposed a comprehensive conceptual framework "to examine the relative efficiency of several alternative methods of price support for agricultural commodities" (13). The link with international trade is direct, as he stresses in a footnote that his analysis refers only to goods competing with imports. Recently, Buckwell and others have followed this approach to measure the costs of the CAP.

Here again, the theoretical limits of the approach should not be overlooked. It does permit us to define total costs and to derive unit average and marginal costs. Thus, it provides criteria to judge the relative efficiency of various policies. But, it is subject to the fundamental limitations of the Marshallian concept of surplus. First, as indicated by Boulding, "it is perhaps better to call it the buyer's surplus; the corresponding concept for sellers may be called 'sellers' surplus"(2). But, the most important limit of the concept, as used for policy analysis in terms of costs, is that it assumes that the social welfare function can be aggregated from individual utility functions. Boulding, for instance, shows that from an individual's indifference curve, one can derive an individual's demand curve and that the corresponding buyer's surplus is equal to "the compensating payment which would compensate for the loss of the market," if the marginal utility of money can be taken as constant. For computing a policy total welfare cost, we must aggregate the individual's surpluses so defined; one must further accept to add in one lump sum consumers' surplus, producers' surplus, and budget cost. At this stage, the judgment of the analyst intervenes. Analysts must decide whether or not the assumptions are too heroic for their intellectual tranquility. In any case the assumptions should not be forgotten.

A final set of limitations of the surplus approach is that it is fundamentally based on partial equilibrium analyses. Dardis (1967) has carefully spelled out the limits resulting from this feature: "The use of partial equilibrium analyses in the present study rests on the following assumptions:

1. The relative unimportance of grain production and trade in grain in the United Kingdom economy;

2. The equivalence of consumer prices to free market prices resulting from the employment of a deficiency-payments system;

3. A relatively inelastic domestic supply;

4. An elastic world supply."

This should be sufficient to illustrate the type of assumptions which must be made to ignore the macroeconomic effects of a policy change.

The analysis in terms of costs of the CAP has often been unduly restricted to the political debate regarding budget contributions. Economists have identified other types of costs due to the trade and welfare effects of the policy. These can indeed be viewed as the total costs of the policy. But, estimating them is fraught with many theoretical difficulties, in addition to the practical and technical ones which have not been discussed in this paper. In my judgment, the most serious limitation stems from the use of static partial equilibrium analysis which is not well suited for analyzing the long-term impact, particularly in terms of possible resource misallocation, of the CAP. These effects could only be assessed in the framework of a dynamic model, reflecting changes in farm structures, labor and other input use, technical and institutional changes, etc. This implies that long-term total costs are not of much use because they are too far removed from the concept of opportunity costs 8/ and they rely on shaky assumptions about the existence of a long-term equilibrium. By contrast, it may be very useful to identify the diverse short-term costs associated with a contemplated change in policy. This is what we try to illustrate in the following section.

Costs Associated With Dairy Policy Alternatives

Here, an attempt is made at identifying various costs associated with possible changes in the CAP. No attempt will be made at adding up these costs, in the belief that identification of diverse costs, together with the identification of the gainers and losers, is more useful in the policy debate than a global judgment about the effectiveness of each policy. In this respect a serious limitation of the exercise should be pointed out: The analysis is conducted at the Community level, and no attempt will be made to disaggregate at

8/ The previous presentation of the historical background and of the structure of European agricultural policies should hopefully be sufficient to convince the reader that there is no reference situation, such as totally free trade for instance, against which to usefully compute total cost.

national levels. As already indicated, domestic costs will only be taken into account. Assuredly, the costs to outside countries can be very important but they are outside the scope of this paper.9/

First, I tried to build a specific enough analytical framework for the agricultural sector as a whole. But, this proved to be inadequate because, as seen above, there exists a large variety of measures supporting the various markets; it is not possible to build a specific enough frame of analysis to handle all these instruments at once, or this can only be done in very general and not very useful terms. Therefore, I chose to work on the example of a market for one product. Milk was chosen because dairy policy is one of the most controversed in the EEC. Dairy surpluses have accumulated and their disposal takes a large share of FEOGA expenses. A coresponsibility levy, that is, ultimately a decrease in the level of price support, has been instituted and this has been the object of numerous debates, particularly between the EEC Commission and farm organizations as well as among farmers, many of them being upset with their organization officials for having accepted the scheme.

Given the current debate about CAP problems two alternatives to the current policy will be examined: a reduction in the level of price support and the establishment of marketing quotas with differentiated prices. 10/ Each one constitutes a prominent feature of proposals made over the last few years: for the former by the Commission and for the latter by the French Socialist Party.

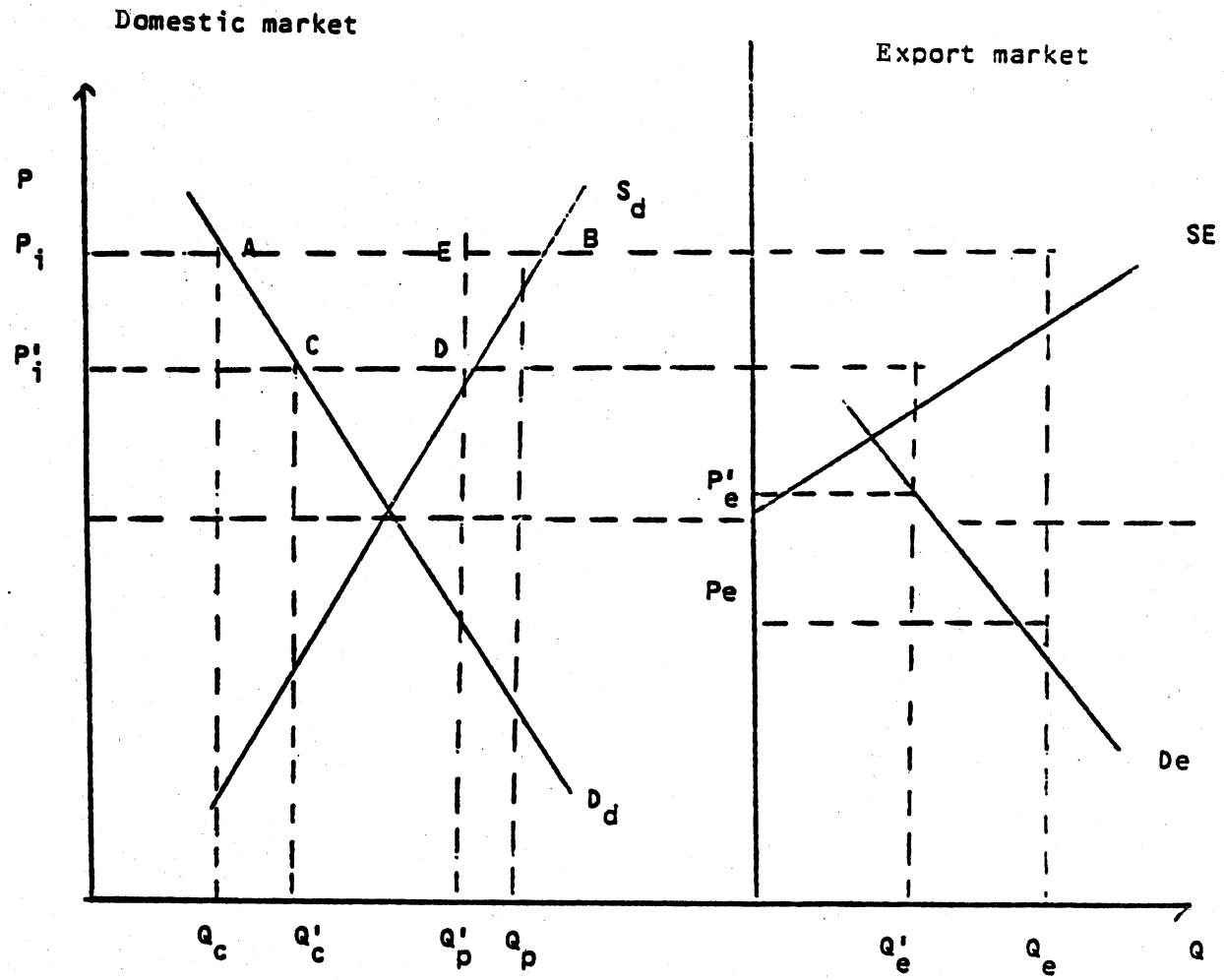
Reduction In Level of Price Support

The analysis of the effects of a decline in the price-support level is conducted in figure 1. It is assumed that at intervention price Pi, the quantity produced (Qp) is determined on the domestic supply function (Sd), while quantity consumed (Qc) is determined on the domestic demand function. Neglecting intervention storage, or assuming that it is only temporary, the difference must be exported. So if Qe is quantity exported, Qe = Qp - Qd. For each intervention-price level, a quantity to be exported can thus be derived; this is expressed on the right-hand side of figure 1 by the export supply function (Se). In present circumstances, the corresponding point on the (Se) curve is well-above the corresponding demand curve (De) on the export market, which sets the level of price (Pe) at which Qe can be exported. A restitution equal to Pi - Pe has to be paid out by FEOGA. When the intervention price is decreased from Pi to Pi', under usual assumptions

9/ For a recent evaluation see (25), who also show that the results can be somewhat surprising. Thus, they estimated that if a 50-percent reduction across the board in tariffs and other trade barriers for 99 commodities in 19 Organization for Economic Cooperation and Development (OECD) countries would greatly benefit the LDCs as a whole, it would not help the low-income group of LDC's, the welfare gains on exports being offset by losses on reduced imports of cereals.

10/ For a recent and general presentation see (14); a good collection of papers regarding national attitudes was presented in Bruges in 1979; see the papers by Clerc, Marsh, Ferro, Lechi and Ricci, and Tangermann, in (24).

Fig 1 : Impact of a decline in price support level.



regarding short-term demand and supply elasticities, less is produced (Q'p), more is domestically consumed (Q'c), less will have to be exported (Q'e), fetching a higher price (P'e) on the export market.

The budget, trade, and welfare impacts (costs) are straightforward:

Budget savings are equal to: Qe (Pi - Pe) - Q'e (P'i - P'e). The amount saved is the greater: the larger the decrease in price intervention, the greater the elasticity of domestic supply; the greater the elasticity of domestic demand, the lower the elasticity of export demand.

The balance of payments impact is equal to Q'eP'e - Qe Pe. It is a function of domestic supply and demand elasticities and export demand elasticity. If the latter is larger than 1, a decline in intervention price brings about a loss in foreign-exchange earnings.

The consumers' gain, estimated as the change in consumers' surplus, is the area $P_iACP'_{ij}$.

Obviously the greater the price decline, the larger is the consumers' gain; the latter also increases with the elasticity of domestic demand.

The producers' loss, estimated in the same manner, is the area $P_iP'BD_i$. Of course, it depends on the extent of the reduction in intervention price, and on the elasticity of domestic supply; the greater that elasticity, the lower the loss of producers.

The value of resources transferred out of agriculture is equal to area $Q_pQ'_pDB$. It is the greater the larger the decline in intervention price, and the larger the elasticity of supply.

These results shed some light on the debates about this policy alternative. Of course, producers are against it, while those who have the consumers' and taxpayers' welfare at heart are for it. Let us note that, beyond this obvious conflict of interest, much depends on supply and demand elasticities which are poorly known. If the domestic supply and demand elasticities are low and the elasticity of export demand relatively high, a likely situation, the consumers' gain is not very large, while the producers' loss is large and the impact on the balance of payments is negative. Since, in addition, the amount of resources transferred to other sectors was limited, one can understand why it was only under budget pressure that this policy change was proposed.

Quotas and Differentiated Prices

For the sake of clarity, only a simple version of this policy will be discussed here. The analysis is conducted in figure 2, drawn in the same manner as figure 1. With current policy, the same initial situation prevails, characterized by Pi, Qp, Qc, Qe, and Pe. Let us assume now that up to a total quantum q, the same intervention price Pi prevails and that beyond the quantum a, lower intervention price P'_i is enforced. We assume further than the quantum is distributed in individual quotas to producers in such a manner that they all face a marginal price P'_i. Thus, Q'p is produced at the intersection of (Sd) with price P'_i. The export supply curve changes since Q'e = Q'p - Qc, the price to consumers having not changed this time. (Se) "tilts" counter-clockwise to (S'e). The same export demand curve gives us the price P'e at which Q'e can be exported.

The budget, trade, and welfare effects can be analyzed as follows:

Budget savings are represented by the shaded area on the left-hand side of figure 2. This results from the fact that q - Qc is still paid by the intervention agency at price Pi, while Q'p - q is bought at P'i. In the initial situation, budget cost was Qe (Pi - Pe). In the new situation it is (q - Qc) Pi + (Q'p - q) P'i - Q'eP'e.

The amount saved depends on the elasticity of supply, the elasticity of export demand, the quantum, and the price differentials. It is greater the larger the price differential, the smaller the quantum, the higher the elasticity of supply, and the smaller the elasticity of export demand.

The balance of payments effect is Q'eP'e - Qe Pe. For a given price differential it depends only on the elasticity of domestic supply, which is the same as the elasticity of export supply since domestic consumption does not change, and on the elasticity of export demand. Here again, if the latter is greater than 1, the new policy leads to a loss in foreign-exchange earnings.

Domestic consumers are not affected.

Producers' loss is represented by the area EBDF. It is the greater the smaller the quantity, the larger the price differential, and the smaller the elasticity of supply.

The amount of resources transferred to other sectors of the economy is represented by area $Q_pQ'_pBD$. As in the previous case, it is the greater the larger the price differential, and the larger the elasticity of supply.

These results also shed some light on the debates around this policy alternative. One can understand why it is attractive in the short run in spite of the well-known long-term problems posed by quotas. 11/

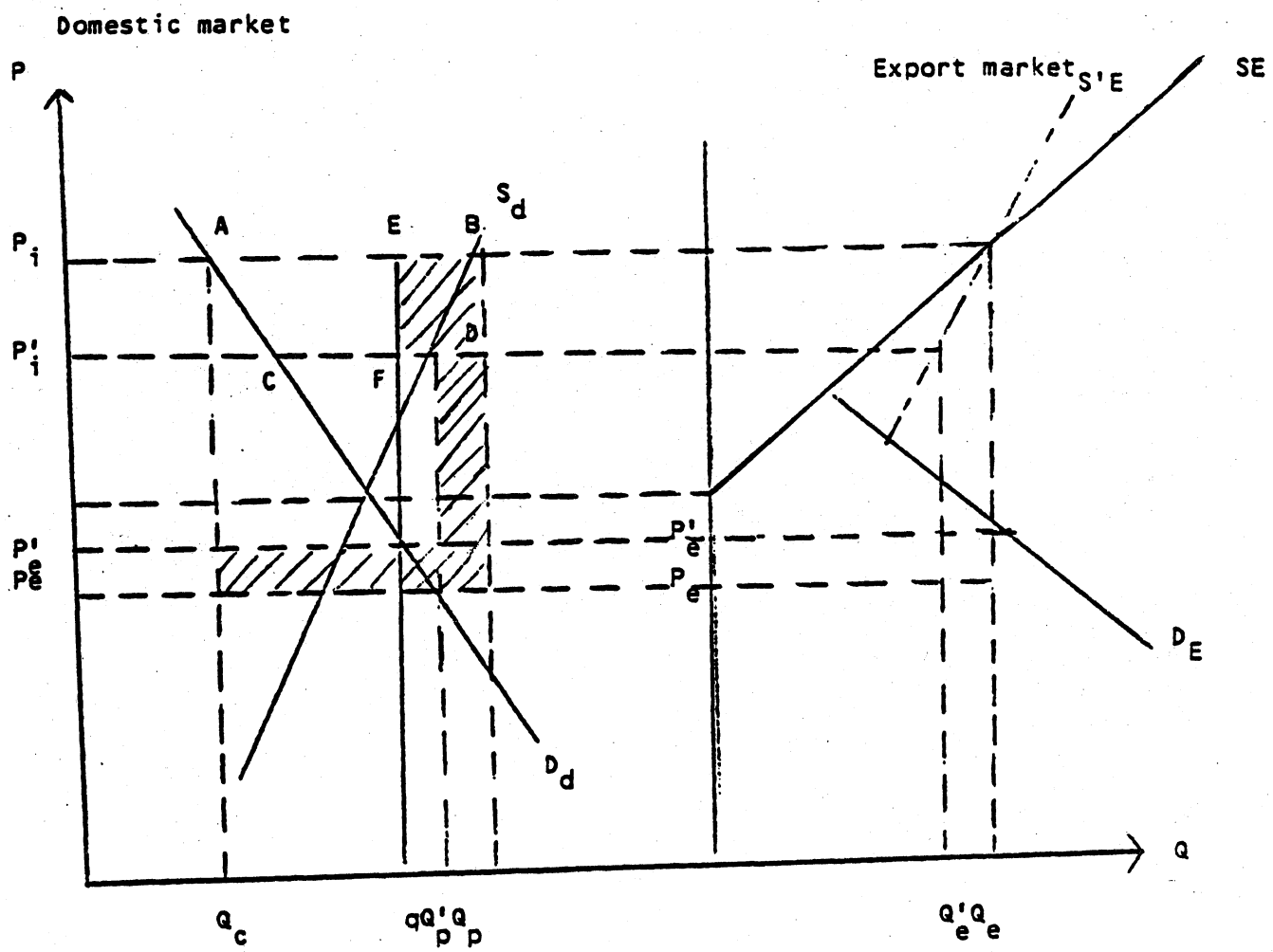
Budget expenses can be reduced, without hurting producers too much. Besides, even though (or perhaps because) there has been little discussion about procedures for distributing quotas among producers, the scheme seems to lend itself easily to some income redistribution among dairy farmers, protecting the smaller ones, while permitting an increase in the price differential if large surpluses would pile up again.

Comparison Between the Two Policy Alternatives

The comparison between the two alternatives, to be useful for policy discussions, must be done holding some variable constant (usually a policy objective variable) and investigating differences in other dimensions of the problem. For the purpose of analysis, it is convenient to compare the impact of the two policy changes for the same reduction in price Pi - P'i, even though prices are policy instruments and not policy objective variables.

11/ (10), Hathaway, 1963).

Fig. 2 - Impact of quotas and differentiated prices.



From the previous analyses, it appears that the same price differential brings about the same reduction in total supply and the same reduction in the use of mobile resources. With a reduction in the level of support, consumers gain more, producers lose more, and the reduction in budget expenditures is larger than with the establishment of marketing quotas and of a price differential equal to the price reduction of the first alternative. The balance of payments effect is larger in absolute value with the former than with the latter, its sign depending on the elasticity of export demand.

The preference for one, rather than the other, of these two alternatives will thus depend on the relative weights given to these various gains and losses. In any case, it seems difficult to incorporate them in a single social utility function, of which one could then seek the optimum.

In order to clarify the choice, it would be more useful to compare the two alternatives for the same value of a given policy objective, for instance, for the same amount of budget savings. Simple algebra shows that equalizing the two expressions of budget savings given above leads to one equation of the first degree relating three instrument variables (decline in price support level, quantum, and price differential), the parameters of the equation, depending on the initial price and quantity values, and the elasticities of supply and demand. This means that it is possible to achieve the same budget savings but, if a quota scheme is enforced, the price differential must be greater than the reduction in the price-support level of the first alternative. The larger the quantum, the greater the price differential must be. Assessing geometrically the impact of such comparable policy alternatives on the other variables becomes unmanageable. One would need to resort to a simulation exercise.

This exercise will hopefully be sufficient to illustrate the limits of policy analysis in terms of costs. Within these limits, the usefulness of such an analysis should, however, not be neglected. One may perhaps regret that agricultural economists have given too much attention to long-term costs, which in my view at least are not very meaningful and only very partial, while neglecting the short-term impacts, which can more easily be analyzed in reference to a partial equilibrium framework, and which weigh so much in the policy decision process.

Of course, this state-of-the-art is not intellectually satisfying. Economists often pride themselves with their ability to pay attention to long-term adjustments; whereas policymakers, particularly politicians, cannot afford to do it. Thus, the point of view expressed in this paper tends to undermine the social function traditionally claimed by economists.

Actually, the thrust of the argument is a little more complicated than that:

- Economists should be careful not to oversell their case. Economic analysis of policy issues is always partial and should not be presented as global and comprehensive. In this respect, the concepts of long-run total cost and effectiveness are dangerous.

- But, partial analyses can be very useful and concepts of short-term costs to various social groups are relevant.

- Long-term impacts are of course essential and, therefore, should be investigated. Economic tools can be very useful for that purpose, so much more so if the analysts are keenly aware of their main limitations. What we need are approaches to the dynamics of adjustments and of the interrelationships between economic and political phenomena.

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