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***THE EU AGRICULTURAL POLICY: A CONSUMER VIEWPOINT***

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# The EU Agricultural Policy: a Consumer Viewpoint<sup>1</sup>

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<sup>1</sup> Part of this paper was discussed at the 26-5-1998 meeting of the EU Consumer Council, DG-24, Brussels.

# **1. NEED FOR A CONSUMER POLICY**

After the fall of the Berlin Wall and the collapse of centralised socialist regimes, the essential contribution of market forces to the increasing of social welfare and fostering of economic development are universally acknowledged. Almost all governments world-wide are now explicitly or implicitly accepting free enterprise and free trade as the major engine for economic development. The economic potentials of private self-interest in generating income and wealth are generally appreciated, together with the social benefits of the 'invisible hand' in the allocation of economic resources.

## **1.1 Market failures**

However government intervention in the economy is by no means ruled out, it still accounts for a large share of income production and distribution, almost 50% of GNP in the European States. Yet its action is becoming less and less centred on production and trade, and increasingly oriented towards offsetting the negative impact of market failures on social welfare, i.e. improving economic efficiency, reducing income disparities, stimulating the supply of public goods and positive externalities while contrasting negative externalities.

If government action in offsetting existing market failures were perfect, the economic and social objectives stated in the EU Treaties would be fully achieved and social welfare would be largely improved.<sup>2</sup>

## **1.2 Government failures**

Unfortunately, as anyone can bear witness, this is not the case at present. Large market failures are still evident: the impact of economic policies is often unknown or misunderstood by citizens, resource misallocation is widespread in the economy, income distribution is unsatisfactory, particularly in some states and regions, and environmental protection is far from being fulfilled. There is obviously 'government failure' preventing the desired offsetting of the existing market failures. Sometimes economic policies not only fail to correct existing market failures, but themselves generate negative effects on transparency, efficiency, equity and sustainability, resulting in a net reduction of the existing level of social welfare.

Which are the main causes of such government failures? One major cause lies in the difference between the approach needed in dealing with economic issues in the private sector and the approach needed in dealing with policy issues in the public sector. In the market economy self-interest is privately and socially useful and welcomed as it is a major source for economic development. Competition in free markets allows the 'invisible hand' to a large extent to turn private greed in social welfare, in the interest of the society as a whole.

In the public sector market competition does not work. Consequently each individual dealing with public policy issues is requested to aim directly for the attainment of the welfare of society as a whole. This can be done by eliminating or compensating the existing failures arising from an imperfect functioning of markets and of the private sector or by means of direct policies attaining stated social goals.

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<sup>2</sup> Policies and markets would be more transparent, available economic resources would be allocated in the best way in order to attain the stated policy objectives. An agreed amount of income redistribution among citizens would be implemented in order to attain a targeted equitable social justice and safeguard economic development, environmental objectives would be reached, and a sustainable economic development would be guaranteed.

### **1.3 Private interference in policy-making**

Should then people working in the public sector be 'genetically' different from people working in the private sector? In theory yes, in a utopian world.

Yet again this is unfortunately not the case in the real world where citizens are genetically similar and rather sensitive to their own personal interests. At the same time they are aware that the 'common good' should be attained in order to reduce social conflicts and improve in the long term the economic welfare of all citizens. As the variability in character and moral attitudes of human beings is great, we may easily find on one hand philanthropist individuals aiming at social goals while operating in the private sector. On the other hand some public servants are rather indulgent of their private interest when making public decisions, even if the attainment of their personal welfare results in a much higher welfare loss for society as a whole.

A different kind of interference of private interests in public policy making is the deliberate grouping of private individuals or firms in order to influence policy makers. Lobby organisations have increased spectacularly in the EU, from 167 in 1960 to 3500 in 1995. Most of their work can be justified in terms of improving information and providing technical support for policy makers, however a considerable amount of their action is channelled towards the influencing of economic policies in favour of their private interests.

As yet this is not necessarily harmful for society as a whole. A number of policy measures do simultaneously increase the income of private groups and social welfare by improving the existing allocation of economic resources and income distribution, reducing negative externalities or fostering positive externalities.

However a number of other policy measures are biased in a way as to increase the income of special sectoral pressure groups at a considerably higher cost for society as a whole. Income transfers to certain groups of producers attained by means of distorting market prices, for example, can reduce the transparency of government intervention, misallocate economic resources, worsen the distribution of income among citizens and have a detrimental effect on the environment. In order to increase the income of certain producers, often consumers and taxpayers pay such income transfers, and society as a whole faces an extra burden in terms of social welfare as it could end up with an inefficient organisation of production, worse income distribution and worse environmental conditions.

### **1.4 Countervailing 'horizontal' pressure groups**

The present organisation of the public sector is not always capable of contrasting the noxious influence of such sectoral, private-oriented pressure groups, as will become evident after the analysis of the EU economic policy in the agri-food sector. Policy makers are already under the pressure of their personal private interest and often find it difficult to stand firm in defending the interests of society as a whole, resisting the well orchestrated action of sectoral pressure groups. This is probably one of the main causes of the 'government failures' previously mentioned.

How is it then possible to maximise social welfare, fully attaining the objectives stated in the EU Treaties? Sectoral pressure groups could be better contrasted by similar pressure groups grounded on private organisations, aiming at the welfare of society as a whole rather than at particular interests. As all citizens are consumers, consumer organisations are in principle the prominent example of such 'horizontal' pressure groups, as the 'private' interests of consumers tend to coincide with the interests of society as a whole. The efficiency and strength of such private horizontal organisations could be properly and 'physiologically' used in order to defend the common interest and better attain the objectives stated in the EU Treaties.

Unfortunately most consumer organisations do not yet consider themselves as defenders of public interest, in contrast with producers' lobbies. On the other hand their financial resources are

much lower than those usually available to most sectoral groups. This is also due to the fact that consumer organisations fight for competitive markets and consequently cannot earn monopolistic rents in order to finance their political action as is often the case for producer organisations.

However, if policy makers honestly aim at attaining the highest possible welfare for society as a whole, they should promote an effective consumer policy in the public sector at all decision making levels (international, Community, national, regional, local) and support consumer organisation at least as much as they support sectoral organisations. Their political action in implementing the objectives stated in the Treaties could find a very effective ally in an explicit and developed consumer policy as well as in stronger and more effective consumer organisations.

## **2. EUROPEAN CONSUMER POLICY**

Consumer policy was not considered as very important by the founding Fathers of the European Economic Community, actually consumers are mentioned only three times in the Treaty of Rome: twice concerning the Common Agricultural Policy (CAP) and once dealing with the competition policy.

### **2.1 Developments of Consumer Policy**

The need for a consumer policy at a European level emerged in the early Sixties, as it became evident that the existing institutional structure of the Community did not fully attain the policy objectives stated in the Treaties concerning the interests of consumers. Sicco Mansholt, Commissioner for agriculture convened first in 1961 the representatives of consumers' organisations in order to discuss some features of the Common Agricultural Policy which could be considered too sector-oriented and corporatist, transferring income to farmers at a disproportionate cost for society as a whole. Later in 1968 a 'Unit for Consumer Protection' was established at the Directorate General for Competition. Consumer interests were directly associated with the dismantling of imperfections and monopolistic rents in the internal market, as consumers benefit most from economic advantages in terms of resource allocation generated by a competitive market.

In 1981 a 'Service for Consumer Policy' was established at the Directorate General for Environmental Protection, stressing the importance of the non-economic components of social welfare such as safety, health protection and environmental externalities. A 'Consumer Consultative Committee' including representatives of consumer organisations was instituted in 1973, and in 1975 the 'First Programme for a Consumer Protection and Information Policy' was adopted, followed by a Second Consumer Programme in 1981.

In 1988 the 'Consumer Policy Service' became independent from specific Directorates General, and a first 'Three-year Action Plan for Consumer Policy in the EEC (1990-92)' was approved in 1990, followed by a 'Second Commission Three-year Action Plan (1993-95)' in 1993. The coincidence of general interests with consumer interests is mentioned in the introduction of the First Action Plan: "it is important to pay attention to consumer interests not only for their own sakes, but also for the benefits of producers, distributors and enterprise in general". "Consumer interests should also be reflected in the establishment of other Community policies (i.e. environment, industrial, agriculture, transport and social policy)." Four main areas of consumer policy are identified: information, representation, security, and transactions in the market, later qualified as 'protection of consumer economic interests'.

The Amsterdam Treaty signed in 1997 enhanced the legal status of consumers. In Article 129A consumer protection becomes an independent objective of the EU, which shall support and supplement the policies implemented by Member States, according to the principle of subsidiarity.

A strong 'horizontal clause' is instituted by which Community Consumer Policy should also monitor other policies both at Community and national level in order to protect consumer interests.

## **2.2 Right to information and education**

Undistorted information is a fundamental need for the good social and political functioning of a country. If the conception of reality is distorted, the door is open to injustice and endemic quarrelsomeness between social groups.<sup>3</sup> Furthermore, consumers end up with having to pay for the bad functioning of the market and of public administration, as they are not always provided with a correct and complete information on the issues concerning them. Despite the commendable activity of various autonomous consumer organisations, households are still unable to get adequate information on the goods and services they buy on the market and on the actual impact of policy-measures dealing with market prices or involving increased taxation.

For example, sometimes the Commission itself fails to provide adequate and correct information. The conspicuous annual documents prepared since 1962 for the discussion of the level of farm prices describe clearly the likely impact of the proposed decisions on prices as far as farmers' revenues and the cost for the EU budget burdening EU taxpayers are concerned. Strangely enough, the cost for consumers due to the increased market prices of farm products is totally ignored although, according to OECD estimates, such a burden is larger than the burden on taxpayers. How can the Council of EU Agricultural Ministers evaluate correctly the impact of their decisions on farm prices if 60% of the cost of price support burdening households is overlooked?

Such distorted information is also diffused in various brochures<sup>4</sup> prepared for the general public, stating that the cost of the CAP is ECU 100 per citizen per year, ECU 2 per week, without quoting any statistical source. OECD publishes annually a large analytical study, detailed for all OECD countries and for most agricultural commodities, where agricultural policies in the EU are estimated to cost ECU 315 per capita. This amounts to a transfer of ECU 14960 per full time farmer equivalent and ECU 762 per hectare of agricultural land. These more documented figures would communicate a rather different message to the reader.

EU and national governments would do better to guarantee to the greatest number of consumers as possible sufficient education and information on the characteristics of the goods and services available on the market as well as on the foreseeable effects at least of those policy measures directly affecting market prices and consumer interests.

## **2.3 Right to representation**

Individual consumers are systematically at a disadvantage in terms of bargaining power with respect to goods and services suppliers. Rarely can a consumer stand the financial burden necessary to promote a court case to protect his rights against a car manufacturer, for example, or against a multinational insurance company. According to the general principles of equity and competition, government is strongly motivated to protect the interests and rights of citizens by means of an easy access to justice. Moreover, as the policy-making process is strongly influenced by pressure groups manipulating information, the public administration should be restructured in

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<sup>3</sup> According to a well-known saying, 'truth is the first victim of war'. When relationships, even between social groups, worsen, everyone tends to interpret facts in a more self-centred, biased way, reducing the possibility of reaching a quick and pacific compromise between diverging points of view.

<sup>4</sup> EU Commission (1996) How does the European Union manage agriculture and fisheries?, Europe on the Move. Office for Official Publications of the European Communities, Luxembourg. Commissione Europea (1996) La politica agricola comune in movimento. L'Europa in Movimento. Ufficio delle pubblicazioni ufficiali delle Comunità Europee, Lussemburgo. Both brochures are published in all EU languages. Estimates of the costs of the CAP are not specified by year, OECD figures refer to 1995, and they also include national expenditure which however accounts only for a minor share of the total cost of agricultural policies, about 14%.

order to favour a more correct functioning of the public decision making process, balancing the representatives of horizontal and sectoral pressure groups according to the interests at stake.

For example, when decisions are taken concerning administered prices, implying income transfers from consumers to producers, horizontal organisations should be represented in the same proportion as their counterpart, whose economic interests are opposite. At present, producers' lobbies are usually much better represented and much more effective in supporting their issues. Consumer representatives are usually under-represented and often cannot be as good as producer representatives in dealing with specific topics. The staff of consumer organisations is very limited compared with that of producer organisations, and obviously their policy analysts cannot be as well documented on specific technical issues.

#### **2.4 Protection of health and safety**

The basic motivation that guided Community legislation in the field of non-economic issues such as consumer health and security is the improvement of the quality of life. Consequently action is taken to promote consumer health and safety, protecting citizens from buying and consuming defective or harmful goods. The same approach is used for services that do not fully guarantee consumer safety.

At present most of the financial and human resources involved in consumer policy are spent on health and safety issues. In addition to the recent important developments in the food sector, the results of the Community policy regarding consumer health and security are flattering. For example, in the field of preventive legislation, the Directive 92/59 on general product safety and the related Rapid Exchange System (REIS), are characterised by a horizontal approach. They go beyond the existing specific regulations for various products and establish new general principles in the field of the liability of supply of services. Consequently they are not only a reference point for legislation on product security, but also a model for future initiatives in other fields.

#### **2.5 Protection of economic interests**

Most of the market and government failures which worsen the allocation of economic resources are paid by consumers as they are the last link in the chain: producers of raw materials, manufacturers, wholesalers, retailers, consumers. Moreover, some policy measures manipulated by pressure groups increase the economic burden on households through higher market prices for goods and services and higher taxation, when budget expenditure is used for producer subsidies distorting markets and investments.

An effective consumer policy, strongly supported by consumer organisations, is probably the most promising instrument capable to improve the economic performance of present market economies. It could monitor a transparent and correct implementation of economic policies favouring the combined action of honest policy makers and 'horizontal' pressure groups. Unfortunately the potential of consumer policy in protecting consumer economic interests is not yet fully perceived, neither by policy makers nor by consumer organisations.

The minimal share of financial resources allocated to consumer policy proves this lack of perception at a European level. The EU expenditure for consumer policy accounts for 0,025 % of the EU budget. It is much lower than the expenditure allocated to finance most sectoral policies, let alone the Common Agricultural Policy, which absorbs almost half of the Community budgetary expenditure. Paradoxically the CAP money is not spent in order to favour structural adjustment and solve the farm problems, but rather to support market prices and generate further income transfers from consumers to farmers.

### 3. OBJECTIVES OF THE AGRI-FOOD POLICY

In order to assess the effects of sectoral policies on social welfare, it is advisable to analyse their impact on more detailed objectives.

**'Transparency'** is needed as a democratic prerequisite, in order to allow policymakers and citizens to understand the effects of policy measures on the economy and on society as a whole.

**'Efficiency'** in the allocation of existing resources in the short as well as in the long run (consequent on their impact on investments). **Stability** and **consistency** with macroeconomic and other sectoral policies may be considered as components of the efficiency objective.

**'Equity'**, appraised by assessing the policy impact on inter-sectoral, interregional, interpersonal and functional distribution of income.

**'Sustainability'**, appraised by assessing the likely impact on natural resources, on positive and negative externalities affecting the environment, and on the production of public goods.

Should we include the **'protection of farm incomes'** among the objectives of government intervention in agriculture, even if this is clearly a sectoral rather than a general objective? The answer depends on what is meant by "protection.". If it is understood as the legitimate defence of agricultural interests in the context of the legitimate interests of all other social and occupational groups, then the answer should be positive. . When the increase in agricultural welfare coincides with a greater, or at least equal increase in collective welfare, policies are perfectly consistent with the general principles expressed above. Obviously all contributions to social welfare should be taken into account, not only those which are economic in nature and directly expressible in monetary terms, but also those concerning externalities such as countryside and landscape or the production of public goods.

However, it is often the case that support given to farm incomes is maintained even when the cost to other social groups is significantly higher than the benefits accrued to farmers. In order to justify such support, the special treatment for the members of the agricultural sector must be justified on 'trascendent' elements related to agricultural fundamentalism. Such an approach, which is often followed in EU policy making, is necessarily subjective and is usually not accepted by impartial policy-makers or representatives of horizontal organisations who tend to put all EU citizens on an equal footing.

### 4. DEVELOPMENTS OF THE AGRI-FOOD POLICY

After numerous unsuccessful attempts bringing together West European countries, the success of the European Economic Community (EEC) was largely due to the fact that it did not directly tackle the central issues on which national autonomy and independence were based, namely macro-economic and monetary policies, defence and foreign policies.

The EEC was born with the major immediate objective of creating a 'common market' among member countries. Its strategy towards European unification was to gradually implement an increasing number of sectoral policies in order to eventually reach integration also in the core macro-economic and monetary policies. These 'sectoral' features of the historical development of the European integration process explain a number of problems, which arose in the years following the Treaty of Rome and are still preventing the better economic performance of the Union.

Historical, economic and social conditions have now substantially changed and the solution to these problems is now much easier and feasible, provided that appropriate political action is taken. To this end a radical change in the consumer role in economic policies is essential.



#### **4.1 Present features of the CAP**

The Common Agricultural Policy (CAP) is probably the most apparent example of a sectoral policy which although performing a fundamental role in the process of European integration in the Sixties, is now manifesting a large number of contradictions due to the prevalence of special sectoral interests over general interests.

The EU was born and developed under the flag of free competition and free markets, and actually specific political action is oriented to the EU Competition Policy. Nevertheless the CAP is characterised by various non-competitive features reducing social welfare:

- output prices in the domestic market are not determined by market forces, but are administered by policy makers to a very large extent;

- for an increasing number of products (e.g. sugar, milk) restrictions are placed on the quantities produced at farm level in order to administer the complicated system of public intervention applied in these markets;

- administrative controls are imposed on the use of arable land and other inputs (e.g. chemicals) in order to reduce production;

These features constitute a kind of public intervention in agriculture more characteristic of a state monopoly than of a market economy. They also result in the negative aspects of such monopolies:

- deliberate misuse of available resources (e.g. land set-aside) in order to reduce domestic supply and keep a high level of domestic market prices;

- detailed bureaucratic management; and high administrative costs at Union, national, regional and local levels, partly borne by farmers themselves;

- a reduction in the entrepreneurial opportunities facing farmers because their decision-making is increasingly limited by bureaucratic constraints;

- the frustration of inter-sectoral and interregional mobility of resources and of the necessary structural adjustment process in the long term;

- the capitalisation of production rights in asset values.

A wide number of CAP reforms have been tried since the institution of the EEC, ranging from the structural Directives in the early seventies to the super-levies, the stabilisers, etc. All these attempts failed mostly because when the system of market prices is heavily distorted, economic resources oriented to agriculture by policy makers are necessarily misused.

Farmers correctly invest more where commodity prices are higher, maximising their private profits and incomes, but when higher prices are the outcome of policy decisions, the result is lower domestic demand and higher supply, generating surpluses. Consequently any extra output is extra revenue for farmers on private grounds, but is a net liability for society as a whole in terms of export subsidies or other budgetary costs needed for surplus disposal, let alone the burden on domestic consumers paying higher prices. As a consequence, subsidising farm investments generates higher surpluses and extra costs for society as a whole. Such structural policies are doomed to failure in a market economy where farmers are still left some freedom to choose their investments.

#### **4.2 Perspectives**

The GATT Uruguay Round clearly stated the domestic and international harmfulness of price support policies, which are included in the 'red box'. In Marrakesh the EU committed itself to gradually reducing such policies, however the rate of reduction is strongly hindered by well organised and co-ordinated pressure groups at all decision levels in the Union.

The existing unbalanced system of price support, when transferred to the new EU members, the Central and Eastern European Countries (CEECs), will contribute to a huge misallocation of

economic resources in Europe and in the international markets, given the large relative size of the enlarged EU economy in the world. High rents will benefit CEECs' landowners while consumer and taxpayers will have to bear the burden of a policy distorting market prices and investments towards the production of commodities not required by consumers. Moreover a number of administrative controls such as production quotas and land set-aside will be necessary as was the case in previous centralised socialist regimes.

## **5. THE AGRI-FOOD SECTOR IN EUROPE**

The share of EU household consumption expenditure in food, beverages and tobacco as proportion of total consumer expenditure has decreased in the last few decades to less than 20%. This is mainly due to a low income elasticity of food demand, common to all developed countries. Strangely enough, in some brochures<sup>5</sup> on the CAP published by the Commission such a negative trend is presented to support the opinion that the CAP benefits consumers by keeping an alleged low level of food prices in the Union.

The farm structure in the EU is still very diversified among Member states. The average utilised agricultural area per farm is about 6 ha in Italy and ten times larger in the UK. More than 60% of holdings (over 1 ha) are smaller than 10 ha. In small farms economies of scale cannot be exploited and labour productivity is much lower than in larger farms. The huge income transfers to farmers generated by the price support policy hinder the natural inter-sectoral mobility of resources, of labour in particular. They maintain an inefficient structure of production in agriculture, perpetuating the need for state aid in order to 'protect' farm incomes.

In some abandoned areas a specific policy targeted at keeping farmers on the land could be justified, however supporting high market prices throughout all Europe in order to keep farmers in a few disadvantaged regions is obviously an inefficient policy.

Government expenditure in agriculture has been increasing since the institution of the CAP, although the share of expenditure for agriculture in the EU budget starts decreasing. However almost 50% of the EU budget is still absorbed by the Guarantee section of the European Agricultural Guarantee and Guidance Fund (FEOGA), dealing with market support. This high share of EU expenditure, reaching only 5% of the employed civilian population, producing 2% of GDP is a shocking feature of the CAP. What makes it much more unacceptable is the fact that such huge financial efforts do not solve the problem of low farm incomes by favouring the structural adjustment of the sector and higher mobility of resources in the economy. Instead the likely results are on the opposite side, perpetuating inefficiency inequity and low sustainability of the EU economy.

The self-sufficiency ratio of the EU has substantially increased as a consequence of the price support policy. Expanding supply could be justified to a certain extent in the early Sixties, when the EEC was still a net food importer, as a means for attaining a higher level of food security. However such justification is not any more valid at present since the EU is a net exporter on many commodity markets.. EU citizens could be proud of the increased share of EU export on total world exports if domestic prices were not distorted, but there is little to be proud of if exports are heavily subsidised by taxpayers, distorting international prices and trade. Moreover the large majority of taxpayers are not even aware that their money is being wasted in such a way.

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<sup>5</sup> See footnote 4

## **6. FIRST OPTION: 'STATUS QUO'**

### **6.1 Present support to agriculture**

According to OECD estimates, at present about 50% of the value of the EU's agricultural production is subsidised by the government in various ways, i.e. the amount of public support is as large as the whole agricultural value added.<sup>6</sup> If the value of agricultural production were computed at prices prevailing on the world markets rather than at the administered high domestic prices, transfers to agriculture associated with agricultural policies would be more than twice the value of the EU agricultural value added.

The differences by product in the level of EU price support are quite significant, ranging from more than 60% for beef to less than 10% for pig-meat and eggs and no support at all for wool and potatoes. It would be interesting to know the logical reasons, if there are any, for this significant disparity in public support among products and consequently among the producers concerned. Unfortunately, the differences in these levels of support seem to be correlated mainly with the unbalanced bargaining power of the various pressure groups operating in the decision-making process of agricultural policy.

### **6.2 Transparency**

A significant feature of the price support policies is their lack of transparency. Very few people manage to understand how big the transfer of income may be among consumers, taxpayers and producers caused either directly or indirectly, because of the cross-substitution effects between products both on the supply side and on the demand side. The Commission does little to improve this transparency, and on the contrary does not even mention the costs for consumers in the documents provided to policy makers when taking decisions on the annual level of support for agricultural prices.

A further set of data largely unknown is the amount of the costs borne by the national and regional budgets as a consequence of the CAP price support. These costs are increasing rapidly, in particular in terms of the administrative set-up required to carry through agricultural policy measures such as production quotas and the land setting-aside.

### **6.3 Efficiency**

According to numerous estimates,<sup>7</sup> in the EU-12 about 30% of the income transfers flowing from households to producers is likely to be lost in inefficient allocation of resources. Part of these costs is due to storage costs and surplus disposal costs, which would be unnecessary if the CAP only attempted price stabilisation and not a domestic price support far above world market levels.

After the 1992 CAP reform, costs for storage and withdrawals from markets have lowered together with export refunds. This beneficial effect in terms of budgetary costs is however counterbalanced by the cost of granting subsidies to farmers for keeping idle arable land through the set-aside programs. Less visible extra costs for society as a whole are the allocative cost of not exploiting fully available land resources, and the environmental costs of using extra polluting inputs as fertilisers to increase yields per hectare while keeping a share of fertile land uncultivated.

Higher food prices tend to increase the wage levels and production costs for all enterprises, whilst taxation to support agriculture has to be borne mainly by the rest of the economy. The development of non-farm related sectors in the economy is likely to be delayed and their international competitiveness is likely to be lower. The argument for price support based on the need to avoid unemployment is, at most, valid only in the very short run and at a local level. It

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<sup>6</sup> Agricultural inputs account for almost 50% of the value of final agricultural production.

<sup>7</sup> See for example European Commission DG-II (1994, p.91), Roningen, Dixit and Seeley (1989), de Veer (1989).

applies to rural communities where alternative job opportunities are not immediately available. At national and at EU level the reduction of agricultural price support and the enhanced mobility of economic resources is likely to increase economic activity and total employment.<sup>8</sup>

Reducing the support to agricultural prices in past years would have promoted greater inter-sectoral mobility of labour, which would actually have brought advantages to those working in agriculture, at least in the medium term. The cost of adjustment for those directly concerned could have been considerably reduced if the economic resources absorbed by price support had been redirected to facilitate mobility of labour and temporary income compensation payments.

#### **6.4 Consistency with other policies**

Heavy agricultural spending runs contrary to the aim of macro-economic stabilisation, and high levels of supported prices contribute directly to inflation. On the whole the Maastricht targets necessary to enter the European Monetary Union are made more difficult to reach by member countries as a consequence of the 'red-box' instruments implemented by the Common Agricultural Policy.

Dumping surpluses on the world markets created huge problems in international trade relations as world price levels were artificially depressed to the detriment of natural exporters. Natural exporting countries, in order to keep their market shares and offset the negative impact of EU dumping, are compelled to subsidise their own production and exports at the expense of their public budget.

In the longer term price support and quantitative restrictions are likely to hinder inter-sectional and infra-sectoral structural adjustment in the EU-21, generating further economic costs. As the supply of land is rather rigid, the extra profits transferred to farmers by price support and quotas are gradually incorporated in asset values. This increases the cost of land to those wishing to expand or enter the industry, reducing the dynamic of the land market. Supply management measures as production quotas and land set aside, are likely to further hinder the dynamic of land markets and obstruct the long-term adjustment process.

#### **6.5 Equity**

Agricultural price support acts as a regressive tax on the consumer, since in the poorer families expenditure on food accounts for a higher proportion of the family budget. In consequence, low-income families, paying higher prices for food products, bear a proportionately greater burden in comparison with the higher-income families.

On the other hand, the high agricultural prices create a flow of income to the farmers in proportion to the quantity supplied. Land-owners or the farmers who own large farms benefit to a greater extent from these price policies, although they very often already enjoy an income far higher than the national average. In contrast, the owners of small farms, who usually work on the farm themselves, benefit from price support to a much lesser extent. As was stressed years ago by the European Commission, 80% of the transfer of income goes to benefit fewer larger-sized farms (20%), while only 20% is directed towards the large number of smaller farms (80%). Unfortunately, the 1992 reform of the CAP and the Commission proposals in Agenda 2000 envisage semi-decoupled compensation payments in proportion to the cultivated acreage, and thus do not improve this regressive redistribution of income among farmers.

Agricultural price support thus worsens the overall distribution of income and runs counter to the many policies undertaken by governments to redistribute income from the richer to the poorer.

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<sup>8</sup> According to some estimates, the abolition of the CAP would increase total employment by 1 million jobs (Stoeckel 1985)

### 6.5.1 Regional redistribution

The First Report on Cohesion in Europe demonstrated the positive role played by price support in the redistribution of income among regions.<sup>9</sup> As the more industrialised and developed regions of the EU are on average richer and more populous than the rural regions, any assistance to agriculture, including that obtained by way of price support, improves inter-regional income distribution as a general rule. Agricultural support generates a transfer of income mainly from rich regions (where the burden borne by the taxpayers and consumers is generally greater than the benefit obtained by the agricultural producers) to the poorer regions (where the relatively high proportion of the economy occupied by agriculture causes the burden on taxpayers and consumers to be generally less than the benefit received by the agricultural producers).

This effect of present agricultural policy is certainly positive and consistent with the cohesion objectives of the EU. However, it is an effect obtained indirectly, in that the price support policies are attuned to individual productive sectors and not to the redistribution effects caused at the regional level. Consequently it may be presumed that these same effects in terms of inter-regional redistribution of income could be obtained at a lower social cost for the population as a whole, by means of regional policy measures aimed specifically at regional objectives.

## 6.6 Sustainability

Since the level of prices on the domestic market is decided by the Council of Ministers of Agriculture rather than by the market forces which would bring the markets back into equilibrium, market imbalances tend to worsen even further in the long term. As we have already experienced with the failure of the structural directives of 1972, an unbalanced system of domestic prices creates an unbalanced system of investments and consequently a potentially unbalanced productive structure increasing market distortions and the related social costs. While corrective measures of an administrative kind, such as production quotas and the set-aside of cultivated land, may serve to reduce export subsidies, or other public expenditure used to dispose of the surpluses, they do not solve the problem in economic terms. The social cost of these instruments, in fact, is very high and tends to increase to the extent producers perceive the unbalanced price system as being permanent. Such a perception encourages them to make investments which are correct from a private point of view but very wrong from the perspective of society as a whole.

The sustainability in economic terms is thus very low, as it tends to increase distortions in the economy.

### 6.6.1 Natural environment

It is certainly true that agriculture can produce positive effects on landscape (conservation of the countryside and the environment, settlement in areas at risk of depopulation, etc.) for which the farmers may be compensated by public intervention. However, it appears evident that the positive landscape effects of agriculture are strictly linked to local conditions and could be obtained more efficiently and at lower cost by way of specific measures of environmental or regional policy. Alongside these advantages, indiscriminate policies affecting the entire territory of the EU, such as agricultural price support, produce much larger disadvantages for society as a whole.

A higher price of the product creates a greater use of harmful inputs such as pesticides and fertilisers, increasing the level of pollution of the soil and water in rural areas. The quality of the food products often goes down when the use of hormones or pesticides is increased. Soil erosion is often increased by price support. For example, in many central and southern Italian hill regions the high price of cereals has contributed to a greater extension of this crop on to the hills, causing erosion of the soil which has reduced its fertility and increased the risks of downhill flooding.

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<sup>9</sup> European Commission (1996) and Tarditi and Zanias (1996).

### 6.6.2 Social environment

An 'ethically sound' society is a public good, which can be enjoyed by everyone and benefits producers as well as consumers. Consequently governments are usually committed to preserving and improving ethical standards.

The effects of present farm price support on the social environment are less discussed in the literature. In the short term, the increase in public intervention, detailed regulations and bureaucracy at the local level are likely to reduce the existing entrepreneurial capacities and increase the propensity to fraud.<sup>10</sup> Opportunities for fraud and reduced transparency in market transactions have a remarkable negative impact on social welfare especially in regions where the public administration is less efficient.

In the EU, administrative controls have often been implemented by organisations closely related to farmers, even though not directly elected by farmers within the region. It is not surprising to find out that such controls have not always been as effective as possible. In order to limit financial losses and the deterioration of the ethical environment in rural areas, it would be preferable for administrative controls to be carried out by the central EU administration. The detected cases of fraud should be widely publicised.

## 7. SECOND OPTION 'AGENDA 2000'

Taking as a starting point the "Agricultural Strategy Paper" and quoting the Commission's First Report on Cohesion "which argued in favour of a more rational development of agricultural production, through a greater market orientation of prices and continuing structural adjustment", "Agenda 2000" declares that "it is now time to formulate concrete proposals to reshape the common agricultural policy and prepare it for the next century."<sup>11</sup>

After giving a favourable assessment of the process of reform started in 1992, the document goes on to evaluate the long-term prospects of the international markets and outlines the "political objectives of the CAP" which are fully consistent with declarations made by the European Commission on earlier occasions.

"...further reform of the CAP must *improve the competitiveness* of Union agriculture on both domestic and external markets. Lower prices will benefit consumers and leave more room for price differentiation in favour of high-quality speciality products. Greater market orientation will facilitate the progressive integration of the new Member States and will help prepare the Union for the next WTO round. It will also help the Union to reinforce its position as a major world exporter."<sup>12</sup>

### 7.1 Effects in the EU-15

The principles underlying the GATT-WTO agreements signed at Marrakesh, which undoubtedly inspired the recent American agricultural policy, do not seem to have played a major role in the 'Agenda 2000' discussion document. The changes proposed over a time-frame of almost a decade are fairly limited.

Agenda 2000 leaves the basic structure of public intervention in the Community's agricultural industry virtually unchanged, retaining the greater part of the numerous negative aspects described in the earlier sub-sections.

Judgements on the scale of the Agenda 2000 agricultural policy option obviously depend also on the personal point of view, and it is probably the case that some Eurocrats view the scale of the reform as considerable. Such a view may arise from the approach traditionally followed by the

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<sup>10</sup> Currently fraud is estimated as accounting for 9% of the EU budget and is mainly concentrated in the CAP.

<sup>11</sup> Part 1, III, 0.

<sup>12</sup> Part 1, III, 3.

Eurocrats involved in the perennial updating and reform of the CAP. We might call such approach "Ptolemaic" in that it places the decisions of Brussels at the centre of the economic universe, and considers the interests of the other productive sectors and the other countries of the world as essentially subordinate.<sup>13</sup>

In the debate on the level of domestic prices for the coming agricultural year, for example, the starting point for debate is the decisions taken by the Council of Ministers in previous years and the final point is the decisions which will have to be taken for the following year.

The budget costs are frequently presented on their own as the "costs of the CAP" even net of the budget credit items such as the levies on agricultural imports and the sugar levies.<sup>14</sup> While it is evident that the import levies are 'budget' credit items, they are paid for by the consumers in the Community by way of a higher price for the product on the domestic market relative to the border price, consequently they constitute a cost for consumers. Similarly, the levies on sugar producers are a consequence of the price support through production quotas, eventually they are paid for by the consumers by way of higher domestic prices. If the domestic prices were the same as the international prices, producers would have no reason, and certainly would not wish, to pay levies to the budget in order to "self-finance" export subsidies, which in any event, would not then exist.

Even the jargon commonly used in the EU smacks of this "Ptolemaic" approach. In the CAP "export subsidies" are called "export refunds". Why? Because while for everyone else 'export subsidies' are budget expenditures to dispose of production surpluses generated by price support policies, for the CAP they are "refunds" to the exporters to compensate for the fact that border prices are lower than domestic prices decided on by the Council of Ministers of Agriculture.<sup>15</sup>

If we use an approach which we might term "Copernican", in other words if we consider the EU as a country taking international market prices into consideration when deciding the price levels on the domestic market, then the current way of viewing the problems becomes apparently arbitrary<sup>16</sup>. Border prices, in a global perspective, represent the opportunity cost of domestic production and should be taken into great account in deciding and evaluating domestic policies.

We will not dwell on various similar cases<sup>17</sup>, which would give further confirmation of this agro-Eurocentric view of the CAP. It does, however, emerge in macroscopic terms if we consider that according to the Commission document more than 44% of the budget of the EU in the next ten years will be spent directly or indirectly on supporting agricultural prices and incomes. In so doing resources are inefficiently retained in agriculture, despite the fact that another large slice of the

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<sup>13</sup> Such an approach, further developed in all its aspects, was typical of the centrally managed economies, which appear, however, to be on their way to extinction.

<sup>14</sup> For example, European Commission, The Agricultural Situation in the Community, Table 3.4.1, in which these "Net costs of the CAP" are also presented as a percentage of the GDP and per inhabitant of the EC.

<sup>15</sup> Occasionally, one may read that the motivation for these refunds is "to increase the competitiveness of our production relative to that of non-member countries." This highly idiosyncratic concept of competitiveness would also benefit from clarification. Our economic system certainly does not become more competitive by subsidising exports, and in fact the contrary can be demonstrated. Private exporters are 'more competitive' as they can dump goods at a lower price on foreign markets at the expense of taxpayers.

<sup>16</sup> One is reminded of the story of that wife who, to convince her husband to buy her a fur coat costing 200 thousand ECU, claims that by buying it they would "save" 100 thousand ECU relative to the price of the one on display in the window. The reference point is surely very important in any judgement.

<sup>17</sup> Such as the public subsidy given to the olive oil wholesalers, which was called "consumption aid" because it reduces the price on the domestic market relative to the producer price decided in Brussels net of production aid. In reality, if we take the border price as our point of reference we realise that what is called "consumption aid" is granted only for domestic production and therefore has the same effects as a production subsidy, with the difference that it is distributed at a different level in the distribution chain. If the lowering in price of olive oil on the domestic market relative to the border price was really desired, the subsidy would have to be granted to the entire quantity consumed, including imported olive oil, and not only to the quantity produced in the EU. The domestic price would then be lower than the import price, benefiting consumers. For this commodity the EU constitutes the largest share of the world market, consequently EU protectionist policies have a devastating effect on the international price and on non-EU olive oil producers.

budget will be spent to promote structural adjustment, which is based on the inter-sectoral mobility of resources. We have already pointed out that structural adjustment in the presence of highly distorted market prices can cause more social harm than good, as we have already experienced in the past. However, according to Agenda 2000, virtually half of the Community budget will be spent to support CAP doing so, distorting market prices and reducing the efficiency of the 'Structural policies' whose implementation costs a further third of the Community budget.

## 7.2 Effects in the CEECs

The Agenda 2000 envisages a "slow completion" of the 1992 reform for EU-15 but creates large problems in Europe if we consider all the countries to which it will be applied, including the new Member States of the EU from Central and Eastern Europe. For these countries, the application of the CAP described in Agenda 2000 constitutes a major step backwards to protectionism and State intervention in the agri-food economy. It takes them back in many ways to forms of centralised regime which they have only just thrown over and which they would not reintroduce of their own free will unless constrained to accept the *acquis communautaire* as a condition of attaining the overall advantages of membership in the EU.

Their domestic prices could take as a reference international prices largely resulting from the interaction between supply and demand on the global market, contributing to their own well-being and to that of the rest of the world. On the contrary their productive system will have to adapt to an agricultural price system which is the heritage of decades of pressure from sectoral lobbies in countries quite different from their own, without any economic rationale. Moreover, they will have to accept constraints on supply, on production and on the use of production factors which has very little to do with market economics and which will ultimately frustrate their comparative advantages on the European as well as on the world market.<sup>18</sup>

For CEECs, investing limited financial resources available in the agricultural sector would be a mistake also from a general economic standpoint. Such resources would be withdrawn from more productive uses in other and non-protected sectors, the demand for which is expanding, moreover higher prices for food products, increasing the cost of living and fuelling wage claims, would reduce the international competitiveness of non-agricultural sectors.

Unfortunately, Agenda 2000 runs the risk of confirming the impression in those governing the CEECs that the price support system of the CAP must inevitably be adopted if they are to be accepted into the EU. Consequently, there is a danger that the process of assimilating their national agricultural policies to the CAP will accelerate.

## 8. THIRD OPTION 'COMPLETING THE 1992 REFORM'

In its "Agricultural Strategy Paper,"<sup>19</sup> presented in Madrid in December 1995, the Commission offered three future options for future agricultural policy: the "status quo," the "radical reform" and the "development of the 1992 approach." This last option was chosen as the best, and it was stated in the text that the approaches to be adopted were intended to "resolutely continue the approach initiated with the reform of 1992, deepening it where necessary and extending it to other sectors."

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<sup>18</sup> Let us simply consider the effects the increase in prices on the market will have on land values. The price of land is still low in the countries of Central and Eastern Europe, of the order of a few hundreds of dollars per hectare. When they will adapt to EU agricultural prices land values will go up considerably. For this reason alone, production costs to pay land rents would increase significantly in the future, lowering the international competitiveness of the agricultural output. In order to avoid serious surpluses they too will be constrained to impose production quotas, which will not reduce land values but will draw a distinction only on the basis of privilege, namely having or not having the right to produce. This will further reduce the mobility of the resources of land, labour and capital and thus the overall efficiency of their agricultural sector from the point of view of society as a whole.

<sup>19</sup> European Commission, 1995.



Actually the reform of the CAP outlined in Agenda does not 'resolutely continue' the 1992 approach.<sup>20</sup> We shall therefore examine a second option which proposes to complete the reform of 1992 by deepening it and extending it to other sectors within the time frame envisaged by the plan referred to, in other words before year 2006. This option "Completion of the 1992 Reform" is consistent with the interests of consumers and of society as a whole. It is still very different from the "radical reform" as indicated by the Commission. Such a radical option would envisage the total dismantling of price support and the re-nationalisation of the financing of income supports and agri-environmental subsidies.<sup>21</sup>

## **8.1 Reducing the red box, sectoral policy measures**

The level of market price support would be reduced over a three-year period (1999-2001) to an average annual level of 10% of the border price. In other words, the import tariffs (and the export subsidies to the extent that they are compatible with the agreements made under GATT-WTO) could vary from one year to another between 0% and 20%, so as to establish a buffer against potential excessive variations in prices on the world market.

Such a level of protection is still far higher than the average support given to non-agricultural products, but a border protection of this scale could be justified in the light of a policy of stabilisation of domestic market prices by means of flexible use of border measures. This allows in particular for the specific variability of agricultural prices, which is related to agriculture's specific production characteristics, subordinate to external and sometimes unpredictable events, in particular those related to the weather.

With this reduction in price support both problems of excessive use of polluting inputs and of production surpluses would be solved to a large extent. The present measures of supply management (production quotas and set-aside of cultivable land) would not be needed any longer.

### *8.1.1 Completion of the decoupling of the compensation payments*

"Compensation payments for structural adjustment" completely decoupled from the quantity produced would be instituted, with the principal function of "compensating" those farmers who wished to extend or transform their farm as a consequence of the completion of the reform of the CAP. They are therefore limited in time, reaching their expiry in 2006, although their level would already be known to the farmers from 1999 onwards. Credit bonds relating to the compensatory payments, guaranteed by the EU, could thus be traded on the financial market and capitalised by the farmers. They could be used for restructuring farms or invested in other productive activities if more profitable. An unbiased inter-sectoral labour mobility would be allowed.

The concept of these "compensatory payments for structural adjustment" needs to be clarified. They do not constitute compensation for a loss of revenue calculated on the basis of the reduction in the price support multiplied by the quantity produced. This type of calculation expresses a static view, as though the structural adjustment did not modify the economic conditions of the entrepreneurs with respect to what they would have been if the system of relative prices had not changed. When relative prices change in a market economy, the entrepreneurs reallocate investments and find a new economic strategy leading to a new situation. One of the

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<sup>20</sup> It is interesting to note how the need for a thorough reform of the CAP is voiced to some degree or other by all the parties, not only by consumers' organisations but by the Ministers of Agriculture themselves and not only by the countries most open to the market such as the United Kingdom (MAFF, 1995). Also, according to the German Minister of Agriculture Kinkel "it cannot be right to remain in a situation in which more than 50% of the Community budget is destined to be used for agricultural subsidies. Sooner or later we will have to think about reforming the structure of agriculture." (Agra-Europe 25.7.97, p.3). In practice, however, the implemented reforms are systematically reduced to minimal provisions by the Council of Ministers.

<sup>21</sup> Cf. European Commission, 1995. For arguments in favour of a radical reform, see National Consumer Council, 1988 and 1995.

recipes for increasing the economic rate of development is precisely in this flexibility of the productive structure.

If the resources used in agriculture enjoyed full mobility, compensatory amounts for a change in market prices would not be necessary. We see this from what generally occurs in other productive sectors where the government does not intervene whenever there is a change in relative prices. In agriculture, however, the mobility of resources is less than in other productive activities, which is what makes these "compensatory payments for structural adjustment" appear necessary and fair. Certainly, they should not become net contributions from the public budget to reconstitute the former unit revenues per hectare or per cattle head. Unfortunately this is proposed, for example, in Agenda 2000 for milk, with the result that the income distribution remains almost unchanged from what it was before the reform and structural adjustment is hardly conceivable.

These payments then, would be a compensatory contribution either for the costs necessary to transform the farm in order to make it compatible with the structural adjustment required by the reform, or for the temporary loss of income in the adjustment period. After 2006, when restructuring ought to be finished, the financial flow relative to these compensation payments would potentially become a saving in the budget of the European Union net of the costs of expanding the agricultural policy measures not under reduction commitment under the GATT-WTO agreements.

These payments would be defined in total at the moment in which decisions were taken on the completion of the reform and would therefore certainly be decoupled from future production in terms both of average yields and of acreage used for the different products. In consequence, they would ease the process of reform of international agricultural trade which will start again in 1999 with the new multilateral GATT-WTO negotiations.

These two measures, on the reduction of agricultural price support and the institution of compensatory payments for structural adjustment, should also be applied, with the necessary adaptations deemed appropriate on a case by case basis, in the remaining sectors of agricultural production not covered by the 1992 reform.

## **8.2 Increasing green box, horizontal policy measures**

The underlying principle of a reformed CAP is that government should favour inter-sectoral structural adjustment and not hinder it. Farmers, like any other producer in the EU, should be remunerated for every contribution to social welfare, and in proportion to such a contribution. Production of goods or services sold on the market should be equitably remunerated as should positive externalities and public goods which improve the quality of life or the environment.

The EU should start to implement a set of agricultural policies consistent with the GATT-WTO principles, converging not only between themselves but also towards international markets. This strategy would be fully consistent with the objectives of the Treaty of Rome and with the long term goals repeatedly declared by the EU in a number of international fora including OECD and GATT-WTO.

### *8.2.1 Measures not under reduction commitments under GATT-WTO rules.*

The policy measures which could attain the objectives declared by EU policy makers combining both producers and consumers interests without creating problems on international markets are the 'green box' measures listed in Annex 2 of the GATT-WTO Agreement on Agriculture signed at Marrakesh on 15 April 1994.

'Green box' policy measures shall meet the fundamental requirement that they have no, or at most minimal trade distorting effects on production. The support shall be provided through a

publicly-funded government programme not involving transfers from consumers, and shall not have the effect of providing price support to producers.<sup>22</sup>

Some of these policies are directed to reducing the risk of unstable markets (public stockholding for food security, government participation in insurance programmes, payments for relief from natural disasters). Others would be designed to promote economic development. Structural adjustment assistance (producer and resource retirement programs, investment aids) would be co-ordinated with an improved network of services for agriculture (research, training, extension, marketing, infrastructures), with rural development measures (payments under regional assistance programmes) and with environmental measures (payments under environmental programmes).

In contrast with price support, these instruments are not product-specific but can be targeted at specific policy objectives and/or at specific local conditions. These features increase the possibility of monitoring their effectiveness and their costs and benefits for social groups as well as for society as a whole.

### **8.3 Likely effects on production and EU budget**

Frame 8.7-1 shows the make up of the value of agricultural production from 1979 to the present time into four components: value at the border (at international prices); market support (increase in value on the domestic market obtained by means of supporting producer prices); direct subsidies to farmers; and other product-specific support (usually provided at national level).

These figures are drawn from estimates published annually by the OECD<sup>23</sup> and refer only to a subset of agricultural products, approximately two-thirds of the overall value of the agricultural production of the EU.<sup>24</sup>

The reduction in the support to domestic prices would entail a reduction in the value of the agricultural production on the domestic market. In addition to the market price, which will be supported to a moderate degree, producers would receive the "compensation payments for structural adjustment" up to 2006. The subsidies currently provided to farmers in terms of general services and national assistance are kept unchanged. Frame 8.7-2 shows an estimate, inevitably approximate and with a high top limit, of the probable effects of this second option on the agricultural component of the budget of the EU.<sup>25</sup>

Community expenditure on "accompanying measures" and on the permanent measures for structural adjustment (Guidance Section of the EAGGF, Objectives 1, 5a and 5b) should be increased to promote a permanent frame of reference for those working in agriculture. In Frame 8.7-2 these have been increased respectively to 5 and 6 thousand million ECU 1997/year. The agricultural "Other expenditures" are unchanged.

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<sup>22</sup> Agreement establishing the World Trade Organisation (1994) Annex 2, p.20

<sup>23</sup> OECD (various years), Agricultural Policies...

<sup>24</sup> The structural adjustment in the Community's agricultural sector should promote a reduction in the number of less efficient farms and an increase in the average farm size. Taking into account that, in particular in marginal zones, the agri-regional and agri-environmental interventions will largely mitigate the effect of the reduction in price support, while all quantitative constraints to agricultural production (quotas, land set-aside) would be falling, the overall border value of the production of the Fifteen should not vary to any major extent. In our chart, we have held it constant in real terms, assuming an average rate of inflation of 2% in future years, as in Agenda 2000.

<sup>25</sup> The budget expenditure for export refunds, still representing more than 7 thousand million ECU, would be reduced almost completely, partly because of the increase in domestic demand, but particularly because of the dismantling of the export refunds following the reduction in price support. The expenditure for stockpiling and interventions in the market to withdraw surpluses would similarly be reduced. These interventions would regain their original function of instruments of market stabilisation, rather than being used for the destruction of structural surpluses.

On the basis of these hypotheses, more than half of the current expenditure from the agricultural budget would become available for the "Compensation payments for structural adjustment" up until 2006 and for other uses beyond that date.<sup>26</sup>

#### **8.4 Effects on transparency**

Price support would be reduced to a relatively low level if it is compared with the traditions of continental agricultural policy starting from the third decade of this century. It could, on the other hand, be considered relatively high if compared with the protection and the price support given to non-agricultural products. However, the function of this protection is clearly to stabilise the domestic market by means of interventions at the border which are well known to be cheaper than direct interventions at the production level. As the level of protection is uniform, the relationships between the prices of the various products will remain relatively undistorted and the transparency on the domestic market will increase considerably.

The completion of the reform will significantly simplify all the bureaucratic and administrative apparatus in agriculture, making it easier for citizens to understand and assess how the money paid by taxpayers is spent. The identification alone in theoretical terms of an option of this type will contribute to transparency as it should make it possible to have a better understanding of the characteristics of current agricultural policy relative to a feasible and sufficiently well-defined option.

The demand for greater transparency is particularly strong in the CEECs, where the remnants of centralised public intervention remain, either in institutions or in the mentality of individuals and continue to impede an improved operation of market forces. Not forcing the CEEC to acquire the more negative, *dirigiste* and bureaucratising aspects of the *acquis communautaire* would certainly contribute to the transparency of their policies.

#### **8.5 Effects on efficiency**

##### *8.5.1 In the domestic market of the Fifteen*

If principles of market economy which at present are generally accepted world-wide and consistently taught to students in agricultural economics are true, then the elimination of the present distortions on the domestic and international markets should generate a significant improvement in the inter-sectoral, intra-sectoral, national and global allocation of resources.

Evidently, to obtain this *permanent* improvement in economic efficiency it is necessary to bear a *temporary* cost of structural adjustment. This will require careful managing if we wish - by means of institutional changes and/or targeted compensation payments - to reduce as far as possible the costs sustained by farmers which will have to adapt to a greater flexibility in the use of resources. However, the path of reform must be taken resolutely, or else we will see a repeat of the errors made in the past, when pseudo-reforms, often managed in a confused manner, at times worsened the existing situation rather than bringing the expected benefits.

##### *8.5.2 In the new Member States*

Not forcing the CEEC to apply the negative portions of our *acquis communautaire*, but eliminating instead those negative factors from the Fifteen, could smooth the path of economic development in the new members of the EU. It could reduce the scale of expenditure in agriculture and promote a balanced development of the different sectors of the economy, on the basis of the respective comparative advantages and of the requirements of national, European and international demand.

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<sup>26</sup> For example, if the financing necessary for the "compensatory payments for structural adjustment" available up to 2006 were not sufficient, the EU could issue part of these funds, which would become available in the following years, in the form of credit certificates in order to finance the "completion of the reform" by 2006.

It would not be necessary to impose production quotas for milk or sugar or to subsidise set-aside of cultivable land in the enlarged EU, thus avoiding the related costs for consumers and taxpayers. Any potential excess of supply over demand could be exported to the international market without a major strain on the budget and within the limits of the GATT-WTO agreements. EU enlargement to the CEECs would be much easier and smooth, not generating price and investment distortions in the new Member States.

## **8.6 Effects on equity**

Allowing domestic prices to fall closer to world market prices benefits consumers in proportion to their expenditure on the protected agricultural products. Those for whom lower food prices are most important are low-income households, such as single parents and pensioners.

### *8.6.1 In the domestic market of the Fifteen*

The impact of the completion of the reform on the redistribution of incomes will in some aspects be similar to that already started with the reform of 1992. The burden on consumers will be significantly reduced, while that on taxpayers will remain the same at least until 2006. Public money however will not be spent in order to maintain or worsen an agricultural production and market structure which is inefficient and expensive, but in order to reform this structure decisively and permit lower taxes in the future.

By reducing the transfers from consumers (regressive with respect to income) to producers (proportional to the size of the farm) the completion of the reform will improve the interpersonal distribution of income, in consistency with the policies applied by the governments of the Fifteen.

Incomes from land-owning, in particular in the more intensive regions where the accompanying measures will be of a lesser scale, will be reduced, as will the related land values. The greater the capacity of the entrepreneurs to reallocate resources commensurately with the new level of market prices and with the new opportunities for integrating income offered both by the existing and by the new accompanying measures, the less negative impact there will be on agricultural incomes.

### *8.6.2 Limited compensatory payments*

The amount of the compensatory payments will be the subject of negotiations among the policy makers, even if it will inevitably be constrained by the limitations of the public budget at the various administrative levels. The fact that these compensatory payments are decoupled from production significantly reduces the effects that they will actually have on the future development of the sector.

The average per capita farm income in the years while the reform is being implemented, however, would probably increase less than incomes in the other production sectors. This event will not be welcome by farmers. However, if policy makers aim at favouring inter-sectoral mobility of labour it would hardly be logical to provide rates of income growth in the sectors with excess resources higher than those prevailing in sectors to which the surplus resources should be transferred. This unfortunately has happened also in recent years, because of the overcompensation of the cereal producers. These structural reforms are a bitter medicine even if, like medicine, the unpleasantness is temporary while the benefit resulting from it is long-term.

### *8.6.3 In the new Member States*

The new Member States would not be constrained to support agricultural prices with the consequent redistribution of income from consumers and taxpayers to producers, and would avoid not only a further unbalancing of incomes but also foreseeable social conflicts. It would, in fact, be difficult to justify an increase in land-owning revenue in particular at the same time as a drop in purchasing power in the poorer classes of consumers.

In these countries, a cost is already being paid in redistributive terms owing to the introduction of the market economy which increased income differences among citizens. This cost however is considered justified in terms of greater well-being as a whole and a higher rate of economic development. These justifications would lose their validity in the event of a worsening of income distribution resulting from the introduction of agricultural price support.

## **8.7 Effects on sustainability**

### *8.7.1 In the domestic market of the Fifteen*

We have already referred to the fact that a reduction in price support would reduce the use of polluting inputs and their related harmful effects on the environment. Additionally, soil erosion would be reduced in some hilly regions, as would atmospheric pollution in areas of intensive livestock-breeding.

In certain marginal zones, the reduction in price support may lead to agriculture being abandoned, if it does not prove feasible to maintain economically viable agricultural holdings through the economies of scale made possible by restructuring and by increasing farm sizes. The improvement in cultivation and breeding techniques which may be obtained from more efficient general services to agriculture should also be taken into account. In such cases, in addition to the traditional accompanying measures, the agri-regional and agri-environmental interventions financed by the new accompanying measures and by the support payments for structural adjustment should make it possible to facilitate solutions which would be of greater benefit for local populations and society in general.

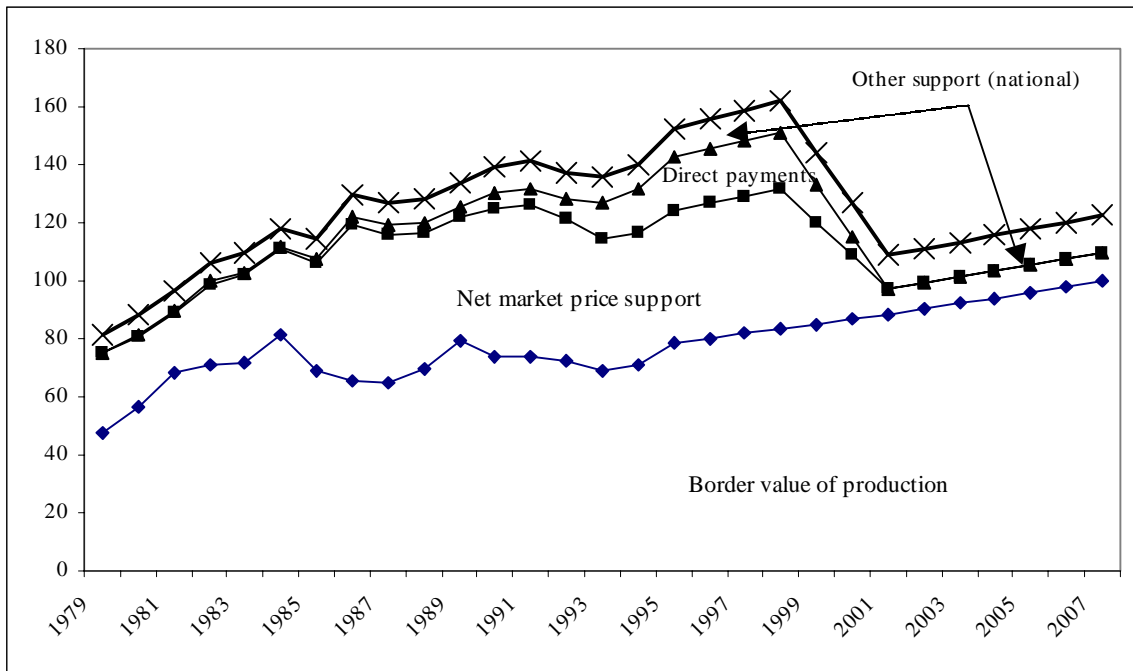
Reducing the bureaucratic apparatus needed to carry out and monitor the various forms of "management of supply," over and above the saving of public finances which can certainly be used in a manner more advantageous to society, will also make it possible to eliminate the wasted time, the constraints on production and the fraudulent practices, which will improve the ethical and social climate in the rural zones.

Not only the accompanying measures, but also the agri-environmental and agri-regional measures will have to be applied at the local level with an inevitable increase in bureaucracy, at least in certain regions. It will therefore be necessary to define the various forms of intervention at local level clearly and unambiguously, and to promote efficient forms of monitoring of public intervention by the local populations and the central administration.

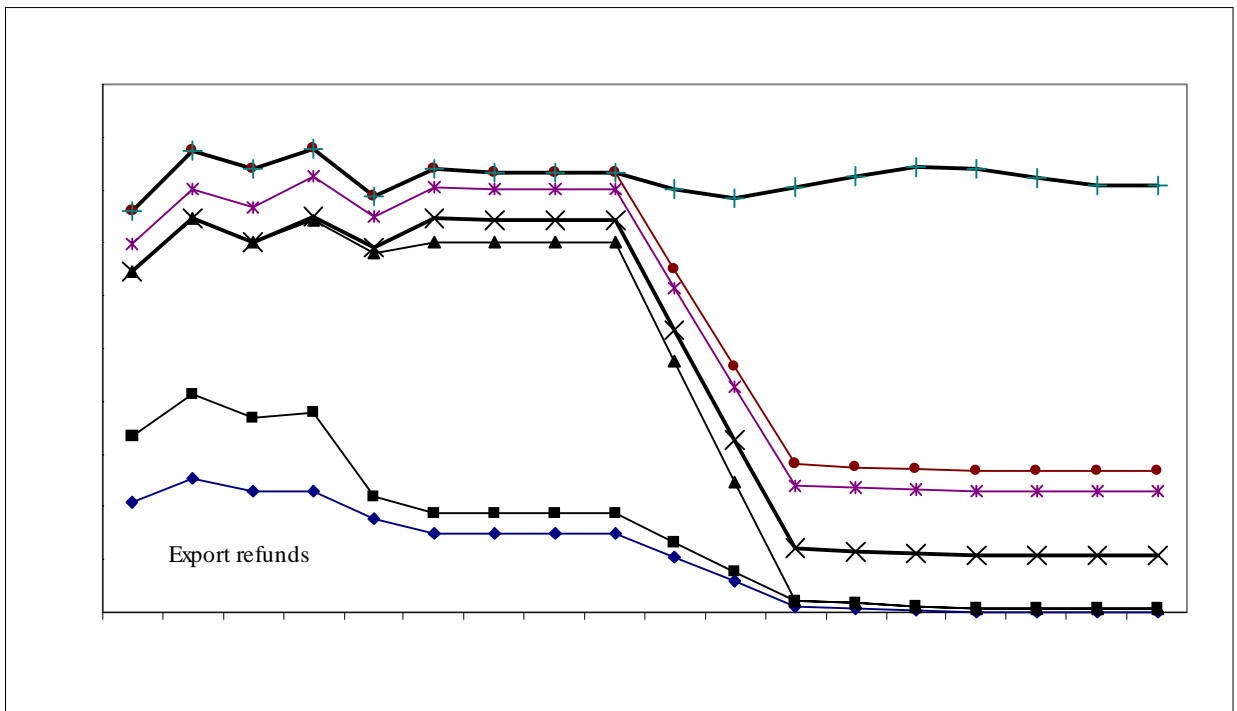
### *8.7.2 In the new Member States*

The use of polluting inputs and their harmful impacts on the countryside will increase much less in the CEECs if the latter are not constrained to adopt the price support envisaged by Agenda 2000. The effects on the social environment arising out of a lower level of bureaucracy in public intervention in agriculture will also be highly welcome in countries which have suffered for decades the harm inflicted by a centralised and bureaucratic economic system.

**Frame 8.7-1 Components of the value of agricultural production (bn ECU)**



**Frame 8.7-2 Components of the agricultural expenditure of the EU (bn ECU 1997)**



## 9. CONSUMER STRATEGY

### 9.1 Perspective developments

The Commission proposals following the document 'Agenda 2000' on the future of the European agricultural policy up to year 2006 do not change substantially the approach followed by the traditional CAP, notwithstanding the numerous criticisms from experts, scholars, policymakers and from the Commission itself. Actually, since the beginning of the EEC, the Commission proposed sensible and more biting reforms of the CAP, but the decisions of the Council of Agricultural Ministers were systematically overlooking them,<sup>27</sup> reducing the scope of the proposed reforms or frustrating them in the application procedures.

The risk of producing proposals creating political problems in the Council of Ministers is probably the main reason why the Commission is producing a 'low profile' proposal for the CAP reform in the next decade. The lack of transparency, inefficiency, inequity, and low sustainability of such a reform proposal is surely perceived by the Commission, but the strength of the agricultural lobbies and their influence on Ministers of Agriculture in each Country does not allow a more incisive long-term strategy. The experience gathered in the last four decades does not encourage the Commission to run the risk of proposing policies more oriented at the general interest, as a political power countervailing particular and sectoral interests does not exist in practice. In the EU administration the Council of Consumer Ministers does not monitor EU sectoral policies, while among consumer organisations in Member Countries only a few devote some interest to monitoring the CAP.<sup>28</sup>

However the political situation may change in the future. The EU Consumer Policy in the Amsterdam Treaty is reinforced and a strong horizontal clause envisages a systematic monitoring of other EU policies in order to verify their consistency with the interests of EU consumers. Up to now the responsibility for the manifest waste of public money and resource misallocation generated by the CAP, which was repeatedly pointed out also by the Commission, could be ascribed to the farm lobbies and the Council of Agricultural Ministers. From now on such a responsibility will be shared by consumer organisations and by the Council of Consumer Ministers, unless an effective strategy is envisaged in order to implement the article 129A of the Amsterdam Treaty. Such strategy in defence of consumer interests should involve all the other basic aspects of the consumer policy: information, representation, security.

### 9.2 Information

Consumers are usually less interested in the technicalities and effects of government intervention in agriculture, due to its complexity. It is also because the impact of a change in the price of one product, say milk for example, will influence only slightly the family budget. In contrast, farmers who produce milk are deeply involved in the outcome of policy decisions on the subject because a large share of their income could be at stake.

The media's presentation of news generally reflects this difference of interest. As a result, information at the regional and national levels is frequently partial and distorted in a number of ways in favour of those who are more interested in the

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<sup>27</sup> The most important proposal for CAP reform before 1992 was proposed by the Agricultural Commissioner Sicco Mansholt. The first consistent and courageous proposal was never examined by the Council of Ministers. (Fennell 1998)

<sup>28</sup> For example the National Consumer Council in the UK.



subject and are actually the people who follow most the information produced by the media. Often the Member Country's interests are identified with those of its own farmers.

In much of the European press, agricultural policy problems relating to the impact of price support measures on consumer welfare receive little mention, while producer benefits or losses are usually widely publicised. The result is either a lack of information or very distorted information amongst both farmers and the general public on the actual impact of policy measures.<sup>29</sup>

Although clearly stated in article 39 of the Treaty of Rome and in a number of official documents and declarations, the basic principles of the CAP sometimes are not properly perceived among people dealing with agricultural policy issues: experts, bureaucrats, policy-makers.

The fundamental distinction between sectoral welfare and social welfare is not always clear. A number of bureaucrats imply that benefits for farmers are always welcome, no matter of how much are the related (often unknown) costs for society as a whole. Moreover they often consider their precise duty to exploit any source of transfers to the agricultural sector to whom they feel somehow to belong. After all the more important is the agricultural sector, the more secure is their job and the greater are their opportunities to advance in career and salary.

In most instances these feelings are subconscious. When these public servants discuss the problem, usually they immediately admit that they should aim at the welfare of society as a whole and not at welfare of a particular group of people when in contrast with overall welfare. This is sometimes also the case for teachers of agricultural-related topics in High Schools and Universities.

The consumer strategy for monitoring the CAP should then start from aiming at a complete and unbiased information in all communication media in order to improve the perception of present problems in the general public. This should be the fundamental base for improving sectoral policies at all decision-making levels from local and regional up to national and Community level.

### **9.3 Representation**

According to common sense, if a policy decision, such as deciding the level of administered market prices for agricultural products, involves an income transfer from consumers to producers, then consumers should be directly and institutionally involved in such a decision, ideally sharing 50% of the bargaining power. If such a political decision is left only to people located on one side of the bargaining board, who are directly or indirectly related to sectoral interests (e.g. ministers of agriculture very often are elected in rural constituencies, a number of bureaucrats involved in agricultural institutions are land-owners or tightly related to producer organisations, etc.), the probability that the outcome of the decision-making process could be biased in favour of sectoral interests and against overall economic and social welfare is quite high. This is the case also when policy makers involved in the decision-making process are under a unilateral pressure of sectoral policies, without a countervailing pressure generated by lobbies defending the general interests of EU citizens.

In order to effectively monitor sectoral EU policies at all policymaking levels it is necessary to carry out a profound reform of consumer representation in all decision making bodies. Unfortunately this is not enough. In order to provide consumer representatives with the information and professional expertise necessary to stand the

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<sup>29</sup> Partial and distorted information among citizens and farmers is documented also by surveys carried out by Eurobarometer (Tarditi 1996, Consumer...)

arguments of their counterparts in decision-making bodies, a larger background organisation of economic policy information and research should be built up in coming years. Present multimedia communication techniques could substantially reduce the cost of such organisation, provided it were structured in the most efficient way by allowing a direct access to information on internet by all peripheral consumer units.

If consumer organisations were fully successful in countervailing producer lobbies, could they take advantage of a possible superiority in bargaining power damaging producers? This hypothetical situation is very unlikely, if not impossible, due to the very nature and objectives of consumer policy. As consumers aim at the general interest, they would support any legitimate request of representatives of sectoral lobbies if consistent with the interest of society as a whole. The possibility of an excessive power of consumer lobbies in policy decision-making is difficult to envisage and consequently to implement if the objectives of consumer policies are correctly attained.

In order to create a wide and effective consumer organisation in Europe, especially at national level where producer lobbies are more powerful, a considerable financial effort is needed. However such financial effort could be decided by national and EU governments only if policymakers are convinced of its usefulness in easing the attainment of the EU Treaties and National policy objectives. This brings us back to the need for complete and unbiased information together with the need for change in the policy objectives pursued at present by consumer organisations and by a large share of the people involved in consumer policy in the local, national and Community public sector.

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# The EU Agricultural Policy: a Consumer Viewpoint

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## Summary

The final objective of government intervention is the attainment of the 'common good' for society as a whole. Government are supposed to intervene in market economies mainly in order to offset market failures. However governments themselves often fail to maximise the common good, especially when private interests prevail.

In the decision-making process of the CAP agricultural lobbies play a predominant role, without any substantial counterpart lobbying to defend the interest of society as a whole. Although, according to common sense, food surpluses and related budgetary costs (export subsidies, food storage, etc.) would disappear if public price support were dismantled, this elementary solution to the most important problems raised by the CAP was never fully accepted. The cost of the CAP, mainly due to the agricultural price and farm revenue support, amounts to almost 50% of the EU budget, paid by taxpayers. Moreover, according to OECD estimates, an almost similar invisible transfer of income to agricultural producers is borne by consumers paying higher market prices. Consequently, although agriculture accounts only for 1.7% of the Community GDP, the cost of the CAP is as big as the total EU budget.

The performance of sectoral economic policies is usually appraised on the grounds of three sub-objectives better specifying the broad dimensions of social well-being: economic efficiency, social equity and environmental sustainability.

The effects on economic efficiency are manifestly negative. Domestic market prices are distorted among farm products, capital and labour resources are retained in agriculture while their productivity for society as a whole would be much larger in other industries. If at least the CAP were consistent with structural adjustment in the long term then, sooner or later, the problem would be solved and the present waste of economic resources terminated. Unfortunately this is not the case as present distortions in market prices generate distorted investments.

In terms of social equity, higher food prices act as a regressive tax on food burdening proportionally more worse-off households who spend a much larger share of their family budget on food than better-off households. On the other hand better-off farmers producing larger amounts of commodities whose price is supported get a much larger share of the benefits. As a result income disparities among citizens are increased.

In terms of environmental sustainability the impact of farm price support is mixed. On the one hand higher farm prices stimulate the use of polluting inputs such as fertilisers and pesticides. On the other hand price support is likely to prevent serious problems in terms of depopulation or reduced environmental standards in some marginal regions. However these positive effects are circumscribed to specific areas and could be attained in a much more effective way by specific agri-environmental and agri-regional policy measures.

According to the recent document of the Commission Agenda 2000, the very nature of the CAP will not be substantially changed before 2006. The worse aspects of the CAP in EU-15 will be reduced to a certain extent, but this positive impact on European social well-being is likely to be largely offset by the negative impact on

new Member Countries which will have to accept the *acquis communautaire* in agricultural policy.

In the Amsterdam Treaty a strong 'horizontal clause' is instituted by which Community Consumer Policy should also monitor the other EU policies both at Community and national level in order to protect consumer interests. Up to now the noxious effects of the agricultural price support policy could be cast to farm lobbies and to ill-informed policy makers, however in the future the Consumer Policy will be co-responsible for the reduction of social welfare generated by the CAP as well as by other sectoral policies.