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THE CAP AND 1992 :  
A FRENCH POINT OF VIEW

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## The CAP and 1992: A French Point of View

by

Yves Leon and Louis P. Mahe

### Introduction

Events occurring since the early 1980s, both on the world scene and in Europe itself, have largely altered the economic and political landscape around the Common Agricultural Policy (CAP).

On the world scene, depressed prices of agricultural products have resulted from the sluggish demand due to the slow economic growth and the burden of the foreign debt in traditionally importing countries. Meanwhile, agricultural capacity in rich countries has not been adjusted downward fast enough to cope with the imbalance between demand and productivity trends. Because of inflation in costs and weak prices, farm incomes have suffered. A strong international activity to reassess agricultural trade policies in rich countries has developed, which culminates now in the GATT round of negotiations. The farm policy of Europe is still the target of criticisms from the main exporters and is under pressure to reduce the level of support provided to farmers.

Within Europe also, new circumstances have appeared which call for a significant reform of the CAP. Surpluses in most community markets and the related expenditures of the European Guarantee and Guidance Fund (FEOGA) have made the need for change more obvious to many.

But agricultural problems are not the only source of pressure for the CAP to adjust to new times. The prospect of the Single Market and the "relance européenne" has revitalized faith in European integration, and has also brought new blood to European affairs. The CAP, long viewed for its Community-unifying role, has become somewhat outdated under these circumstances. It is bound to change as both its means and principles have ceased to be considered untouchable dogma.

In this paper, we argue that the CAP has already made some significant changes over the past few years in response to the new circumstances. But we also point out that some basic problems of European agriculture are still unresolved, and that the supranational nature of the CAP and history constrain the margin of maneuver into narrow bounds.

We turn next to the expectations of France from the CAP and its role in the European farm policies. This view is largely critical in that it can be argued that our country has not really played the cards of comparative advantage in the earlier period of the Green Europe. However, there are some tentative explanations for that to have occurred, but some changes have now become unavoidable.

In the last section, we briefly review the prospects of 1992 and other circumstances, including environmental problems, for the future developments of the CAP. We conclude that, however hard it might be to justify on some economic grounds, the CAP

is not so different in many respects from most developed country farm policies faced with similar circumstances.

### **The New CAP Has Arrived**

Every year by early winter, the wine growers of the Beaujolais area in France launch an advertizing campaign which spreads like a rumor over Europe: the slogan "The new Beaujolais has arrived." Every year as well by early spring the price negotiations ritual takes place in Brussels and is the occasion to discuss policy changes often coined "reform" of the CAP. The CAP has been continuously reformed since its inception, but one may question how deep and serious can be a reform which comes every year or so like Beaujolais.

### The New Vintages of the 1980's<sup>1</sup>

Starting from the early 1980s however, the need for and the will to reform has gained momentum, and it is fair to say that the vintages from 1984 to 1988 are a bit special.

The dairy quota first turned out to be a major decision, even if, as economists, we do not like this type of policy instrument. This system was obviously the only way to stop the explosion of milk surpluses without bearing the political cost of cutting prices. Incomes have been preserved, particularly for those now in production who benefit from sizeable quota rights. The newcomers and the next generation will not benefit, but they, like consumers, had little to say in the decision process. In terms of market balance and of stock disposal, the quota system has been quite effective. Deliveries have declined from 99 million tons in 1984 to 94 in 1988 (table 1). Meanwhile public stocks of butter and powder have been drastically reduced. These new measures have brought with them significant budget savings, particularly on intervention measures in spite of the cost of disposing of "old stocks."

The will to cut dairy surpluses has been confirmed by further reductions of the dairy quota from 99.4 million tons in 1984-85 to 91.0 million in 1988-89. Penalties for exceeding quota references are now more strictly applied than in the early years of the program. Altogether, the dairy quotas have brought deep changes in the European farm sector, and casual estimates of the equivalent producer price cuts run around 20-25 percent in real terms (Guyomard and others, 1988).

The significant impact of the EC dairy quota can now be observed in both the domestic and world markets for dairy products. Butter production in 1988 was down by 20 percent relative to 1983, the last year of the pre-quota era. Butter stocks have also decreased drastically, partly due to special programs of old stocks disposal and also to the fall in purchases which declined by 8 percent in the first half of 1988 as compared to the same period of 1987. Butter prices have moved up on the domestic market reaching the intervention price (rather than being 8 percent below in 1987). Similar changes have occurred with skim milk powder. Skim milk powder prices were even 25 percent above intervention prices (CCE-- EC Commission--, 1989). The tension in the domestic market is partly due to the expanding demand for manufactured fresh dairy products,

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<sup>1</sup>Figures quoted in this section come from CCE -- EC Commission-- (1989).

and partly to the world situation where prices have increased by 20-50 percent for butter, and 50-100 percent for skim milk powder.

At the Brussels European Council in February 1988, several restrictive measures were taken. The "budget discipline" now imposes a ceiling on the increase of FEOGA expenditures for market support at 74 percent of the GDP growth rate. This is far less than the average increase from 1980 to 1987 (about 2 percent in real term under current GDP growth rate, versus 6 percent). The actual way to make it work, however, is to have price decisions and accompanying measures to help reduce market imbalances. The budget stabilizers have given more power to the Commission to do that, as objective ceilings on production in excess supply are now specified. The Maximum Guaranteed Quantities (MGQ) have already become effective in several sectors although, as they were decided after plantings of the 1988 crop, the full effect remains to be seen.

For grains, the 1988 crop (162.5 million tons) overshot the MGQ (160 million tons) and a levy of 1.6 percent was withheld from producers. In the price decisions for the crop year 1988-89, the producer price was cut by 3 percent as a result of the application of stabilizers. This is done through a co-responsibility provision which can be revised after the actual crop level is known. For grains, the productivity trends are expected to make production hit the ceiling in any normal year. If prices in ECU are decreased by 3 percent as expected, it is a price cut of about 6 percent per year in real terms at the producer level that can be implemented by the Commission. These changes are potentially able to control grain surpluses.

Another clear-cut example of the capability of the budget stabilizers system to reduce production incentives is found in the oilseed sector. For rapeseed as an example, prices were reduced by 10 percent for the 1987 crop and 7.6 percent for 1988. The limit of 10 percent which existed on the price cut was also removed, making the system potentially more severe for the coming year. For sunflower, the price cut in 1988 was 19.8 percent. On the basis of the last couple of years, it is hard to maintain that budget stabilizers have not brought any real change.

The adjustment through support price cuts and budget stabilizers has also been complemented in the 1989-90 price decisions by lowering the safety net of "intervention." More exactly, the EC Commission has clearly expressed the will to restore the role of public storage as a safety net rather than a normal outlet. Commodities are to be purchased by the public storage agencies at a price lower than intervention price, and permanent intervention was abandoned in favor of shorter periods during the crop year (the intervention period for grains was cut by 1 month at the last price decisions).

Even if some colleagues from Europe and in several quarters of the world express doubts about stabilizers, we think that it is fair to say that over the past few years the EC has done quite a bit to impose a clear limitation on the usual system of open-ended price support policies, as can be seen in table 2 where prices in real terms have decreased noticeably and much more than in the past in the grain sector.

Table 1--Effects of dairy quota on the domestic and international markets

Commodity	1980	1983	1984-85	1985-86	1986-87	1987-88	1988-89
Milk deliveries (1,000 t)	95,751	103,635	99,113	99,900	100,100	94,240	--
Quotas <sup>1/</sup> (1,000 t)	--	--	99,440	98,970	99,260	93,450	90,993
Dairy cows <sup>1/</sup> (1,000 heads)	25,520	25,363	25,765	25,043	24,303	23,868	22,491
Public stocks (1,000 t):							
Butter	147	686	973	1,018	1,297	888	--
Skim milk powder	231	957	773	514	847	594	--
International prices: <sup>2/</sup>							
(\$/ton):							
Butter	--	1,800	1,300	950	1,050	750	1,150
Skim milk powder	--	780	640	600	680	760	1,150

-- = Not available or not applicable.

<sup>1/</sup> EC 10; Source: EC Commission, *The Agricultural Situation in the Community*, various issues.

<sup>2/</sup> Quotation is the lower end of bracket, FOB North European and selected world ports; Source: U.S. Dept. Agr., For. Agr. Serv., *World Dairy Situation*. FDS, Nov. 1988.

### Which Forces Move the CAP Now

The CAP has a long tradition of high support prices. Before the significant changes mentioned above, some relatively minor adjustments were made in the past in response to domestic pressures (farm incomes, budget) as well as international changes (world prices).

There is now in the EC a completely new situation generated by the reversal of the trade balance for most temperate zone product commodities. After milk, grains are now in permanent excess supply, and marginal production has to be exported. The gap between domestic and world prices must be met by export restitutions; thus, all the additional cost of farm price support is now borne by the budget.

The self-sufficiency tends to spread over the whole sector as resources freed by the surplus commodities (dairy, grains), as a result of explicit or implicit price cuts, are moved to the remaining relatively uncontrolled products (oilseeds, other protein crops, beef). A permanent excess supply for beef is to be expected in the long run after the negative effects of the dairy quota are exhausted. This is already the case for oilseeds and other protein crops which substitute easily for grains. The budget consequences in the case of oilseeds are huge because, as in the U.S. case for grains, the support is provided through deficiency payments, and expenditures become highly sensitive to quantities supplied and to world prices. FEOGA spending on oilseeds has soared dramatically over the last few years.

The immediate effect of product expansion on budget costs has changed the economic and political environment of policymaking within the Council of Ministers. The additional costs of the CAP are no longer hidden in the consumer losses of real income as they are visible on the records of the public budget. This new situation introduces a feedback mechanism leading to a continuous reassessment of the economic and political basis for continued price support policies. These countervailing forces are amplified by



the implications of the financial solidarity principle which puts a burden on the less "agricultural" and net importing (or now rather, less exporting) countries. It is commonplace to see the United Kingdom, and increasingly, Germany, advocating budget-savings.

Table 2--Annual changes in farm prices in real terms

Commodity	1985-75 (3)	1982-81 (1)	1983-82 (1)	1984-83 (1)	1985-84 (1)	1986-85 (2)	1987-86 (4)	1988-87 (4)
	Percent							
Total	-2.4	-0.2	-2.7	-3.1	-4.2	-3.6	-4.5	-1.7
Vegetables	-2.1	-.4	-.8	-3.9	-5.4	-1.7	-4.6	-3.3
Cereals	-3.2	-1.6	-.7	-6.9	-9.0	-2.8	-5.9	-7.3
Animal products	-2.7	-.1	-4.3	-2.5	-3.3	-5.1	-4.5	-.4
Beef	-3.1	1.2	-4.8	-5.7	-4.5	-6.7	-2.5	-3.2
Dairy	-1.9	1.1	-.7	-4.1	-1.0	-.7	-2.5	+2.4

1/ Eurostat, *Semester Statistics*, 1, 1987. 2/ *Agricultural Situation*, 1988.

3/ *id.*, 1987. 4/ Eurostat, *Statistiques Rapides*, 1989, 12, p. 15.

Budget costs are not the only force acting in favor of revision, however. The lack of markets for subsidized exports (particularly dairy products), the transfer of the benefits to foreign consumers (Eastern Block purchases of cheap butter) and, more generally, the perceived waste of goods from excessively long public storage,<sup>2</sup> have also contributed to undermine the strength of traditional advocates of continued and unlimited support.

An active international activity has developed in the GATT and other circles increasing the foreign pressure on the CAP. But it is our belief that these foreign forces, however strong, have limited impact compared to domestic forces. In some occasions they may even backfire as they give some "ad hoc" nationalist arguments to the group who fights to defend "our national trade interest," whoever actually benefits from current policies eventually. Conversely, the argument that foreign producers are also adjusting to new times is a useful way to help convincing domestic farm organizations that changes are to be made everywhere.

The changes mentioned above are not to be regarded as negligible as we argued. However, they should not lead us to forget the basic problems of European agriculture which makes bold policy adjustments difficult to achieve, and particularly so in the context of a supranational organization where national second thoughts are the rule rather than the exception.

### The European Agricultural Problem

The CAP has long been criticized on economic grounds, and we think there is some basis for that. But the challenge of achieving European integration in a declining industry was not a small one. The example of the steel industry in Europe and in the

<sup>2</sup>The Commission decision to include the corresponding cost to the budget of the current year means a clear change in attitude with respect to intervention.

United States shows that hard policy choices are costly to make. The fiber and textile industries in rich countries provide another example of national attitudes trying to escape the implication of changing comparative advantage in the world. European agriculture is no exception to that, and the situation is made even more complex by the heterogeneity of European agriculture, which the recent enlargement has markedly increased.

In the original EC-6, the agricultural problem was not too heterogeneous in the sense that protectionist policies had been the rule since the late 19th century in the larger countries (Germany, France, and to some extent Italy). The famous Franco-German compromise, also called the wedding contract, that is, French farm exports in exchange for German industrial products, was not so hard to reach. Prices were set at a high level, particularly upon insistence of German producers. Countries like Belgium and Netherlands who had opened their agriculture to world influence were able to adjust as their agricultures were efficient, open to trade, and oriented toward animal products which also benefited from the common market organizations. As a consequence, they were less penalized by the high grain policy, and even less so as their compound-feed industry developed rapidly on cheap imported feed ingredients thanks to the bound tariffs on nongrain feedstuffs.

The first enlargement created a new situation with the membership of the United Kingdom, a large country, traditionally low-cost importer of food, but with a modern agricultural sector, whose capacity had been clearly underestimated<sup>3</sup> (the self-sufficiency rate in the United Kingdom has moved from 65 percent in 1970-74 to 140 percent in 1985 for grains and from 18 to 73 percent in butter).

At least two conflicting views on agricultural policy were constantly opposing each other in Europe: the British complaining about the cost of the CAP for Britain and arguing for lower support and the French and Germans pushing for price increases qualified as "sufficient" to maintain farm incomes. The conflict has now become less tense after the solution of the so-called British contribution problem in 1984 (an issue which should fade somewhat anyway with the rapidly increasing rate of self-sufficiency in the United Kingdom). Meanwhile the MCAs have also provided some flexibility in the CAP and allowed Germany to have higher domestic prices than its partners.

The second enlargement to the south (Spain and Portugal) has further increased the heterogeneity in European agriculture in the opposite direction of smaller, less efficient, and low-income farmers. This in itself prevents a drastic shift toward direct income payments as the needs are in the south and the resources in the north, and the solidarity principles, even if celebrated in words, will rapidly reach their limits.

Because of the predominance of small farms in much of Europe, it is both politically and economically difficult to speed resource adjustment by pressing prices and therefore incomes downward. Because of the heterogeneity of the European agricultural sector across countries, a consensus of policy reforms is hard to reach. Because of the supranational nature of the decisionmaking process, and the need for quasi-unanimous

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<sup>3</sup>Denmark and Ireland were in a different situation, welcoming high prices, as they were "exporting" countries with a large farm sector.



agreement, compromise and bargaining will continue to take place, as vested interests of some social groups are treated as national interest in the Council of Ministers.

This supranational nature of the CAP leads to an externality problem in the institutional framework, as it is possible to externalize partly the budgetary and economic costs of price support policies on other partners, thanks to the financial solidarity principle. The net importers lose in that game and they take any opportunity, particularly when the unanimity voting is the rule rather than the exception, to bargain some specific program which is geared toward their own national interests. This has led the CAP into a situation where programs are very complex and cumbersome to implement. This has also led to the upward bias in the price decisions every year, as can be seen in table 3 below.

Table 3--Annual changes in support prices: Decisions versus proposals

Year	Proposals		Decisions			
	In ECU (a)	In national currency (b)	In ECU (c)	In national currency 1/ (d)	Inflation rate 2/ (e)	Support prices in real terms (e)-(d)
1980/81	2.4	--	4.8	10.5	12.1	-1.6
1981/82	8.9	--	9.2	10.9	10.6	.3
1982/83	9.0	--	10.4	12.2	10.5	1.7
1983/84	4.4	4.4	4.2	6.9	8.6	-2.3
1984/85	.8	-.5	-.5	3.3	7.0	-3.7
1985/86	-.4	0	+.1	1.8	6.0	-4.2
1986/87	-.1	.9	-.3	2.2	5.5	-3.3
1987/88	-.5	.2	-.2	3.3	4.0	-.7
1988/89	0	.3	-.1	1.6	3.9	-2.3
1989/90	-.2	.6	-.3	1.3	3.7	-2.4

-- = Not available or not applicable.

1/ Including monetary adjustment. 2/ First year of split year.

Source: Eurostat, National Accounts; Notes Rapides de l'Europe Verte, 14, 21, 23, 27, 30, 35, 41, 44; CCE-- EC Commission, com (89) 40/1.

The new CAP, as presented in the first section, should not lead us to forget that the traditional CAP is still alive. It will prevent drastic changes from happening, but will probably develop according to the following lines:

- o Price support reduced slowly as a response mainly to budget pressure.
- o Production kept under control (quota, MGQ).
- o National measures to compensate income losses, pursued particularly in richer countries (Germany and France).
- o Direct aids financed from common European resources kept under check.

- o Resource adjustment policies implemented (set-aside, early retirement...), but with a limited impact on surpluses.
- o Burden of price support largely maintained on the consumer and the user to prevent expanding budget cost.
- o Decisionmaking process and MCAs or VAT mechanisms biased toward ECU price increases, so that producer prices in Germany do not fall in an unacceptable way.

A fully market-oriented policy or an elimination of the CAP are unlikely. Rather, the trend leans toward budget-saving and income-preserving policy reforms which may end up being more inward looking than internationally open and relying on supply management policies rather than on decoupling and income transfer. To a large extent, France's role in the CAP has allowed these traditional features to develop in the past 30 years.

#### **France's Strategies and Role Within the CAP: After the Sweets, the Sour Grapes?**

The traditional approach of farm policy in France has been biased in favor of protectionism and an extensive intervention of the State in the sector. Again, the roots have to be traced back to the 19th century at least (as in the case of Germany) with the Meline tariffs providing a shelter from international competition. In the postwar period, farm policy was designed to restore the production capacity of the sector, and soon the need for structural adjustment was felt and an active structural modernization policy was carried in the Golden Sixties, when economic growth was fast enough to absorb labor freed by the farm sector. This is also the period when the CAP was implemented and the fairly protectionist habits were taken. From the point of view of a French analyst, the two important questions today are:

- o Whether the choices made over the last 30 years in the CAP were really the right ones in regard to economic efficiency and longrun national interest.
- o Whether it is still possible today to shift the strategy to more sound economic foundations.

Relevant questions are also whether it was possible to envisage a different historical scenario, and whether the CAP has really contributed to build an agricultural sector ready to face future challenges. By and large, the choices made in that period are often better explained by a political rather than an economic rationale.

#### A Shortrun Strategy

It was long thought that higher prices obtained in Brussels were a good thing for France. As the agricultural common market was built around the grain sector, the high price policy for grains was considered as a good for France, in view of the production capacity and the large farms of the Paris basin. High price policy was the option retained for most sectors where European production was significant, in particular for sugar and animal products (save maybe for pork and poultry).

France's trade balance has always been fragile, and the contribution of the farm and food industries to the external balance was seen as an asset in meeting macroeconomic targets. This is why France has never fought very actively for lower common prices which Germany has always wanted high anyway, to protect their relatively small farm structures.

It is clear that agricultural trade in France has benefited from the CAP and that the value of exports of the crop sector would not have been the same without the CAP. France has been able to externalize part of the cost of the price support policies. One may question, however, if the longrun negative effects of the high grain price policy are not large enough to offset the shortrun benefits on the balance of payments.

First, by keeping feed grain prices high, France has somewhat choked the growth of the animal sector not only for pork (for which the country is a permanent large net importer) and poultry, but also for dairy and beef which had to compete with profitable crops for land. The record of France in the animal sector is far from being in line with the country resources, even without taking Netherlands as a normal reference.

Second, high grain prices have led to concessions on the external tariff for other feedstuffs which has created the cereal substitute issue in Europe and to some extent stimulated the import demand for protein feed. This has closed a significant part of the internal European market to French exports of grains, notwithstanding the increased self sufficiency of partners (U.K. is now a net exporter of barley), and made the exports of grain depend on restitutions.

To rewrite history is impossible, but it is questionable whether that was really the best way to ensure a sound positive balance in our agricultural trade in the long run. The sugar quota system is probably even a better example of the drawbacks of such a strategy. Clearly with that system, France has not played the cards of comparative advantage, and all countries have requested their market share, including the ones who are prone to make pleas for free market policies.

Most of the ingredients usually included in the political economy of agricultural protection seem to apply to the French example as well. Until recently, the share of farmers in employment and in the votes was still important. Their representation in the unions was controlled by the larger farmers who favor high prices paid by passive consumers rather than social subsidization programs. It is probable that without the CAP the parameters of the political game would have been different and prices would have been lower in France.

The heterogeneity of French agriculture also contributed to make price cuts more difficult, as some farmers could stand lower prices, while small farmers are close to the poverty line. The common view was also that farmers should "earn their income from the market," that is, the consumer. Under such circumstances, prices are never high enough when small and fairly poor farmers are brought into the front scene.

One would be tempted to argue also that little contradiction was given by the general thinking about farm problems including the agricultural economics profession itself, which was fairly biased toward agrarianism and the small farm problems. This may relate to the long tradition of protectionism which was not even questioned in the 1960s and certainly less in the 1970s where economists were, to say the least, not biased in

favor of market-oriented policies but explained that the capitalist forces were the main causes of the problem.

It is doubtful that more widespread critical analyses of the French farm policies would have made a great difference on the observed developments, at least in regard to the German case where economists have long been critical without apparently affecting deeply the course of events up to now. Policy reforms require more than good economic analysis to be implemented. Changes in the political economy of decisionmaking or in the nature of the problems are necessary for a reorientation to occur as we observe now. It can be argued, however, that a better explanation of the opinion that labor had to move out of the farm sector and that regional economic development cannot depend on farm price support might have helped the country to take greater advantage of the rapid growth of the 1960s to improve its competitiveness in agriculture.

### The Time for Sound Resolutions

The favorable trade balance in food and agriculture should not generate any illusion. Exports are mainly composed of raw products and little of high-value-added items. Animal products have some weak points (pork, sheep). Given the overall self-sufficiency of the EC, the dependency of our exports to third countries on FEOGA subsidies threatens our exports in the long run, even more so as budget costs are scrutinized and as our partner countries become more and more reluctant to contribute to enhance our export capability.

This weakened situation has already materialized in the slow deterioration of balance of payment transfers from the CAP within agriculture, and the net financial balance for France has now become limited and sensitive to future price cuts in surplus commodities. It can be argued that the type of specialization of French agriculture induced by the CAP has to be phased out as in all other member states, and comparative advantage can no longer be played as easily as it was in the period of growth of total agricultural output.

This viewpoint is no longer rare in France, where a significant change in the mood, a "frémissement" as we say, can be felt in the public agencies and even in the farmer organizations. The consensus over the unquestioned virtues of price support is now broken and a debate is going on. Certainly, the new pressures on the CAP have contributed to this increased awareness, but the new momentum of the European construction due to the Single Act and 1992 has also started bearing on the events.

### **1992: The Single Market Will Affect the CAP in the Long Run**

It is not easy to predict how much progress will be made by 1992 on European integration as a result of the Single Act, but there will be progress. It is widely recognized that the direct effects on agriculture and the CAP should be limited since all the necessary legal basis for market unity for agricultural products has been available since the Treaty of Rome. It is likely, however, that the indirect effects of 1992 on the CAP could be significant in the long run if the integration of the rest of the European economy goes far enough to include the common currency and the removal of borders.



In regard to agriculture and the food industry, the single market is likely to impact first through the necessary harmonization of nontariff barriers on food products; second, by the harmonization of macroeconomic policies and of the regulations in sectors supplying inputs and services to agriculture; and third, by the general political climate generated by 1992 and the reordering of priorities it may lead to in European affairs.

### The Single Market and the Food Industry

The removal of nontariff barriers related to health regulation and consumer protection will open a very large market to the European and foreign firms of the food industry which meet the required standards. This increase in competition is supposed to enhance efficiency and allow firms to take advantage of economies of scale. The cost of "non-Europe" in the food industry has been evaluated to be from 600 to 1,200 million ECU annually in the Cecchini Report. This estimate is at best tentative, but the increasing-returns nature of the food industry does not leave much doubt on the sign of the efficiency gains. The larger firms have already taken this for granted as shown by the intense activity of consolidation and purchasing of shares to gain control over the European market (163 alliances in 1988 according to Viaene, 1989).

How does the French food industry stand in face of this increased competition? The size of the industry is similar to the one of Britain and Germany, but it does not quite match the relatively large capacity of the French farm sector in Europe. This is reflected in the composition of the trade of agricultural and food products which include a limited amount of elaborated goods of the so-called second transformation which has a high-value added. The net trade balance is negative in this category (4.1 billion francs in 1987 while the global surplus is 27.2 billion francs in the agricultural and food balance). By comparison, Germany and the Netherlands do much better with surpluses of respectively 3.7 billion and 7.3 billion francs (Gagey, 1989).

This relatively poor performance may be due to the economic structure of the industry where firms are smaller than in our European partners. Few corporations are big enough (with the exception of BSN, 7th largest in Europe) to serve as a leader in equity restructuring and firm acquisition to reach a size sufficient for the new European market.

The geographic zone of influence is also a matter of concern for the French food industry, as the domestic market is by and large the essential outlet for most firms. For example, the group BSN makes 70 percent of its sales in France, while Nestle sells 70 percent of its production out of Europe.

The relatively modest scale of the French food firms may also contribute to the explanation of the weakness of research and development in that sector (R & D spending is reported to be 0.12 percent of turnover in France as compared to 0.7 or 0.8 percent in the United States). The balance of payments for licenses has consistently been negative in that sector since 1978, and the purchase-to-sales ratio of licenses has been 0.11 in the food industry as compared to 0.44 in the rest of the economy (Gupta and Vincent, 1986).

To summarize, the structure and performance of the French food industry is barely adequate, even if it should be able to benefit from the traditional image of quality in some products. The firms must adapt to the new trends in food habits, specialize in



areas where markets expand, and enlarge their size and geographical coverage if they are to take advantage of the single market. The cooperative firms in the food industry which are extensive in France will find adjustment to a rapidly changing environment particularly demanding.

At the core of the issue of the removal of intra-community trade barriers for food products is the process of food law harmonization among member states. Up to now, the general approach to this question is the principle of mutual recognition which was stated by the Court of Justice of Luxembourg in the famous case, "Cassis de Dijon," and in several other cases generating a jurisprudence along these lines. According to this principle, a product legally manufactured and sold in a member state must be sold without legal obstacle in the whole Community.

In the annex to the White paper (CCE-- EC Commission-- Livre Blanc, 1985), the Commission lays the guidelines for the implementation of the Single Market in the food industry. The Commission took the position of limited regulations, drafting directives aimed at labeling legislation on additives, material, and equipment rather than an official control of foodstuffs content, i.e., the "recipe approach."

France has issued a memorandum on the completion of the internal market for food law which is based on four concerns:

- o The close link between food and health and the sensitivity of the public opinion to these issues.
- o The importance of sales denominations and qualitative specification in regard to consumer protection and fair trading.
- o The existence of varied national rules which reflect the richness of food tradition in Europe.
- o The interaction of the single market for food law and the "acquis communautaire," i.e., the working of the CAP.

The memorandum essentially expresses concern about the possible risk for quality of foodstuffs if they are economically forced to adjust down to the level of the country with minimum standards as a result of the mutual recognition principle. It reflects some doubts on the efficiency of the free market system in the context of consumer safety.

There is some economic substance in this position which should not be viewed as a sole desire to preserve genuine food traditions or as a petty gastronomic parochialism. The memorandum accordingly favors a horizontal harmonization of general standards, rules of inspection, and labeling. It also favors a vertical harmonization for a limited number of foodstuffs in regard to the sales denominations<sup>4</sup> and the composition of products. The introduction of a standardization policy at the Community level is also suggested to approve standards and professional practices. We take it that in the United States the

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<sup>4</sup>It suggests to distinguish generic denominations which all countries would have to comply with, and country specific denominations for which an inventory is requested.

harmonization of standards is viewed as a positive feature allowing the foreign firms to meet ahead of time a unique set of conditions for the whole European market.<sup>5</sup>

### 1992 and the CAP

The single market will modify the environment of the CAP, rather than impact directly upon it. First, harmonization of policies in the area of indirect taxes is likely to be an issue of importance considering the large divergences in VAT rates applied to farm inputs and food. The outcomes of such an harmonization are unclear. There may be differential effects among member states as a large number of farmers in EC countries (except U.K., Denmark, and the Netherlands) still use the special VAT regulations since they do not carry complete bookkeeping records.

Second, the single market should make the transportation industry more competitive in Europe and decrease the cost of food and feedstuff transportation. These goods are bulky and this in itself is likely to reduce the still existing price differentials in farm and food products among member states. Comparative advantage should work more efficiently and specialization of regions might increase. A similar effect may result from the single market in the banking system and more generally in the farm input industry.

Third, market unification in foodstuffs, even if the process is not completed by 1992, will probably increase the pressure on the CAP in the areas of highly protected raw materials which hamper the competitiveness of the food industry. The acceleration in the use of biotechnology techniques is likely to enhance the competition emanating from substitutes for traditional food or feed products, and distorting price policies will be harder to maintain in the long run.

Fourth, the frontier-free Europe and the single market principle will make nationally managed production and import quotas, national aids and targeted variable premium (beef and veal), as well as the MCAs look at odds with the general trend of fostering economic integration and market competition. In that respect, however, we do not see as likely in the near future the phasing out of production quotas in dairy, and even in sugar. There are so many built-in interests now in these sectors that an income problem has been transmuted into an asset problem which makes it even more irreversible.

The issue of MCAs is probably different in that the borders will eventually fall and a common currency will be implemented if the political will keeps its current momentum.<sup>6</sup> Then, one can hardly see the custom officials being kept at work just for the sake of monitoring MCAs. Because the forces at work behind the CAP are still there, national aids will develop, particularly in Germany, sometimes using environmental objectives as a pretext rather than as a fundamental rationale.

This new setting should partly cut the biases toward price increases in Europe as some of the transfers will become more visible on the budget and will therefore trigger some political debate regarding the merits of their longrun distributional impacts. In any case,

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<sup>5</sup>See D. Kelch paper in this symposium.

<sup>6</sup>The borders may, however, still last a while if only for controlling live animal flows, as many areas in Europe are not free from swine and bovine disease.

this general trend will also foster the competition on markets as the user price will be less closely linked to the producer price.

Fifth, the general political climate will have an impact on the future of the CAP, as it will no longer be the unique symbol of an integrated Europe. This has already been felt by the farmers themselves who reveal in public polls that they have lost some faith in Europe as the solution to their problems.

Sixth, the expected gain in GNP growth rate as a result of the single market and the decreased inflation should relieve some pressure on the farm sector which could benefit from some stimulation on the demand side and from better trends in input/output price ratios. This more buoyant economic outlook, if it does materialize, should also help the adjustment of the CAP a lot by creating jobs and attracting resources from the farm sector -- a better economic outlook than the sluggish growth of the last decade.

Last, there is increasing concern in many member states, particularly the northern members, that pollution and damage to the environment by agriculture may add significant pressure toward less intensive farming. Recent policies such as the set-aside or nitrogen regulations, do not suggest however that environmental goals are likely to be pursued through lowering price supports.

### Conclusion and Summary

The CAP has already made significant adjustments to control surpluses and budget expenditures. 1992 and the single market will bring some new pressure for a gradual adaption of the CAP to the concept of border-free Europe.

These changes will remain limited in the near future, however, since the CAP, as any other policy, is trapped in a network of contradictory forces which limit the margins of maneuver. The budget will continue to be the leading force behind the changes, and any budget-saving policy instrument which does not hurt farmers' incomes will remain popular among policymakers. As farmers do not like direct payments, decoupling will not develop to a large scale, unless well-accepted and economically sound instruments of transfers are invented as a reward to farmers for their role as keepers of nature.

This situation is not so unusual in developed countries, and the plea for free trade is always made by countries in areas where they have a comparative advantage. This is why the United States and others have only grain and not dairy or sugar programs in mind when they advocate free trade or even market-oriented policies. There is a high correlation between the economic rationale and national interest in that context. It may be that, as in induced innovation theory, many economic research programs and policy prescriptions are also induced by national interests and the economic and political environment.

In that context, while protectionist in most sectors, the CAP is not so unusual as it is often portrayed and it can be qualified as a fairly common agricultural policy. This has implications for the GATT in that the dominant forces at work being domestic, limited commitments are most probably to be expected.

The single market and "relance européenne" will nevertheless change some of the cards in the farm policy game. Some policies may just turn out to be too hard to implement

in a border-free Europe, and others may be caught under increased critical review as being in contradiction with the spirit of 1992 and with the increasingly felt need to preserve the quality of the environment.

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