

**AGRICULTURE IN THE UNITED STATES AND THE EUROPEAN  
COMMUNITY. DOMESTIC DEVELOPMENTS AND THE GATT, WITH  
PARTICULAR REFERENCE TO THE CRISES OF THE 1980s AND TO  
THE URUGUAY ROUND NEGOTIATIONS**

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## AGRICULTURE IN THE UNITED STATES AND THE EUROPEAN COMMUNITY. DOMESTIC DEVELOPMENTS AND THE GATT, WITH PARTICULAR REFERENCE TO THE CRISES OF THE 1980s AND TO THE URUGUAY ROUND NEGOTIATIONS

Agriculture has been the stumbling block in the last GATT/WTO Rounds, including the ongoing Doha Round. This is the result of the particular features of the farm regimes in many developed and developing countries in which tariff barriers are just part, and not necessarily the most prominent, of the protectionist measures in the agricultural sector. Indeed, direct and indirect support of market price and of producers' income are not less important in the management of the system. Governments also provide support to close the gap between domestic prices and international market prices, allowing their farmers to find foreign outlets for a supply that is constantly growing under the spur of ever growing productivity. International agreements can, thus, affect deeply the domestic policies of the parties involved in the negotiations.

This thesis argues that hostilities between the two main trade partners in the international farm market, the United States and the European Community, have their root in the defence of their market share rather than in the conflict between different economic ideologies. In contrast to non-primary products, the agricultural trade rules in the stillborn Havana Charter and in the long-lasting GATT allowed wide room for manoeuvre for protectionist and subsidising measures. In the twenty years that followed the coming into being of the General Agreement on Tariffs and Trade the United States tried to secure its market in the member states of the European Community and to curb its growing competitive potential in the world market, but it does not seem that it was ready to make a reshaping of its own system conditional on an international agreement. The strains that afflicted the US and the EC systems in the early 1980s had some features in common but their causes and their effects differed. The proposals tabled by the United States aimed at a freer market but did not mean the removal of all kinds of government-financed support and above all were bound to impose a much heavier burden on EC farmers than on their US competitors. In turn the European Community was not ready to commit itself to international deals whose effects on its farm policy would go beyond those of the limited domestic reforms agreed on by the member states. Finally, a formally multilateral, but actually bilateral agreement, was reached when the European Community implemented a farm reform that partially replaced its traditional price support system with an income support system similar to that in place in the United States and the latter abandoned its demand for a radical curtailment of domestic and export subsidies and focused on limited commitments that, however, could rein its European competitors' export capacity.

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## INTRODUCTION

In August 2003, eleven years after the adoption of the Common Agricultural Policy reform named after the then Commissioner for Agriculture and Fishery, Ray MacSharry, and ten years after the Uruguay Round, the international press announced the news of joint proposals by the US and the European Union (former European Community) in the run-up to the ill-fated Doha Round Cancun Meeting.<sup>1</sup> The European Union had obtained some concessions from the United States, particularly a 'parallelism' between cuts in export refunds by the Union and limits on export credits provided at concessional rates to US commodities exporters. The Union had improved its negotiating position by taking a controversial step towards 'decoupling' its domestic subsidies, approaching its regime to the farm support regime established by the US seven years earlier under the 1996 Federal Agriculture Improvement and Reform Act (FAIR). Yet, hopes for rapid progress were soon dashed when agriculture once again proved the main stumbling block. Notably, the European Union ruled out further concessions on tariff cuts under pressure from the main beneficiary of farm programmes, France, supported by Ireland. The Europeans were not, however, the only culprits as the US dragged its feet on concurrent reductions in America's trade distorting farm subsidies.<sup>2</sup>

The fact that agriculture is still the stumbling block of the Doha Round indicates that progress in the preceding Uruguay Round had been far from decisive. Three leading legal scholars point out that upon the conclusion of the 1994 WTO Agreement on agriculture what the parties achieved was only the beginning of liberalisation and that future negotiations on the same issue were warranted.<sup>3</sup> Yet the initial ambitions of the United States supported by the Cairns group were apparently quite high and they were not abandoned for long despite the fierce resistance of the European Community, which, however, by the end of the Round could claim to have carried out a comparatively much more comprehensive domestic reform than its trading partners, the US in particular,

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<sup>1</sup> *Financial Times*, 15 August 2003, p. 7; *Le Monde*, 15 August 2003, p.3.

<sup>2</sup> *Financial Times*, 11 January, 2006, p. 8.

<sup>3</sup> Mitsuo Matsushita, Thomas J. Schoenbaum, Petros C. Mavroidis, *The World Trade Organization: law, practice and policy* (Oxford: Oxford University Press, 2006), p. 294

whose farm regime it had substantially adopted. Besides, the Uruguay Round was not the first GATT round in which agriculture had been the main cause of conflict between the two trading blocs. The Kennedy Round and the Tokyo Round saw the attempt of the United States to curb the skilful exploitation by the European Community of the special treatment for agriculture allowed by the 1947 GATT and by the stillborn Havana Charter, which were not willing to question the interventionist farm policies carrying the day in the United States and in those states of Western Europe of which the EC Common Agricultural Policy would be the heir. In both rounds, however, the European Community withstood any attempt to change its regime whether in the making or as already established. The early 1980s saw the crisis of US farming, whose exports experienced a 39.5 per cent free fall in the five years following 1981, while the EC Common Agricultural Policy frequently seemed on the point of collapsing under budget strains. The Republican Executive called for a radical reform of the US farm policy, which was only partially endorsed by Congress. In the GATT negotiations the Reagan Administration tabled a proposal for the long term dismantling of trade barriers and subsidies hindering or distorting international trade in agriculture, but these negotiating objectives were gradually abandoned by the succeeding Republican Executive. Finally George Bush was willing to strike an agreement on the basis of rather reduced cuts to import barriers and subsidies, probably destined to curb its Western European rival's export ability, while recognising the mechanism of a reformed CAP.

#### *The subject and the arguments of the thesis*

This research investigates the factors that led to modest results in the reform of the agricultural trade regime arguing that, despite the apparent reshaping of the system and the conflicts between and within the negotiating parties, continuity of objectives and preservation of the fundamental interests of the parties were the prevailing feature of the process. It maintains, therefore, that the reforms carried out at home in the two trading areas were not radical and did not exclude governmental intervention in the farm market, while the agreement reached in the GATT was first and foremost a bilateral agreement under which the European Community obtained recognition of the new operational system of the CAP, accepting in exchange some curtailment in its capacity to export subsidised products.

The research covers a wide span of years dating back to the New Deal reform in the US and, regarding international relations, to the origin of the GATT. Indeed, reforms attempted or carried out at home by the transatlantic trade partners as well as the Uruguay Round talks on agriculture cannot be properly understood without taking these previous events into consideration. However, it concentrates on the period from the early 1980s to the end of the Uruguay Round, because in that period the well-established mechanisms of both the US and EC regimes came under stress and international negotiations were called for US initiative. This focus on the two transatlantic partners and rivals is not accidental. Certainly, other states or groups of states had a significant share in world food trade and made their voices heard in multilateral negotiations on agriculture, but it was the competition between the US and the Community that occupied centre stage in trade developments and negotiations, and political debate in favour and against domestic reforms was especially heated within the two transatlantic blocs.

This thesis has three strands of analysis. The first concerns the development of the US farm economy from the 1930s, focusing on the crisis of the 1980s. The thesis argues that the displacement caused by the domestic price support mechanism was a main factor in the fall in US exports but was certainly not the only cause, being accompanied by the negative effect of the dollar's soaring value and by mistakes in commercial policy. It also argues that the export contraction was not the dominant cause of the US farmers' distress, which was mainly the upshot of the Reagan Administration's choices about the fiscal deficit and, therefore, interest rates. Likewise it maintains that the recovery that occurred during the Uruguay Round was mainly due to exogenous factors like the decline in the dollar value, although the farm acts of 1985 and 1990 increased the competitiveness of American farmers by fostering greater reliance on market forces.

The second strand of analysis deals with the formation of the European Community Common Agricultural Policy and with the growing strains on such policy in the 1980s. It rejects the approach of those, who, either from an economic or political economy perspective, focus on the distorting effects of the CAP and explain its survival with reference to the 'political resistance to the forces of economic and technological change', identified with the influence of farm lobbies

over the EC governments and the European Commission itself.<sup>4</sup> Instead it concentrates on the different stakes of the various member states and of the Commission in the management of the EC farm policy. It argues, therefore, that some member states protected the status quo and strenuously resisted attempts at reform not just because they were subservient to their farm lobbies but because they benefited from this policy in terms of trade enhancement and maximum return to their financial contribution to the European foundation.

The third strand of the research – which overlaps with the other two – deals with the negotiations between the two competing economic areas and with the interrelation between changes in their domestic regimes, whether actual or hoped for, and their stances in the multilateral talks on agricultural trade. It is argued, however, that the relationship, particularly evident in the period mainly, though not exclusively, covered by the research was not unidirectional (for instance domestic developments or objectives influencing negotiating stances) or uniform for all the parties concerned and could shift during the various stages of the negotiations.

The link between domestic developments and international negotiations has already drawn the attention of political scientists. Thus, Paarlberg argues that the more market-oriented agricultural policy officials of the Reagan Administration saw the Uruguay Round as an opportunity to pursue their domestic objectives for farm policy reform through a multilateral negotiation.<sup>5</sup> Likewise, Coleman and Tangermann argue that the reform of the Common Agricultural Policy was significantly shaped by proposals and outcomes in the international negotiations on agriculture within the Uruguay Round.<sup>6</sup>

These approaches to explaining the links between domestic objectives and multilateral goals and developments have, however, a strong limitation in the very fact that they have been used with reference to a single event during a rather short

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<sup>4</sup> Wyn Grant, *The CAP in the Global Agricultural Economy: Prospects for the 21<sup>st</sup> Century* (paper for the 1997 IPSA World Conference), p.1; D.R. Harvey, 'Costs, Benefits and the Future of the Common Agricultural Policy', *Journal of Common Market Studies*, XXIV (1985) n.1, p.7; Susan Senior Nello, 'An Application of Public Choice Theory to the question of CAP Reform', *Review of European Agricultural Economy*, 11 (1984), p. 265.

<sup>5</sup> Robert Paarlberg, 'Why Agriculture Blocked the Uruguay Round: Evolving Strategies in a Two-Level Game', in William P. Avery, ed., *World Agriculture in the GATT* (Boulden, Lynne Rienner Publisher, 1993), p.41.

<sup>6</sup> William D. Coleman and Stefan Tangermann, 'The 1992 CAP Reform, the Uruguay Round and the Commission: Conceptualizing Linked Policy Games', *Journal of Common Market Studies*, 37 (1999), p.387.

period, resulting in an attempt to prove a theory with a very limited sample. This limitation entails two basic flaws. Firstly, it does not prove whether the model works in another context, in another domestic and negotiating environment. Consequently, it does not explain which factors, if any, have modified the previous economic and political conditions at home and why the position in the international negotiations is going to change or even to be abandoned at a later stage. It is, therefore, more appropriate to look at such models as a methodology that must be used in a historical perspective and which can, therefore, give different empirical results according to the changing context.

The idea of a possible link between changes in domestic regimes and stances and outcomes in international negotiations on agricultural trade is based on an elementary observation. In the nineteenth century, states protected their agriculture along with their industries by tariff barriers, which hindered the access of foreign products without affecting the functioning of the market inside the customs area. From the 1930s, tariff barriers were just part, and not necessarily the most prominent, of the protectionist measures in the agricultural sector. Direct and indirect support of the market and of producers' income, together with public support of agricultural investments, were not less important. This system based on a multifaceted array of measures survived World War II and was inherited by the EC Common Agricultural Policy, with its three-pronged protectionist mechanism of non tariff barriers to imports, domestic price support and export subsidies.

International agreements can, thus, affect more or less deeply domestic policies of the parties involved in the talks. The party calling for concessions must take into account the possibility that its farm regime is going to change too. There are therefore two alternatives which, however, can be viewed in a continuum: it can pursue a multilateral agreement that is going to affect its trade partner's regime in the knowledge or in the hope that its own domestic regime will not be affected or will be only marginally altered, or it can call for an agreement also entailing a reform of its farm regime. The latter can be done in the knowledge that only in the context of a wider agreement could the domestic lobbies' opposition to reform be broken and in the expectation that international commitments would bring about a sharing or a shift of costs to their trade partners' disadvantage. On the other hand the party that opposes the reform proposals has four options: it can resist the proposed reforms because they entail unbearable costs either in political

or economic terms; it can accede to the request but only to the extent that is compatible with ongoing or prospective autonomous reforms to its domestic system, as was for long the attitude of the European Community in the GATT negotiations on agriculture; it can carry out a domestic reform which can limit the costs of complete or partial acceptance of the reformist proposals and exploit their potential advantages; and finally it can accept the call for a reform, even if costly, because it expects a trade-off in other areas of the negotiations.

Thus, the relationship between domestic and international reforms could be inbound or outbound. That is, an international reform can be sought to create the best environment for a domestic reform or to pursue domestic goals, or a domestic reform can be carried out to adapt the market in the concerned economic area to the pressure of an actually or prospectively changing international regime. The thesis argues that the interplay changed in the course of the agricultural crises of the 1980s and with the start of the Uruguay Round. In the Kennedy and in the Tokyo Round the US, i.e. the party calling for concessions did not envisage any reform at home aiming instead at opening up the EC agricultural market or curbing its strengthening export capacity. The European Community, on the other hand, viewed any reform of the growing up CAP system as economically and politically unacceptable. In contrast, in the first stages of the Uruguay Round the US government was willing to accept a radical reform at home, if joined by equally radical commitments by its trading partners and the EC in particular. In a second stage, however, as the domestic reforms were beginning to work, encouraging more market-oriented decisions for American farmers, the United States was prepared to accept international commitments which would not require further reforms at home or a dismantling of its trading partners regime but, in line with its traditional goals, would simply curtail their room for manoeuvre in the competition for foreign markets. In contrast, the European Community shifted from its original stance towards carrying out a reform at home that would meet the minimum requirements of an approaching international agreement, without changing the fundamental goals and effects of the current regime.<sup>7</sup>

#### *The agricultural economy environment and its features*

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<sup>7</sup> At the time the so-called MacSharry reform was agreed upon by the member states the European Community had already become the European Union. For sake of simplicity we shall use the term European Community for the entire period covered by the research.

Obviously, this scheme by itself does not explain the strength and direction of the link between domestic and international developments nor does it give any clue to the economic, social and political factors that influenced such developments. This is obviously left to each of the following chapters. At this introductory stage, however, is useful to outline the particular features of agricultural economy which form the background of the events subsequently described.

There is no denying that agricultural trade flourished after World War II. By 1990, according to the FAO, food exports, excluding fisheries, had grown by 150 percent in volume on a 1960-65 basis.<sup>8</sup> In nominal value they soared by 790 percent.<sup>9</sup> Yet, their share of world trade decreased and, more importantly, contrary to what Le Heron suggests, the expansion of trade in farm produce, leaving aside the processing and distribution industries, did not introduce a globalization process, at least in the period under review, unlike the alleged situation in manufacture and services.<sup>10</sup> Following the distinction between 'internationalisation' and 'globalization' suggested by Hirst and Thompson, it appears that temperate-zone agriculture underwent a process of internationalisation - growth in cross-border trade which, however, did not efface 'the continued relative separation of the domestic and international frameworks for policy-making and the management of economic affairs, and also a relative separation in terms of economic effects'.<sup>11</sup> In contrast, globalization implies the development of economic relations which transcend borders, and 'in such a global system distinct national economies are subsumed and rearticulated into the system by international processes and transactions'.<sup>12</sup> Institutional and structural factors prevented this 'qualitative leap'. For instance, at the threshold of the 1990s, US agriculture, that is, the leading producer, although increasingly a high-tech industry, remained a family-farm-based industry, in which less than 2 per cent

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<sup>8</sup> FAO Yearbook - Trade, Table 4, 1976, 1982, 1992.

<sup>9</sup> Ibid.

<sup>10</sup> Richard Le Heron, *Globalized Agriculture: Political Choice* (Oxford: Pergamon Press Ltd, 1993), chapt. 9.

<sup>11</sup> Paul Hirst and Graham Thompson, *Globalization in Question. The International Economy and the Possibility of Governance* (Cambridge: Polity Press, 1999), p. 8.

<sup>12</sup> Ibid., p. 10; Also, Jan Aart Scholte, *Globalization a critical introduction* (Houndmills, Palgrave MacMillan, 2005), p. 54, 68.

were corporate agribusiness investments.<sup>13</sup> Foreign persons' holdings accounted for 1.2 per cent of total US farm acreage in 1981; 1.5 per cent ten years later.<sup>14</sup> Arguably then, 'agriculture' as distinct from the farm processing and distribution industries, was bound to keep strong economic and political roots in the national soil.

Along with internationalisation, both North America and Western Europe witnessed an active regionalisation process resulting in the elimination of tariff and quantitative barriers to trade in agriculture, first among the EC member States and later between Canada and the US, extending from 1994 to Mexico. Here too, however, national economies remained the primary actors. In the European Community the Common Agricultural Policy (CAP) entailed not only the opening of national markets but the establishment of a common organisation. Yet the CAP did not subsume the farm sector of member states. The Community Executive did not replace those member governments whose representatives held the final decision within the Council. Besides, the establishment of the CAP did not entail a common market for undifferentiated EC products, but secured free trade, with priority over foreign competitors, for producers from France, Germany, Italy and so on.

From an economic angle, as agriculture was part of an internationalisation process, movements in the main traders' markets (whether in supply, price or exchange levels) promptly affected their trade partners. This does not imply, however, that these changes were experienced simultaneously with the same intensity and in the same direction in the whole world market as expected in a globalized economy. From a political angle bonds between farm constituencies and government bodies remained strong. Not only did the farm industry retain its links with the home country, but it still considered national governments as the main source of political support and protection. On the other hand, governments were prepared to provide financial assistance because, in contrast to a globalised market, benefits bestowed on national enterprises could not spill-over to economic agents beyond national borders.

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<sup>13</sup> Robert L. Thompson US agricultural policy. Components, goals and possibilities for change, *Food Policy*, 15, n.2 (1990), p. 199.

<sup>14</sup> Statistical Abstract of the United States. 1982-83, Tables 1140 and 1157. 1992, Tables 1077, 1085.

Public choice theory, focusing on the relations of elected and appointed government officials with client groups can shed some light on domestic agricultural policy issues.<sup>15</sup> Such models, for instance, could explain why bold proposals made by the US Executive, like the 1948 Brannan plan, ended in failure as they clashed with the opposition of the main farm organisations in the US. It also sheds some light on the resilience to change shown for over twenty years by the CAP. Yet, historical analysis rarely bears out the idea that public authorities, as suggested by the mentioned theory, are bound to act as proxy for economic constituencies. Benedict, referring to the role of farm organisations during the New Deal years, remarked that, although the new organisation gave them opportunities for policy leadership never enjoyed before, 'their role during the 1930s tended to be secondary rather than dominant', as 'they were for the most part followers of administration leadership, rather than creators of new policies and programs'.<sup>16</sup> Governments can pursue autonomous goals that do not fit with the measures demanded by economic constituencies directly concerned and must also arbitrate between various interest groups which could be equally influential. Quite often governments can take decisions that apparently coincide with the requests of their constituencies, but their actual goals can be different. In the case of agriculture farmers can lobby to enhance their welfare, whereas governments provide their support having in mind the role of agriculture in the overall national economy and in its trade balance in particular.

As with other sectors, governments could not ignore domestic economic realities, including their constituencies' demands, in conducting agricultural negotiations with their trade partners. Outcomes in international negotiations, including trade in agricultural products, are thus determined by the consistency of the prospective agreement with the expectations of the groups immediately concerned in the domestic sphere. Yet, as pointed out by those scholars who rely on Putnam's two level-game analysis, governments can exploit the opportunities provided by multilateral negotiations and agreements to widen their room for manoeuvre in domestic policy objectives, thus overcoming resistance from

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<sup>15</sup> See in particular James A. Caporaso and David P. Levine, *Theories of Political Economy* (Cambridge: Cambridge University Press, 1992) p. 133 et seq.; For a public choice analysis of US trade Policy, Robert K. Baldwin, *The Political Economy of US Import Policy* (Cambridge Mass.: The MIT Press, 1985), p.80.

<sup>16</sup> Murray R. Benedict, *Farm Policies of the United States, 1790-1950. A Study of their Origins and Developments* (New York: American Book – Stratford Press, Inc., 1953), p. 346.

directly affected interest groups.<sup>17</sup> This is because policies bound to be voted down at home become acceptable if encompassed in a multilateral agreement entailing concurrent advantages and a wider sharing of prospective costs. This is also because policies pursued by governments become part of a wider negotiating package involving a greater number of constituencies some of which can have vital interests in securing a deal on other items under negotiation.

### *Questions underlying the research and its structure*

The defence of the interpretation offered by this thesis against competing explanations is left to the relevant chapters. At this stage, however, we can establish a procedural scheme based on a set of questions, the answer to which will help verify the hypotheses underlying the thesis:

- Which was the place of agriculture in the multilateral regime at the centre of which was the General Agreement on Tariffs and Trade?
- Did the proposals tabled by the United States and the European Community during the various GATT negotiations on agriculture aim exclusively at achieving a more favourable trade environment for the proponent without altering its domestic regime, or were they also directed at permitting an otherwise unachievable reform of their domestic policies?
- Were the reforms attempted or carried out in the United States and in the European Community aimed at coping with domestic economic needs or were they induced by international pressures?
- Were the crises that affected both US and EC agriculture in the 1980s determined by flaws inherent in the respective regimes or were they caused by other factors, like slacken demand, exchange rate variations, monetary or fiscal policies, or even the trade distorting effects of the domestic policies of their competitors? Were there any real similarities between events on either side of the Atlantic? Were the measures worked out by the two trading partners to provide a response to the economic challenges comparable?
- With specific reference to the European Community, what was the role of the Community Executive, i.e. the European Commission and of the member states in shaping domestic farm policies and stance in multilateral negotiations? Was the position of the various member states uniform or were there contrasting attitudes?

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<sup>17</sup> R.D. Putnam, "Diplomacy and Domestic Policy: The Logic of Two-Level Games", *International Organisation*, 43 (1988), p.427et seq.

Which domestic factors influenced the member states' stance in the negotiations on the Common Agricultural policy and in the GATT?

Considering the foregoing, the thesis is divided into three parts.

The first part (Chapters I - II) concerns the domestic and multilateral background. The origin and characteristics of the agricultural regime in the US and the Community are analysed. We also compare them and their impact on international trade and describe the first stages of the multilateral regime for agriculture, developed prevalently, but not exclusively, in the GATT. This part should provide better understanding of the interests and respective goals of parties concerned in future negotiations, shedding light on the reasons for conflicting attitudes among EC member countries in the Uruguay Round negotiations.

The second part (Chapters III – V) focuses on the years of crisis in the agriculture market that preceded the Uruguay Round. We again adopt a two-track approach, first observing the impact that the deteriorating economic environment had in the US and the EC, and the different kinds of problems confronting the two areas. We then proceed to analyse those international developments which centred on a series of trade disputes between the US and the EC focusing finally on the negotiations preceding the Uruguay Round.

In the third part (Chapters VI – VII) we examine the negotiating process involving the EC and the US in the Uruguay Round, internal developments in the two trading blocks, with particular attention to attempted modification of the Community farm regime culminating in the MacSharry Reform, and the interaction between domestic and multilateral developments.

#### *Sources of the thesis*

Finally, a few notes must be given on the sources of this research. The thesis is mostly based on official published sources, quite often making a comparative use of them. A primary distinction can be made between sources referring to domestic, that is, US and EC developments, and sources on international negotiations, although the idea of an impassable border between the two would be misleading, as often sources mainly used for the former area also concern the latter.

As regards the development of the US agricultural regime the thesis firstly relies on the parliamentary work of both Houses of Congress reported by the *US Code Congressional and Administrative News – Legislative History*. This primary

source is supplemented by publications like *Congressional Quarterly Almanac* and by the various reports and data sets of the Economic Research Service of the US Department of Agriculture. The thesis also relies on the records of the proceedings and debates of the US Congress provided by the Library of Congress and on the *Public Papers of the Presidents of the United States* together with the *Economic Reports of the President to Congress*. For the developments in the European Community the research primarily relies on the *Communications and Reports of the European Commission* and on the *Draft minutes of the meetings of the Council (Agriculture)* which provide the official records of the member states' perspectives and stances on agricultural issues. Other main sources are the *Commission's annual Reports on the Agricultural Situation in the Community*, the *Bulletin of the European Community* and the *Debates of the European Parliament*. The research also considers of particular importance periodicals like *Agra Europe* and *Agence Europe*, which provide detailed and continuous coverage of agricultural matters both from a technical and a political angle. As special attention is given to the budgetary implications of the EC farm policy the research also heavily draws on the annual *Reports of the Court of Auditors*.

The primary material for the multilateral negotiations is provided by the *WTO GATT documents* and the *GATT-Uruguay Round document series*. In May 2006 all the official GATT documents were derestricted. Actually, however, the bulk of the sources concerning the proposals and the debates on farm trade was already available long before that date. The analysis of this material assumes a strong interest in, or at least endurance with, the nuts and bolts of economic law and agricultural economy. As regards the EC perspective and stance another basic source of documentation can be found in the *draft minutes of the Council (General Affairs)* and to a lesser extent in the *draft minutes of the Council (Agriculture)*. For the United States the research mainly relies on the same sources listed above with reference to domestic developments

The WTO documents, however, have a limitation that the economic historian must try to overcome either by referring to other sources, if available, or relying on economic analysis. The documents on the GATT negotiations, and on the Uruguay Round in particular, give a clear idea of the stance of the negotiating parties, of the reasoning supporting their proposals, and of their attitude towards the positions of the other parties. Yet, there is not always evidence of the more

particular interests lying beneath the stance of each participant. An example based on negotiations conducted in another area and under the aegis of another Organisation (the Organisation for Economic Cooperation and Developments) can provide an illustration of the problem. In the late 1980s and early 1990s the United States, backed this time by Japan, conducted a battle to untie credit aids, that is soft loans to developing countries. The two countries accused some EC member states (nominally France, Italy and Spain) of providing trade distorting subsidised credit under the cloak of aid to development, because the loans were conditional on the purchase of products from the country offering the facilitated (in terms of interest rate and repayment period) loans. The reading of the OECD documents would give the partially correct idea that the US and Japan just wanted to secure fair trade against countries exploiting development aid for commercial ends. Yet, if one looks beyond the records of the negotiation and focus on the features of the markets to which the credit aids were mainly directed we may guess that untied credits, whatever their origin, were bound to funnel towards Japanese and American goods. Indeed, Japan and the US had a dominant position, in terms of investments and trade link, in the market of those developing countries which relied for their developments projects not only on grants but also on facilitated loans, nominally South American countries and most East and South East Asian countries. Therefore one could argue, that if the untied credit proposal were accepted, as it finally was, whatever the move of their trade competitors, the main beneficiaries would be the United States along with Japan.

The same kind of questions applies to the GATT negotiations. For instance, the WTO documents make clear that the so-called 'zero 2000' proposal tabled by the US in July 1987 was not just a negotiating tactic but the expression of a policy firmly pursued by the US Executive to liberalize agricultural trade. However, the question remains whether the Reagan Administration's stance was determined by uncompromising idealism aimed at a radical reform of the world and US regimes or whether other more pragmatic factors were at play. There is also the question of the factors that induced the Bush Administration to gradually assume a more flexible posture in the negotiations and finally to accept much less radical changes in the support mechanism in both the US and EC farm regimes. Likewise, the WTO documents provide a clear picture of the European Community's stance and goals in the negotiation, but not always give unequivocal

evidence of the interests at stake and of the factors underlying the changes in its position.

As regards the European Community the problem has been overcome by relying on the minutes of the General Affairs Council and to a lesser extent on those of the Council for Agriculture, which provide evidence of the stances and perspectives of the member states on the negotiating process in the GATT. The sources for the United States – which do not extend to private correspondence between government officers or to the files of the US Trade Representative and of the Department of Agriculture, that is the two authorities most involved in the Geneva farm negotiations – do not provide unequivocal documentary evidence of US goals other than those stated at the negotiating table. The research, thus, relies on the rich economic literature, often published by the US Department of Agriculture, which deals with the likely effects and the economic background of the proposals put forward in the various stages of the negotiations. It also looks at the statistical evidence concerning the evolution of the agricultural economy during the period under review. Based on these elements, the thesis draws some conclusions on the reasons lying beneath the US proposals as well as on those of its transatlantic partner, trying to give an answer to the fundamental question underpinning the research: *cui prodest* from an economic perspective? Finally, to compare the US and EC systems the research has found a major source of information in the OECD studies on national policies and Agriculture trade, particularly with reference to the two trading partners.

## **CHAPTER I**

### **US AND EC FARM POLICY AND FARM ECONOMY PRIOR TO THE CRISIS OF THE 1980s.**

The farm policies of the United States and the Europe Community present several similarities in forms and levels of state intervention. These similarities, however, conceal strong differences in a number of factors. Some of them lie in the different structures of US and EC farming and in their productive potential. Others concern different forms of protection from foreign competition which is much more complex and impermeable in the European Community. Mainly, they differ in the decisional process that shapes farm policy, as the EC member states did not surrender their agricultural policies to the new supra-national organisation, but used it as a tool for supporting their national economic aims and their farmers' interests.

#### **1) United States**

##### *An overview of the trend in the US agriculture sector up to the 1980s crisis*

The relationship of the United States and the European Community in the agricultural sector can certainly be viewed from various angles: the US declining economic hegemony, competition between economic superpowers, the rise of a new farm trade regime and so on. Yet, it boils down to the search for outlets for an ever- growing supply of farm produce, spurred by constantly growing technical advances in an economic environment characterised by governmental intervention.

Specifically regarding the United States, productivity was the blessing of the American farm economy whose origin dates back to the nineteenth century. The technological developments that boosted production in the twentieth century can be viewed as the second propelling rocket in a process that had started in the same area, i.e., the Mid West and the Great Prairies, in the previous century. Cyrus McCormick's reaping machine was the forerunner of the tractor, and hybrid seeds,

viewed as a product of modern science, appeared before 1870, securing the agricultural colonisation of the arid American West.<sup>1</sup>

As shown by Table 1 in the first part of the period under review, i.e., up to the aftermath of the Tokyo Round, output, after the slight drop in the first years of the Great Depression, recovered in the second half of the 1930s, gaining momentum in World War II and accelerating further in the 1960s. This trend is reflected in the productivity growth both in farm output per unit of total input and in production per acre. Farm output per hour of farm work skyrocketed from the early 1960s, even though a non-minor part of the prodigy must be attributed to the ‘decimation’ undergone by rural populations. Indeed, farm labour productivity, which grew by 7 times from 1950 to the end of the century, caught up with non-farming productivity in the early 1980s whose index increased by 2.5 times but from a higher basis.<sup>2</sup> As Olmstead and Rhode point out, the typical farm worker in the US, though dwindling, in 1990 produced fifteen times as much as his counterpart in 1910.<sup>3</sup> Using a farm multifactor productivity index Gardner shows that the log-linear trend line (which gives the growth rate) between 1910 and 1930 is somewhat less steep than the corresponding trend line based on data from the second half of the 1930s up to the beginning of the current century.<sup>4</sup>

**Table 1.1 US Farm output and productivity indexes, 1929 - 1979 (1967 = 100)**

YEAR	FARM OUTPUT	PRODUCTIVITY INDICATORS		
		Farm output per unit of total input	Crop productivity Per acre	Farm output per hour of farm work
1929	53	52	56	16
1939	58	59	60	19
1949	74	71	70	32
1959	88	87	85	59
1969	102	103	106	110
1979	129	119	130	184

Source: Economic Report of the President, February 1982, Table B-95.

<sup>1</sup> Alan L. Olmstead and Paul W. Rhode, ‘The Red Queen and the Hard Reds: Productivity Growth in American Wheat, 1870-1990’, *The Journal of Economic History*, 62 n. 4(2002), p.940.

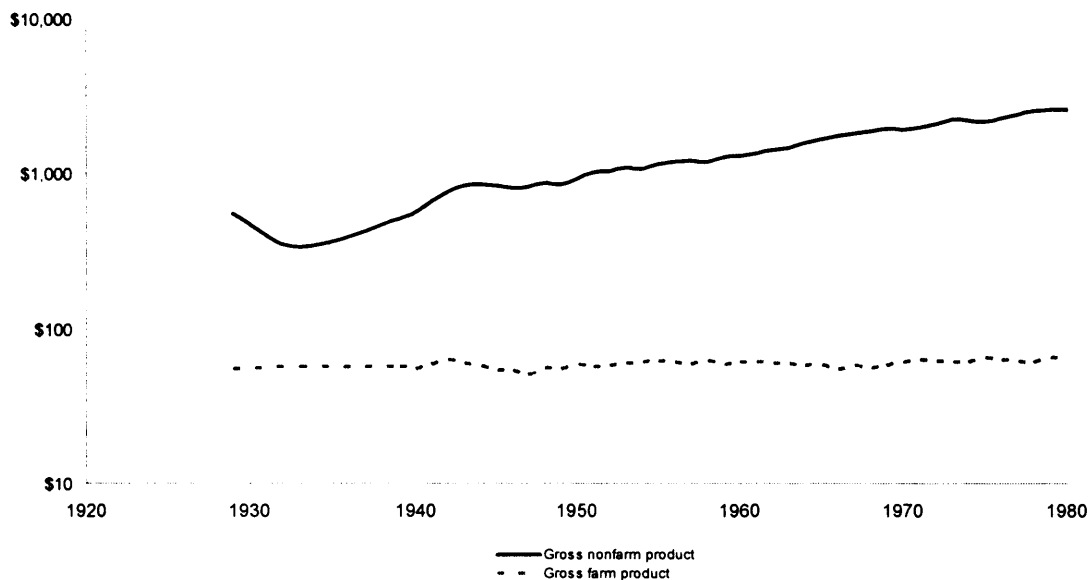
<sup>2</sup> Bruce L. Gardner, *American Agriculture in the Twentieth Century: How it Flourished and What it Cost* (Cambridge Mass.: Harvard University Press, 2002), p.32.

<sup>3</sup> Alan Olmstead and Paul W. Rhode, “The Transformation of Northern American Agriculture, 1910-1990”, in Stanley L. Engerman and Robert E. Gallman (eds), *The Cambridge Economic History of the United States* (Cambridge:Cambridge University Press, 2000), p. 633.

<sup>4</sup> *Ibid.*, p.44.

Yet, this blessing often turned into a handicap if value added by the sector rather than physical output is considered. Greater productivity meant lower cost per output unit, which immediately resulted in lower prices as demand did not keep pace with supply. In turn, the destiny of farm product prices was to fall relative to non- agricultural prices buoyed by sustained demand. Thus, the agricultural gross domestic product (GDP) grew at a much lower rate than non-agricultural GDP (Fig. 1.1). As a result, the contribution of the farm sector to the gross national product shrank from 8 per cent in 1929 to a meagre 2 per cent in 1980.

**Figure 1.1 US Gross National Product by Sector, 1929-80 (billions of 1982 dollars) - Semilogarithmic scale**

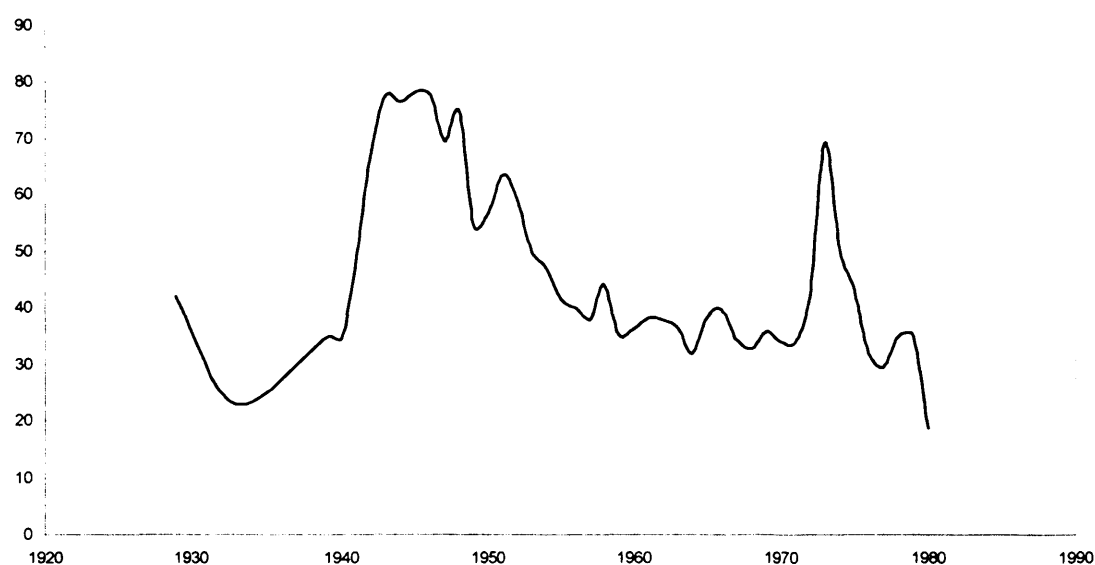


Source: data from Economic Report of the President, February 1988, Table B-8

The parity ratio, that is, the ratio of prices received by farmers to prices paid (including interest, taxes and wage rates), which had reached and surpassed 100 in the 1910s, slipped in the 1920s and plummeted during the great recession. It was necessary to wait for the upsurge in demand during World War II to pass the 100 threshold but it declined again after the Korean War to pass the golden gate only during the 1970s, soon being followed by the slump of the 1980s. Consequently, the farm income, in real terms, showed a large deviation around, however, an almost flat trend-line and in 1980 it was lower than in 1929 (Figure 1.2).

This is not to say that individual farmers were worse off. On the contrary, after the slump of the 1920s and 1930s, per capita income steadily improved. The gap with the non-farm population was gradually reduced and even completely bridged for short spells in the 1970s. Concentrating on the upper band of the farm population, Paarlberg and Paarlberg even claim that when the crisis of the 1980s was over, by the early 1990s the net worth of farm people exceeded that of non-farm people by a substantial margin.<sup>5</sup> The apparent contradiction with the income of the whole sector is easily explained by the denominator in the ratio: the farm population which in 1930 averaged over 30.5 million, accounting for 24.9 per cent of the US population, by 1980 had shrunk to just over 7.2 million, accounting for a modest 2.7 per cent of the total population.<sup>6</sup>

**Figure 1.2 US Net farm income, 1929-80 (billions of 1982 dollars)**



Source: data from Economic Report of the President. February 1988. Table B-96

<sup>5</sup> Robert Paarlberg and Don Paarlberg, 'Agricultural Policy in the Twentieth century', *Agricultural History*, 74,2(2000), p. 137; Also, Bruce L. Gardner, 'The Federal Government in Farm Commodity Markets. Recent Reform Efforts in a Long Term Context', *Agricultural History*, 70, 2 (1996), p.181.

Gardner, however, remarks that the decline in the income disparity between farmers and non-farmers could never have been accomplished without including non-farm income in measuring the wealth of the former.

<sup>6</sup>Statistical Abstracts of the United States, 1981, Table n.1159; Andrew Hacker, *A Statistical Portrait of the United States* (New York: The Viking Press, 1983), p. 98.

The concerns of the American farmers and of the government concentrated on the following often complementary, but sometimes contradictory, goals: how to hold in check the growing potential of farm output while fully exploiting its benefits in terms of available supply and low costs? How to secure agriculture prices in keeping with non-farm product prices? How to avoid wide fluctuations of farm prices and income, despite the fact that, in contrast with manufactures, they are affected by factors outside the control of individual farmers?

### *The US Farm Regime: inception and evolution*

It is against this background that the US farm regime took shape. Its roots date back to the New Deal agriculture reform of the 1930s.

Actually, the debate that led to the emergence of the New Deal legislation can be traced back to the agricultural slump of the preceding decade. Calls for government intervention to buoy up falling prices were to be heard in Congress in the early 1920s. The McNary-Haugen bill provided a high domestic and a low export price for wheat, joined with production control. Producers of other commodities developed similar proposals. Attempts to introduce price/production control met, however, with the Executive's unwavering opposition.<sup>7</sup> President Coolidge vetoed the bill twice in 1925 and 1926.

Things changed in 1929. President Hoover pushed through Congress a commodity stabilisation plan whose main agency was the Federal Farm Board. The plan was cloaked as a form of governmental support to the orderly free play of the market but actually represented the first step of governmental intervention. It was an ill-fated attempt, as the board collapsed a few years later under the strain of accumulated commodities whose cost it could not recover and it was wound up by the Roosevelt Administration.

The incoming Democratic Administration tried to stem the crisis by acting concurrently on the three factors that marked it: overproduction, downward price spiral and tied credit. Particularly regarding prices, the new administration's goal, at least the official one, was to revert to the golden age of the 1910s when

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<sup>7</sup> Gilbert Fite, *American Farmers: The New Minority* (Bloomington: Indiana University Press, 1981), p. 44

agricultural prices had reached parity with the cost of agricultural inputs. The administration, however, soon realised that the parity objective could only be pursued through a corresponding curtailment of production. Price support was, therefore, to be limited to those farmers who accepted acreage control. In December 1932 the President of the American Farm Bureau Federation (AFBF), Edmund O'Neal, announced his support for the domestic allotment proposal. In May 1933 the Agricultural Adjustment Act (AAA) was passed which gave the Secretary for Agriculture the power to curb production with the aim of bringing supply in line with demand, and consequently to raise the price of certain basic commodities: wheat, cotton, corn, tobacco, rice, milk, and dairy products. Farmers who signed contracts to curtail production were to receive direct payments, the so-called "benefit payments", financed by special taxes levied on processors of farm commodities.<sup>8</sup> An agency was established to administer the programme, the Agricultural Adjustment Administration.

In June 1933, Congress passed the Farmer Credit Act which provided for a comprehensive Federal Credit System. A year later the Act was followed by the Farm Bankruptcy Act, which allowed a five-year moratorium against foreclosures.

However, the cornerstone of the system, which is still one of the main tools of the US agriculture regime, was created by Executive Order (n. 6340 of 16 October 1933) a few months after the enactment of the AAA. The Commodity Credit Corporation (CCC) was established as a credit agency but also acted as a price support mechanism. The CCC provided non-recourse loans to farmers at a loan rate that was annually fixed by Congress. The loan rate, which was not synonymous with interest rate, simply defines the amount of credit provided by the Corporation for bushels of farm produce covered by government programmes.<sup>9</sup> The farmer was required to pledge his commodities as collateral for the loan. As the loan was non-recourse, farmers had the option of either paying it back at concessional interest rates or defaulting and forfeiting the produce to the Corporation. The choice was not random: if the market price was higher than the principal to be repaid, farmers would reimburse the loan, keeping

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<sup>8</sup> Murray R. Benedict, *Farm Policies of the United States*, p. 283.

<sup>9</sup> Originally, governmental programmes concerned six basic crops: cotton, wheat, corn, tobacco, peanuts and rice. In the course of the years they extended to a cornucopia of other crops and to dairy products.

the product to sell it on the market. If the market price was lower, farmers would default surrendering the collateral to the CCC. Although conditions and terms for the provision of non-recourse loans varied according to the product concerned, in general terms they were available in every year in which production estimates exceeded domestic consumption and the foreseeable price fell below a percentage of the parity ratio.<sup>10</sup> The new mechanism acted therefore as a floor for returns expected by producers. However, the system could work only if accompanied by constraints on production; otherwise it would result in a growing gap between market and support prices, forcing the CCC to acquire a glut of product at a loss. Therefore, only those farmers who had signed contracts to reduce their acreages for products used as collateral could take out loans.

Initially, the above outlined three-pronged mechanism was considered favourably both by Congress and farmers. When the Supreme Court declared the processing taxes unconstitutional in 1936, Congress promptly passed the Soil Conservation and Domestic Compensation and Allotment Act providing government payments for soil conservation practices to those farmers who replaced soil-depleting crops with soil preserving ones. The former coincided with the bulk of crops considered to be in surplus and previously subject to the AAA. The set of reforms was made more systematic by the Agricultural Adjustment Act of 1938, which maintained their main instruments. In particular, the Act confirmed the goal of achieving regular supply without engendering a surplus (in the words of Secretary for Agriculture, Wallace ‘an ever normal granary’) and of recovering the parity of the 1910s between farm and non-agricultural prices.

The actual achievement of these goals in the years immediately preceding and following the 1938 Act is rather doubtful. It is quite likely that the reduction in acreage did not bring any significant curtailment of output, as it was easily offset by increases in productivity and by setting aside only less fertile land. Price recovery was briefly helped by a severe drought, still alive in the collective memory of the American people. But the drought of the mid 1930s was a scourge for most Mid West and Great Plains farmers. From 1937, the drought over, production started to rise and prices to fall.

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<sup>10</sup>In particular, Murray R. Benedict, *Farm Policies of the United States*, p. 332.

CCC non-recourse loans certainly helped buoy up prices as well as farmers' income. According to Fearon, in 1939 government payments amounted to nearly 10 per cent of total farm income.<sup>11</sup> Some observers argue, however, that the Corporation would have followed the fate of the Federal Farm Board if the war had not dramatically changed the demand for agricultural produce.<sup>12</sup> Moreover, the New Deal regime did not aim at eradicating rural poverty. The main beneficiary of the farm programmes was not the small farmer. Payments in compensation for set aside were linked to acreage and the CCC loans were a direct function of the amount of crop provided as collateral. In short, they tended to favour owners of commercial farms, which explains why Roosevelt's reforms had the backing of the AFBF.

The War radically changed the environment for farmers and governmental programmes. Prices were boosted by strong demand and there was no need for CCC price support and acreage control. Instead, farmers were encouraged to increase supply. In 1943, the US neared full agricultural production while prices soared. During the war years, for the first time in almost thirty years, the elusive goal of parity was achieved.

This success did not last long. Already during the war fears had arisen that prices might plunge in the aftermath of hostilities. The Steagall Amendment of 1941 pegged the prices of many commodities at high levels until two years after hostilities were officially declared over. Since the declaration was issued by President Truman on December 31, 1946, the amendment expired on December 31, 1948. Support prices were, thus, determined as a high percentage (mostly 90 per cent) of the parity price. The latter, in turn, was linked to the parity price in the golden age of the 1910s, adjusted to the increase in input prices relative to the same period.<sup>13</sup>

The Truman Administration was quite reluctant to keep the system in place for long, foreseeing a price dip and a concurrent burden on the CCC's budget. The Secretary for Agriculture, Charles F. Brannan, proposed a new

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<sup>11</sup> Peter Fearon, *War, Prosperity and Depression. The US Economy 1917-45*. (Oxford: Philip Allan Publisher, 1987), p. 187.

<sup>12</sup> Ibid. p. 267.

<sup>13</sup> The mechanism is summed up by the following identity:  $PP_t = P(1910-14) \times AIP/100$  where  $PP_t$  is the parity price in year  $t$ ;  $P(1910-14)$  is the average price for the same product in the course of the 1910-14 period and  $AIP$  is the average price of the inputs paid by farmers on the same 1910-14 basis. The support price in year  $t$  is  $SP_t = 0.9 PP_t$ .

standard of support based on direct income subsidisation through deficiency payments rather than price support which was to be determined on a more recent basic period than the golden age. The new standard was to be accompanied by a limitation of farm production eligible for price support and was to be available only to those producers who practiced good soil conservation.<sup>14</sup> The plan, therefore, anticipated many of the ideas, in particular direct payments to producers, which were embodied in the reform introduced twenty years later. This aspect explains why the proposal was backed by the liberal National Farm Union which represented small farmers and whose main goal was farmer's income enhancement. Conversely, the proposal was firmly opposed by the AFBF, which, though favourable to greater loan rate flexibility, was adverse to direct subsidies, considered as a form of open governmental meddling.

Despite its commitment not to interfere with the play of market forces, which in the Republicans' view would more efficiently achieve the parity objective, the Eisenhower Administration did not significantly modify the price support regime, though it adopted more flexible support prices to stem overproduction. However, in its move to release market forces, the Republican Administration curbed the various crop limitation schemes it had inherited. This had the effect of increasing agriculture supply and with it CCC interventions causing strains on the Corporation's budget.<sup>15</sup>

The Kennedy Administration tried to overcome the problem by replacing the voluntary acreage control system with a mandatory bushel quota system, i.e. a system of direct production control. The consideration offered to farmers was the continuation of high support prices. In 1963, the Executive, sensing the opposition of the big commercial farmers' lobby in Congress, decided to submit its proposal to a referendum which applied only to the sector with the worst glut problem, wheat. It was soundly defeated both in Congress and in the referendum due to the opposition of the American Farm Bureau Federation, which considered the bill a blatant example of state interference.<sup>16</sup>

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<sup>14</sup> Virgil K. Dean, 'Charles F. Brannan and the Rise and Fall of Truman's "Farm Deal" for Farmers', *Agricultural History* 69, 1 (1995), p. 48; Virgil K. Dean, 'Why not the Brannan Plan', *Agricultural History*, 70, 2 (1996), p. 270.

<sup>15</sup> Willard W. Cochrane and Mary E. Ryan, *American farm policy 1948-73* (Minneapolis: Minnesota University Press, 1976), p. 34.

<sup>16</sup> Gilbert Fite, *American Farmers*, p. 170

Despite its misfortune, Kennedy's proposal set the stage for the reforms carried out by the Democratic Administrations, which were embodied in the 1965 Food and Agriculture Act (P.L. 321). As usual, the regime that took shape in the 1960s was a compromise. On the one hand, any attempts at mandatory production control were definitely abandoned while levels of price support via loan rates were lowered to world price equilibrium. Income support was mainly achieved by relying on direct payments to producers who opted for participation in authorised production control programmes.<sup>17</sup> Direct payments were determined according to farmers' normal production, i.e., allotment acreage times a yield trend. The Republican Administration of President Nixon did not alter this trend. The voluntary feature of the programmes was maintained as was the shift from price support to direct income support. The 1973 Agriculture and Consumer Protection Act (P.L. 86) modified the direct payment system introducing two new concepts which remained at the basis of the US system up to the FAIR Act of 1996: target price and deficiency payment. Target prices were announced annually in advance of the crop year according to production costs and yield forecasts. Deficiency payments bridged the gap between target prices and the average market price or the loan rate, whichever was the higher.<sup>18</sup>

The reforms of the 1960s and 1970s had a two-fold effect. Firstly, the regime contained the upward pressure on domestic farm prices, allowing export crop prices to match or approach prices prevailing in the international market without the need for subsidies. Secondly, it increased budget costs, at least in times of low average market prices, since, in contrast to the pure loan rate regime, the burden on the taxpayer was not shared by domestic consumers forced to buy agricultural produce at higher price. Direct payments, at least in the form of deficiency payments did not reduce incentive to overproduce; rather they encouraged the expansion of local production, interfering with international trade.<sup>19</sup> Indeed, they usually resulted in total returns for farmers above those provided by the equilibrium market price, which in turn were a direct function of the supply placed in the market.

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<sup>17</sup> Willard W. Cochrane, *The Development of American Agriculture. A Historical Analysis* (Minneapolis: University of Minnesota Press, 1979), p. 147.

<sup>18</sup> U.S. Code Congressional and Administrative News – Legislative History. 93<sup>rd</sup> Congress – First session. *Agriculture and Consumer Protection Act of 1973*, pp. 1172 – 1325.

<sup>19</sup> D. Gale Johnson, *World Agriculture in Disarray* (London: Fontana the Trade Policy Research Centre, 1973), p. 40

Thus, the measures envisaged by the US price/income support regimes, nominally their set-aside provisions, were never able to stem effectively the flow of produce induced by high farm productivity. Actually, it has been contended that this system of support fostered the production excess it aimed to prevent, whereas the invisible hand of the market would have been better able to hold it in check.<sup>20</sup> Soon, therefore, Democratic and Republican Administrations had to tackle the problem of boosting demand for US commodities, both abroad and at home, with the aim of absorbing commodity surpluses. At home, commodity management was linked to welfare programmes, like the Food Stamp Program, the Child Care Food Program, and the Commodity Supplemental Food Program, thus promoting an alliance between farmers and supporters of state commitment in the fight against poverty.<sup>21</sup> A plurality of factors, some of which were not independent of governmental farm policy, influenced the performance of US agricultural trade.

#### *Foreign Trade and its impact on the farm economy*

Although the United States had already become the main world industrial power even before World War I, as shown by Table 2, in the first half of the 1920s farm exports still accounted for almost half of American exports. However, their share of the total amount of exports decreased from the 1930s and never regained the importance of previous decades. The export contribution to farm income after the steady fall of the 1930s and 1940s achieved a value comparable to the first decades of the century only from the early 1960s. Nonetheless, in the twenty five years following the end of hostilities, agricultural exports grew at a steady and robust rate of 4.7 per cent per year. Thus the United States remained by far the leading farm produce trader (Table 1.2).

After World War II exports were first seen prevalently as surplus disposal. The Marshall Plan and later the Agricultural Trade Development and Assistance Act (P.L.480) of 1954, under the cloak of support to friendly governments, concurrently provided a convenient outlet for US farm stocks. However, the exploitation of the international market gradually became an objective in itself

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<sup>20</sup> Don Paarlberg, *American farm Policy. A Case Study of Centralized Decision Making* (New York: Wiley and Sons Inc., 1964), p. 339.

<sup>21</sup> See Joseph N. Belden, *Dirt Rich, Dirt Poor. American Food and Farm Crisis*. (London: Routledge & Kegan Paul Plc, 1986) chp. 4.

# **SPECIAL NOTE**

**THE FOLLOWING**  
**IMAGE IS OF POOR**  
**QUALITY DUE TO THE**  
**ORIGINAL DOCUMENT.**

**THE BEST AVAILABLE**  
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and was seen as an essential component of American agricultural development.<sup>22</sup> The Kennedy Round was an important moment in the effort to open up foreign markets to US products. The instruments of trade policy became more sophisticated too. Within the array of instruments provided by PL 480, grants were increasingly replaced by concessional loans. Likewise, direct export subsidies were joined by export credits provided under various pieces of legislation, such as the Commodity Credit Corporation Charter Act of 1949 and the Agricultural Trade Act of 1978.

The progress of the first thirty years was dwarfed by the export bonanza of the 1970s and early 1980s. Between 1970 and 1975, farm exports posted a growth rate of 200 per cent, almost as much as in the whole of the previous thirty years. By 1980 the value of US exports was almost six times that of 1970 (Table 1.2).

The United States was the main beneficiary of an unprecedented growth in world farm trade. Between 1970 and 1980 world trade in food products soared by about 347 per cent in nominal value and by about 67 per cent in volume. US exports soared by 464 per cent in nominal value and by 164 per cent at constant 1982 prices.

**Table 1.2 US FOREIGN TRADE IN AGRICULTURAL PRODUCTS**

YEAR	Exports of agricultural Products (US\$ billion)	as % of gross farm income	as % of total exports	Farm trade balance (US\$ billion)	Trade balance (US\$ billion)
1910-14 (average)	1	13.83	48.92	0.2	0.5
1921-25 (average)	2	16.91	46.16	1.9	0.9
1931-35 (average)	0.7	9.16	37.34	- 0.1	0.3
1940	0.5	4.43	9.34	- 0.8	1.7
1945	2.3	9.06	14.13	0.5	6
1950	2.9	8.76	28.62	- 1.1	1.1
1955	3.2	9.55	22.18	- 0.8	2.9
1960	4.8	12.34	24.42	1	4.9
1965	6.2	13.33	23.43	2.1	4.9
1970	7.3	12.45	17.18	1.5	2.6
1975	21.9	21.83	20.45	12.6	0.9
1980	41.2	27.38	18.40	23.8	- 25.3

Source: 1910-1935 Statistical Abstracts of the United States, various issues. 1940 Onwards, Economic Report of the President, February 1982, Table B-94 and Table B-97

<sup>22</sup> See Jimmie S. Hillman, 'Evolution of American Agricultural Trade Policy and European Interaction', in Hartwig de Haen et al. (eds.) *Agriculture and International Relations Analysis and Policy. Essays in Memory of Theodore Heidhues* (London: The MacMillan Press Ltd, 1985), p. 160.

The reason for this extraordinary increase was two-fold. Backstage there was a slight, but with cumulative effect, gap between production and consumption going back to the 1950s. World food production outside the US grew by 2.95 percent per annum between 1950 and 1972, whereas in the same period consumption grew by 3 per cent per annum. The cumulative effect of this apparently negligible discrepancy caused world trade to grow at a rate of 5.5 per cent yearly, i.e., almost twice as fast as output. The diverging process, however, accelerated in the following nine years when the gap between production and consumption outside the US rose by a yearly average of 0.25 per cent. The divergence between demand and output was, therefore, 5 times as great as previously <sup>23</sup>. The gap was particularly wide in certain key food products, like wheat and coarse grains where the US was the dominant producer. According to the International Wheat Council, in the market year 1972/73 wheat production fell to 337 million tons, contracting by over 7 million tons relative to the previous year. <sup>24</sup>

On the other hand, in the early 1970s demand for food produce in the international market increased, partially in response to contingent factors like shortages in the Central Plan economies, in particular the USSR and China, affected by bad weather. In the summer of 1972, following a poor harvest, the Soviet Union entered the American market and purchased some \$750 million worth of wheat and feed grains. In the years preceding the Afghan crisis imports from Eastern Europe and the USSR increased by 41.9 per cent annually.<sup>25</sup> Pressure on the market was also caused by growing needs for food, as well as agricultural raw materials, in some fast growing economies in East Asia and South-East Asia. Finally, the hike in world population, which grew by 75 million in 1972 alone contributed to the soaring demand.

To explain the success of the United States in exploiting the increased demand for food produce, the Organisation for Economic Cooperation and Development pointed to the role of 'residual adjuster' played by the US farm

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<sup>23</sup> François Duchêne, Edward Szczepanik, Wilffied Legg, *New Limits on European Agriculture. Politics and the New Agricultural Policy* (Beckenham: Croon Helm Ltd, 1985), p.61

<sup>24</sup> See J.C. Nagle, *Agricultural Trade Policies* (Westhead, Saxon House, 1976), p.53.

<sup>25</sup> Timothy Josling, 'World Food Production, Consumption and International trade. Implications for U.S. Agriculture' in D. Gale Johnson (ed.), *Food and Agricultural Policy for the 1980s* (Washington and London: American Enterprise Institute for Public Policy Research, 1981), p. 87 et seq.

industry, stressing its ability to buffer market shocks in those sectors in which it was the main supplier, especially grains and oilseeds.<sup>26</sup> The farm policy that took shape since the 1933 AAA proved flexible enough to adapt its implementation to the needs of the particular moment. In previous decades set aside programmes and the fixing of high loan rates had been instrumental in buoying international prices. In the 1970s, however, the US not only went on bringing loan rates in line with market prices but also relinquished production control. Besides, at the beginning of the decade the stock of American commodities, particularly grains, was at a low point.

Gardner, on the contrary, contends that in the 1970s 'the primary movers of events were not matters of agricultural policy'; governmental action in areas like monetary and taxation policy or international trade policy had 'a greater impact on the international performance of the sector'.<sup>27</sup> In particular, the devaluation of the dollar boosted American exports; also the above-mentioned array of commercial instruments, such as export credit and long-term arrangements with importing countries, gave US farmers a competitive edge over their trade partners.

The export bonanza was fully reflected in the new, enhanced, role of farm products in the US trade balance. Contrary to most other sectors, farm imports grew much less than exports, generating an expanding positive farm balance. The gap between exports and imports can be explained by the already dominant US position in the international market for certain basic products, and by its limited dependence on foreign produce. Thus, the devaluation of the greenback helped to boost exports without having the same effect on imports. On the contrary, for manufactured merchandise, with the exception of 1973 and 1975, devaluation backfired and while boosting exports caused more rapid growth in imports. The agricultural sector was, therefore, bound to be considered of strategic importance in the vain effort to redress an increasingly declining trade balance.

The joint pressure of internationalisation and the stricter links with the food and fibre industry, both requiring specialization and industrialisation, brought about remarkable changes in the composition of the farm population. Fite

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<sup>26</sup> Organisation for Economic Cooperation and Development, *National Policies and Agricultural Trade. Country Study. United States* (Paris: OECD, 1987), p.92.

<sup>27</sup> Bruce L. Gardner, 'Consequences of Farm Policies during the 1970s', in D. Gale Johnson (ed.), *Food and Agricultural*, p. 71.

points out that in 1960 only 2.9 per cent of all farmers belonged to the large commercial farmer category with cash receipts exceeding \$40,000 a year, whereas by 1977 the percentage had increased to 18.9 per cent, collecting 78.6 percent of the total cash income from farming. Hence less than 20 per cent of the farming population earned over 75 per cent of the sector's income<sup>28</sup>

Changes in the economic environment which took place in the 1960s and accelerated in the 1970s also engendered a transformation of the political process at the basis of farm legislation and of the administrative measures concerning the sector. Farm associations ceased to be the only interlocutor of Congress and the Executive as other interest groups stepped into the process. As Bonnen et al. remark, farm and agribusiness interests had to recognise one another and share influence in Congress and the Department of Agriculture.<sup>29</sup> The link between farm programmes and welfare programmes also helped the establishment of bonds with urban groups whose interests and perspectives were quite distinct from those of the farmers and their organisation, particularly the AFBF.

## **2) The Common Agricultural Policy: Beginnings and First Developments**

*A multifaceted background for a complex process.*

Even a cursory comparison of the Common Agricultural Policy with the other pillars of the European foundation shows that their common ground is limited. The official philosophy for industrial goods, services and capital is grounded on free market play, which should entail the elimination of non-competitive producers. However, not only the actual working but also the declared purpose of the CAP was based on administered prices, intervention by public bodies and the generalised protection of a class of producers on whom the impact of natural selection would have been much more severe. In short, the free market philosophy, which allegedly is at the heart of the European construction, stopped at the gates of the countryside. This bifurcation can only be explained if the choices that underlay the Common Agricultural Policy are viewed as a legacy of

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<sup>28</sup> Gilbert Fite, *American*, p. 179.

<sup>29</sup> James T. Bonnen et al., 'Further Observation on the Changing Nature of the National Agricultural Policy Decision Processes', *Agricultural History*, 70, 2 (1996), p. 137.

regimes firmly established in the majority of main players in the shaping and subsequent developments of the CAP game.

The attention given by governments of the progressively growing number of member countries to the sector dates back to the second half of the nineteenth century and was mostly associated with protectionist choices. There were a few exceptions - the UK, Denmark and the Netherlands, and not all of them were permanently and unconditionally committed to the free market. At any rate, the free traders, whether because of tardy entry into the Community or their low political weight, were not destined to leave a dominant hallmark on the CAP's mould.

The protectionist bias in the majority of prospective member countries became even stronger during the depression that hit the agricultural sector prior to World War II. The pattern, however, did not change when peace was restored, despite the free trade course prevailing, with different speed and strength, in other sectors of the European economy. This is hardly surprising. At the outset of the period under review farmers' political weight was not disproportionate to their presence in the economy. In 1958, the percentage of EC workforce employed in agriculture was about 19 per cent of the total workforce, declining in just twenty years to roughly 8 per cent. Yet, farmers' political import did not decline. Keeler explains the farmers' ability to retain their position despite the shift in the economic picture by two factors: demographic multiplier and disproportionate enfranchisement.<sup>30</sup> Despite the rural exodus the number of those linked to agriculture, whether by blood bonds or economic interests, remained substantial. The density of farmer organisation membership, defined as the number of actual members divided by the number of potential members, was very high in all member countries relative to the density in industrial and service sectors. Moreover, farmers' membership tended to concentrate in a few dominant unions. This allowed farmers to wield a disproportionate political clout both in Brussels, where the Comité des Organisations Professionnelles Agricoles (COPA) was the most firmly established umbrella association, and principally in each member

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<sup>30</sup> John T.S. Keeler, 'Agricultural Power in the European Community. Explaining the Fate of the CAP and GATT Negotiations', *Comparative Politics*, 28, 1 (1995), p. 127.

state where dominant farmer unions were granted official recognition, as in France.

Within the common path, however, there were strong differences in the structure of the agricultural sector and in the political and economic preferences of member countries, which in turn influenced both the original formation of the Common Agricultural Policy and its developments.

### France

In the twenty five years after the end of World War II, the working population employed in agriculture in France fell from 36 per cent to 10.1 per cent.<sup>31</sup> Yet, the percentage remained above the average of the nine members Community, and despite the sector's concurrently declining share in the whole economy, the level of production increased on average at a rate of 2.5 per cent per annum between 1952 and 1972. The growth rate was particularly remarkable in cereal production (7 per cent), securing French predominance in the European market and later in the world market.<sup>32</sup> In short, from the early 1950s the objective of the Republic was to fully exploit its potential and expand its market share with a special eye to Western Europe, and in particular to its recovering neighbour, following and competing with the American model.<sup>33</sup>

French agricultural reform, which began in the 1950s, received particular attention under Pompidou, first as Prime Minister under General de Gaulle and later as President, and then under Giscard d'Estaing. It relied on four tenets: price support, tariff protection, export support, anticipating the CAP export policy<sup>34</sup> and a severe rationalisation policy directed at promoting productivity, in

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<sup>31</sup> Francois Caron, *An Economic History of Modern France* (London, Methuen and Co. Ltd, 1979), p. 206.

<sup>32</sup> *Ibid.*, p 222.

<sup>33</sup> Helene Delorme, 'French Agricultural Policy Objectives', in Rasmus Kjeldhal and Michael Tracy (eds.) *Rationalisation of the Common agricultural policy?* (Copenhagen: Institute of Agricultural Economics, 1994), p. 40.

<sup>34</sup> This is illustrated by a dispute that opposed France to Australia in the GATT. The dispute arose because under French law the Office National Interprofessionnel des Cereales (ONIC), which controlled collection and domestic sales and exercised import and export monopoly, with regard to the export of wheat and wheat flour whose world prices were lower than domestic prices, made a payment (*ristourne*) to exporters to cover the gap.

particular of labour, through reductions in the number of agricultural workers and concentration of farm holdings.<sup>35</sup>

The reform was not imposed from the top but was negotiated with the farming unions, more precisely with the main federation, the Fédération Nationale des Syndicats d'Exploitants Agricoles (FNSEA) and implemented with its active participation.<sup>36</sup> In its turn, the FNSEA was aware of the need for close connection with the two main sector organisations (wheat and sugar), Association Générale des Producteurs de Blé (AGPB) and Confédération Générale des Planteurs de Betterave (CGB). As Neville-Rolfe points out, the cooptation of the above-mentioned organisations necessarily gave them a prominent voice in FNSEA's decisions.<sup>37</sup> The Federation, which also managed to strengthen its links with the association of livestock producers, therefore, represented different and often opposing interests. The interests of the great grain producers of the Paris Basin did not coincide with those of the Breton milk producers, nor did they coincide with those of small and medium-sized farmers who represented the bulk of the agricultural fabric elsewhere in the Republic. Besides, while the FNSEA was the main and politically dominant farmer federation, it was not the only one: left-wing movements were also present in the agricultural arena with different philosophies from that of the main federation. Thus, the Mouvement de Défense des Exploitation Familiaux (MODEF), founded in 1959 by members of the Communist party and of the Socialist party, contested the instances of modernisation accepted by the FNSEA's directorate, claiming that such policies would lead to the obliteration of thousands of small farmers.<sup>38</sup> This viewpoint was shared, in a more extreme form, by the Paysans Travailleurs (PT) federation, which demanded a national policy cutting all links with Brussels.<sup>39</sup>

### Germany

Compared to France the political setting for agriculture in the Federal Republic of Germany was much more uniform. The country that emerged from

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<sup>35</sup> Helene Delorme, 'La politique Agricole dans l'Internationalisation des Echanges', in Pierre Coulomb et al. (eds.) *Les Agriculteurs et la Politique* (Paris: Presse de la Fédération Nationale de Sciences Politiques, 1990), p. 34.

<sup>36</sup> John T.S. Keeler, *Agriculture*, p139..

<sup>37</sup> Edmund Neville-Rolfe, *The Politics of Agriculture in the European Community* (London: European Centre for Political Studies, 1984), p. 108.

<sup>38</sup> John T.S. Keeler, *The Politics of Neocorporatism in France: Farmers, the State and Agricultural Policy-making in the Fifth Republic* (Oxford: Oxford University Press, 1987), p.84

<sup>39</sup> *Ibid.*, p. 86.

World War II with much deeper scars on the agricultural sector than its neighbours, suffered from food shortage. Separation from the Eastern Länder, the nation's traditional food provider, left a predominance of small holdings with the exception of Schleswig-Holstein. Despite rationalisation efforts, in 1982 over 50 percent of German farms were smaller than 10 ha, whereas that group's weight was below 34 per cent in France and 25 per cent in the UK.<sup>40</sup> The partition of Germany also affected the composition of farming classes with the disappearance of the great protestant landowners (the Junkers) of the East with their historical links with political power in Berlin.

The farm population in the newborn Federal Republic was, therefore, more unitary. The political preferences of the western farmers remained fundamentally conservative, mostly directed to the moderate Christian Democratic Party (CDU) and its Bavarian partner (CSU), while a minor share of their vote went to the Free Democratic Party (FDP).

Possibly, just this substantial homogeneity explains why farmers in the Federal Republic were under the umbrella of a single federation, the Deutscher Bauernverband (DBV). According to Tracy, already in the 1950s the DBV could claim to represent 77 per cent of all independent farmers.<sup>41</sup> The strength of its membership allowed the federation to have its standpoint acknowledged and defended in Brussels by the Christian Democratic government, first, and by the coalition government led by the CDU, later. After strict cooperation with the Christian Democrats up to 1969, the Federation found a new supporter within the Socialist – Liberal (SPD-FDP) coalition, from 1969 to 1982, in the Free Democrat agricultural minister, Josef Ertl, a Catholic and a Bavarian.

Just a few years after the proclamation of the Federal Republic, the Adenauer government laid down the statutory law for assistance to agriculture. The Agriculture Act of 8 July, 1955 stated the following objectives: guarantee of a reasonable standard of living for the agricultural population; increased productivity; price stability and assurance of regular food supply at prices affordable to lower income groups. The law, therefore, aimed to respond to the

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<sup>40</sup> Alan William, *The Western European Economy: A Geography of Post-War Developments* (London: Hutchinson Education, 1987), p. 139.

<sup>41</sup> Michael Tracy, *Government and Agriculture in Western Europe 1880-1988* (Hemel Hempstead: Harvester Wheatsheaf, 1989) p. 236.

interests of the farmers, as an important political group, and to the food problems that had scarred Germany in the aftermath of the war.

The act did not commit the government to maintaining any defined price level. The government, however, was required to submit an annual report to parliament especially showing the development of farm income and had to put forward a yearly 'green plan' to pursue the above listed objectives.<sup>42</sup> This political commitment had a strong impact on the future developments of the Common Agricultural Policy, as it made the defence of German farmer's income the main tenet of the contribution of the Federal Republic in CAP policy-making.

#### The other founder members

The Netherlands also had experimented with protectionism and direct assistance to farmers during the slump of the 1930s and in the aftermath of World War II. However, its goal in participating in the negotiations that led to the emergence of a common agricultural policy was market liberalisation, which would have allowed it to exploit its high value-added output and price advantage in sectors like livestock, dairy products, and horticulture. Its main aim was, therefore, to quickly open the potentially rich market of its industrial neighbour, Germany.<sup>43</sup> However, it was far from interested in securing high support prices as they would buoy up less efficient competitors and would increase the cost of imported inputs like cereals for livestock.

The characteristics of the sector in Belgium as in Luxembourg were rather different and to a certain extent resembled those prevailing in Germany. In both countries the contribution of the sector to the whole economy was small, both in terms of output and workforce. Belgian farmers, however, had the advantage of being organised in a single union, the Boerenbond, prevalently Flemish and with great influence on the policy of the Flemish Christian Democratic Party, which was a cornerstone in any coalition government.<sup>44</sup> Belgium, therefore, was lukewarm to a rapid process of liberalisation and more interested in obtaining high guaranteed prices.

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<sup>42</sup> Michael Tracy, *Government*, p. 224; Gisella Hendriks, *Germany and European Integration: The Common Agricultural Policy: an Area of Conflicts* (New York: Berg Publishers, 1991), p. 37.

<sup>43</sup> Edmund Neville-Rolfe, *The Politics*, p. 207

<sup>44</sup> *Ibid.*, p. 62.

The Italian agricultural sector shared similarities with both the French and the Germans, but they were only superficial. In the 1960s, the number of people employed in agriculture was greater than in France, as was the sector's share in GDP. As in Germany, the main Italian farm federation, the Associazione Italiana dei Coltivatori Diretti had strong links with the ruling Christian Democratic Party: actually, it was a creature of the party. The second largest union, the Confederazione Nazionale dell'Agricoltura Italiana which represented the 500,000 farmers employing wage labour, that is, the most efficient share of the sector, had considerably less political influence.

However, the potential of the Italian farm sector for trade development was lower than in other major member states, and the drive for an 'Italian miracle' did not assign any particular role to the farm sector except as reservoir of manpower. Secondly, the objectives of the Italian farm policy were often divergent under the constraints of Italy's economic dualism. The high proportion of food imports triggered by the high income elasticity of Italian demand and the substantial change in the Italian diet brought about by the industrial miracle of the 1950s and 1960s meant that the government favoured low support prices for certain products like beef and cereals, prevalently produced in the North, where agriculture was more efficient but where competition by other member states was stronger. On the other hand, Italy was interested in securing a market for its Mediterranean products whose competitiveness was low and needed to be enhanced through measures other than price support, which carried the day in moulding the common agriculture regime.

*Origins and first developments of the Common Agricultural Policy: political and institutional aspects.*

The CAP regime that took shape in the course of the 1960s was the result of a laborious compromise between different goals and attitudes. From the early 1950s France, like the Netherlands, recognised the need to find outlets for its surplus in temperate zone produce.<sup>45</sup> The Republic, which initially played with the idea of supply agreements with importing European countries, notably Germany and the UK, soon agreed with the Dutch to establish a common market and a common organisation for agricultural products as the best way to secure

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<sup>45</sup> Alan S. Milward, *The European Rescue of the Nation-State* (London: Routledge, 1992), p. 265.

favourable export outlets to its farmers. In the Federal Republic the Agriculture Ministry shared the hostility of the Deutscher Bauernverband to the creation of a CAP, while the economic ministries favoured exposing German farmers to stiffer international competition and were opposed to moves that could hinder progress in manufactured exports.<sup>46</sup> During the negotiations in the 1950s, the UK accepted the idea of a High Authority for Agriculture, supported by France, but insisted on preserving its inter-governmental character with the diminished role of reconciling differences in national policies.

The Treaty of Rome, which established the European Community, in contrast to the articles relating to the movement of industrial products, included only general provisions on the establishment of a common agricultural regime.<sup>47</sup> Art. 38 (1) provided that the Common Market should extend to agricultural policy. Art. 39 (1) listed the following objectives to such policy:

- to increase agricultural productivity through technological progress and optimal utilisation of the factors of production;
- to ensure a fair standard of living for those employed in agriculture;
- to stabilise markets;
- to guarantee regular supplies;
- to ensure reasonable prices to consumers.

As Hendriks remarks, these objectives were an almost faithful reflection of the aims set out by the German Agriculture Act of 1955.<sup>48</sup> However, in Germany actual priority was given to the pursuit of tangible results in terms of standard of living, i.e., income support to farmers. In the wider context of a not yet implemented European common policy, the answer was less straightforward. Retrospectively, the above-listed objectives do not always appear mutually consistent. Reasonable consumer prices were not necessarily consistent with a guaranteed standard of living for producers, especially if, in line with prevailing traditions in EC member countries, a price support system was chosen in lieu of deficiency payments. As demonstrated by the US experience, increasing productivity and supply availability did not always fit with a high income for farmers. Besides, productivity goals were usually fulfilled by technological

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<sup>46</sup> Douglas Webber, "Agricultural Policy. The hard core", in Douglas Webber, ed., *The Franco German Relationship in the European Union*. (London Routledge, 1999), p. 112.

<sup>47</sup> Joseph McMahon, *European Trade Policy in Agricultural Products* (Dordrecht: M. Nijhoff, 1988) p. 8.

<sup>48</sup> Gisella Hendriks, *Germany*, p. 59.

progress induced by exogenous factors and were better left to the action of market forces.

Contrary to industrial products, art. 40 of the Treaty of Rome provided that the Common Market for agricultural produce must be accompanied by the establishment of a common organisation of the market, whose outlines, according to art. 43 (1), had to be established by a conference of the member states. Three alternative policies could be selected depending on the products concerned: common competition rules; compulsory co-ordination of the national market organisations; establishment of a single market organisation. The conference held at Stresa in July

1958 reached a number of important conclusions on the following: the need to reform the structure of agriculture in the six member states, without prejudice to the family character of its holdings; the establishment of Community wide prices, slightly above world prices; the pursuit of total self-sufficiency.<sup>49</sup>

Following the Stresa Conference, the European Commission submitted a draft proposal to the Economic and Social Committee in June 1960. This proposal included free circulation of agricultural products within the Community to be phased in over a transitional period; close interdependence of structural market and trade policies; and the adoption of a system of common prices to be achieved through a three-pronged regime based on variable levies and target and threshold prices. A month later the Council created the Special Committee on Agriculture (SCA) to prepare future Council decisions on agriculture. As Neville-Rolfe remarks, the decision to create the SCA meant that, unlike other sectors, policy decisions were withdrawn from the dominant influence of the national Ministries of Foreign Affairs, as policy proposals on the Common Agricultural Policy would be filtered by a body other than the Committee of Permanent Representatives (COREPER).<sup>50</sup> However, in spite of the Commission's role as sole initiator and administering authority of Community legislation, this meant that the Commission had to consider the Council's perspective in the preparatory stage.<sup>51</sup>

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<sup>49</sup> Joseph MacMahon, *European*, p.12.

<sup>50</sup> Edmund Neville-Rolfe, *Policy*, p.208.

<sup>51</sup> Elmar Rieger, 'The Common Agricultural Policy', in Helen Wallace and William Wallace (eds.),

*Policy-Making in the European Community* (Oxford:Oxford University Press, 1996), p.108.

In December the Council accepted the principal proposals of the Commission on a common price regime, the achievement of Community preference through the variable levy mechanism, and the establishment of financial solidarity through a common fund to cover intervention costs. However, their implementation turned out to be difficult. One of the major causes for slow progress was Germany's fear of a compulsory alignment of its commodity prices, specifically wheat, with the lower prices of its European partners and also of an excessive rise in imports from other member countries. In June, the French Prime Minister, Michel Debré, threateningly declared that without a common agricultural policy, a common market was impossible. Only after a twenty-eight day marathon a package agreement on support methods in the new common market organisation was reached on 14 January, 1962. The agreement was followed by a set of regulations concerning gradual establishment of Common Market organisation for a number of products. The first was Regulation 19/62 for the key sector of cereals, which served as a model for other commodity regimes.<sup>52</sup> Concurrently, a single fund, the European Agriculture Guidance and Guarantee Fund - EAGGF (better known by its French acronym, FEOGA) was established by Reg. 25/62<sup>53</sup> It formed part of the Community budget, and was earmarked for the financing of export refunds to allow EC exports to match those prevailing in the world market, market stabilisation, and structural adjustments. Its operation was to be financed by duties imposed on imported products and other forms of financing to be established. The implementation of this provision, however, depended on further regulations.

Thus, in early 1962 the general framework of the Common Agricultural Policy had been established, and measures concerning individual markets drawn up. Agreement on market regulations for dairy products, rice and beef was reached in December of that year.

Regulation 19/62 provided for the progressive reduction of the gap between domestic prices and their convergence towards a single price. The question, however, was where to set this price. Prices in the six member countries were higher than the world price for grains but there were substantial divergences between members. Italy and Germany were in the upper range, while the

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<sup>52</sup> Journal Officiel des Communautés Européennes, 1962, p.933.

<sup>53</sup> Journal Officiel des Communautés Européennes, 1962, p. 881.

Netherlands and France were on the lower side. France, whose prices had previously neared German ones, occupied the lowest end of the spectrum and was close to world prices due to the devaluation of 1959, which had not been followed by corresponding upward changes in farm prices. This made German farmers confident of seeing an upward shift in French prices in the short term. Moreover, the Christian Democratic government was unwilling to alienate farm support in the run-up to the election due in autumn 1965.

Only after another marathon Council session did Germany accept a price of 106.25 UA (Unit of Account) per ton, equivalent to 425DM. The date of enactment of the common price regime, however, would be postponed until June 1, 1967. On the other hand the adjustment agreed by the Federal Republic was modest. Thus, despite an apparent German concession, the whole set of common prices were pushed towards the upper end of the range: the initial threshold price and the basic intervention price were fixed at a level almost twice as high as the world price.<sup>54</sup>

The Common Agricultural Policy was not particularly affected by the first enlargement, which brought the UK, Ireland and Denmark into the Community on January 1, 1973. Several reasons explain the absence of any significant reform. Firstly, the Six asked the applicants to accept two basic principles: to adopt the treaties and all subsequent Community legislation and solve any problem of adjustment by transitional arrangements rather than renegotiation of existing rules.<sup>55</sup> Secondly, during the three EC-UK negotiations on accession, food policy in the UK underwent substantial changes that, at least partially, had smoothed over some contentious issues that could have hampered accession to the CAP. The Conservatives, back in office in 1970, were about to replace the existing British deficiency payment regime, considered too heavy a charge on the budget, with a minimum import price regime, implemented through import levies, despite the foreseeable hike in the cost of living.<sup>56</sup> The declining weight of the Reciprocal Commonwealth Preferences, and the relative slow growth of Commonwealth trade made it easier to shift to Community preference. Certain transitional arrangements, particularly concerning the maintenance of New

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<sup>54</sup> See Michael Tracy, *Government*, p. 260.

<sup>55</sup> Michael Tracy, *Agriculture in Western Europe. Challenge and Response 1880-1980* (London:Granada,1982), p. 305

<sup>56</sup> JC Nagle, *Agricultural Trade Policies* (Westmead: Saxon House D.C., 1976), p. 16.

Zealand butter supplies and Commonwealth sugar imports, were agreed on, but with no effect on existing Community mechanisms.

Ireland and Denmark, both with a strong agricultural sector, gained from the accession which provided an outlet for their products at higher prices than in the international market.

The enlargement coincided with the beginning of the mandate as Commissioner for Agriculture of Petrus Lardinois, who followed, after the brief interregnum of Carlo Scarascia Mugnozza, another Dutchman, Sicco Mansholt. Mansholt began his appointment with proposals for radical reform of the newborn CAP, based on structural rationalisation instead of price support, which, however, were ignored by the Council for Agriculture. The Commission's price proposals during the 1967-1972 period were moderate in nominal terms, though it must be remembered that the rate of inflation then was much lower than that from 1973.

Lardinois, on the other hand developed fully the idea of farm income enhancement through price support which had shaped the CAP fabric at its inception. The Commissioner's proposals, thus, were based on the so-called 'objective method', according to which farm prices should be related to the provision of a working income comparable with non-agriculture income. Support prices, therefore, soared in nominal terms: taken across the board they rose at an annual average of over 9.5 per cent, and over 13 per cent in national currencies.<sup>57</sup> The resulting pressure on the budget, together with a slowdown in inflation rates led to more prudent policies under the new commissioner Finn Gundelach. Under his guidance price increases were just at 3 per cent and 6.5 per cent respectively. Given the still high rate of inflation, this meant a decrease in real terms. Yet, farm prices remained well above world prices.

#### *Features and economic effects of the EC regime and their consistency with member states' goals*

The regime established in the 1960s and which characterised the following decade was a price support system, sharing many points with the American regime prior to the reforms based on direct income support. It lacked, however, the instruments of production control of its US counterpart, as it originally aimed

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<sup>57</sup> Edmund Neville-Rolfe, *The Politics*, p.272.

at achieving self-sufficiency rather than holding supply in check, and had a more sophisticated and much less permeable mechanism of import protection: the variable levy.

The CAP system relied on the administration of three prices. The target price represented the desired price in the EC yearly agreed by the Council of Agriculture Ministers. To ensure that the market price fell within some range of the target price, two others were administered. The threshold price was the minimum for imports and was set below the target price to reflect some notional cost of transport from ports of entry to national markets. The difference between the CIF (cost, insurance, freight) and the threshold price was bridged by a variable levy, calculated on a daily basis. This levy, therefore, contrary to import duties, constantly varied according to world prices and never allowed import prices to fall below the supported price of EC products, thus guaranteeing Community preference. Finally, every year the Council established the intervention price, which was the minimum that the Community guaranteed to domestic producers. It established a floor to the Community market, as intervention agencies had to buy in at that price any product supplied by farmers, providing required minimum quality standards were met.

The new regime secured the convergence towards a single price in the six member states but that price was short lived. This failure was not caused by inherent tensions in the new complex structure but by factors external to the agriculture regime, though with decisive influence on its functioning: monetary turmoil from the end of the 1960s which marked the following decade.

Like the European Coal and Steel Community, the European Economic Community adopted a unit of account (UA) for budgetary and other purposes, which had the same gold content and, therefore, the same value as the dollar. Agricultural prices were converted into national currencies when intervention prices were paid and variable levies collected. This was easily done when the fixed exchange rate regime was in place. However, only two years after the establishment of common prices within the CAP, in August 1969, the French franc was devalued by 11.11 per cent and in October the Deutschmark was re-valued by 9.29 per cent.

The conversion rate from the UA should have equalled the French and German currencies' new exchange rate, but that would have rekindled inflationary

pressures in France, while entailing a decrease of the income guaranteed to German farmers. The solution was found in the split between the UA conversion rate for agricultural products and the new official exchange rates of the French and German currencies. The agricultural conversion rate, better known as green money, came, thus, into being, but as a temporary device, limited to Germany and France. In turn, the divergence between the official rate and the agricultural conversion rate would have led to trade distortion, as the country with the higher intervention price (Germany) would have been flooded with farm goods from its EC partners, while exports of French producers would have skyrocketed, their revenues being repatriated at the actual exchange rate, with an extra profit. To avoid such disequilibria monetary compensatory amounts (MCAs) were introduced which depended on differences between the central and the green exchange rate. The French government was, therefore, requested to place temporary subsidies on food imports from EC member states, and levy taxes on exports to the Community members. This was called 'negative MCA'. Germany, on the other hand, introduced positive MCAs, subsidising its exporters, while imposing import levies of 11 percent on all CAP products.<sup>58</sup>

The arrangement, supposedly only temporary, became a permanent feature of the CAP fabric with the definitive collapse of the Bretton Woods fixed parity regime.<sup>59</sup> The permanent and generalised adoption of green money signified splintering the common market for agriculture in terms of national prices, causing for most of the 1970s divergences between producers' receipts in member states higher than in the period preceding the implementation of the common price regime.<sup>60</sup>

Quite soon EC trade partners and many economists argued that high levels of protection enjoyed by European producers resulted in trade restriction on agricultural imports and in the acquisition of market share unjustified in a level playing field for exports.

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<sup>58</sup> See Christopher Ritson and Ian Swinbank 'Europe's green Money', in C. Ritson and R. Harvey (eds.), *The Common Agricultural Policy* (Wallingford: CAB International, 1996), p.127.

<sup>59</sup> The MCA were definitely integrated into the CAP by Reg. 2746/72 EEC, which made their application compulsory where the deviation from a member state's par value, as recognised by the IMF, occurred.

<sup>60</sup> M. Claude Vian, "Politique Agricole Commune and Politique Monétaire", in Jean Roux (ed.), *Politique Agricole*, 159; Denis Bergmann and Pierre Baudin, *Politiques d'Avenir pour l'Europe Agricole* (Paris: Economica, 1989), p.61.

Since Viner's research, economic theory has argued that a customs union can be either trade creating or trade diverting.<sup>61</sup> A trade creation effect occurs if the removal of trade barriers between customs union's members results in concentration of production in lower-cost producers and in increased exports to other members of the union. But, if with the establishment of the customs union a member country switches from low-cost external sources of supply to high-cost sources within the union, the latter has diverting effects.

**Table 1.3 INTRA-EC AND EXTRA-EC FARM TRADE (1966-1981)**

Year	1966-75: Mill. EUA		1978-81: Mill. ECU	
	Intra-EC Imports (1)	Extra-EC Imports (2)	(1)/(2) %	Extra-EC Exports (3)
1966	3,611	11,202	32.2	2,828
1969	5,800	11,478	50.6	3,176
1972	9,425	14,000	67.3	4,682
1975	18,948	24,497	77.4	8,800
1978	30,562	36,127	84.6	13,288
1981	42,016	44,722	94	26,054

Source: Eurostat Agriculture Yearbook various issues

The period between the years preceding the full implementation of the CAP and the closure of the 1980s saw the unstoppable rise of intra-Community trade as imports from other EEC countries skyrocketed from a poor 32 percent of extra EC-imports in 1966 to a percentage nearing parity in 1981 (Table 1.3).

Factors like lower transport costs and closer across-the-border links between producers and consumers in a common market contributed to the growing demand for European products. These factors, however, were not enough to explain the preference for EC produce, given the gap between world prices and government-supported prices in the EC (Table 1.4).

**Table 1.4 Prices of certain agricultural products in the EC as a percentage of prices in the world market (1968-80)**

Product	1968/69	1970/71	1973/74	1975/76	1977/78	1979/80
Soft wheat	195	189	79	124	216	163
Maize	178	141	98	128	203	190
White sugar	456	203	66	109	255	130
Beef	169	140	111	196	196	204
Pork	153	134	131	113	137	152
Butter	504	481	320	320	388	411
Olive Oil	173	155	96	207	211	193
Oilseeds	203	131	77	127	153	185

Source: Eurostat Agriculture Yearbook various issues

<sup>61</sup> Jacob Viner, *The Customs Union Issue* (London: Stevens & Sons Limited, 1950), Chp. iv.

With the exception of the 1973/74 market year, given the hike in world prices induced by unexpected pressures of international demand, prices in the Community tended to be, on average, more than twice as high as those in the international market, with peaks of over 300 per cent for butter and white sugar.

The apparent paradox of the growth in intra-Community trade despite the gap between administered prices in the Community and those in the world market is only explained by the impermeable wall created by the variable levy, which constantly offset any price differential. On the other hand, artificially high prices in the Community inhibited specialisation between agriculture, whose contraction would have been much more rapid and marked, and other more productive sectors of the European economy, as well as between different regions in the agricultural market.<sup>62</sup> Thus despite the plunge registered in the first decades of the Common Agricultural Policy, in 1980 both the working population employed in the sector and its share of the GDP were much higher than in the United States. The agricultural population, which in 1958 averaged 19.2 per cent of the total working population still amounted to 8.2 per cent in 1980. The share of agriculture in the domestic GDP was 12.2 per cent in 1958, declining to 3.7 per cent twenty two years later, but with strong regional variance.<sup>63</sup>

And yet, as in 1981 extra-EC imports still exceeded intra-EC imports. They also largely exceeded EC exports to third countries. EC authorities could, therefore, claim that the Community was the world's largest importer of agricultural products. The picture, however, changes significantly if one focuses on those products in which the Community's natural resources were not at a disadvantage and to which the bulk of EC's commodity policies and financing were directed: temperate zone produce. The deficit was overwhelmingly due to agricultural raw materials used in industry, or to agriculture produce not from the temperate zone.<sup>64</sup> Conversely, in respect of temperate zone products the Community was increasingly self-sufficient during the 1970s and competed more and more aggressively in the world market.

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<sup>62</sup> Caroline Saunders, "The CAP and the Intra-EC Trade", in Christopher Ritson and David Harvey, eds., *The Common Agricultural Policy and the World Economy: Essays in Honour of John Ashton* (Wellingford: CAB International, 1991) p.169.

<sup>63</sup> Commission of the European Community, *The Agricultural Situation in the Community – 1982 report*, p. 191.

<sup>64</sup> See François Duchêne et al., *New Limits*, p. 55.

Regarding self-sufficiency, i.e., domestic production over the total amount of supply available for domestic consumption (domestic production plus imports minus exports), the rate grew considerably during the 1970s reaching 100 per cent by the end of the decade for most products concerned except vegetable oils. Besides, the achievement of self-sufficiency was not limited to a few member states with long-standing advantage in agricultural resources (Table 1.5).

**Table 1.5 Degree of self-sufficiency for some EEC agricultural products**

	<u>soft wheat</u>	<u>maize</u>	<u>total cereals</u>	<u>vegetable oils and fats</u>	<u>poultry meat</u>	<u>pork</u>	<u>beef and veal</u>	<u>butter</u>	<u>sugar</u>
<b>Aver.56-60</b>	90	64	85	19	93	100	92	101	
<b>EEC-6</b>									
<b>1968/69</b>	109	45	86		99	100	89	112	103
<b>EEC-6</b>									
<b>1975/76</b>	101	53	87	29	104	99	99	107	105
<b>EEC-9</b>									
<b>1980/81</b>	126	66	105	38	111	101	104	114	125
<b>EEC-10</b>									

Source: Eurostat. Agriculture Yearbook. Various issues

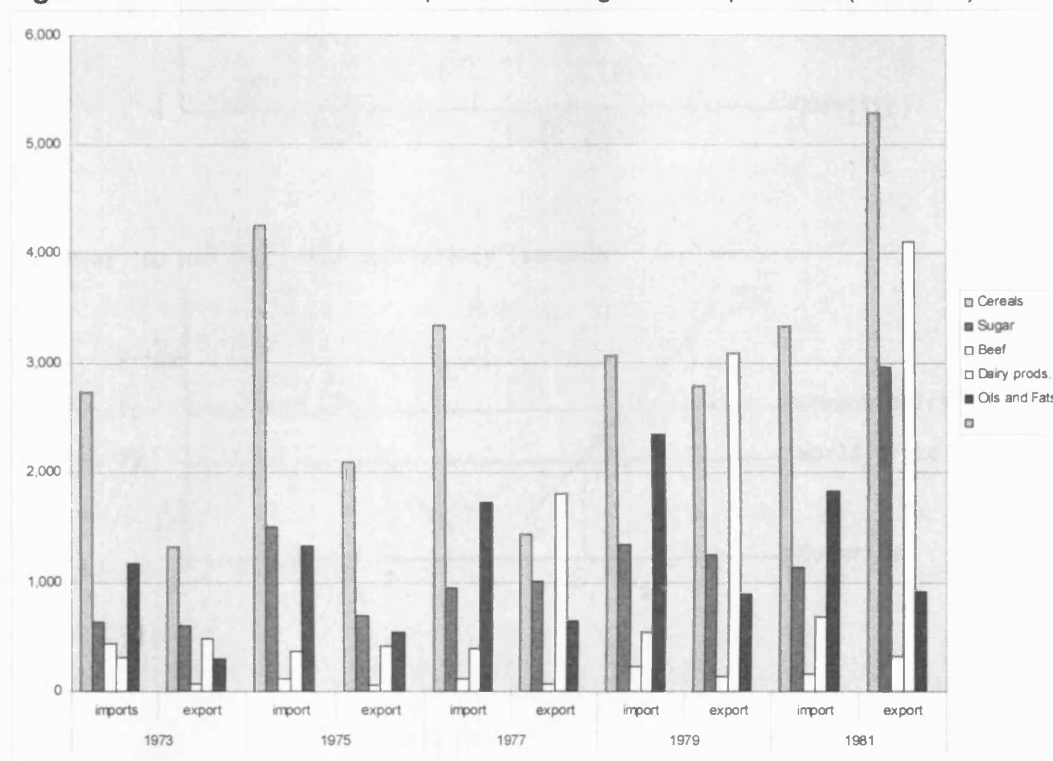
If France was already self-sufficient in most temperate zone products in the 1950s, Germany attained self-sufficiency in cereals, dairy products, sugar and beef during the 1970s. The United Kingdom remained a large importer, but in a few years managed to increase its soft wheat self-sufficiency ratio from 62 per cent to 89 per cent.

Concurrently, although imports continued to grow with the exception of beef and veal, exports soared in the second half of the decade, overtaking imports by the beginning of the 1980s, except for oils and fats (Figure 1.3).

By the second half of the 1970s, the Community had become one of the largest exporters of dairy products and sugar, displacing some competitors from large areas of the world market. In 1978 Australia and Brazil complained to the

GATT that the EC had displaced them from numerous markets because of its export subsidisation policy for sugar.<sup>65</sup>

**Figure 1.3** EC-12 Trade in temperate zone agricultural products (US\$ mill.)



Source: Eurostat Agriculture Yearbook. Various issues

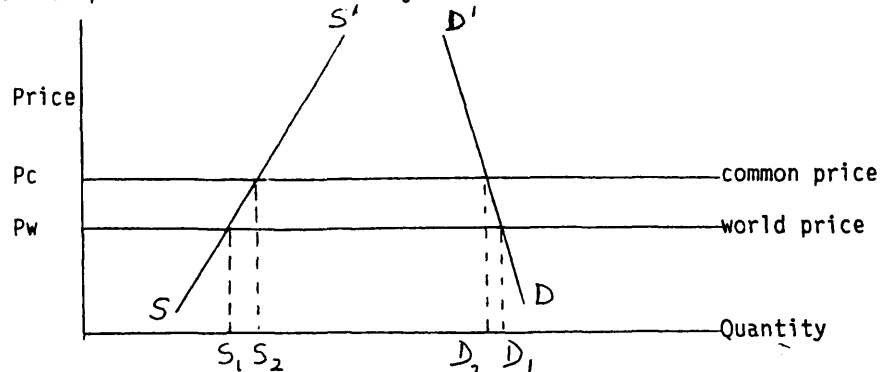
The economic effects of the regime – schematised in the following graph - varied according to the achievement or non-achievement of self-sufficiency.<sup>66</sup>

<sup>65</sup> *European Communities – Refunds on Export of Sugar: Complaint by Australia*. Report of the Panel adopted on 6 November 1979 (L/4833). GATT- Basic Instruments and Selected Documents. Twenty-sixth Supplement (1978-79); *European Communities – Refunds on Export of Sugar: Complaint by Brazil*. Report of the Panel adopted on 10 November 1980 (L/5011). GATT- Basic Instruments and Selected Documents. Twenty-seventh Supplement (1979-80).

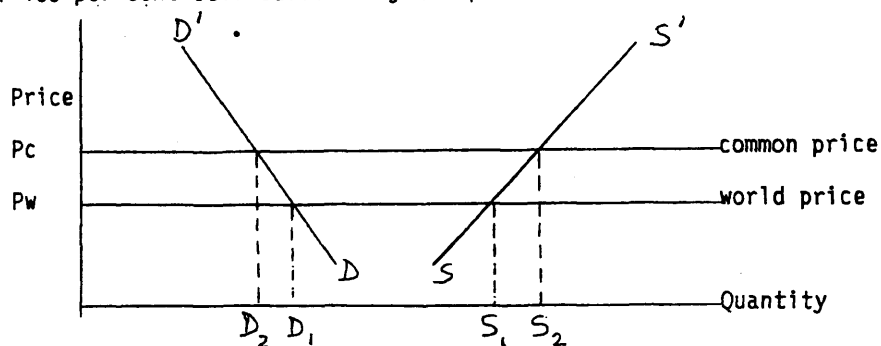
<sup>66</sup> The figure is taken from Organisation for Economic Cooperation and Development, National policies and Agricultural Trade . Country Study: European Community (Paris: OECD 1987),p. 241.

**Figure 1.4** Markets for products with a common organisation, according to the degree of self-sufficiency

a) Under 100 per cent self-sufficiency (deficit)



b) Over 100 per cent self-sufficiency (surplus)



As shown in figure 1.4-a, if the Community supply was in deficit, in the event that domestic prices were fixed above world prices, as the Community was insulated from an inflow of produce by the variable levy, domestic demand decreased while domestic supply increased. This caused a welfare loss for EC consumers, forced to buy less goods at higher prices, whereas farmers experienced a corresponding welfare increase as they could place more produce in the EC market at higher prices. There was no burden on the Community budget, as domestic demand was large enough to absorb domestic supply. Foreign suppliers, on the other hand, were disadvantaged twice due to the decrease in Community consumers' demand and the greater supply domestic farmers could place in the market.

The picture became more complex in the surplus case (Fig. 1.4-b) because of the impact that price support and its counterpart in the form of export refunds had on the Community's budget, and, through its intermediary, on member states' taxpayers.

Intervention agencies bought EC farm products at fixed minimum prices (intervention prices) and had to dispose of them at a loss. Sometimes agricultural commodities were resold when there was less pressure on the market; alternatively they were distributed as grants or at subsidised rates to disadvantaged people within the Community or as development aid to foreign countries. The charge on the budget was given by the purchased surplus multiplied by the intervention price, plus administrative expenses, minus the sum recovered by selling the commodity.<sup>67</sup> A more sophisticated way of disposing of the product was to sell it abroad at subsidised price. The subsidy (generally called export refund) matched the difference between the world market price and the Community's. The cost of these refunds was the exported quantity multiplied by the unit cost of the subsidy. The effects on domestic consumers and producers were those already examined in the deficit case. However, their impact on foreign competitors was more severe as not only did foreign exporters undergo a restriction of the EC outlet unable to exploit their cost advantage due to variable levies, but European producers could effectively compete on the international market despite higher domestic prices.

Each member country's level of success in shaping the CAP could be measured by its correspondence with national objectives. The assessment can be based on two benchmarks.

- 1) a country can have a dominant goal which can be fulfilled, partially fulfilled or not fulfilled at all by the CAP.
- 2) Member states can have many goals, which do not necessarily form a single pattern. Relevance must be given not only to the number of goals met by the Community's regime, but also to the extent the regime comports with them.

Germany falls into the first category. Its main goal being a relative high income for its farmers, it succeeded in making the CAP mechanism revolve around generous support prices, fixed at a higher level than that of most member

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<sup>67</sup> Denis Bergmann and Pierre Baudin, *Politiques d'Avenir*, p. 52.

countries. It strengthened its success by the adoption of green money, which helped insulate farm incomes from the effects of currency revaluation.

France, in contrast, achieved a plurality of objectives, but the success was marred by some backlashes and loopholes in the regime. Thus, France succeeded in securing a protected market for its growing agricultural potential. However, having accepted, especially regarding grains, prices above those prevailing within its borders, it allowed marginal producers in other member countries, like Germany, to survive and compete, impairing its competitive edge. Besides, the Dillon GATT Round created a loophole in the Community's otherwise impermeable variable levy barriers, allowing duty free or low duty imports of animal feed substitutes for cereals such as tapioca, maize gluten feed and soy beans. France, therefore, had to turn to markets outside the Community unprotected by the variable import levy wall.<sup>68</sup> In this it was mainly helped by the EC export refund mechanism, which was bound to become one of the main bones of contention with the US. Moreover, the establishment of a green market rate above the market rate parity handicapped for a long time its agricultural investment efforts by constraining output prices while input prices continued growing.<sup>69</sup>

Italy failed its contrasting objectives remaining largely dependent on exports whose prices grew and it could not obtain the EC commitment to a large-scale structural policy until the entry of other Mediterranean countries, which quickly became successful competitors. The Netherlands secured a larger market, but had to accept prices above its competitive edge and its beef and dairy sectors had to bear higher input prices, until they could resort to cereal substitutes.

The remaining countries benefited from a policy they had not shaped. The UK particularly, having become a large cereal producer benefited from high prices for grains. However, as agriculture had a modest share of GNP, the question of its contribution to the Community budget, largely destined to support the farm sector, would certainly become a critical issue.

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<sup>68</sup> See Jean Moulias, "L'Exportation de céréals. Une Grande Affaire mal traitée", in Pierre Coulomb (ed.), *Les Agriculteurs*, p. 125.

<sup>69</sup> Helene Delorme, *French Agricultural*, p. 42.

### 3) The place of the EC and the US in the world agricultural trade and a comparison of their farm policies

Foreseeably, both the United States and its trans-Atlantic trade partners within the European Community registered rapid growth in farm exports during the 1970s and secured their position in world trade (Table 1.6).<sup>70</sup>

US exports grew particularly fast (by 627 per cent between 1969 and 1981), their share of world exports increasing from 13 per cent to 19.4 per cent. The growth rate for main agricultural export produce, cereals and feeding stuff, was especially dynamic. Cereals grew fastest, soaring by 690 per cent in current value, from US million dollars 2,463 to US million dollars 19,462. Feeding stuff increased by 559 per cent from US million dollars 413.4 to US million dollars 2,722.

**Table 1.6 WORLD TRADE IN AGRICULTURAL PRODUCTS (1969-1981)**

Country	EXPORTS								
	Index Numbers (I.N.): 1969=100								
	Year 1969			year 1975			year 1981		
	US\$ bill.	I.N.	%W.EX.	US\$ bill.	I.N.	%W.EX.	US\$ bill.	I.N.	%W.EX.
<b>World</b>	<b>47.6</b>	<b>100</b>	<b>100</b>	<b>121.9</b>	<b>256.1</b>	<b>100</b>	<b>232.6</b>	<b>489</b>	<b>100</b>
Belg-Lux	1	100	2.1	3.1	310	2.6	6.3	630	2.7
Denmark	1.1	100	2.3	2.9	264	2.4	5.1	464	2.2
France	2.9	100	6.1	8.5	293	7	17.9	617	7.7
Germany	1	100	2.1	4.8	480	3.9	10.5	1,050	4.5
Greece	0.4	100	0.9	1.8	450	1.5	1.2	300	0.5
Ireland	0.4	100	0.9	1.5	375	1.2	2.6	650	1.1
Italy	2.4	100	5	3	125	2.5	6.1	254	2.6
Netherlands	2.6	100	5.5	8.5	327	7	15.9	612	6.8
UK	1.1	100	2.3	3.5	318	2.9	7.9	718	3.4
<b>EC countries</b>	<b>12.5</b>		<b>26.3</b>	<b>37.6</b>		<b>30.9</b>	<b>73.5</b>		<b>31.6</b>
Argentina	1.4	100	2.9	2.2	157	1.8	6.5	464	2.8
Australia	2.1	100	4.4	5.3	252	4.3	9.5	452	4.1
Brazil	1.8	100	3.8	4.9	272	4	9.8	544	4.2
Canada	1.4	100	2.9	4.2	300	3.4	7.8	557	3.4
Japan	0.3	100	0.6	0.4	67	0.3	1	533	0.4
New Zealand	0.9	100	1.9	1.6	178	1.3	3.6	400	1.5
URSS	1.6	100	3.4	2.4	150	2	2.9	181	1.2
United States	6.2	100	13	22.5	363	18.5	45.1	727	19.4
<b>Developed</b>	<b>26.7</b>	<b>100</b>	<b>56.1</b>	<b>76.6</b>	<b>287</b>	<b>62.8</b>	<b>162.3</b>	<b>608</b>	<b>69.8</b>
<b>Developing</b>	<b>16.4</b>	<b>100</b>	<b>34.5</b>	<b>35.4</b>	<b>216</b>	<b>29</b>	<b>56.4</b>	<b>344</b>	<b>242</b>
<b>Centr.Plan</b>	<b>4.6</b>	<b>100</b>	<b>9.6</b>	<b>10</b>	<b>217</b>	<b>8.2</b>	<b>13.9</b>	<b>302</b>	<b>6</b>

Source: Estimates based on FAO: Trade Yearbook. Various issues

<sup>70</sup> The years covered by the table have been selected because they include a period of great expansion of world trade in agriculture and because the new policies that influenced the performance of the EC Member States were in effect by 1969.

**Table 1.6 WORLD TRADE IN AGRICULTURAL PRODUCTS (1969-1981)**

Country	I M P O R T S								
	Index Numbers (I.N.): 1969=100								
	Year 1969			year 1975			year 1981		
	<u>US\$ bil.</u>	<u>I.N.</u>	<u>%W.IM.</u>	<u>US\$ bil.</u>	<u>I.N.</u>	<u>%W.IM.</u>	<u>US\$ bil.</u>	<u>I.N.</u>	<u>%W.IM.</u>
<b>World</b>	<b>50.5</b>	<b>100</b>	<b>100</b>	<b>136.9</b>	<b>271</b>	<b>100</b>	<b>253.4</b>	<b>502</b>	<b>100</b>
Belg-Lux	1.5	100	3	4.1	275	3	7.5	500	3
Denmark	0.4	100	0.8	1.1	245	0.8	2.3	575	0.9
France	3.1	100	6.1	7.6	239	5.6	17.3	429	5.2
Germany	5.6	100	11.1	13.4	300	9.8	22.2	396	8.8
Greece	0.2	100	0.4	0.6	300	0.4	1.2	600	0.5
Ireland	0.2	100	0.4	0.6	300	0.4	1.5	750	0.6
Italy	3.1	100	6.1	8.2	265	6	12.8	413	5
Netherlands	1.9	100	3.8	5.8	305	4.2	10.5	553	4.1
UK	5.6	100	11.1	11	196	8	14.9	266	5.9
<b>EC Countrs.</b>	<b>21.6</b>		<b>42.8</b>	<b>52.4</b>		<b>38.3</b>	<b>86.2</b>		<b>34</b>
Australia	0.2	100	0.4	0.6	300	0.4	1	500	0.4
Argentina	0.1	100	0.2	0.2	200	0.1	0.5	500	0.2
Brazil	0.3	100	0.6	0.9	300	0.7	2.2	733	0.9
Canada	1.2	100	2.4	3	250	2.2	4.9	408	1.9
Japan	3.6	100	7.1	11.2	311	8.2	18.5	514	7.3
New Zealand	0.1	100	0.2	0.3	300	0.2	0.3	300	0.1
URSS	1.9	100	3.8	9.2	484	6.8	21.2	1,116	8.4
United States	5.6	100	11.1	10.2	182	7.5	18.3	327	7.2
<b>Developed</b>	<b>36.5</b>	<b>100</b>	<b>72.3</b>	<b>89</b>	<b>244</b>	<b>65</b>	<b>178.9</b>	<b>490</b>	<b>70.6</b>
<b>Developing</b>	<b>8.6</b>	<b>100</b>	<b>17</b>	<b>29.1</b>	<b>338</b>	<b>21.3</b>	<b>34</b>	<b>395</b>	<b>13.4</b>
<b>Central Plan</b>	<b>5.4</b>	<b>100</b>	<b>10.7</b>	<b>18.8</b>	<b>348</b>	<b>13.7</b>	<b>40.5</b>	<b>750</b>	<b>16</b>

Source: Estimates based on FAO: Trade Yearbook. Various issues

The EEC member states followed closely the transatlantic commercial partner. France, with a growth rate of 517 per cent, strengthened its position as second largest trader of agricultural produce, increasing its share from 6 per cent in 1969 to 7.7 per cent twelve years later. The world market share of the Netherlands grew to 6.8 per cent from 5.5 per cent in 1969. But the most rapidly growing trade partner was Germany, whose export growth neared 1,000 per cent, enlarging its market share from 2.1 per cent to 4.5 per cent.

The European Community strengthened its presence concurrently. Due also to the enlargement from six members to ten members, its world export share grew from 12.5 per cent to 31.6 per cent, that is, higher than the US. If the fast growing share of intra-EC trade is subtracted, the Community was the second

largest exporter, close behind the US. On the other hand, the European Community had the largest quota of agricultural produce imports.

The developed countries' export share grew to the detriment of developing countries which dropped from 34.5 per cent in 1969 to 24.2 per cent in 1981. Conversely, developed countries slightly reduced their import share and increased their export quota by 24 per cent. This trend, however, went beyond the decade. Data collected by Tyers and Anderson for the years 1961-64 and 1983-86 show that, while in the former period industrial market economies were slightly below the food self-sufficiency level (-1.5 per cent), they exceeded it by almost 15 per cent in the latter period. Developing countries, which exceeded food self-sufficiency by around 3 per cent between 1961 and 1964, fell below that level by 2 per cent twenty two years later.<sup>71</sup> The two scholars argue that this trend was strongly influenced by growth in agricultural protection and export subsidisation in many industrial countries, indicating the European Community's CAP as the main culprit.

Also remarkable was the upsurge in demand from the Central Plan Countries, the USSR particularly, which in just over ten years leapt by 650 per cent.

The previous sections indicate that farmers received considerable governmental assistance both in the US and in the EC and arguably the level of Community assistance was higher than in the United States. The question, however, is whether the gap was significant and whether their respective policies followed the same direction which calls for a quantitative comparison, in turn requiring a quantifiable benchmark. A multi-national comparative analysis, based on a common parameter, is provided by the 1987 report of the Organisation for Economic Cooperation and Development focusing on the end of the period under review. The parameter adopted by the Organisation was the so-called 'producer subsidy equivalent' (PSE), defined as an indicator of the value of the transfers from domestic consumers and taxpayers to producers, resulting from a set of

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<sup>71</sup> Kym Anderson and Rodney Tyers, *Global Effect of Liberalising Trade in Farm Products* (Hemel Hemstead: Harvester Wheatsheaf, 1992), p. 52.

agricultural policies at a point in time.<sup>72</sup> The PSE includes four groups of policies:

- 1) Market support policies, which simultaneously influence domestic producer and consumer price. The assistance to domestic producers is measured by comparing supported domestic market price and unsupported domestic or external reference price;
- 2) Direct income support, i.e., measures that transfer money directly to producers without raising consumer prices;
- 3) Indirect income support, which lowers input costs;
- 4) A residual category encompassing a wide range of measures with a long term cost reduction impact, like production rationalisation, tax concessions and processing and marketing aid.<sup>73</sup>

The PSE can, therefore, be expressed thus:

- 1) As the total amount of assistance for commodity product:

$$Total\ PSE = Q (P_d - P_w) + D - L + B$$

where Q is the level of production;  $P_d$  is the domestic price;  $P_w$  is the world price; D are direct payments, L are levies collected from producers, and B summarises all other forms of support.

- 2) As the total value of assistance per unit of quantity produced:

$$Total\ PSE/Q.$$

- 3) As a percentage of the value of output plus any direct net payment, like deficiency payments less producer levies:

$$100 (Total\ PSE)/Q(P_d) + D - L$$

where D is direct subsidies, and L is producer levies.

The assistance to producers from support measures may be covered by several sources: domestic consumers and taxpayers as well as foreign producers and consumers. The latter two sources being difficult to assess, the OECD analysis focused on the contribution of domestic sources.

Farm policies frequently involve both consumer and taxpayer transfers to producers with effects both cumulative and offsetting.<sup>74</sup> For instance, in the CAP

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<sup>72</sup> Carnell Cahil and Wilfried Legg, "Estimation of Agricultural Assistance Using Producer and Consumer Subsidy Equivalent". Theory and Practice", *OECD Economic Studies*, 13 (1989), p 15.

<sup>73</sup> Organisation for Economic Co-operation and Development, *National Policies and agricultural Trade* (Paris, OECD, 1987), p.101.

<sup>74</sup> Carnell Cahil and Wilfried Legg, *Estimation*, p. 17

case price support through variable levy barriers, which entails consumer transfers, when self-sufficiency is achieved, is accompanied by buying-in and storage costs and by export refunds, affecting the taxpayer. On the other hand direct payments to producers, involving taxpayer transfers, involve a concurrent reduction in price support at the advantage of the consumer.

As Table 1.7 shows, assistance to producers was much higher in the European Community than in most other OECD members. The EEC accounted for 45.85 per cent of total OECD assistance, while the US share was just 16.98 per cent. Japan accounted for 17.28 per cent. Australian and Canadian shares were just 0.5 per cent and 2.7 per cent respectively.<sup>75</sup>

**Table 1.7 FINANCING OF AGRICULTURAL POLICY (average 1979-1980-1981)**

	<b>Taxpayers (1)</b> Billion ECU	<b>Consumers (2)</b> Billion ECU	<b>(2)/(1)</b> %	<b>GDP*</b> %	<b>GVA**</b> %
<b>USA</b>	19.4	7	36.1	1.3	42.1
<b>Canada</b>	1.6	0.9	56.3	1.2	42.6
<b>Australia</b>	0.5	0.2	40	0.5	9.2
<b>New Zealand</b>	0.2	0	0	1.4	13.7
<b>Japan</b>	10.2	16.7	163.7	2.9	104.3
<b>EEC</b>	21.1	35.8	169.7	2.8	93.2

Source: OECD: National Policies and Agricultural Trade, Costs of agricultural policies, 1987-Annex II Table 3 and table 4

\* GDP = Gross Domestic Product at Market Price

\*\* GVA = Gross Value Added by Agriculture at Market Price

Concurrently, the EEC incurred the highest policy costs affecting both taxpayers and consumers. Only in Japan did costs exceed those of the European Community area as a percentage of gross domestic product (GDP) and gross value added (GVA). The greater weight of consumer costs in financing EC agricultural policy is relevant and reflects the fact that the CAP aimed at securing price support through levy barriers against foreign produce that could have been price competing with domestic production.

Farm policies in the EC and the US also differed in areas of support covered by budget expenditure (Table 1.8). According to the OECD, government intervention implying budgetary costs and, therefore, a burden to the taxpayer, concerned five areas: Category I, development of agricultural techniques;

<sup>75</sup> Organisation for Economic Co-operation and Development, *National*, p.122, figure 4.

Category II, disease control; Category III, structural improvements; Category IV improvement of the processing and marketing system and consumption aid; Category V, price and income support. A sixth category can be added including expenditures by local or state authorities whose breakdown is not possible.<sup>76</sup>

In the United States the greatest proportion of public expenditures fell into category IV, processing, marketing and consumer aid, whereas in the EC the greatest proportion was absorbed by category V - price and income support. Expenses covered by the EC budget did not replace those borne by member states; rather there was a division of tasks, the former bearing the bulk of price support, and the latter addressing more long-term goals, like production rationalisation and marketing and consumer aid.

**Table 1.8** Public expenditures related to the implementation of agricultural policies (EC - US)  
average 1979-1980-1981

	Category I		Category II		Category III		Category IV		Category V		Category VI		Total	
	M.ECU	%	M.ECU	%	M.ECU	%	M. ECU	%	M. ECU	%	M. ECU	%	M. ECU	%
<b>USA</b>	814	4.2	542.2	2.8	1607.8	8	10581.1	55	3548.7	18	2292.7	12	19386.5	100
<b>EC States</b>	1263.8	13	454.8	4.7	4733.6	49	1506.4	16	1630.7	17	126.2	1.3	9715.4	100
<b>FEOGA</b>	4.7	0	0	0	391.6	3	657.5	5.8	10378.2	91	0	0	11432	100
<b>EC Total</b>	1268.5	6	454.8	2.2	5125.2	24	2163.9	10	12008.9	57	126.2	0.6	21147.4	100

Source: OECD: National Policies and Agricultural Trade. Costs of agricultural policies, 1987 - Annex II Table I

The United States was among those that generously subsidised their producers, and it is arguable that in the early seventies the gap in assistance level with the European Community may have been narrower. On the other hand, the forms of assistance bestowed by the EC to its farmers were the most likely to cause market disruption.<sup>77</sup>

Thus, initially the main threat to exporting countries was viewed in the insulation caused by the variable levy with its trade diverting effect to the detriment of low cost exporters and their demands in multilateral negotiations focused on the CAP mechanism import barriers. However, during the seventies, concurrent with increased Community self-sufficiency, the United States and other major exporters of temperate zone produce started to perceive another

<sup>76</sup> Ibid. p.128.

<sup>77</sup> On the different impact of different support measures on trade equilibrium see G.H. Peters, "The Interpretation and Use of Producer Subsidy Equivalent", *Oxford Agrarian Studies*, 17 (1988), p. 204.

threat. The EC began to be considered not only as protectionist but also as an increasingly aggressive competitor able to capture new markets. This state of affairs started to attract the attention of US negotiators during the Tokyo Round.

## CHAPTER II

### THE GATT REGIME FOR AGRICULTURE AND THE MULTILATERAL NEGOTIATIONS ON TRADE IN AGRICULTURAL PRODUCE BEFORE THE URUGUAY ROUND

#### 1) A theoretical framework for the multilateral regime of trade in agricultural products prior to the Uruguay Round

The evolution of international trade in agricultural products and the indecisive negotiations on agriculture between the signing of the General Agreement on Tariffs and Trade (GATT) in 1947 and the closure of the Tokyo Round, twenty two years later, bear out the peculiar place given to agriculture in the post-world war Two international trade regime, where international regime can be defined 'as sets of implicit and explicit principles, norms, rules and decision-making procedures around which actors expectations converge in a given area of international relations'.<sup>1</sup>

According to Cohn the agricultural trade regime is one of the most conspicuous results, though not the only one, of the tension between sovereignty and interdependence. The latter relies on cooperation among states and curtailment of state interference with the management of international economy, being based on the principles of liberalisation, multilateralism and non discrimination. The former, which is grounded on the principle of exceptionalism, major interests and reciprocity, asserts national autonomy in controlling and developing the domestic economy or, at least, some of its sectors.<sup>2</sup> Extending Cohn's view to the whole of the international trade regime Wolfe considers the GATT as 'a compromise between the need to end the managed trade of the 1930s and the equal imperative of the New Deal'<sup>3</sup> In his view, free trade was not the objective of the GATT but a reference point which could be made compatible with domestic needs, as states were left free to preserve domestic economic policies that could interfere with the play of the market.

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<sup>1</sup> John Gerard Ruggie, *International Responses to Technology: Concepts and Trend*, *International Organization*, 29 (1975), p. 570

Robert Keohane, *After Hegemony Cooperation and Disorde in the World Political Economy* (Princeton: Princeton University Press, 1984), p.56 et seq..

<sup>2</sup> Tehodore H. Cohn, 'The Changing Role of the United States in the Global Agricultural Trade Regime', in Willliam P. Avery, ed., *World Agriculture and the GATT* (Boulder and London: Lynne Rienner Publishers, 1993), p.18

<sup>3</sup> Robert Wolfe, *Farm Wars* (Basingstoke:MacMillan, 1998), p.43.

The GATT regime set the stage for trade negotiations, which for a long time were prevalently focused on tariff cutting and established a set of principles and rules instrumental to the objective of freer trade, a term that is not equivalent to free trade.<sup>4</sup> These were:

- 1) Most Favoured Nation (MFN) regime, providing for the extension of favourable treatment granted to a party to the Agreement to all other parties.<sup>5</sup>
- 2) Grant of National Treatment, i.e., a treatment no less favourable than that afforded to nationals, with regard to goods imported from other parties, but not extending to factors of production.<sup>6</sup>
- 3) Concession binding, i.e., the commitment not to apply duty rates higher than those formally agreed in the negotiations with regard to a tariff item. It follows that once a tariff reduction has been granted to other participants in the negotiation (and is listed in the so-called 'schedules of concession') it cannot be repealed without negotiating due compensation to the affected parties.<sup>7</sup>
- 4) Abolition, with limited and temporary exceptions, of trade barriers other than tariffs, such as quotas.<sup>8</sup>

This normative framework, however, did not determine what sectors and products should be negotiated, or the level of the multilateral concessions. Such a choice was left to the contracting parties in the course of successive negotiating rounds.<sup>9</sup> States were, therefore, free to put into practice national policies aiming at preserving social conditions, or making national industries more competitive, even though these policies affected international trade. Agricultural policies were among the most prominent examples.

## **2)The coming into being of the GATT and the limits to its free trade message**

Agriculture had its due place in the 'proposals for consideration by an international conference on trade and employment' put forward by the United States in December 1945. These called for negotiations, under the aegis of the

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<sup>4</sup> W.M. Scammell, *The International Economy since 1945* (London: MacMillan, 1983), p. 46 et seq..

<sup>5</sup> GATT 1947, Art. I.

<sup>6</sup> GATT 1947, Art. III.

<sup>7</sup> GATT 1947, Art. II, Art. XXIV:6, and Art.XXVIII.

<sup>8</sup> In particular, GATT 1947, Art. XI. Art. XII and Art. XIII.

<sup>9</sup> Patrick A. Messerlin, 'Le rôle du GATT et les enjeux de l'Uruguay Round', *Politique Étrangère*, 58 (1993), p. 256.

United Nations, on a new multilateral regime centred on an International Trade Organization (ITO) which was to parallel what the International Monetary Fund was for financial matters. Explaining the various items of the proposals, their main author, the Assistant Secretary of State, William Clayton, outlined the following principles for trade in agriculture:<sup>10</sup>

- 1) With regard to export subsidies no member of the Organisation should use them to enlarge its world market share as compared with the share prevailing in a previous representative period, to be determined through international consultation
- 2) In case of a world surplus, or threat of a world surplus in a commodity, the main producers and consumers should hold consultations in view of promoting consumption increases or reduction of production and, if necessary, seeking the conclusion of international commodity arrangements.
- 3) International commodity agreements should aim at preventing beggar-my-neighbour practices to find unilateral solutions to commodity problems, and to provide a period of transition for the orderly shift of resources and manpower out of over-expanded sectors.

In short, the perspective of the State Department was far from free trade and non-intervention. On the contrary, it assigned a role to intergovernmental agreements in smoothing over the asperities of the market and, although with specific reference to state support through subsidisation, recognised market sharing.

These ideas were later embodied in the Havana Charter signed on March 23, 1948. Scholars have debated the issue why the US negotiators agreed to depart from the free trade principles marking their initial approach to the ITO talks.<sup>11</sup> These principles, however, applied to industrial products. The attitude was quite different for primary products, arousing criticism particularly from developing countries many of which relied on agricultural exports.<sup>12</sup> The American negotiators were indeed well aware that a market oriented approach on farm products was not consistent with the existing American regime. Quantitative

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<sup>10</sup> Letter of Assistant Secretary Clayton, to the Secretary of State, November 1, 1945, *The Department of State bulletin*, XIII (1945), n.337, December 9, p. 914.

<sup>11</sup> Richard Toye, 'Developing Multilateralism: The Havana Charter and the Fight for the International Trade Organization, 1947-48', *International History Review*, 25 (2003), p. 282 et seq.

<sup>12</sup> Thomas W. Zeiler, *Free Trade Free World. The Advent of GATT* (Chapel Hill: The University of North Carolina Press, 1999), pp. 34, 101, 185.

restrictions, initially opposed by the US for manufactured products, were instead a useful tool for a farm regime based on price support and production control, which could have been easily thwarted by the inflow of lower price products. Likewise, price support provided by the CCC through non-recourse loans were a form of subsidisation, and export subsidies would be needed if, as expected, world prices fell below the price level secured by the domestic mechanism of intervention.

The final text of the Havana Charter allowed subsidies on primary products, though subject to specified conditions. Quotas could be introduced to support domestic production management programmes. An entire chapter of the Charter was devoted to commodity arrangements, maintaining, however, the principle that commodity management agreements could be entered into only in case of burdensome surplus or widespread unemployment or underemployment in the sector concerned.<sup>13</sup>

In 1947 negotiations for an international wheat agreement, the main temperate zone commodity, were resumed after the interruption caused by the war. Their forerunners dated back to the 1930s. In 1933, a two year quota agreement was concluded between nine exporting and thirteen importing countries under whose terms the exporters agreed to accept definite quotas and the importing countries undertook not to increase their wheat production further and to reduce import costs. Although the agreement failed, an International Wheat Advisory (IWA) Committee, created by the 1933 Conference continued to exist.

A first new wheat agreement, signed in 1948, was not ratified by all participants. However, after the success of the 1949 Washington Conference, a second agreement was signed in April 1949 and entered into force in July.<sup>14</sup> The agreement had the stated objective of securing supply to importing countries and outlets to exporters at equitable and stable prices. It established maximum and minimum prices within which member countries were to attempt to maintain market prices. Subject to waivers, it also provided for guaranteed purchases for signatory importing countries and guaranteed sales for exporting countries. Thus, the latter agreed to supply regularly the commercial needs of the importers at

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<sup>13</sup> Completion of ITO Charter as Hope for a Troubled World. Statement by the Department of State, March 25, 1948, *The Department of State bulletin*, XVIII (1948), n. 456, April 4, p. 442.

<sup>14</sup> International Wheat Agreement Enters Into Force, *The State Department bulletin*, XX (1949), n. 522, July 18, p. 75.

prices within the prescribed range and when the maximum price was reached to make available some quantities at that maximum. A corresponding engagement was taken by importing countries with regard to purchases at minimum prices.<sup>15</sup> The stability of the agreement was secured by the dominant producer, the United States which, until 1967, acting in close cooperation with Canada, managed to keep the international price of wheat within the range established by the previous agreement of 1933.<sup>16</sup> Prior to the Kennedy Round four other wheat agreements were signed in 1953, 1956, 1959 and 1962.

The project for the creation of an International Trade Organization entrusted with the supervision of a new international economic order, not limited to trade, soon proved too ambitious, as the Havana Charter was weighed down by conflicting interests that the negotiators were never able to reconcile during the lengthy controversial talks that ended in 1948. The Havana Charter was to enter into force when a majority of the countries that had signed the final act of the Havana Conference approved the document. If a majority failed to approve by the end of one year, then the Charter could come into force when only 20 countries had approved it. The first move was in the hands of the US Congress. Then, it was hoped that most other signatories would follow suit. However, protectionist lawmakers in Congress feared that the establishment of an international authority to implement multinational rules would curtail their power to defend the interests of their constituencies and of the American economic lobbies, among which the farmer lobby had no minor place. Their resistance was not offset by action from the liberal business community, as the latter came to feel that many provisions of the Charter supported by the United Kingdom could hamper free trade and interfere with the free enterprise system on which the US prosperity relied.<sup>17</sup> In winter 1950, during the Torquay GATT Round the US Executive announced it had withdrawn the bill for the Charter ratification.

The failure of the ITO charter did not mean the end of progress towards a free trade oriented multilateral system, as the Havana Charter impasse had been

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<sup>15</sup> Edward C. Cale, 'The International Wheat Agreement of 1949', *The State Department bulletin*, XX (1949), n. 512, April 24, p. 507.

<sup>16</sup> Bertrand Hervieu, 'La France et l'Organisation des Marchés Agricoles Internationaux', in Jean Raux, ed., *Politique*, p. 129.

<sup>17</sup> Thomas W. Zeiler, *Free Trade*, Chp. 8 and 9; Also, Richard N. Gardner, *Sterling-Dollar Diplomacy in Current Perspective. The Origins and the Prospects of our International Economic Order* (New York: Columbia University Press, 1980), p. 376.

preceded by the successful conclusion of the negotiations on a General Agreement on Tariffs and Trade (GATT) in October 1947. The Agreement sanctioned reductions of trade barriers that were outstanding for that time, covering over 45,000 items and accounting for almost two-thirds of the import trade of the negotiating countries and half of total world imports.<sup>18</sup> Tariff concessions were only one aspect of the Agreement. They were accompanied and underpinned by a series of legal provisions which were to be incorporated into the wider and more ambitious fabric of the International Trade Organization.

The General Agreement was able to cross the US Congress straits undamaged because its object was less ambitious and because its implementation was not conditional on Congress approval. Indeed, the Agreement was implemented in the US as a self-executing agreement, negotiating authority having been granted at an earlier stage to the Executive under the Reciprocal Trade Agreement Extension Act of 1945. It was, however, intended to be a subsidiary agreement under the ITO Charter and to depend on the Charter and the ITO secretariat for servicing and enforcement. Besides, as the renewed authority was going to expire in 1948, to avoid delays that threatened to impair the implementation of the Agreement a 'Protocol of Provisional Application' was signed in November 1947, becoming effective on January, 1, 1948. Contrary to the expectations on the eve of the apparently successful conclusion of the ITO negotiations, it was only through this 'provisional protocol' that the General Agreement was applied during the next 48 years.

The General Agreement, however, unlike the Charter was quite reticent on agricultural issues, as the regulation of farm trade was left to the latter.<sup>19</sup> Indeed, the only provisions that made express reference to agricultural products were two sections of article XI, limiting the general ban on import quotas, which was adopted at the instance of the US delegation to conform the Agreement to US legislation. However, the exemption only applied where import restrictions were

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<sup>18</sup> *Memorandum by the Acting Secretary of State to President Truman*, Washington, October 24, 1947, *Foreign Relations of the United States*, 1947, V.1, p. 1015-1025; Thomas W. Zeiler, *Free Trade*, p.121.

<sup>19</sup> A legal analysis of GATT provisions referring to trade in farm products in the period preceding the Tokyo Round is provided by Kenneth W. Dam, *The GATT: Law and International Economic Organization* (Chicago: University of Chicago, 1970), chp.15; Also Edmund McGovern, *International Trade Regulation. GATT, the United States and the European Community* (Exeter: Globefield Press, 1986) chp. XIV.

necessary to the enforcement of governmental measures imposing limits on domestic production or sales.

As regards the other major trade distorting practice, subsidies, the GATT was rather silent, or at least ambiguous. The original text of Article XVI of the Agreement just provided the loose obligation to report all subsidies that operate to increase exports or reduce imports. However, the GATT 1954-55 review session added four paragraphs to article XVI concerning export subsidies on industrial and primary products. As regards the former the addition introduced a ban on export subsidies that resulted in export prices lower than comparable prices for similar domestic goods. For the latter the article, like the Havana Charter, prevented the contracting parties from using export subsidies which resulted in 'having more than an equitable share of world export trade'. The amendment, which was signed by the industrial countries, opened, therefore, a rift between manufactured goods and agricultural produce. A clear cut prohibition applied to the former whereas the ban on export subsidies on primary products was made conditional on the proof of a rather abstract parameter, the acquisition of a non equitable share of world trade. The ambiguity of the legal benchmark resulted in an unwarranted leeway for subsidising countries, among which the European Community turned out to be the main beneficiary. The article said nothing about domestic subsidies which could have trade distorting effect. However, importing countries were allowed, under Article VI of the General Agreement, to impose countervailing measures on subsidised products, either industrial or primary, if they caused or threatened material injury to domestic industries. The United States managed to obtain an exception to the material injury test, exploiting the so-called 'grandfather clause', which allowed contracting parties not to modify a regime in force before the signing of the Agreement. Countervailing measures could, therefore, be used as a protectionist device when necessary.<sup>20</sup>

### **3)The growth of protectionist pressures**

Foreseeably, the absence of a clear discipline for agricultural trade and its apparent isolation from the mainstream of GATT rules induced the parties to the Agreement to further assert their national autonomy when conducting agricultural

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<sup>20</sup> See Seamus O' Cleireacain, 'Subsidies and Countervailing Duties', *World Economy*, I (1977), p. 443.

affairs. Despite the suitability of the new multilateral regime to US practice, it was the United States that set the stage in dodging GATT regulations to preserve its agricultural policy. GATT Art. XI allowed quotas only to restrict production and remove temporary surplus. Not all the American farm programmes supported by quantitative restrictions on foreign products had such goals. Some programmes imposed quotas just to insulate domestic price support programmes from foreign competition.

The Trade Agreement Extension Act of 1951 introduced an amendment to section 22 of the Agricultural Adjustment Act providing that 'no trade agreement or other international agreement heretofore or hereafter entered by the United States shall be applied in a manner inconsistent with this session'. The Senate report asserted that whenever action under section 22 would conflict with any trade agreement, domestic legislation and administrative practice should prevail.<sup>21</sup> Quotas were subsequently imposed on cotton, wheat, peanuts, oats, rye and barley, irrespective of concurrent implementation of domestic production and sales restrictions.

The Netherlands was the first to open fire against the amendment claiming its inconsistency with the relevant GATT provision. The United States, however, managed to obtain a waiver from GATT obligations under article XXV of the Agreement which was exceptionally broad, having no time limit and requiring only an annual report.<sup>22</sup> Thus the US showed it was ready to sacrifice the officially cherished new multilateral regime to its domestic interests to appease powerful lobbies. The West European countries immediately followed suit, since Belgium, Luxembourg and later Germany, applied for waivers allowing them to retain their quantitative restrictions on agricultural produce.

However, the main blow to the spirit if not the letter of the GATT regime came from the newborn European Economic Community. Both free trade areas

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<sup>21</sup> U.S. Code Congressional and Administrative Service 82<sup>nd</sup> Congress First Session, 1951 – Legislative History. *Trade Agreement Extension Act of 1951: Senate Report n. 299*, Apr. 27, 1951. Conference Report n. 537, May 31, 1951.

<sup>22</sup> GATT Basic Instruments and Selected Documents (BISD), 3<sup>rd</sup> Suppl., 1955. *Section 22 of the Agricultural Adjustment ACT (of 1933) as Amended* p. 36. GATT Art. XXV, section 5, provides that 'in exceptional circumstances the Contracting Parties (to the General Agreement) may waive an obligation imposed upon a contracting party by this Agreement'.

and customs unions had secured full recognition in the GATT text. Among the requirements for the establishment of a customs union the relevant article of the General Agreement, Art. XXIV, provided that duties and other regulation of commerce imposed at the institution of such a union could not, on the whole, be higher or more restrictive than the corresponding duties and regulations applicable in the constituent territories prior to its formation. The problem lay in how to assess the general incidence of duties and regulations. To this end a working group was established by the Parties to the General Agreement to discuss the modification of tariffs previously bound by EC member states following implementation of the EC Common External Tariff.<sup>23</sup>

The representative of the EC member states argued that the arithmetical average method the Community would adopt was fully consistent with the provisions of the General Agreement.<sup>24</sup> Most members of the group, however, held that ‘an automatic application of a formula, whether arithmetic average or otherwise, could not be accepted and that the matter should be approached by examining individual commodities on a country by country basis’. Regarding the EC’s future agricultural policy the participants felt that it could result in the exclusion of a large share of trade with third countries, arguing that some measures envisaged under the Treaty of Rome caused ‘a strong presumption of increased external barriers’.<sup>25</sup>

Thus, the Community failed to receive the endorsement of other parties to the GATT to its common tariff, although there was no official condemnation. However, the implementation of the common tariff and changes to be introduced in the import regime for agricultural products caused the first serious skirmish between the EC and the US – the ‘chicken war’.

To guarantee that the establishment of a common tariff did not increase the impact of trade barriers relative to the period preceding the customs union, GATT Art. XXVI:6 provided that customs union members must offer compensatory adjustments when they increased previously bound duty rates on individual items.

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<sup>23</sup> Concerning tariff binding and its legal effects see section 1, p.57.

<sup>24</sup> Trade theory and elementary maths show that the simple average system preferred by the Community allows a trade area to increase overall tariff barriers while claiming that the average tariff is unchanged, as the customs union can reduce tariff rates in sectors where imports are low and increase them in sectors previously more open to foreign competition.

<sup>25</sup> GATT BISD, 6<sup>th</sup> Suppl. *The Treaties establishing the European Economic Community and the European Atomic Energy Community* (L/778).

Therefore the Community held negotiations with the other Contracting Parties parallel with the 1960 Dillon Round of the GATT. The main 'demandeur' was naturally the major exporter to the EC, the United States.<sup>26</sup> A settlement was reached for most items affected by tariff increases, but postponed for a series of agricultural products affecting about 10 percent of US trade, also because the EC was not yet able to know the exact impact of its new import barrier regime for those products covered by CAP.

The United States had established a thriving poultry market in Germany. The duty charged by the Federal Republic was 4½ per pound. On July 1, 1962 the German national tariff had to adapt to the EC import regime, an import fee of approximately 13½ per pound being imposed. American shipments dropped by 40 percent relative to the previous year. The US immediately claimed compensation, by tariff reductions on other items and when negotiations did not produce satisfactory results it declared itself entitled to withdraw concessions, i.e. bound tariff reductions, on US \$46 million worth of EC trade. The EC accepted the compensation principle, but argued that compensation should not exceed US \$19 million trade value. The controversy was eventually brought before a GATT panel which established the amount of compensation rights as US \$ 26 million. In January 1964 President Johnson signed an order increasing US duties on four products of primary interest to the EC: brandy, trucks, dextrine and starch.<sup>27</sup>

#### **4)The Kennedy Round and the first hesitating steps towards a freer market for agricultural produce**

The 'chicken war' was not a mere scuffle between two powerful commercial blocks but should be seen as a warning shot from the US against what it saw as the growing threat of a West European Common Market impervious to American products, where the CAP figured prominently.

It is difficult to locate the turning point in American policy towards a drive for trade liberalisation, especially for agricultural products which possibly preceded the 'chicken war'. However, the manifesto of the new US attitude

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<sup>26</sup> In diplomatic and international studies parlance, the term 'demandeur' indicates the party pressing for concessions by the other parties on a particular issue in the negotiation.

<sup>27</sup> In particular, Gerard and Victoria Curzon, 'The Management of Trade Relations in the GATT', in Andrew Shonfield, ed., *International Economic Relations of the Western World.. - I Politics and Trade* (London:Oxford University Press, 1976), p. 213.

towards the European Common Market was embodied in President Kennedy's special message to Congress on foreign trade policy, delivered January 22, 1962 to obtain authority for a new round of multilateral talks. Kennedy, stressing the importance of increased exports for the US economy, viewed the emerging EC market as a pivotal opportunity for American trade expansion, arguing, however, that if the US Executive was unable to bargain-down the Community's external tariff, exports to Europe might decline, with likely displacement of American plants to Europe, 'in order to get behind the external tariff wall of the EC'. The stake for American farmers, particularly dependent upon West European markets, was high, as 'our agricultural trade with that area is four to one in our favour'.<sup>28</sup>

Contrary to the co-operative approach prevailing in other sectors of the Round named after the late President, negotiations on trade in agricultural products were marked by clashes reflecting opposed philosophies as to the regulation of domestic and international markets. Consistent with the declared goal of opening up the West European Market, initially the United States, backed by Canada, Australia and New Zealand, proposed that agricultural produce like industrial products be subjected to a 50 percent across-the board reduction. This proposal was considered unrealistic by most observers of the Kennedy Round as it required the Community to relinquish a regime, based on the variable levy, considered cornerstone of the CAP.<sup>29</sup> Moreover, the proposal had the disadvantage of coming at a time when the EC regime had not been fully implemented.

The European Community's counterproposal presented a completely different philosophy. For the Community, the incidence of the variable levy was itself influenced by the extent to which trade partners produced and exported at prices determined by factors other than free market forces. The CAP, therefore, could not be singled out as the only culprit, since the orderly functioning of the market depended on a comprehensive approach to all forms of government intervention in agriculture and, therefore, not only on levies, but also production subsidies, price support and export subsidisation to which all main parties used to resort. The proposal, called Mansholt II, presented by the EC Commissioner for

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<sup>28</sup> Public Papers of the Presidents of the United States – John F. Kennedy, 1962. *Special Message to the Congress on Foreign Trade Policy*, January 25, 1962, pp. 68-77.

<sup>29</sup> John W. Evans, *The Kennedy Round in American Trade Policy. The Twilight of the GATT?* (Cambridge, Mass.: Harvard University Press, 1971), p. 203.

agriculture, Sicco Mansholt, centred on the freezing of the ‘montant de soutien’ (margin of support), encompassing all forms of direct support provided by any country to its farmers.<sup>30</sup> The ‘montant’, to be evaluated for all farm products marketed by parties to the GATT, was determined by the difference between a reference price and one obtained by farmers in their respective countries, plus any direct subsidy to producers. The reference price could be either the average world market price during a reference period, or, if a representative world market price could not be established, a price negotiated between GATT members. The margin of support would remain bound for three years therefore preventing GATT parties from raising their level of protection, but would be automatically increased if the reference price fell, thus providing an immediate response to world price depressing effects of subsidisation practices. The binding of the support margin would be joined by agreements on food products like cereals, sugar, vegetable oils and fats, and dairy products, based on internationally agreed reference prices and the control of supply to avoid surplus.

Mansholt’s proposal had the advantage of providing an all encompassing, and rather unbiased, approach to the gamut of farm supporting practices. It was not however directed to their curtailment, but aimed only to cap them and for a limited period. It also had the disadvantage of relying on a benchmark particularly difficult to assess; even more so as the EC had not yet completed the implementation of its CAP regime.<sup>31</sup>

The exporters, led by the US, considered the proposal as an attempt to obtain recognition and acquittal of a policy destined to hinder farm imports in the EC. A new proposal was tabled by the US in June 1964.<sup>32</sup> This, which the US Special Trade Representative, Christian Herter, labelled ‘pragmatic’ to contrast it to the Community’s ‘dogmatic’ approach, recognising the inevitability of the EC’s variable levy divided agricultural products into three groups. Duty free

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<sup>30</sup> GATT Documents, Committee on Agriculture - *Statement by the Representative of the European Economic Community before the GATT Committee on Agriculture regarding the Negotiating Plan of the EEC for the Agricultural Part of the Kennedy Round*, TN/64/AGR./1 (19 February, 1964).

<sup>31</sup> A detailed analysis of the EC perspective is provided by GianPaolo Casadio, *Commercio attraverso l’Atlantico. Dal Kennedy Round al Protezionismo* (Roma:IAI, 1973), pp. 141-73.

<sup>32</sup> GATT Documents, Committee on Agriculture - *Statement of the United States Delegation on its Position concerning the Proposal of the European Economic Community for Agricultural Negotiations in the Kennedy Round*, TN/64/Agr/4 (17 June 1964); USDA, Major Agricultural Objectives in Trade Negotiations, August 7, 1963 (NSF Box 309-310 Trade General 8/63)

products, like cotton and soybeans should be bound at zero rate. Products protected only or mainly by tariffs should have them cut. For products subject to ongoing or prospective commodity arrangements, which would fall under the variable levy regime, the level of protection as proposed by the EC might be applied subject to provisions for assuring continuous market access and the opportunity to share demand growth.

The question of guaranteed access was taken up in 1966 with regard to grains, to which the US, as major world supplier, attached great importance. The Community accepted in principle to limit its grain output to an agreed percentage of domestic consumption, thus maintaining its self-sufficiency below 100, but made it conditional to the acceptance of the 'montant de soutien' scheme.<sup>33</sup> It was also agreed that production above the agreed amount should be disposed of as food aid to developing countries.

The United States' argued that an international grains arrangement should assure producers an adequate income by balancing production and demand. This would have required exporters to impose restraints on their production and marketing, an undertaking consistent with longstanding American regulations but for which its partners were unprepared. Apparently then, the US original thrust for overall trade liberalisation through tariff reductions out of necessity turned into an agreed management of the market, an objective not excluded by the ITO Charter but on which GATT was silent. Soon, however, disagreement emerged when principles were translated into practice, as the Community offered a 90 per cent self-sufficiency rate, well above both the exporting countries' demand for an 86 per cent rate and the actual level attained by the EC.

The final agreement on agricultural products, reached after a negotiating marathon in May 1967, bore modest results. According to Preeg, tariff reductions on dutiable imports of non-tropical products other than cereals, meat and dairy products averaged 22 per cent, a substantial cut but somewhat lower than those

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<sup>33</sup> Parlement Européen – Documents de Séance 1966-67. Document 136, 28 Novembre 1966. *Rapport sur les problèmes relatifs à une organisation des marchés mondiaux des produits agricoles, en particulier les cereals.*

agreed on non- primary products.<sup>34</sup> Moreover, with regard to the main importer, the EC, most products were left outside.

Cereal trade was handled by a Memorandum of Agreements on Basic Elements for the Negotiation of World Grains Arrangement, signed June 30, 1967 within the framework of the Round's final act.<sup>35</sup> The Arrangement, signed three months later, had two components: the Wheat Trade Convention and the Food Aid Convention. The former increased the floor and ceiling price for wheat and modified certain benchmarks previously used in price assessment. However, no provisions for access market sharing and price support were adopted. The United States, having been unable to secure its export share in the EC, finally agreed with its European counterpart on minimum prices well above the previous five-year average. This agreement was certainly inconsistent with a free trade perspective but at that time seemed to boost US wheat exporters' revenue. Indeed it was supported by most farm associations, though with the remarkable exception of the Farm Bureau.<sup>36</sup> The Food Aid Convention committed the signatories to provide 4.5 million metric tons of wheat to developing countries, the US supplying 42 percent of the total commitment and the EC covering 23 percent of the shipments. The convention had the merit of combining aid to famine-hit countries with the reduction of wheat stocks overhanging world markets, but failed to provide a link between food donations and the defence of the wheat floor price set in the Trade Convention. No progress was realised in the beef and dairy products sectors.

The Grains Arrangement was soon under pressure. An unexpected abundance of wheat caused by favourable weather conditions and a contraction of international demand in 1968-69 resulted in a decline of prices below the minimum level set by the Wheat Trade Convention. After the collapse of the arrangement a new international wheat agreement was established in 1971. Like its predecessor it included wheat trade and food aid conventions, but the former

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<sup>34</sup> Ernest H. Preeg, *Traders and Diplomats. An Analysis of the Kennedy Round of Negotiations under the General Agreement on Tariffs and Trade* (Washington D.V.: The Brookings Institute, 1970) p.251

<sup>35</sup> GATT BISD, 15<sup>th</sup> Suppl. *Trade Conference Final Act*, p. 18.

<sup>36</sup> *Memorandum from the President's Special Assistant (Rostow) to President Johnson, November 3, 1967*, Foreign Relations of the United States, 1964-1968, p. 843; Thomas B. Curtis, John Rober Vastine Jr., *The Kennedy Round and the Future of the American Trade* (New York: Praeger Publishers, 1971), p. 60.

lacked the price provisions and merely provided a statistics gathering operation and a forum for discussion.

According to Warley, the Kennedy Round underlined the shift in political power in the post-war world 'as the United States, which previously set the tune of trade negotiations, was unable to prevent the European countries from realizing and even strengthening in the course of the negotiations a policy it disapproved'.<sup>37</sup> However, the US endeavour to liberalise agriculture was not without conditions and ambiguity. The US was the demandeur in sectors like grain where it was the main exporter, but no corresponding offers were made where it adopted a protectionist stance, like dairy and beef, nor was it prepared to discuss subsidies and other forms of support to American farmers as it would have been obliged to do had it accepted the EC proposal for assessment and temporary binding of the 'montant de soutien'.<sup>38</sup> Leaving aside the 'montant de soutien' question, the Community was in no position to undo or restrict a policy that it claimed was a cornerstone of the EC fabric, especially if such a policy had not yet been fully implemented.

##### **5) The Tokyo Round and the failure to bridge the gap between the US and the EC stance on agriculture**

The fundamentals underlying the stance of the two main trade partners in the Kennedy Round did not change in the following round. On the contrary, a set of factors rendered their position more entrenched. Firstly, the emergence of a fully-fledged CAP was viewed by European policymakers as a means of curbing the flight from the countryside when the slack economy of the seventies prevented absorption of manpower from other sectors. Secondly, the growing trade deficit stressed the need for the US to offset its deficit in manufactures and industrial raw materials with an agriculture produce surplus. All this hindered progress in the Tokyo Round talks on agriculture, eventually affecting their outcome.

The declaration signed on 14 September, 1973 at the GATT Ministerial Conference in Tokyo stressed the need to achieve expansion and ever greater liberalisation of world trade, but in agriculture called for 'an approach to

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<sup>37</sup> J. Warley, 'Western Trade in Agricultural Products', in Andrew Shonfield, ed., *International*, p.387.

<sup>38</sup> Sicco Mansholt's Diatribe, *The Economist*, July, 8, 1967.

negotiations which, while in line with the general objectives of the negotiations, should take account of the special characteristics and problems of the sector'.<sup>39</sup> The Declaration, therefore, tried to reconcile the opposing positions of the two main participants, but it also set a multifaceted framework for negotiations in agricultural trade. Whereas in the previous rounds tariff reduction was the dominant if not the only object, in the Tokyo Round the focus shifted to non-tariff measures, like quantitative restrictions and subsidies, most of which were not limited to trade in manufactured goods but affected trade in primary products too.

The new multilateral background caused different reactions from the US and the EC reflected in their negotiating mandate. The negotiating mandate to the US Executive was embodied in the Trade Act of 1974, substantially changing the relationship between Congress and Executive in the negotiation and implementation of multilateral trade agreements. Whereas previous trade agreements had been implemented by presidential proclamations as self-executing agreements, from the 1974 Trade Act onwards, excepting tariff cuts, trade agreements must be approved by lawmakers. On the other hand, by adopting the so-called 'fast-track' procedure, Congress waived its power to introduce amendments during ratification proceedings, subject to some control on the Executive's proposals during negotiations. In setting the US objectives in the multilateral negotiations the grant of authority did not distinguish between primary and non-primary products, implicitly subscribing a unitary regime.<sup>40</sup>

The negotiating mandate agreed by the Council of Ministers for the European Commission pointed out that 'the specific objective of the agricultural negotiations should be the expansion of trade in stable world markets, in accordance with existing agricultural policy'. The Council also stressed that the Common Agricultural Policy corresponded to agreed conditions of agriculture within the Community and 'its principles and mechanism....do not constitute a matter for negotiations'.<sup>41</sup> In short, the Community made it immediately clear that: 1) negotiations could only be based on the special status of agriculture; 2)

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<sup>39</sup> GATT BISD, 20<sup>th</sup> Suppl. *Declaration of Ministers Approved at Tokyo on 14 September 1973* (MIN (73)1 pp.19-22.

<sup>40</sup> In particular, Gilbert R. Winham, *International Trade and the Tokyo Round Negotiations* (Princeton: Princeton University Press, 1986) p. 129 et seq.

<sup>41</sup> The Council of the European Community. *The Development of an Overall Approach to the Forthcoming Multilateral Trade Negotiations in Gatt*, 1/135/73 (COMER, 42) 29 June 1973.

market discipline to be pursued through a set of arrangements on the main basic products, was a necessary precondition for trade expansion and not to be left to the free play of the market; 3) national policies had to be respected and the CAP especially could not be amended by multilateral agreements not only as far as its principles were concerned, but also regarding its mechanism, i.e., from the variable levy to the export refund, whatever their impact on international trade.

These divergent objectives deeply affected the negotiations. In 1974 six groups were established under the umbrella of the Trade Negotiations Committee to deal with the main subjects of the Round: tariffs, non-tariff measures, safeguards, sector measures, tropical products and agriculture. The US approach aimed at market liberalisation in primary and non-primary products and was, therefore, opposed to separate negotiations within the agriculture group on market discipline and trade distortion whenever they were common to trade in manufactured goods. The Community representatives endeavoured to ensure that agricultural issues be discussed only within the agriculture group to avoid the risk of trade off between agriculture and industry concessions.<sup>42</sup> In 1975, a compromise was reached whereby the 'agriculture' group would deal with agricultural aspects of tariffs and non-tariff measures but would treat them in conjunction with the work of the 'tariff' and 'non-tariff measures' groups.<sup>43</sup>

Similar differences marred the working of the subgroups set up within the agriculture group: 'grains', 'meat' and 'dairy'. Particularly for 'grains', the most prominent trade sector, the United States requested that discussions on market regulation be held within the International Wheat Council rather than in the 'grains' subgroup which was to focus on market liberalisation. The EC maintained that a new international wheat agreement should be negotiated in the MTN framework, contending that the Geneva negotiations, rather than address market liberalisation, should set up market stabilisation mechanisms, centred on stock management and constraint on market prices.<sup>44</sup>

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<sup>42</sup> General Agreement on Tariffs and Trade, *The Tokyo Round of Multilateral Trade Negotiations. Report by the Director General of GATT* (Geneva, April 1979), p.19.

<sup>43</sup> T.E. Josling, *Agriculture in the Tokyo Round Negotiations* (Ashford: Headley Brothers Ltd., 1977), p. 11.

<sup>44</sup> See Simon Harris, *EEC Trade Relations with the USA in Agricultural Products: Multilateral Tariffs Negotiations*, Occasional Paper n3 (Whye College, Ashford, for the Centre for European Agricultural Studies, 1977)pp. 16-20.

The 1975 compromise proved impracticable and negotiations stalled for over two years. Only in 1977, after the new US President Jimmy Carter secured a commitment to complete the Tokyo Round from the heads of government at the London Economic Summit, did the pace of multilateral talks in Geneva accelerate. A new compromise formula was agreed for agriculture. At a meeting in July 1977, the new US Trade Representative, Robert Strauss, agreed with his European counterparts that the multilateral negotiations would not upset any structural policy of the EEC and, as agriculture had its specific character, it could be negotiated in parallel with industry.<sup>45</sup> Retrospectively it can be argued that the US had decided to subordinate agricultural trade liberalisation to rapid progress in other trade policy areas. Indeed, agriculture occupied quite a modest place in the final acts of the Tokyo Round. As Warley noted, every minister for agriculture had 'no difficulty in assuring his constituents that he had surrendered little existing protection'.<sup>46</sup>

Even though important reductions, amounting to 40 percent of the tariff wall, were agreed, they were made on just a quarter of the dutiable agricultural exports, omitting particularly those covered by the CAP variable levy. Concerning the regulation of particular commodity markets, the Round produced an International Dairy Arrangement (IDA) which provided for minimum export prices for butter, milk powders and certain cheeses, and established a mechanism for information exchange and policy consultations. However, the agreement had neither enforcement mechanisms nor stocking and production adjustment provisions. The Bovine Meat Arrangement created a council with the task of monitoring the sector and a mechanism of consultation and settlement of differences but had no economic or regulatory provisions.

Regarding farm export subsidies, limited progress was brought by the Code on Subsidies and Countervailing Duties covering both industry and agriculture. The Code provided a more precise interpretation of the term 'equitable share of world export trade' and extended the ban to export subsidies

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<sup>45</sup> Gilbert R. Winham, *The Tokyo*, p. 166.

<sup>46</sup> Thorald K. Warley, 'Agricultural Trade Policy Issues in the 1980s', in De Haen et al., eds, *Agriculture and International Relations* (London: The MacMillan Press, 1985) p. 251.

that resulted in the acquisition of a non equitable share 'in a particular market' and in cut price competition in that market.<sup>47</sup>

Consistent with the United States, and contrary to EC hopes, negotiations on grains market regulation were held outside the GATT, under the auspices of the International Wheat Council. The negotiations, however, stalled due to differences between the United States and the European Community on the establishment of a fixed price range for wheat and on the use of export subsidies. For a moment the US, Canada and Argentina considered an arrangement which would have excluded the importers, but the Carter Administration, hostile to an agreement that could be seen as a cartel by consumer nations, among which developing countries were the majority, abandoned the proposal.<sup>48</sup> The inconclusive wheat agreement of 1971 was, therefore, not replaced by a more efficient one.

## Conclusion

While post-war economic and political conditions pressed for the opening of markets for industrial goods, in agriculture the political environment, not only in Western Europe, took the opposite direction. The potential drift to extend liberalisation to agricultural trade was successfully countered to protect national interests, at first with the blessing of the United States. The fledgling GATT regime was easily dodged either by waivers envisaged by the General Agreement itself or by the 'de facto' establishment of protected areas that went beyond what the GATT would allow to customs unions.

In short, each trade partner, despite GATT principles, but not necessarily its rules, was able to consolidate its autonomy. The international regime moulded in the 1950s and 1960s was characterised by several areas protected from foreign competition, rather than by free trade.

Belatedly, the US realised that the system it had helped establish thwarted its own interests. The means chosen by the US to open foreign markets to its farm products, relying on tariff cuts, was consistent with the concurrent GATT. This ignored more pervasive forms of protection established by trade partners

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<sup>47</sup> General Agreement on Tariff and Trade, *The Tokyo*, p. 129.

<sup>48</sup> See Theodore Cohn, 'The 1978-79 Negotiations for an International Wheat Agreement: An Opportunity Lost?', *International Journal*, 33 (1978-79), p. 136.

including the US itself. The EC's unsuccessful proposal for the adoption of an international regime based on the 'montant de soutien', though astutely centred on CAP objectives, acknowledged the reality of the largely exploited freedom of each trading partner to regulate its own market for agricultural products through subsidies and import barriers, while concurrently trying to discipline such liberty under an international settlement. In the Tokyo Round the United States tried to negotiate a more comprehensive approach to farm trade barriers but clashed with the European Community which was openly unwilling to sacrifice its fully established regime.

In the deteriorating economic environment of the 1980s the need to buoy up the food products market imposed a thorough GATT rules revision, which entailed their enlargement. The question was once again which philosophy would dominate the review.

## **CHAPTER III**

### **DIFFICULTIES IN THE US FARM REGIME 1981-1986**

The beginning of the 1980s saw a dramatic U turn in the fortunes of American agriculture. The crisis, by some commentators equated to the crisis of the 1920s and 1930s, had many facets. The US share of world farm exports declined sharply (from 19.4% in 1981 to 9.6% in 1996) and the share of agricultural exports in farmers' revenue shrank. Farmers' net income plummeted along with the value of farm property. From 1982 severe financial strains affected both farmers and credit institutions.<sup>1</sup>

The multifaceted crisis, has been the object of theoretical and political debate. The explanations are not necessarily mutually exclusive. A first viewpoint points to macroeconomic factors. Following this approach we can shape a triangle of factors engendering the farm slump and consequent financial distress, at the apex of which is the US budget deficit: excessively high (real) interest rates; the mentioned deficit; and the strength of the dollar. A second outlook stresses the importance of the economic policy environment, both domestic and international. In this context some commentators have focused on the distorting role played by the US farm regime itself, which induced US farmers to shun competition in the international market and prefer the easy domestic outlet with the safety net provided by government intervention. Others emphasise the 'unfair' competition of foreign producers. It is also arguable that the development of the crisis was affected by the uncertain and sometimes contrasting responses provided by the US Executives and by US lawmakers.

#### **1)The starting point**

Developments in US farm policy must be read in the light of and contrasted to the Reagan Administration programmes, proposed both with regard to the overall management of the economy and agriculture.

A month after taking office, Reagan centred his programme for economic recovery on tax cuts and a substantial reduction in the growth of federal

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<sup>1</sup> *The Economist*, 11 December 1982.

expenditure. As military spending, according to the Administration's projects, was to be increased and so-called 'social safety net' programmes were to be preserved, the axe had to fall on those programmes which, in the President's opinion, meant unwarranted spending and government interference with the free play of the market.<sup>2</sup> In the message accompanying the proposals for the fiscal year 1982, the President asked for tax cuts of \$53.9 billion, to be coupled, according to quite an optimistic forecast, with a \$48.6 billion reduction in federal spending.<sup>3</sup> In spite of setbacks in spending control, the same outlook marked Reagan's successive budget proposals.<sup>4</sup> Among the fundamentals of the Administration's economic programme Reagan quoted: 1) limiting tax burdens to the minimum levels necessary to finance essential government services; 2) reducing the growth of overall federal spending by eliminating those activities that overstep the proper sphere of government responsibilities and by restraining the growth of spending for other federal activities; and 3) reducing the Federal regulatory burden in areas where the government interfered with the efficient conduct of private business. The President also declared that he was confident about progressively achieving a balanced budget. Regarding agriculture, the Executive stressed the need to reduce surplus supply. The measures proposed by the Administration included freezing of farm crop target prices and fostering sales of agricultural produce abroad, through both commercial channels and government negotiations.

This approach is faithfully reflected in the Administration's proposals for the 1981 farm bill, which was to replace the expiring 1977 Food and Agriculture Act, setting the stage for farm policy in the following four years. The Executive pursued two objectives - to keep the annual budget cost for farm spending at around \$1.5 – \$2 billion per year, principally targeting the dairy programme; and to get rid of some programmes which were not consistent with the administration's free market approach and allegedly hampered American competitiveness in the international market<sup>5</sup>. The target was the support

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<sup>2</sup> Public Papers of the Presidents of the United States – Ronald Reagan, 1981. *White House Report on the Programme for Economic Recovery*, February 8, 1981, p. 116

<sup>3</sup> Public Papers of the Presidents of the United States – Ronald Reagan, 1981, *Message to the Congress transmitting Fiscal Year 1982 Budget Revision*, p.221.

<sup>4</sup> Public Papers of the Presidents of the United States – Ronald Reagan, 1983. *Message to the Congress Transmitting the Fiscal Year 1984 Budget*, March 10, 1983, p.123.

<sup>5</sup> Fred H. Sanderson, 'US farm policy in perspective', *Food Policy*, 8 (1983) n. 1, p.4.

mechanism based on target prices and deficiency payments, which were the hub of the ongoing grain regime.<sup>6</sup>

Concerning wheat, feed grains, cotton, rice and soybeans, the Secretary for Agriculture John Block proposed, rather baldly, to Congress: 1) to terminate target prices and deficiency payments; 2) to terminate authority for set aside (a form of production control); and 3) to grant the Department of Agriculture authority to set commodity loan levels, which were usually fixed by law.<sup>7</sup> The proposal boiled down to repeal the bulk of income support and government interference in the quantities that farmers were allowed to produce and market. Regarding price support, in the previous decade commodity loan rates had only played the role of safety net in the apparently unlikely event of market prices falling below their level. However, as signs of price volatility were increasingly present, the Administration wanted to obtain leeway in fixing the intervention price to prevent it from rising above the sinking market price lest the Commodity Credit Corporation (CCC) should be loaded with stocks to be disposed of at extremely low prices, causing extra burden to the budget compounded by storage costs.<sup>8</sup> Concerning dairy products Block asked for authority to set dairy price support, with periodic adjustments, between 70 and 90 per cent of parity. As expected, the lawmakers considered the Administration's proposals too radical and dangerously susceptible to alienate the support of a large part of their constituencies. The farm alliance, however, was not united in Congress and the Executive was able to exploit rivalries between commodity lobbies. It was also helped by the contrasting attitudes of the House of Representatives, where democrats were in the majority and the Senate controlled by the 'Great Old Party', which, though reluctantly was more inclined to help the Administration in its effort to resist main increases in price and income support.<sup>9</sup> In particular, the coalition between agricultural interests and urban congressmen supporting food stamps - which, as previously noted, helped push generous programmes for farmers through Congress - was impaired by the desire of conservative

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<sup>6</sup> for a description of the target price-deficiency payment mechanism see Chapter.I, section 1.

<sup>7</sup> *CQ Almanac* 1981, p.540.

<sup>8</sup> On the loan rate mechanism see Chapter.I, section 1.

<sup>9</sup> *CQ Almanac*, 1981, p. 535; See also, H Wayne Moyer and Timothy E. Josling, *Agricultural Policy Reform. Politics and Process in the EC and the USA* (New York: Harvester Wheatsheaf, 1990) p. 146.

Republicans to curb outlays for food stamps.<sup>10</sup> Thus, the Administration was all in all successful in withstanding Congress's demands for substantial assistance to its commodity lobbies. On the other hand, it was far from achieving its aim of reshaping the farm support mechanism.

The bill that President Reagan signed into law on 22 December 1981, just after the House of Representatives cleared it by a two-vote margin, significantly reduced the minimum support level for dairy products, to be fixed in dollars instead of being linked to parity as in the past. Target prices were not abolished, but the law provided for annual increases in grains and cotton target prices that fell short of the expected inflation rate. Concurrently loan rates for grains were frozen at the 1982 level, while those for rice and cotton were allowed to increase at a rate lower than the expected rate of inflation.<sup>11</sup>

In short, the Agriculture and Food Act of 1981 continued the declining trend in real support price, without altering its mechanism. There was, however, a snag. The prospective decrease rested on stable market prices. Agricultural conditions soon deteriorated (Table 3.1). From the 1982 market year the main US farm exports fell causing carry-over stocks to increase (except for 1984 thanks to a severe drought the previous year and the implementation of a new programme directed to reduce production and inventories, known as PIK). This was bound to cause growing strain on the Agriculture Department's budget.

**Table 3.1 US Share of total world grain exports and volume of US government stocks**

Year	Exports 1,000 metric tons	world export %	government stocks 1,000,000 metric tons
1975	82,441	48.7	
1976	77,646	45.7	
1977	88,065	48.9	
1978	94,171	48.4	2.6
1979	110,813	52	5.5
1980	114,537	50	13.3
1981	110,459	48.2	12.3
1982	95,689	44.5	14.8
1983	96,902	42.8	45.5
1984	96,218	40.1	23
1985	61,933	30.3	29.3

Source USDA, Grain exports and volume of government stocks, 1987.

<sup>10</sup> Craig L. Infanger, William C. Bailey and David Dyer, 'Agricultural Policy in Austerity: The Making of the 1981 Farm Bill', *Amer. J. Agr. Econ.*, 65 (1983) p. 1

<sup>11</sup> *CQ Almanac*, 1981, p. 536.

## 2) Features and causes of the farm crisis: was it just self inflicted pain?

### *Performance of US farm exports*

Campagna remarks that 'curiously, Reagan, the budget balancer, accumulated larger deficits when in office than all his predecessors combined'.<sup>12</sup>

Those who have focused on the economic developments in the Reagan years agree that the Republican Administration was much more successful in reducing revenues than in cutting expenditures (Table 3.2).<sup>13</sup>

**Table 3.2 FEDERAL RECEIPTS, OUTLAYS AND DEBT**

	year 1980			year 1983			year 1986		
	US\$ mill.	I.N.	% Total	US\$ mill.	I.N.	% Total	US\$ mill.	I.N.	% Total
<b>Total Outlays</b>	<b>590,920</b>	<b>100</b>	<b>100</b>	<b>802,327</b>	<b>136.79</b>	<b>100</b>	<b>990,258</b>	<b>167.6</b>	<b>100</b>
Nat.defense	133,995	100	22.7	209,903	156.6	26	273,375	204	27.6
Intern. affairs	12,714	100	2.2	11,848	93.1	1.5	14,152	111.3	1.4
Space-Science	5,832	100	1	7,935	136.1	1	8,976	153.9	0.9
Energy	10,156	100	1.7	9,353	92	1.2	4,735	46.6	0.5
Environment	13,858	100	2.3	12,672	91.4	1.6	13,639	98.4	1.4
<u>Agriculture</u>	8,839	100	1.5	22,901	259.1	2.8	31,449	355.8	3.2
Commerce	9,390	100	1.6	6,681	71.2	0.8	4,890	52.1	0.5
Transportation	21,329	100	3.6	21,334	100	2.6	28,817	131.8	2.9
Local Develop.	11,252	100	1.8	7,560	67.2	0.9	7,233	64.3	0.7
Educ-Soc.servs.	31,843	100	5.4	26,606	83.6	3.3	30,585	96	3.1
Health	23,169	100	3.9	28,641	123.6	3.5	35,936	155.1	3.5
Medicare	32,090	100	5.4	52,588	163.9	6.5	70,164	218.6	7.1
Income security	86,540	100	15	122,598	141.7	15.2	119,796	138.4	12.1
Social security	118,547	100	20.1	170,724	144	21.1	198,756	167.7	20.1
Veteran benefits	21,185	100	3.5	24,846	117	3.1	26,356	124.4	2.7
Adm. Of Justice	4,582	100	0.7	5,099	111.3	0.6	6,603	144.1	0.7
General Govern.	13,030	100	2.2	11,241	86.3	1.4	12,533	96	1.3
Net Interest	52,512	100	8.9	89,774	171	11.1	135,969	258.9	13.7
Offset.Receipts	-19,942	100	-3.4	-33,976	170.3	-4.2	-33,007	165.5	-3.3
<b>Total receipts</b>	<b>517,112</b>	<b>100</b>	<b>100</b>	<b>600,562</b>	<b>116.1</b>	<b>100</b>	<b>769,091</b>	<b>148.7</b>	<b>100</b>
Ind.Income tax	244,069	100	47.2	288,938	118.4	48.1	348,959	143	45.4
Corp.Inc. tax	64,600	100	11	37,022	- 42.7	4.6	63,143	97.7	8.2
<b>Total surp./def.</b>	<b>-73,808</b>	<b>100</b>		<b>-207,764</b>	<b>281.5</b>		<b>-221,167</b>	<b>300</b>	
<b>Gross Fd. debt</b>	<b>914,317</b>	<b>100</b>		<b>1,381,886</b>	<b>151.1</b>		<b>2,130,131</b>	<b>233</b>	

Source: Calculation based on Economic Report of the President, 1988

<sup>12</sup> Antony S.Campagna, *The Economy in the Reagan Years. The Economic Consequences of the Reagan Administration* (Westport: Greenwood Press, 1994) p. 65.

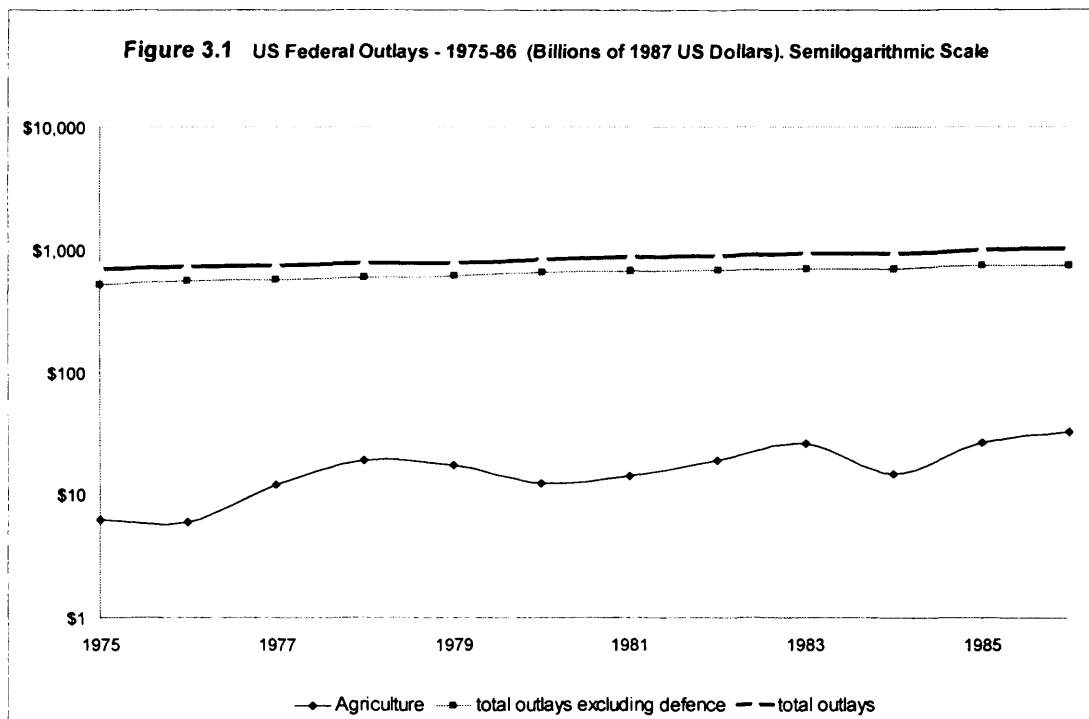
<sup>13</sup> Ibid. p.71; Gordon C. Rausser, 'Macroeconomic and U.S. Agricultural Policy', in Bruce L.Gardner, ed., *U.S. Agricultural Policy: the 1985 Farm Legislation* (Washington D.C.:The American Enterprise Institute for Public Policy Research, 1985) p. 207.

Actually, the Executive consistently pursued the planks of its foreign policy and economic manifesto although economic variables turned out to diverge considerably from its forecast, postponing those items which were not high on its list of priorities. The increase in defence budget authority was essential to carry out the new approach to the Cold War. Income tax reductions were viewed as the cornerstone of its economic agenda. However, the economic philosophy of the Executive, posited that cuts in tax rates would be offset, in the short run, by the tax base increase engendered by the fiscal revolution. The economy, which in 1981 was not healthy, hit a low point in 1982 with a negative rate of growth, thus, preventing the expected increase in the income tax base. Conversely, pruning those programmes not in tune with the liberal outlook of the Administration, was perceived as an unsound manoeuvre in a recession. Once over and a robust recovery in place, it was politically unsound for the Executive as well as Congress to carry out earnest curtailment of expenditures as the election date was nearing. After the election the deficit continued to rise.

It appears, therefore, that the deficit was brought about by soaring outlays. Certainly, in line with Reagan's initial statements, the main cause was the increase in national defence spending, which already in 1980 claimed most of the budget. However, all the other major components, predominantly destined for welfare services, cherished by the Democrats, fared quite well, both in nominal and real terms. Very few items among the budget outlays were heavily trimmed in real terms: international affairs, energy, education and training, community and regional development and general government. But all of them were lesser components of the budget. A main cause of expenditure increases was the growing weight of interest on the federal debt. The greatest growth rate belonged to agricultural expenditures, whose share more than doubled in six years in nominal terms. Their particular dynamic relative to the whole budget also emerges if it is assessed at constant prices (Figure 3.1). However, agricultural programmes were not the main culprit, as in spite of their leap forward, when they peaked in 1986, they were still a modest part (3.2 per cent) of total outlays.

Finally, in 1985 Congress passed the Gramm-Rutman Act that limited the amount of permissible deficit. If, in a fiscal year, budget authority did not comply with established limits, the Office of Budget and Management was empowered to

cut spending across the board, except for some poverty programmes and social security.



Source: US Budget Baselines, Historical Data and Alternatives for the Future, 1994

The budget explosion of the Reagan era was preceded by the upsurge in real interest rates whose emergence dated back to the end of the Carter Administration. In October 1979 the Federal Reserve, in its effort to curb inflation, started to control money supply rather than targeting interest rates.<sup>14</sup> The shift in monetary policy brought about a deceleration in the inflation rate and hence halted the fall of real interest rates (i.e. nominal interest rates corrected for the expected rate of inflation), which by 1980 were climbing. The process accelerated in the course of the following decade along with the growing fiscal deficit.

The 1983 Economic Report of the President to Congress explained the rise in real interest rates as a result of the decrease in the supply of savings, caused both by a decline in private savings, probably triggered by the recession of the early 1980s, and by a large decline in government savings, i.e. a large increase in the federal deficit.<sup>15</sup> In turn, high interest rates were the main cause of the appreciation of the US currency in real terms. Indeed, the high expected real rate

<sup>14</sup> See Federal Reserve Bulletin 66 (1980), p. 40.

<sup>15</sup> Economic Report of the President, February 1983, p. 54.

of return paid by US assets relative to that of its partners made US bonds and equities attractive causing a greater inflow of capital than the expected inflation rate differential would explain (Table 3.3).<sup>16</sup>

**Table 3.3 FOREIGN ASSETS IN THE UNITED STATES 1980-1987 (billions of dollars)**

<b>1980</b>	<b>1981</b>	<b>1982</b>	<b>1983</b>	<b>1984</b>	<b>1985</b>	<b>1986</b>	<b>1987</b>
500.8	578.7	688.1	784.5	892.6	1,061	1,340.70	1,536

Source Economic Report of the President, 1989

Capital inflows had a double impact. The bright side was a twofold decrease of pressure on the American economy. Firstly, the appreciation of the US currency helped abate inflation, directly through lower dollar prices for imports, and indirectly by curbing the price of domestic goods competing with foreign ones. Secondly, capital inflows secured enough funds, particularly to the public sector, preventing it from crowding out private investment, thus keeping the US economy running. The dark side was a strong deterioration in the trade balance, already deeply in the red in the 1970s, with the exception of agriculture. Some sectors that in the previous decade still had a positive balance, such as capital goods and chemicals, went into the red.<sup>17</sup> Agriculture, which in the period 1973-1981 had a \$16.3 billion positive balance, registered a marked decline to \$4.8 billion in 1986 (Table 3.4).

Commentators have, therefore, argued that there was a direct, negative correlation between the appreciation of the dollar in the exchange market and the shrinking share of US produce exports.<sup>18</sup> The available data, however, do not bear out such a close relationship, as the correlation coefficient between the weighted value of the dollar and the US farm exports and trade balance in the period under review was much lower than unity: 0.09 and -0.4 with regard to exports, respectively in

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<sup>16</sup> Ibid. p. 53.

See also G. Edward Schuh, 'International Agriculture and Trade Policies: Implication for the United States', in Bruce L. Gardner, ed., *US Agriculture*, p. 60.

<sup>17</sup> See Sven W. Arndt, 'Government Policy and the Decline in U.S. Trade Competitiveness' in Philip Cogan, ed., *Essays in Contemporary Economic Problems. The Impact of the Reagan Administration* (Washington D.C.: American Enterprise Institute, 1986) p. 308 et seq.

<sup>18</sup> G. Edward Schuh, *International*, op.cit. p. 57.

Barbara Insel, 'A World Awashed in Grain', *Foreign Affairs*, 63 (1985), p. 898.

nominal and real terms; and -0.08 and -0.3 for the trade balance, in nominal and real terms respectively.<sup>19</sup>

**Table 3.4 Multilateral Trade Weight value of the US Dollar and US Agricultural exports and Agricultural trade Balance**

Year	Trade weight value of the U.S. dollar (March 1973=100)		Agricultural Exports	Agricultural trade balance
	nominal	real		
			Billions of US dollars	
1973	99.1	98.8	17.7	9.3
1974	101.4	99.2	21.9	11.7
1975	98.5	93.9	21.9	12.6
1976	105.7	97.3	23	12
1977	103.4	93	23.6	10.2
1978	92.4	84.2	29.4	14.6
1979	88.1	83.1	34.7	18
1980	87.4	84.8	41.2	23.9
1981	103.4	100.8	43.3	26.6
1982	116.6	111.6	36.6	21.2
1983	125.3	117.1	36.1	19.5
1984	138.2	128.5	37.8	18.5
1985	143	132	29.0	9.1
1986	112.2	103.3	26.2	4.7
1987	96.9	90.6	28.7	8.3
1988	92.7	88	37.1	16.1

Source: Economic Report of the President, February 1990. Tables C 103 and C 109

Firstly, the explanation needs some refinements. At the onset of the period in question McCalla, albeit accepting in principle such a perspective, noted that the impact of the dollar rise was bound to change according to the relationship between the various foreign currency and the dollar. Those countries whose currencies moved with the US dollar were to experience the same trend of contracting exports and declining prices. Those countries, like the EC member states, whose currencies were depreciating against the dollar were heading for an improvement in their export competitiveness. For those importers whose currencies were pegged to the US dollar, the exchange rate impact was neutralised vis-à-vis US exports, but their imports from countries with depreciating currencies

<sup>19</sup> A correlation coefficient  $r = \frac{\sum(x - \bar{x})(y - \bar{y})}{\sqrt{\sum(x - \bar{x})^2 \sum(y - \bar{y})^2}}$  is a number between -1 and 1 which measures the degree to which two variables are linearly related. Perfect linear relation with positive slope between the two variables results in a correlation coefficient of 1; a -1 correlation coefficient shows a perfect linear relation with negative slope. If the correlation coefficient is 0 there is no linear relationship between the variables.

would become cheaper relative to US exports. Finally, US farm produce would become more expensive for importing countries whose currencies were depreciating and for inconvertible currency countries which relied on primary product exports and gold sales to finance food imports.<sup>20</sup>

Secondly, it is arguable that the exchange rate was joined and even outweighed by other factors in the causal process.<sup>21</sup> Batten and Belongia, pointing out that the above mentioned theoretical expectations had not always been confirmed by facts, argue that foreign demand for US agricultural exports was about 75 per cent more sensitive to changes in foreign income than to those in the real exchange value of the dollar.<sup>22</sup> Regarding grains, Table 3.5 shows that in the period under review production exceeded consumption. In particular, developing countries affected by the debt crisis had to reduce demand for foreign produce they could not afford to purchase. Further, some of the main importers of US farm produce in the 1970s made great strides in productivity and, therefore, self-sufficiency. The trend was not limited to the European Community but extended to China, India and South East Asia.

**Table 3.5 WORLD PRODUCTION AND USE OF GRAINS**  
(Millions metric tons)

		1982/83	1983/84	1984/85
	<b>Wheat</b>			
Production		479	490	514
Consumption		468	488	503
	<b>Coarse grains</b>			
Production		779	685	807
Consumption		753	789	783
	<b>Corn</b>			
Production		440	346	452
Consumption		418	409	437

Source: Legislative History. Food Security Act (P.L. 99-198)

<sup>20</sup> McCalla, 'Current Macro Policies and Agriculture', *Amer.J. Agr. Econ.*, 62 (1982), p. 866.

<sup>21</sup> See Dallas S. Batten and Michael T. Belongia, 'The Recent Decline in Agricultural Exports: Is the Exchange Rate the Culprit?', *Federal Reserve Bank of Saint Louis Review*, 66 (1984) n. 8, p. 13.

The two scholars remark that 'a simple two variable comparison will not correctly identify the relationship between exchange rate movements and exports because factors other than exchange rate fluctuations influence export flows'

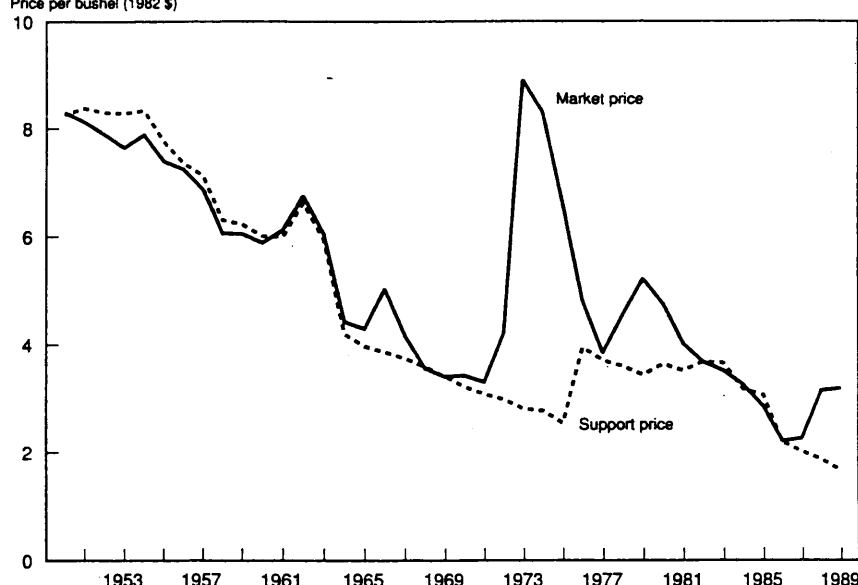
<sup>22</sup> Ibid. p. 13.

As to the relative position of the United States, some scholars as well as the US Administration argued that a further factor played a more decisive role than the dollar's strength: the impact of the federal farm policy.<sup>23</sup> As world market prices fell, loan rates, which at the outset of the decade were far below the market level, became high enough relative to world prices to encourage farmers to forfeit their produce to the CCC (Figure 3.2).<sup>24</sup> The result was that while exports shrank government stocks swelled from 12.3 million metric tons in 1981 to 45.5 million two years later.

**Figure 3.2**

**REAL WHEAT PRICES.** Real U.S. market and support prices follow a similar long-term trend.

Price per bushel (1982 \$)



Source: Economic Report of the President, February 1990, chart 7-1

The message that the Administration conveyed to the lawmakers was that the system preserved by the 1981 farm law was crowding out American farmers in the international market, as the safety net it provided had turned into a viable substitute for market prices, making it easier to produce for the US government. It is also arguable that, adding insult to injury, the increase in US stocks, which averaged 60 per cent of world stocks, by preventing the world market from being

<sup>23</sup> See in particular, Bruce L. Gardner, 'International Competition in Agriculture and U.S. Farm Policy – Introduction', in Martin Feldstein, ed., *The United States in the World Economy* (Chicago: The University of Chicago Press, 1988) p. 443; David Freshwater, 'American Agriculture in the Debt Crisis' in Stephan P. Riley, ed., *The Politics of Global Debt* (New York: St. Martin Press, 1993) p. 142.

<sup>24</sup> Economic Report of the President, February 1986, p. 135 et seq.

a viable outlet for American produce, buoyed up prices to the advantage of foreign competitors.<sup>25</sup> In short, the US regime was indirectly subsidising its competitors, particularly the EC.

A further factor could have played a role in the relative decline of American farm exports. The role of government in farm trade competition went well beyond bestowing export subsidies or providing safety nets for farmers. State to state long term agreements were a key factor in securing outlets for domestic produce.<sup>26</sup> Guaranteed provision of credit, in particular facilitated loans (i.e., with interest rates lower than those prevailing in the market) were also an essential component, as the decision to import by countries other than industrial ones was often linked to availability and credit terms. In turn, facilitated loans provided by public agencies depended on favourable political relations between the lender and the recipient.

The incoming Administration promptly lifted the embargo on the Soviet Union, imposed on 4 January 1980 by President Carter as a reaction to the invasion of Afghanistan.<sup>27</sup> Once again, however, general foreign policy concerns stood in the way of a farm deal. To react against the declaration of martial law in Poland the US government refused to start negotiations for a new long-term grain agreement, preferring to extend the expiring agreement on a year-to-year basis. The Soviet government formerly paid for food imports with its exports, principally oil and gold sales. In 1981, however, the Soviet Union, in spite of gold and diamond sales, was unable to cover all its grain imports and for the first time asked for supplier credit. The US Executive refused official credit for Russian purchases, although it did not try to prevent private banks from offering loans at market rates.<sup>28</sup> Finally, in July 1983 the Agriculture Secretary, announced a five-year grain sale agreement that committed the United States to sell and the Soviet Union to buy at least 9 million metric tons and up to 12 million metric tons of wheat and corn yearly.<sup>29</sup> Meanwhile other countries, like Australia, Canada and

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<sup>25</sup> See Gordon C. Rauser, 'The Political Economy of Agriculture in the United States', in Hans J. Michelmann, Jack S. Stabler and Gary Stoney, eds., *The Political Economy of Agricultural Trade and Policy* (Boalden: Westview Press, 1990) p. 72; Robert Paarlberg, 'The Political Economy of the American Agricultural Policy: Three Approaches', *Amer. J. Agr. Econ.*, 71(1989) p. 1162;

<sup>26</sup> See Dale E. Hathaway, 'Agricultural Trade Policy for the 1980s' in William R. Cline, ed., *Trade Policy for the 1980s* (Washington D.C.: Institute for International Economics, 1983) p. 448.

<sup>27</sup> *CQ Almanac*, 1981, p. 548.

<sup>28</sup> *The Economist*, 8 May 1982, p. 97.

<sup>29</sup> *CQ Almanac*, 1983, p. 387.

Argentina, had established a foothold in the Soviet market, offering the expectation of a grain supply less dependent on political factors and, therefore, less volatile, and often on better credit terms than the US.<sup>30</sup> The United States could not complain of the successful competition of those countries. But in 1982 France entered into an agreement with the USSR for the provision of an 'unspecified' quantity of grain, asserting its autonomy within the European Community in the conduct of farm trade agreements.<sup>31</sup> The Commission did not press charges against the maverick member state. The United States was, however, prepared to give tit for tat to subsidising newcomers whom they considered trespassers.

#### *Farmers' financial stress*

On the other hand, available evidence suggests that soaring (real) interest rates had a dominant role in causing the farm financial crisis or, more precisely, the financial stress, of the 1980s. During the 1970s farm debts had substantially increased due to rising export sales and relatively favourable export prices, in particular for grains and oilseeds. This made their production more profitable, stimulating investments in land and agricultural equipment. Secondly, in times of inflation, like the 1970s, borrowers repaid both principal and interest debts with currency that had depreciated in purchasing power throughout the loan period. Thus, the real cost of the loan, i.e. its real interest rate, was exceptionally low, sometimes negative. Federal tax legislation also stimulated investments in agriculture as farmers were able to use cash accounting rather than accrual methods (thus, postponing the date of assessment for fiscal purposes) and were eligible for investment tax credits and accelerated depreciation.<sup>32</sup> Capital gains in physical assets, nominally in real estate, were considered, rightly in the short run, more than capable of offsetting the cost of borrowing to invest in those assets. They soared by 102 per cent in current dollars and 40 per cent in constant (1982) dollars between 1975 and 1980, before plummeting by 33 per cent in nominal terms and 51 per cent in constant dollars in the next seven years.(Table 3.6)

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<sup>30</sup> *The Economist*, 6 August 1983, p.

<sup>31</sup> See on this issue *Europe*, 28 October, 1982, n. 3475.

<sup>32</sup> See in particular, Barry J. Barnett, 'The U.S. Farm Crisis of the 1980s', *Agricultural History* 74(2000) p.369; Frederick H. Buttel 'The US Farm Crisis and the Restructuring of American Agriculture: Domestic and International Dimensions' in D. Goodman and M. Redclift, eds., *The International Farm Crisis* (London: MacMillan, 1993) p.51.

**Table 3.6 PHISICAL ASSETS OF THE US FARMING SECTOR (billion of dollars)**

	1975	1980	<u>current dollars</u>			1975	<u>constant (1982) dollars</u>			1987
			1985	1986	1987		1980	1985	1986	
Real estate	420.6	850.8	606.4	554	567.2	709.3	992.8	543.8	484.7	482.7
Non-real estate	125.2	213.3	190	181.6	190	211.2	247.7	170.4	158.9	161.7

Source: Economic Report of the President, 1990

Things changed radically in the first half of the 1980s with inflation slowdown and rising cost of debt. In 1980, despite steady growth in financial debt, the farm debt/asset ratio, the main leverage indicator, was 16.2 per cent. By 1985, despite the deceleration in current dollars and the decline in constant dollars of the outstanding debts, the ratio reached 22.2 per cent, falling slowly in the next few years (Table 3.7). However, as we shall notice, in both years the leverage ratio was much higher for large farms and lower for small farms. The main reason for the marked change was the plunge in real estate value rather than growing debt. Various factors contributed to the collapse of the farm land market: the fall in market prices and export contraction resulted in lower gross and net income, depressing expected farm rent. The inflation slowdown deprived real estate of its appeal as a refuge against financial asset devaluation. Finally, land value was affected by the increase in the real discount rate, influenced, in turn, by the higher rate of return in alternative investments and by interest rates paid on farmland.<sup>33</sup> A further upshot was that farmers had difficulties in getting their debts renewed because their prospective collateral had lost part of its market value.

**Table 3.7 FARM DEBT OUTSTANDING (Billion of dollars)**

	1975	1980	1981	<u>current dollars</u>					1987	<u>constant (1982) dollars</u>			
				1982	1983	1984	1985	1986		1975	1980	1985	1987
Farm debt total	91.5	178.7	195.4	203.1	206.5	204.4	188	166.8	153.3	154.2	208.5	168.6	130.5
Debt/asset ratio	15.9	16.2	17.7	19	19.7	21.5	22.2	21.1	18.9				
Real estate	49.9	97.5	107.2	111.3	113.7	112.4	105.9	95.8	87.4	84.1	113.8	94.9	74.4
Non-real estate	41.6	81.2	88.2	91.8	92.7	92	82.2	71	65.9	70.2	94.8	73.7	56.1

Source: Economic Report of the President, 1990

<sup>33</sup> See Luther Tweeten, 'Farm Financial Stress, Structure of Agriculture and Public Policy', in Bruce L. Gardner, ed., *Agricultural*, p. 98.

The impact of the upsurge in real interest rates was especially severe. Farmers who in the first years of the new decade took out new loans or renewed existing ones had to cope with interest rates which were not lower in nominal terms and were soaring in real terms. If inflation is the creditor's tax, deflation is the debtor's tax. Between 1973 and 1981 nominal rates on farm loans averaged 10 per cent, while real interest rates did not exceed 1.8 per cent. By 1983 nominal interests on Federal Land Bank loans reached 11.6 per cent and on rural bank production loans 15.7 per cent. In real terms they averaged 7.8 per cent and 10.5 per cent respectively.<sup>34</sup>

This is reflected in the trend of interest rate costs and their weight on total farm production expenses, shown in Table 3.8. Not only did interest costs soar in the period 1981-1983, but their share of general expenses grew concurrently, as other costs did not rise correspondingly due to slowing inflation and farming activity.

**Table 3.8 Interest rates as percentage of total farm production expenses.**

Year	1) Expenses of farm production US bill.	2) Interests US bill.	(1)/(2) %
1975	75.1	6.4	8.5
1977	189.0	8.5	9.6
1978	103.2	10.2	9.9
1979	123.3	13.1	10.6
1980	133.1	16.3	12.2
1981	139.4	19.9	14.3
1982	140.0	21.8	15.6
1983	140.4	21.4	15.2
1984	142.7	21.1	14.8
1985	133.7	18.7	14
1986	122.1	16.9	13.8

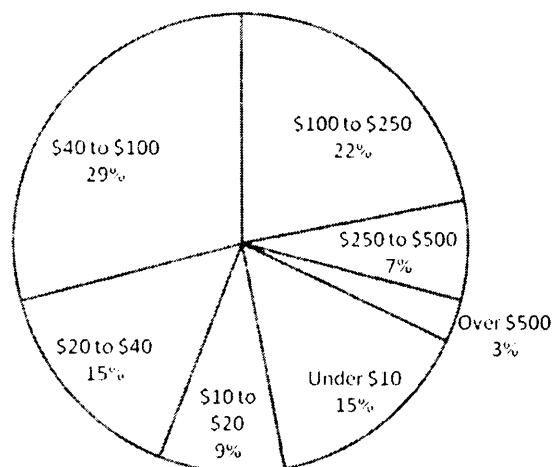
Source :Statistical Abstracts of the United States, 1988

Higher real interests on a large amount of outstanding loans coupled with declining cash flow made it increasingly difficult for farmers to service their debt. As of 1 January 1985 financially distressed farmers, i.e., with debts amounting to more than 40 per cent of assets and negative cash flow, averaged 12.5 per cent of the farm population and 45 per cent of farm operators'

<sup>34</sup> Ibid., p.95- table V.

debts.<sup>35</sup> The impact was rendered more severe by the uneven incidence of financial stress (Figure 3.3).

**Figure 3.3 Distribution of Financially Distressed Farms by Sales Class, January 1985**  
Sales classes in thousands of dollars



Source Economic Report of the President, February 1986

The brunt was borne by predominantly family-size commercial farms, which were both highly leveraged and undergoing declining rates of return on their investments. The US farm population of that period could be divided into three categories. Non-commercial farmers, i.e., those with sales below \$40,000 accounted for over 70 per cent of all farms but only generated 10 per cent of total gross farm income. A second class of farms with sales between \$40,000 and \$250,000 constituted about a fourth of all farms and accounted for about 41 per cent of all gross farm income. Finally, farms with gross sales of more than \$250,000 accounted for 4.1 per cent of all farms but generated almost half of the gross farm income.<sup>36</sup> Small farmers mostly relied on off-farm income to sustain their modest operations and held small amounts of debt. Farmers in the \$40,000-100,000 band, while still largely relying on off-farm income, had borrowed

<sup>35</sup> Economic Report of the President, February 1986, p. 133.

<sup>36</sup> Economic Report of the President, February 1987, p. 151; See also George L. Brinkman, 'Structural Change in Canadian, United States and European Agriculture' in Hans J. Michelmann, Jack Stabler and Gary Stoney, eds, *The Political Economy of Agricultural Trade and Policy* (Boulder: Westview, 1990) p. 102.

heavily to invest and about 27 per cent of them had a debt/asset ratio of over 40 per cent. 33 per cent of farmers in the \$100,000-250,000 sale class had an equivalent ratio. Actually, the percentage of farmers with a ratio exceeding 40 per cent was even higher in the \$250,000-500,000 sale class reaching 38.3 per cent, but most of them managed to break even thanks to their high asset returns. Thus, over 50 per cent of the distressed farms belonged to the \$40,000-250,000 sale class, that is, the hard core of family-size commercial farmers.<sup>37</sup>

Financial problems were also concentrated in the traditional grain-producing areas of the U.S., the Corn Belt, the Lake States and the Northern Plains. In other words, in spite of the limited number of people directly affected, their financial problems had the potential to turn into a political problem.

Difficulties were not confined to farmers. The other side of the coin was the severe strain imposed not only on the Farmer Home Administration (FmHA), the Agriculture Department's lending arm and on the farm credit system, but also on those commercial banks that had lavishly provided credit to farmers in better times and had a consistent amount of outstanding farm debt in their portfolios.<sup>38</sup> The crisis claimed many casualties. As Belongia and Gilbert point out, while in the 1943-1981 period not more than 17 commercial banks failed in a single year, from 1982 the failures went on increasing, reaching 144 in 1986 with a marked concentration among agricultural banks: about half of the 360 banks that failed between 1984 and 1985 were agricultural banks.<sup>39</sup> Despite the weaknesses in their balance sheets, no official demand for help was made until 1985, and the Administration was careful to limit its attention to the FmHA. By spring 1985, however, the extent of the burden on the banking system had become apparent and the most affected banks were poised to cry the farm credit system, the cooperative network holding over 35 per cent of the nation's \$210 billion farm debt declared that the system was under more stress than since the Great Depression. In September, the influential *Wall Street Journal* announced that the federal farm credit system was seeking a federal bail-out for its \$74 billion loan

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<sup>37</sup> Statistical Abstracts of the United States, Farm and Farm Debt-Percentage Distribution by Debt/Asset Ratio, various issues; Sally H. Clarke, *Regulation and the Revolution in the United States Farm Productivity* (Cambridge, Cambridge University press, 1994), p.259.

<sup>38</sup> *CQ Weekly*, Nov.16,1985, p. 2366.

<sup>39</sup> An econometric analysis of the crisis is provided by Michael T. Belongia and R.Alton Gilbert, 'Agricultural Banks:Causes of Failure and the Condition of Survivors' *Federal Reserve Bank of St. Louis Review*, 69(1987) p. 30.

portfolio.<sup>40</sup> Rumours also ran that the federal farm credit system could soon be joined in its appeal by those commercial banks which held a further \$51 billion share of the farm debt.

### **3) The uncertain reply**

In 1983, the Administration tried to persuade Congress to block scheduled increases in target prices in an attempt to push through a new version of its cost-cutting proposal. It was not successful. The House Agriculture Committee discussed the request in May but postponed action indefinitely. The Executive had more luck with the Senate Agriculture Committee which in June approved a target price freeze. However, opposition from farm state senators prevented formal floor debate indefinitely.<sup>41</sup>

The main problem with which the Administration, therefore, confronted was how to curb the mounting and increasingly costly stock of agricultural produce. The initial response was far from the free market approach the Executive had claimed to pursue. In short, in order to realise its wider objectives the Reagan Administration adopted the strategy of avoiding a clash with Congress on a particular item, which in the end led to unwarranted increases in budget outlays.

In 1983, in the hope of winning congressional approval for the freeze of target prices, Agriculture Secretary John Block gave his backing to the so-called 'paid diversion dairy plan', though he withdrew his support in the final part of the congressional session. Reagan was not favourable to the programme, noting that paying farmers for not producing contradicted his free market philosophy. His economic advisers were opposed to the bill as it increased pressure on the budget. The President, however, refrained from vetoing it. One reason, perhaps the main one, was that it also included some provisions on price support for tobacco. Thus, a veto would have dealt a serious blow to one of the President's early southern supporters, Senator Jessie Helms, who was running for re-election in North Carolina. An alternative proposal put forward by Republican Representative Conable, with the blessing of the American Farm Bureau, which would have simply reduced the federal dairy price support, causing supply to fall, was not

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<sup>40</sup> *The Wall Street Journal*, September, 5, 1985.

<sup>41</sup> *CQ Almanac*, 1983, p. 383.

upheld. The new law, which authorised payments to dairymen to 'produce less' was signed by the President on November 28<sup>th</sup>, 1983.<sup>42</sup>

The same interventionist philosophy underlay the Payment in Kind (PIK) plan, though the programme did not need Congressional approval as it was based on existing statutory authority. The PIK, which covered wheat, corn, sorghum, rice and cotton, aimed to kill two birds with one stone by curbing production and reducing inventories. Under this regime farmers who agreed to retire an additional 10 per cent to 30 per cent of their land, would receive a payment in kind equal to an established quantity of the commodity normally grown on the property (95 per cent of yield per acre for wheat and 80 per cent for other crops). The payment was taken either from government stocks or from crops used as collateral for CCC loans. Coupled with the severe drought of 1983, the PIK allowed a 50 per cent reduction in grain stocks in 1984, but inventories climbed again a year later.<sup>43</sup> To make the programme more attractive, on request of the Executive, Congress added some fiscal bonuses to the scheme, allowing deferral of tax payment until the farmer sold the commodity.<sup>44</sup> However, the Administration itself warned that the PIK had drawbacks in the international market, as production cuts at home were likely to stimulate extra-production by competing countries. Once again the Executive was emphasising that government interference with the free play of the market had spillover effects beneficial to foreign competitors and, therefore, detrimental to American producers.<sup>45</sup>

However, with the forthcoming expiry date of the 1981 Agricultural and Food Act, the Administration resumed its pressure on Congress for a radical reform of farm legislation. In 1984, the Executive finally succeeded in pushing through a law (PL 98-258) which imposed a freeze on target price increases for 1984 and 1985.<sup>46</sup> At the beginning of Reagan's second term in office, on 23 February 1985 the Administration asked Congress to eliminate or radically curtail the network of income and price support plus production control that had marked

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<sup>42</sup> *CQ Almanac*, 1983, p.375.

<sup>43</sup> *CQ Almanac*, 1983, p. 381.

<sup>44</sup> U.S. Code Congressional and Administrative News, 98<sup>th</sup> Congress, Second Session – Legislative History. *Payment in Kind Tax Treatment Act of 1983. House Report n.98-14.*

<sup>45</sup> Robert Paarlberg, 'The Political Economy of American Agricultural Policy: Three Approaches', *Amer. J. Agr. Econ.*, 1989, p. 1162.

<sup>46</sup> *CQ Weekly Report*, April 7, 1984, p. 783; *CQ Almanac 1984*, p.361.

the American farm policy since the Roosevelt reform.<sup>47</sup> The Executive gave the bill the provocative heading of Agricultural Adjustment Act, the same as that adopted in 1933. Block explained before the House of Representatives' Committee on Agriculture that the 'aim of the Executive was to set a new course for agricultural policy'. He pointed out that the 1933 Act, which laid the groundwork for the ongoing farm programmes 'was the government's response to an unprecedented crisis,...but it is apparent that the New Deal programs are not working for today's agriculture'. According to Block, agriculture should not be a sector severed from the rest of the economy by market-distorting protection but must recognise its full integration and contribution to the general economic environment, as factors other than price and income support, like interest rates and inflation had greater impact on farmers' welfare.<sup>48</sup> In other words, Block was suggesting that by causing pressure on the budget the ongoing farm programmes contributed to the ills affecting farmers' costs and, on the other hand, prevented them from aggressively competing in the world market.

In particular, the bill required that loan rates be cut to about 75 per cent of average market levels over the previous three years. It also required farmers to repay the loans, at least partially, within a set time instead of defaulting if they chose. This meant that farmers had to take into account only the market and its prices with no viable alternative. Secondly, target prices had to be phased down by 5 per cent a year until they reached the loan rate and deficiency payments would stop completely. Finally, payments for acreage reduction had to be phased out.

As expected, the Executive's proposal for a far-reaching dismantlement of the 50-year-old farm regime was not enthusiastically received by Congress. Daily news of the worsening of the farm crisis with its impact on the whole economy of farm communities, and the fact that quite a few Senators and Representatives from farming states were up for re-election in 1986, did not help the

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<sup>47</sup> *CQ Weekly Report*, March 2, 1985, p. 1985.

<sup>48</sup> U.S. Code Congressional and Administrative Service, 88<sup>th</sup> Congress – Legislative History. *Food Security Act (P.L. 99-198) Statement by John R. Block Secretary of Agriculture Before the Committee on Agriculture U.S. House of Representatives.*

Administration's projects.<sup>49</sup> The President repeatedly threatened to veto any bill that would load the budget beyond a set threshold.

A pre-eminent role in finding a compromise formula that would not run counter to the Administration's basic goals, while not accepting its most radical provisions, was played by Senator Robert Dole, Republican majority chairman in the Senate and member of the Senate Agriculture Committee. His counterpart in the House of Representatives, the Democrat Tom Foley, also showed a certain amount of flexibility. The result was a 'limited win to all sides'.<sup>50</sup> The law, which had the less ambitious title of Food Security Act (PL99-198), reauthorized the basic set of farm programmes, which, however, were significantly reoriented towards market forces. Loan rates were set at 75 per cent of a moving average of market prices, excluding the higher and lower years, which meant that they would move up and down according to market trends. For the 1986 market year, loan rates were permitted to fall by 25 per cent. Payment in kind was authorised for a number of farm programmes, including deficiency payments, land diversion and export subsidies. Target prices were frozen for one or two years, according to the commodity and later allowed to decline. In the short run this latter provision did not help reduce budget deficit. Indeed, as loan rates fell below market prices the gap with the target price and, therefore, the amount of deficiency payments rose.<sup>51</sup> The overall projected cost was \$100.6 billion over the next five years, the bulk of which stemmed from price and income support programmes, which totalled \$69.4 billion. Analogous programmes under the 1981 Agriculture and Farm Act cost \$54.7 over the life of those measures.

The market-oriented reform of the domestic market was accompanied by a set of provisions designed to assist exports through subsidisation. They included additional funding for traditional programmes, such as credit assistance and food aid, as well as new programmes described in more detail in the next chapter, such as the Export Enhancement Program and the Targeted Export assistance Program. The goal of these programmes was to recapture export markets lost, in the opinion

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<sup>49</sup> *CQ Weekly Report*, September 25, 1985, p. 1919; *CQ Weekly Report*, November 16, 1985, p. 2365.

<sup>50</sup> *CQ Almanac*, 1985, p.517 et seq.; Robert L. Thompson, "Recent Developments in United States Agricultural and Food Policy", *Journal of Agricultural Economics* 37(1986) p. 312.

<sup>51</sup> See Bruce L. Gardner, 'Farm Policy and the Farm Problem' in Philip Cagan, ed., *Essays in Contemporary*, p. 245.

of both Administration and Congress, because of unfair foreign competition. The main target was obviously the European Community.

A similar approach on the part of the Administration and similar developments can be found in the handling of farm financial stress. On March 5<sup>th</sup>, 1985 the House of Representatives cleared a bill which provided \$100 million to reduce interest rates on private loans and allowed farmers early advances on federal loans. The rescue plan had been hurriedly attached to a bill providing for non-food emergency aid for Africa. The President promptly vetoed the bill, arguing that severe liquidity problems affected only a minority of farmers, and accused Congress, nominally the Democrats, who had endorsed the rescue programme, of having failed 'in its first major test of bringing spending under control'.<sup>52</sup> Nine months later the President signed into law a programme to rescue the Farm Credit System, worked out on a fast track by the Senate and the House of Representatives after the official confirmation in September of the serious losses faced by the system.<sup>53</sup> The law reorganised the Farm Credit System and prepared the ground for its bailout. The reform gave more supervisory powers to the Farm Credit Administration and created a new institution, the Farm Credit System Capital Corporation, which was to have wide-ranging powers to provide financial assistance to member banks and take over their non-performing loans. The legislation did not appropriate additional funds for the system but gave the Treasury Department discretionary authority to provide assistance by purchasing obligations of the Capital Corporation.<sup>54</sup> Additional capital was later provided by the Agricultural Credit Act of 1987, which also carried out further restructuring of the Farm Credit System. In addition the Act provided assistance to financially distressed farmers by allowing the restructuring of loans from the Farm Credit

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<sup>52</sup> Public Papers of the Presidents of the United States – Ronald Reagan, 1985. *Remarks and a Question Answer Session with Reporters on Signing the Veto Message for the Farm Credit and African Famine Relief Bill*, March 6, 1985, p.248; *CQ Almanac*, 1985, p.542; *Herald Tribune*, 7 March 1985.

<sup>53</sup> *The Wall Street Journal*, December, 18, 1985. *The Wall Street Journal*, December 19, 1985.

<sup>54</sup> U.S.Code Congressional and Administrative News. 99<sup>th</sup> Congress, First Session 1985 – Legislative History. Farm Credit Amendments Act (P.L. 99-205) – House Report n. 99-475; Neil E. Harl, *The Farm Debt Crisis of the 1980s* (Iowa State University Press, 1990) p. 137.

System and the Farmers Home Administration where restructuring was no more costly to the lender than foreclosure and liquidation.<sup>55</sup>

## Conclusion

What can we infer from the foregoing? If we look at the broad picture of economic developments we can argue, with some confidence, that there is no single dominant explanatory factor of the American farm crisis of the 1980s. Undoubtedly the 50-year-old framework of US farm policy contributed to weaken American competitiveness in the changed environment of the 1980s, by creating a protected outlet for American produce at taxpayers' expense rather than forcing farmers to compete in the world market. On the other hand, it could be argued that by so doing the system also provided a lifeline to many farmers at a time when prices were falling and debts were rising. External factors also contributed, from the slack in world demand to competition often subsidised from other countries. But macroeconomic factors of domestic origin also had their impact, stemming from the contradiction of the US economic policy in the Reagan era. In particular high real interest rates affected US competitiveness through the excessive strength of the dollar. On the other hand, they also triggered the farm financial stress.

Nor is there any absolute proof that, in spite of its rhetoric, the Administration was unconditionally bent on dismantling the fabric of farm programmes dating back to the 1930s. Indeed, the Reagan Administration, despite its frequent proclamations in favour of a balanced budget, could be labelled as weak in containing spending. It is possible that the Executive when it was asking for one hundred knew very well in advance that it would obtain fifty, and, therefore was satisfied from the very beginning with such results.

However, if we take events at face value, the odds are dominantly in favour of the thesis that the Executive eagerly pursued the curtailment of farm programme expenditures and the reshaping of the old system. After all, even though agriculture contributed quite little to the federal budget's financial gap, it set a bad example with its growth rate far higher than that of the other outlays, including national defence and interest on the federal debt. First and foremost, it

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<sup>55</sup> U.S. Code Congressional and Administrative News. 100<sup>th</sup> Congress, First Session 1987 – Legislative History. *Agricultural Credit Act of 1987 (P.L. 100-233) House Conference Report n. 100-490.*

was a patent denial of the free market philosophy endorsed by the Executive and one of the pillars of the Democrats' economic policy. It seems, therefore, that the reform was resisted by Congress and the Administration had to accept the deal as the best possible outcome in the short run.

Within this framework it is foreseeable that the Executive should look for means to dodge round such resistance. We must, therefore, consider the events following the 1985 reform to see which of the alternative interpretations are borne out.

## CHAPTER IV

### COMMON AGRICULTURAL POLICY PROBLEMS (1981-1986)

#### 1) The issues at stake

The years of the US farm crisis also witnessed great strains on the EC's CAP. The two crises shared certain points, but overall the picture on the East side of the Atlantic, though gloomy, had quite distinct features regarding causes and developments.

The attainment of self-sufficiency in agricultural produce and its overrun accelerated in the early 1980s. The main temperate zone farm produce exceeded the 100 per cent threshold, though with great variance between member countries (Table 4.1).

**Table 4.1 Degree of self-sufficiency in certain agricultural products (EC 10)**

	wheat	Maize	total cereals	Veg. Oils and fats	Poultry meat	pork	beef and veal	whole-milk powder	butter	sugar
1973/74	104	55	91	81	102	100	96	231	98	105
1980/81	126	66	105	38	111	101	104	378	114	125
1985/86	132	94	121	59	107	102	108	334	133	135

Source: The Agricultural Situation in the Community. 1987 Report

The main overproduction problems lay in the dairy sector, which constituted around 20 per cent of total agricultural production in the European Community. During the previous decade deliveries to dairies had increased by a yearly 2.6 per cent average leading to problems of excessive stocks and pressure on the budget. In 1983 a growth record of more than 3 per cent was reached. As consumption had been growing more modestly (0.5 per cent on average), the gap between supply and domestic demand was bound to increase. The unsuccessful attempts to get rid of milk and dairy products surplus (commonly known as the butter mountain) led to bizarre expedients that put pressure on the Community's budget: payments for milk produce rose by 63 per cent between 1981 and 1984. Among the favourite devices were subsidised sales to the food industry and periodical Christmas butter campaigns, which, however, contributed little to the disposal of surpluses, as consumers would store the concessionary butter and

reduce future purchases accordingly.<sup>1</sup> Another method to reduce surplus was subsidised export, prevalently to the Soviet Union. But butter sales to the Soviets, which had reached a peak of some 500,000 tonnes per year, including food aid, over the 1979-81 period, subsequently declined.<sup>2</sup> At the end of the 1983-84 market year butter stocks had surpassed 1,250,000 tonnes.

The second group of products in the self-sufficiency line were cereals. Here, however, self-sufficiency was not equally distributed. Whereas high levels of milk product supply were common to most of the member states, it was only France that achieved a self-sufficiency level in cereals comparable to that of the United States, followed by the United Kingdom and Denmark. Thus, French Agriculture ministers and farm organisation leaders repeatedly stressed the Republic's export vocation, having, obviously, in mind those sectors, like cereals, where the country's production capacity was particularly strong.<sup>3</sup> France, followed at a distance by Germany and the UK was the main beneficiary of EC cereal budget expenditures. However, leading agricultural economists argued that major French grain farmers could withstand lower prices without dire economic consequences as they had sufficiently high rates of return on their labour and capital.<sup>4</sup> Thus, they were able to compete with their trade partners on a level playing field, or at least on a more level playing field than other European farmers. It is, then arguable that the French model for export promotion was no longer exclusively grounded on EEC scheme assistance, but looked with growing interest at the American pattern, that is, a regime of country-to-country trade agreements, often supported by the provision of export credit. In 1982 the European Commission threatened to take France to the European Court of Justice, France having concluded an agreement with the Soviet Union for the provision of grain, bypassing the Commission's competence under Article 113 of the Rome Treaty, which conferred exclusive rights on questions of foreign trade to the Community.<sup>5</sup>

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<sup>1</sup> Alfred S. Friedeberg, 'Milk Surpluses till the Cows Come Home?', *The World Economy*, 7(1984) n. 4, p. 424.

<sup>2</sup> *Ibid.*, p. 423.

Alfred S. Friedeberg, 'Is an Olive Oil Lake to Join the Butter Mountain?', *The World Economy*, 3 (1980) n. 3, p. 346.

<sup>3</sup> *Le Monde*, 18 May 1983, p.2.

<sup>4</sup> Denis Bergmann, 'French Agriculture. Trends Outlooks and Policies', *Food Policy*, 8 (1983), p. 281.

<sup>5</sup> *Agra Europe*, October 22, 1982, n. 1002, P/3. *Agra Europe*, November 19, 1982, n. 1006, N/2.

Cereals and milk, sugar beet and meal programmes mostly benefited the Northern countries and France. Such programmes received the bulk of EEC farm price guarantee expenditures. However, contrary to general opinion, the Mediterranean countries did not fare badly. Despite the low development of temperate-zone agriculture, Italy managed to capture a robust share of the European Guidance and Guarantee Fund (EAGGF), the farm section of the EC budget, at times surpassing the Federal Republic of Germany as second main beneficiary after France. Greece, in turn, soon fared better in obtaining EC budget funds than farm exporting Nordic countries, like Denmark and Ireland. The products that favoured the Mediterranean countries were olive oil and in Italy also wine, in competition with France and later Spain. Between 1975 and 1981 budgetary expenditures on olive oil had almost trebled and the Commission started to fear that with the entry of Spain, the second major producer after Italy, and Portugal it would face growing surpluses.<sup>6</sup>

The situation was made more complicated by loopholes in the variable levy regime which allowed the importation of low cost competing products, thus preventing domestic production from finding the expected outlet in the Common Market. During the Dillon Round the European Community had bound its tariffs for grain substitutes, more specifically manioc gluten feed and citrus pellets, at zero or near zero level. Thailand had become the main producer and exporter of manioc, followed by Indonesia and Brazil. The US was the major exporter of corn gluten feed, a by-product of the wet corn milling industry, and citrus pellets, a by-product of the citrus juice industry. Due to their content of carbohydrates and protein they represented a valuable substitute for feed grains. Since they were cheaper than EC cereals, whose market price was shored up by the CAP's price support mechanism, breeders in Northern Europe, but also in France, imported them in large quantities, thus, adding to the EC grain surpluses.<sup>7</sup> The same was true for oil seeds and vegetable oils - soybeans, rapeseeds, sunflowers, palm and coconut oil. These products were an important ingredient for margarine and edible oil. Palm and coconut oil was largely produced in Asia, Malaysia being the main

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*Europe*, 28 October, 1982, n. 3475.

<sup>6</sup> Alfred Friedeberg, 'Olive Oil in the EC. Gift from the gods or Trojan Horse?', *Food Policy*, 8 (1983) n.1, p. 15.

<sup>7</sup> In particular Ulrich Koester et. al, *Disharmonies in EC and US Agricultural Policy Measures* (Luxembourg: Office for Official Publications of the European Communities, 1988) Chap. IV.

exporter. So ybean production was mostly concentrated in the United States, Brazil and Argentina. Europe was far from reaching self-sufficiency, but with the help of producer subsidisation since the 1970s, production of rapeseeds and sunflowers had grown rapidly and France was among the main world exporters. Seeds, and in particular soy, were also a valuable feeding stuff and, therefore, a substitute for feed grains. Thus, oil seeds and vegetable oils competed with olive oil, potentially contributing to its looming costly surplus.<sup>8</sup> Even more complex, and treacherous, was the interaction between oil seeds and dairy products. As a low cost feeding stuff, the former encouraged cattle breeding and, therefore, helped boost milk production. As oil, however, they competed with the main milk derivative, butter, thus indirectly increasing the butter mountain.<sup>9</sup>

The growing imbalance between supply and demand caused pressure on the EC budget, as the growth of farm expenses, the bulk of budgetary costs, outgrew the increase in budget revenues.

Arguably, growing surpluses and increasing budgetary expenditures were the price the European Community had to pay to stabilise its farmer's income. Overall, after a dip between 1973 and 1975, the net value added per work unit in the agricultural sector remained constant in real terms over the ten-year period from 1975 to 1985 (Table 4.2).

**Table 4. 2 Indices of Real Net Value Added At Factor Cost Per Annual Work Unit (AWU) 1973-1985**  
1980= 100

	1973	1975	1977	1979	1980	1981	1982	1983	1984	1985
<b>B*</b>	116.2	97.3	95.3	93	98.5	1085	113.5	123.3	118.1	114.9
<b>DK*</b>	111.6	84.8	99.6	91.8	98.7	109.5	130.2	111.8	149.8	139.9
<b>F*</b>	131.1	107.9	106.8	110.2	96	93.8	112.1	104.3	106.8	103
<b>FRG*</b>	128.8	122	122.7	107.1	94	98.9	117.9	95.7	111.8	97.9
<b>GR*</b>	80.1	79.8	83.7	89.9	102.1	108	112.8	101.4	113.9	116.3
<b>IRL*</b>	108.1	115.2	135.4	110	92.7	97.4	105	109	126	117.3
<b>IT*</b>	91.1	94.2	94.6	103.7	100.6	95.7	96.8	101.6	96.8	94
<b>L*</b>	108.9	98.6	108.5	103.8	94.5	101.7	138.8	118.7	118.5	118.5
<b>NL*</b>	112	102.4	105.5	95.6	91.8	112.6	118.6	116.4	121.7	114.8
<b>UK*</b>	129.4	113.9	111.9	103	95.6	101.4	111.8	101.9	120.4	99.4
<b>EC - 10</b>	112	103.1	104.2	103.6	97.3	99.1	109.3	103.6	109.3	102.8

1980 = (1979+1980+1981) : 3

\* B=Belgium; DK = Denmark; F = France; FRG = Federal Republic of Germany; GR = Greece; IRL = Ireland; IT = Italy; L= Luxembourg; NL = The Netherlands; UK = The United Kingdom.  
Source:Eurostat. Agricultural Income. 1986

<sup>8</sup> Kevin Parris and Christopher Ritson, *EEC oilseed product sector and the Common Agricultural Policy* (Ashford Kent: Wye College-Centre for European Agricultural Studies, 1977) p. 35 et seq.  
Pierre Lelong, 'Quelle Politique Agricole Commune' in Jan Raux, ed., *Politique Agricole*, p 360 et seq.

<sup>9</sup> Kevin Parris and Christopher Ritson, *EEC oilseed*, p. 47.

However, firstly the trend varied greatly from country to country; the indicator fell in Germany, France and the UK, it was relatively stable in Italy and Ireland, while rising in Greece, the Benelux and Denmark. Secondly, income stability per work unit masked a steady decrease in the sector's total added value (Table 4.3), despite increased productivity, which was only offset by an equally steady decline in agricultural workforce.<sup>10</sup>

**Table 4.3 Net value added of the farm sector (real:100 = average for 1979/80/81) 1975-1985**

1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985
115	116	112	112	106	97	97	104	97	99	81

Source: The Agricultural Situation in the Community. 1986 Report

There was, therefore, an element of similarity with the US experience. However, in contrast with the United States, EC farm income was not affected by any remarkable export drop. Exports of farm produce in 1985 declined by 15 per cent relative to the 1981 peak but they were still higher than in 1979 and had almost trebled compared to 1973 (Table 4.4).

**Table 4.4 External EC Trade: Exports of Agricultural Products 1973-1985 (US\$ Bill.)**

1973	1975	1977	1979	1980	1981	1982	1983	1984	1985
9.6	11.6	14	22.5	28.8	30.8	26.4	24.9	26.2	26.6

Source The Agricultural situation in the Community: 1985 Report: 1986 Report

The deviation of the income trend among member states was further widened by the system of Monetary Compensatory Accounts (MCAs) created to offset the divergence between the green exchange rate (used to convert into national currencies the Common prices fixed in Units of Account and later in European Currency Unit) and the national currencies' rate of exchange as determined by the market.<sup>11</sup> France was pressing for the abolition of the MCA regime, as it prevented its farmers' income from rising in proportion to the devaluation of the French Franc, in contrast with the other sectors of the French

<sup>10</sup> The Agricultural Situation in the Community. 1986, p. 120.

<sup>11</sup> See Chap. I, section 2.

economy. This discouraged investments, and handicapped the process of agricultural modernisation. Germany opposed the elimination of MCAs as they bolstered its farmers' income despite the growing strength of the Mark. France's claims were, however, in line with the European Commission's perspective as the complex system of subsidies and levies characterising the MCA mechanism contradicted the very principle of market unity on which the CAP was supposedly grounded and created heavy administrative costs.

## **2) The initial response of the Community bodies.**

The first systemic attempt of the European Commission to identify the causes of the perverse effects of the CAP and ways to secure a more balanced farm regime can be traced back to its December 1980 'Reflections on the Common Agricultural Policy', even though proposals for a sectoral reform of the CAP had already been made and sometimes implemented in the 1970s.<sup>12</sup> This was followed by the Commission's 'Report on the Mandate of 30 May 1980' and on the 'Memorandum' of October 1981 on the guidelines for European agriculture.<sup>13</sup>

The Commission centred its criticisms on the absence of a regulatory mechanism to balance supply and demand and on the concentration of CAP benefits on the largest producers and most prosperous regions. It also noted that the continuous increase of farm production had engendered uncontrollable increases in budget expenditures without benefit to farmers. Thus, according to the Commission 'in the present stage of agricultural technology it is neither economically sound nor financially feasible to guarantee price or aid levels for unlimited quantities',<sup>14</sup>

The suggested remedy was based on two concurrent elements: 'guarantee thresholds' and 'producer co-responsibility'. Unrestricted price guarantee and income support could only be allowed for limited amounts of supply above which

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<sup>12</sup> Communication from the Commission to the Council. *Reflections on the Common Agricultural Policy*. Com. (80) 800 final (5 December 1980).

<sup>13</sup> *Commission Report on the Mandate of 30 May 1980*. Com. (81) 300 (24 June 1981)  
Communication from the Commission to the Council. *Guidelines for European Agriculture. Memorandum to complement the Commission's report on the mandate of 30 May 1980*. Co. (81) 608 final (23 October 1981).

<sup>14</sup> Com. (80) 800 final, para 26.

farmers shared in the cost of surplus disposal. Farmer co-responsibility then aimed at allowing the Community to better adjust to budgetary constraints.

In its October 1981 'Memorandum', the Commission suggested that yearly guarantee thresholds be fixed according to medium-term prospects, adopting a five year horizon. The guarantee thresholds were, thus, aimed at securing a balance between supply and demand at the end of the period, regarding both domestic consumption and international demand. Since the new regime would take effect from the farm year 1982-83, the benchmark was 1988.<sup>15</sup>

The guarantee threshold and co-responsibility mechanism could be implemented according to various formulas, varying from one commodity to another.<sup>16</sup> The scheme was, however, to apply to a limited number of farm products and was not an absolute novelty. Sugar quotas dated back to 1967 and milk was subject to a levy system from 1977. Limits on the increase of the guaranteed price were established for cereals from the 1982-83 market year.

A scholar has cunningly remarked that the method adopted for cereals was not synonymous with decline in the price guaranteed to farmers but meant only a reduction in price increase if the threshold was exceeded in the previous years. Thus,

the grant of a robust price increase could completely offset the penalty.<sup>17</sup> Actually a second plank of the Commission's proposals for the reform of the CAP was prudent price policy which should consider price trends in the main competitors' markets. But, 'the Commission proposes and the Council disposes', and proposals by the Commission for moderate increases or even reductions in nominal farm prices were frequently opposed or delayed by the Council and, therefore, malfunctions which they should address were allowed to worsen.<sup>18</sup>

On the other hand the Commission pointed out that since restraints were imposed on EC farmers the principle of Community preference must be

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<sup>15</sup> Com.(81) 608 final, para. 12.

<sup>16</sup> Nominally: a) limiting the increase in the target or intervention price if production exceeded a certain amount; b) reducing the amount of aid available under the CAP if production exceeded the threshold; c) imposing an overall limit on the amount of aid payable in connection with the market organisation; d) imposing a contribution, by means of a levy, to the cost of disposing of any additional production; e) setting a production ceiling, i.e. a quota, on each member state or undertaking.

<sup>17</sup> Rosemary Fennel, *The Common Agricultural Policy. Continuity and Change* (Oxford: Clarendon Press, 1997) p. 161.

<sup>18</sup> Malcom D. Bale and Ulrick Koester, 'Maginot Line of European Farm Policy', *The World Economy*, 6 (1983) n. 4, p. 378.

strengthened to reduce the inflow of competing foreign products wherever the Community was limiting its own production. The other side of the coin was the suggestion of greater Community involvement in export promoting policies, like long term contracts, based on the US pattern, which would secure the export of established amounts of EC produce for a given period at conditions attractive to importing countries.<sup>19</sup>

The Council's initial response was lukewarm. The CAP reform scheme was reproduced in the Commission's proposals for the farm year 1981-82 price review, but the relatively moderate 7.8 per cent average price increase proposed by the Commission was raised to 11 per cent in national currencies by the Council.<sup>20</sup> On average, farm income had deeply declined in real terms in 1980 and, therefore, it would have been politically unsound not to provide generous farm prices. Moreover, the date of the French presidential election was nearing, and President Giscard d'Estaing's Government did not want to antagonise farm voters. The already existing co-responsibility levy on milk and milk products was increased to 2.5 per cent. However, the Council, while agreeing in principle to co-responsibility measures in the cereal sector, decided to postpone their implementation.<sup>21</sup> Later, France voiced its opposition to a co-responsibility levy not accompanied by appropriate measures to stem imports of grain substitute products.<sup>22</sup>

Only France endorsed the proposal for long-term export contracts. Germany and the UK criticised the scheme since it would entail further pressure on the budget. The other members remained indifferent.<sup>23</sup> A year later, however, the Council adopted the proposal for guaranteed thresholds in the cereal sector during the market year 1982-83 price fixing session. The new regulation provided that if average production in the previous three marketing years exceeded the threshold of 119.5 million tonnes, the intervention and reference prices would be reduced in the following market year by 1 per cent for every million tonnes beyond the threshold, up to a maximum of 5 per cent. However, if imports of

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<sup>19</sup> Nicholas Butler, 'The ploughshares war between Europe and America' *Foreign Affairs* 62(1983-84) p.113.

<sup>20</sup> Draft minutes of the 701<sup>st</sup> meeting of the Council (30 March-1 April, 1981), p.4.

<sup>21</sup> Ibid., Annex I, p. 3, p.9.

<sup>22</sup> Draft minutes of the 704<sup>th</sup> meeting of the Council (12 May 1981), p. 12.

<sup>23</sup> *Agra Europe*, October 23, 1981, n. 951, P/3.

substitute products exceeded 15 million tonnes, the threshold would be increased by the amount of the imports overrun.<sup>24</sup>

Subsequently, the Community signed voluntary export restraint agreements (VER) with Thailand, Indonesia and Brazil allowing the Community to impose a tariff quota to imports of manioc from developing countries. A 6 per cent levy was applied to imports within the agreed quota, while any additional quantity would be subject to the levy applicable under the common organisation for the market in cereals, that is, the rather impermeable variable levy regime.<sup>25</sup> The Commission, thus, forced those developing countries that were the main exporters of manioc into an agreement which, despite its name, was not really voluntary, probably using the stick and the carrot of prospective trade restrictions and development aid. It was still necessary to deal with other cereal substitutes, like corn gluten feed, citrus pellets, and soybean, where the major exporter was not a developing country but the United States. The Commission requested authorisation from the Council to open consultations within the GATT to renegotiate the tariff concessions applied to such products, a move bound to meet fierce American resistance.<sup>26</sup>

### **3) The interaction between budget and farm policy problems**

*From the Commission's angle.*

The marketing year 1981-82 price review marked the end of the long-lasting alliance between the Commission and pan-European farm lobby organisations, the Confederation of European Farmers' Unions (COPA) and the General Confederation of European farmers' Cooperatives (COGECA). While in previous years these two actively and gladly contributed to the Commission's price proposals, overtly defending farmers' income, from 1981 onwards the confederations became bitterly critical of such proposals viewed as threatening the economic viability of peasants' lives.<sup>27</sup> Member states' farmers, therefore, concentrated their lobbies on their national governments and on the European

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<sup>24</sup> Bull. EC 4-1982, point. 2.1.78.

<sup>25</sup> The Agricultural Situation in the Community, 1982, p. 68; Bull. EC 7-1982, point. 2.1.91.

<sup>26</sup> Bull. EC 4-1982, point 2.1.51.

<sup>27</sup> *Agra Europe*, February 20, 1981, n. 915, E/2. *Agra Europe*, 20 November 1981, n. 955, E/3.

Parliament rather than establishing a dialogue with the European Executive through the above-mentioned confederations.

This could suggest that since the onset of the 1980s the Commission had focused on rationalising the Common Agricultural Policy and had lessened its links with farm lobbies. Such a pattern would appear to fit better into the rational choice model than the public choice analysis, which seems adequate to explain the close relationship between farm groups, the European Commission and the Council during the 1960s and 1970s.<sup>28</sup> However, the range of problems addressed by the Commission was quite limited and specific: overproduction; budgetary strains; ways to preserve farmers' income; enhancement of Community preference. Other issues, like the overall cost of the CAP and its consumer impact were not addressed.<sup>29</sup> The Commission's new approach to the CAP, in keeping with public choice theory, did not question the predominance of farmers' interests over those of competing groups. Indeed farmers' organisations preserved their competitive advantage in terms of homogeneity of members' preferences and because of the structure of the agricultural sector, characterised by lower mobility than other economic sectors especially in a period of growing unemployment like the 1980s.<sup>30</sup>

Why, then, did the European Commission pursue a policy that did not meet the immediate interests of the farm constituency? Was the rationalisation of the farm sector a goal in itself or was it determined or fostered by other factors? Actually, the Commission not only found it unmanageable to stock and dispose of growing farm surpluses – the part of the story that most attracted public attention – but, more importantly, the costs generated by this severely curbed Community leeway both regarding the management of agricultural programmes and with respect to the implementation of concurrent programmes financed by the Community's budget, like the Social Fund and the Regional Fund. The 1981 Memorandum points out that from 1975 to 1979 the growth rate of the EAGGF guarantee expenditure – which, on average, slightly exceeded 70 per cent of total expenditures – was 23.3 per cent, falling to around 10 per cent a year from 1979

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<sup>28</sup> See Peter W.B. Phillips, *Wheat, Europe and the GATT* (London: Pinter, 1990) p.85 and seq.

<sup>29</sup> For an overall approach to the cost of farm policies in the European Community and its distribution between member states, see D.R. Harvey, 'Costs, Benefits and the Future of the Common Agricultural Policy', *Journal of Common Market Studies*, XXIV (1985) n.1 p.7.

<sup>30</sup> Susan Senior Nello, 'An Application of Public Choice Theory to the question of CAP Reform', *Review of European Agricultural Economy*, 11 (1984) p. 265, 269.

to 1982, while the annual growth rate of the Community's own resources from 1975 to 1982 was an average 12 per cent.<sup>31</sup> More precisely, the then General Director of the Budget of the European Commission noted that the margin of available resources, totalling just 819.2 MECU in 1982, had tailed off and could have disappeared if the growth rate of the EAGGF – Guarantee expenditures had not slowed down from 1979 to 1981, soaring, however, by 20 per cent the following year.<sup>32</sup>

The following elements must be observed to understand the budgetary time bomb and its effects: 1) contrary to what the term 'fund' implies, the European Agricultural Guidance and Guarantee Fund (EAGGF) is not an autonomous fund, but a section of the expenditures of the EC budget, along with the Social Fund and the Regional Fund. The basic distinction is between the EAGGF-Guarantee, destined to short-term price and income support, and the other funds, including the EAGGF-Guidance, aimed at structural long-term improvements. 2) The decision of 21 April, 1970 on the Establishment of the European Communities' own resources replaced financial contributions from member states with autonomous EC fiscal revenues, i.e., agricultural levies, customs duties and the equivalent of 1 per cent of the Value Added Tax calculated by member states on a uniform basis in accordance with the Sixth VAT Directive, which from 1980 onwards constituted the bulk of the EC budget revenue. Not the whole 1 per cent of the Value Added Tax had to be attributed to the European Budget, but only the amount that could cover expenditure, the remaining part constituting the margin of available resources, which was heading for exhaustion. 3) The Community budget was subject to the equilibrium principle between revenue and expenditure, that is, unlike states, the European Community could only borrow in order to lend. Thus, any deficit occurring in a certain year had to be entered as expenditure in the budget of the following year, thus limiting room for new expenditure.<sup>33</sup>

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<sup>31</sup> Com. (81) 608 final, para. 28.

<sup>32</sup> Daniel Strasser, 'Le Financement de la Politique de Garantie des Marchés Agricoles', in Jean Raux, ed., *Politique Agricole*, p.36, table 8.

<sup>33</sup> See, in particular, Daniel Strasser, *The Finances of Europe. The Budgetary and Financial Law of the European Communities* (Luxembourg: Office for Official Publications of the European Communities, 1992) p. 28. 86, 161. Also, Brigid Laffan and Michael Shackleton, 'The Budget', in Helen and William Wallace, eds., *Policy Making in the European Union* (Oxford: Oxford University Press, 1996) p. 73..

Matters reached a head in 1983, when budget expenditures overran available resources, and the paralysis of the CAP mechanism and of the other funds of the EC budget could only be avoided by member states' decisions to cover the deficit. Though the crisis was eventually averted, the situation did not subsequently improve. The 1985 Communication on the CAP from the Commission stated 'it is clear that Community agricultural expenditure cannot grow at rates comparable with those of the past'. The Commission argued that an increase of agricultural expenditure equal to that of the previous ten years (estimated at 7 per cent in real terms) could already lead to a further overrun of available resources by 1986, despite the increase to 1.4 per cent of the share of VAT destined to the Community due to take effect the same year.<sup>34</sup>

*From the member states' angle*

However, a single pattern did not emerge regarding the attitudes of member states towards the joint problems of overproduction in agriculture and exhaustion of available resources in the budget. Various approaches have been adopted to explain the member states' choices. Many scholars have stressed the influence of political factors on the vicissitudes of the CAP reform. Hendricks, for instance, argues that the struggle for farm votes dominated Germany's farm policy and its attitude towards the CAP, while Keeler points to the strong links between farmer organisations and the French government, even under the Socialists.<sup>35</sup> One could then infer that political interests prevailed over opposing financial preoccupations in both domestic and Community policy. On the other hand, as will be seen, during most of the 1980s member states' efforts to reform the Community budget went side by side with the attempt to solve the agricultural surplus problem. The need to curb farm expenditure was the war cry in the British campaign for a fair return to its contribution. A model should then be developed that takes into account costs and benefits of the financial position of each member state in the EC budget. The term 'model' is perhaps ambitious and misleading. We do not aim at a simplistic explanation of member states' choices on budget

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<sup>34</sup> Communication from the Commission to the Council and the Parliament. *Perspectives on the Common Agricultural Policy*. Com. (85) 133 final. 15.7.1985

<sup>35</sup> Gisela Hendriks. 'The Politics of food. The case of FR Germany', *Food Policy*, 12, (1987) n.1, p. 42

John T.S. Keeler, *The Politics of Neocorporatism*, op.cit., p.84 et seq.

and CAP issues only according to their financial position, which could have been determined by various competing factors. It is preferable to provide a statistical benchmark to understand the EC members' position regarding their contribution to the budget and relative pros and cons of a reduction or increase in the Guarantee section of the EAGGF.

Before providing an analysis of the budgetary data we must focus on the impact of the EC budget both politically and economically. Nicols describes the EC general budget as 'Lilliputian by comparison to the national states budgets'.<sup>36</sup> In 1980, the EC budget was just 0.8 per cent of the Community GDP. In 1989, the ratio had risen to 1.04 per cent.<sup>37</sup> somewhat lower than the critical mass a budget required to become an instrument of fiscal policy. However, apart from financing certain new policies, essential to the development of the West European economy, the budget had a pivotal role in the management of the CAP because the largest share of the EAGGF, the Guarantee expenditures, underpinned the EC farm price/income support policy. In its absence the sector would be promptly renationalised, disrupting the principle of market unity around which the CAP revolved, though with the contradictions entailed by the MCA mechanism.

Two factors are relevant in understanding the attitude of the member states: net contribution, that is, the balance between payments and receipts, and return rate, that is, the member state's share in budget expenditures.

The idea of net contribution (Table 4.5) has been criticised from various angles. The Commission, particularly, remarked that calculating national contributions posed considerable methodological difficulties, especially in relation to traditional 'own resources', like customs duties. Actually, the Netherlands with the port of Rotterdam, one of the main doors of European commerce, paid a share of customs duties almost equal to Italy's. Secondly, a narrow focus on budgetary transactions leaves aside the non-budgetary effects of closer integration facilitated by EC policies.<sup>38</sup>

However, expectations of a fair balance between contributions and returns had been a simmering problem since the entry of the UK into the Community and became Mrs. Thatcher's war cry for a substantial revision of the British

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<sup>36</sup> W. Nicols, 'EEC budgetary strains and constraints', *International Affairs*, 64(1987/88) p.27

<sup>37</sup> See Daniel Strasser, *The Finances*, op.cit., p. 313.

<sup>38</sup> Brigid Laffan, *The Finances of the European Union* (Houndmills: MacMillan Press Ltd, 1997) p.47.

contribution to the budget. Generally, one can expect that everything else being equal, the greater the gap between expense and receipts, the greater the resistance to expense increase, as well as the interest in its curtailment. Conversely, the greater the positive balance in revenue and expenditure, the greater the interest in opposing budgetary constraints. Thirdly, as the guarantee expenditure of the EAGGF is the bulk of the Community budget, budgetary expense reductions would be immediately associated with containment of farm expenditures.

**Table 4.5 Balance between annual receipts and contributions to the EC actual own resources (MECU) - by Member state\***

	B	DK	F	FRG	GR	IRL	IT	L	NL	UK
<b>1981</b>										
Receipts	597.9	575.3	3484.5	2502.3	394.7	717.0	2813.3	8.3	1284.8	3124.7
Contributions	990.5	354.4	3491.1	5057.1	254.5	158.9	2526.0	27.2	1287.1	3877.2
Balance	-392.6	220.9	-6.6	-2554.8	140.2	558.1	287.3	-18.9	-2.3	-752.5
<b>1983</b>										
Receipts	735.5	756.5	4254.8	3825.3	1351.4	1026.2	3775.0	5.6	1860.5	4083.6
Contributions	1215.9	479.9	4506.5	6472.1	377.7	269.6	2998.7	43.9	1564.9	5084.4
Balance	-480.4	276.6	-251.7	-2646.8	993.7	756.6	776.3	-38.3	295.6	-1000.8
<b>1985</b>										
Receipts	1070.0	912.5	5416.4	4185.0	1702.8	1548.7	4480.3	8.5	2231.1	3107.4
Contributions	1292.6	620.4	5319.2	7504.3	388.0	296.4	3629.5	50.7	1889.4	5090.3
Balance	-222.6	292.1	97.2	-3319.3	1315	1252.3	850.8	-42.2	341.7	-1982.9

\*B= Belgium; DK = Denmark; F = France; FRG = Federal Republic of Germany; GR = Greece; IRL = Ireland; IT = Italy; L= Luxembourg; NL = The Netherlands; UK = The United Kingdom.

Source: Official Journal of the European Community. Information and Notices. Annual Report of the Court of Auditors. Years 1981,1982,1983.

This reasoning, however, posits that payments in the various sectors of the budget are equally distributed between member states, especially if the state claiming for budgetary restraint receives a comparatively low share of the EAGGF-Guarantee expenditure, due to the low weight of agriculture in its economy. Otherwise, the weight of agricultural guarantee expenditure on the benefits received from the Community budget cannot be ignored (Tables 4.6 and 4.7).

**Table 4. 6 ANNUAL PAYMENTS TO THE MEMBER STATES (MECU)**

Average 1981-83 (a)

	B	Dk	F	FRG	GR	IRI	IT	L	NL	UK	EC-10
EAGGF-Guarantee	545.4	581.7	3149	2378	612.7	517.9	2472	3.6	1427	1350	13039
share of total (%)	92.5	89	84.7	80.6	67.3	59.2	74.3	55	91.1	36.3	70.8
EAGGF-Guidance	19.2	20.7	156.7	116.3	12.1	75.3	102	1.5	28.8	109	641.5
share of total (%)	2.9	3.2	4.2	3.9	1.3	8.6	3.1	23	1.8	2.9	3.5
Fisheries	0.5	2.7	3.9	3.1		11.6	6.9		7.7	8.8	53.3
share of total (%)	0.1	0.4	0.1	0.1		1.3	0.2		0.5	0.2	0.3
Social Fund	17.6	16.6	138.4	81.3	16.8	103.2	221	0.7	12.1	240	847.4
share of total (%)	2.6	2.5	3.7	2.8	1.8	11.8	6.6	11	0.8	6.4	4.6
Regional Fund	9	14	138.7	47.6	163.9	89.5	279	0.3	9	259	1009
share of total (%)	1.4	2.1	3.7	1.6	17.9	10.3	8.4	4.6	0.6	7	5.5
Total	661	653.8	3720	2952	910.6	874.5	3329	6.5	1566	3723	18407

Average 1984-86 (b)

	B	Dk	F	FRG	GR	IRI	IT	L	NL	UK	P*	SP*	EC12
EAGGF-Guarantee	860.4	924	4555	3783	1180	1088	3463	3.5	2096	2000	10.1	91	20058
share of total (%)	84	88.2	85	86	71.2	75.3	74.4	40	92.4	56.7	6.1	11	76
EAGGF-Guidance	13.6	13.6	147.6	91.8	74.2	67.2	157	2.7	20	101			688
share of total (%)	1.3	1.3	2.8	2.1	4.5	4.6	3.4	31	0.9	2.8			2.6
Fisheries	2.8	6	13.8	4.9	1.9	5.4	5.7		2.9	14.6	0.1		84.9
share of total (%)	0.3	0.6	0.2	0.1	0.1	0.4	0.1		0.1	0.4	0.1		0.3
Social Fund	58.1	61	270	102.7	85.8	168.7	405	0.8	36.9	497	36.4	58	1780
share of total (%)	5.7	5.8	5	2.3	5.2	11.7	8.7	9.2	1.6	14.1	21.9	7.3	6.7
Regional Fund	15.9	18.2	218	66	278.3	100.5	509	1.1	14.8	429	63	105	1819
share of total (%)	1.5	1.7	4.1	1.5	16.8	7	10.9	13	0.7	12.2	38	13	6.9
Total	1025	1048	5361	4398	1657	1444	4655	8.7	2268	3529	165.8	805	26397

\* P= Portugal; SP = Spain

Source: Calculations based on Official Journal of the European Community. Information and Notices. Annual Report of the Court of Auditors. Years 1981-1986

(c) PERCENTAGE CHANGES: b/a

	B	Dk	F	FRG	GR	IRI	IT	L	NL	UK	EC-10
EAGGF-Guarantee	57.8	58.4	44.7	59.1	92.6	110.1	40.1		46.9	48.2	53.8
EAGGF-Guidance	-29.2	-34.3	-5.8	-21.1	513.2	-10.8	53.3	80	-30.6	-7.5	7.2
Fisheries	460	122.2	253.8	45.2		-53.4	-17.4		-62.3	65.9	59.6
Social Fund	230.1	267.5	95.1	26.3	410.7	63.5	83	1	205	107.3	110.1
Regional Fund	76.7	30	57.2	38.7	70.7	12.3	82.4	266.7	54.4	65.9	80.3
Total	55	60.3	44.1	49	82	65.2	39.8	33.8	44.8	-5.2	43.4

Source: Calculations based on Official Journal of the European Community. Information and Notices. Annual Report of the Court of Auditors. Years 1981-1986

Even more important in each state's perspective is the share of the payments it receives in a particular sector relative to those of other members of

the Community (Table 4.7). Here, the concept of rate of return focuses on each member state's quota in the various sections of the European budget.

**Table 4.7 MEMBER STATES' RATE OF PARTICIPATION IN THE EC BUDGET'S FUNDS**

	B	DK	F	FRG	GR	IRL	IT	L	NL	UK
<b>1981</b>										
EAGGF Guarantee	4.5	4.6	27.5	18.5	1.3	4.0	19.1	0.0	10.6	9.9
EAGGF Guidance	3.8	3.7	21.3	23.7		10.2	13.8	0.4	3.9	19.2
Social Fund	2.1	2.5	20.8	9.7	0.9	8.1	27.7	0.1	1.9	26.2
Regional Fund	1.2	1.3	8.4	4.5	15.3	10.1	26.5	0.1	0.7	31.9
<b>1983</b>										
EAGGF Guarantee	3.9	4.3	22.6	19.5	6.4	3.9	17.9	0.1	10.7	10.7
EAGGF Guidance	2.5	2.8	25.3	15.0	3.0	11.7	14.3	0.1	4.5	20.8
Social Fund	2.3	1.6	15.8	9.1	2.3	15.1	24.8	0.1	1.4	27.5
Regional Fund	0.6	1.3	17.5	3.6	17.1	7.5	27.4		1.4	23.6
<b>1985</b>										
EAGGF Guarantee	4.6	4.2	23.5	18.4	6.0	5.9	17.3	0.1	10.4	9.6
EAGGF Guidance	1.8	1.9	17.7	11.7	12.1	10.6	25.4	0.3	2.6	15.9
Social Fund	3.5	2.4	18.1	7.8	5.6	12.1	27.1	0.0	3.3	20.1
Regional Fund	0.7	0.5	14.3	3.8	19.0	7.3	23.4	0.0	1.0	30.0

Source: Calculations based on Official Journal of the European Community. Information and Notices. Annual Report of the Court of Auditors. Years 1981-1983-1985.

The tables above show, as expected, that budgetary expenditures allocated to member states grew considerably from the beginning of the 1980s: by 43.4 per cent between the first and the second three-year period. EAGGF Guarantee expenditure grew more slowly than other funds although its share in the total budget actually increased since its growth rate was still high and its starting base particularly large.

Of the four main players only Italy scored a positive net contribution over the whole period. At the other end of the spectrum the UK, despite rebates, had a large and increasing negative balance, and Germany's was even larger. It could, therefore, be argued that both countries would share a common dislike for budget growth. However, in Germany's case, the negative balance was due less to the low level of utilisation of EC funds than to its large contribution to the budget, which was the natural and accepted result of the weight of the Federal Republic in the European economy. France often registered a deficit, which, however, was much smaller, managing at times to reach a positive balance.

The picture is completely different regarding rates of return particularly in the EAGGF – Guarantee section. The UK's rate of return in this section was extremely low and indeed could be viewed as the main cause of her negative balance. Germany, however, had quite a high rate of return, being often the second main beneficiary after France, though closely followed by Italy. Moreover, the weight of the EAGGF – Guarantee in the funds allocated to Germany was particularly high, well above the EC average. The Federal Republic's share in the funds allocated to key farm products like cereals, milk products, sugar and meat was particularly satisfactory. Funds received by Germany for milk products even surpassed those destined to France.<sup>39</sup> This could explain Germany's apparently schizoid attitude which on many occasions emphasised the need for strict budgetary discipline, but at the crucial point pressed for options bound to increase farm expenditure.<sup>40</sup> As expected, France secured the greatest share by far of the EAGGF funds, both in the Guarantee and the Guidance section. It was, therefore, likely that the French Republic would be a staunch supporter of the EC farm policy. The odds, therefore, favoured an 'entente cordiale' between France and Germany, although their goals and their policies did not always coincide.

#### **4) Developments and conflicts (1982-1985)**

The UK's particular financial situation seems to be reflected by its policy. At the May 1982 meeting when the Council fixed farm prices for the market year 1982-83, the United Kingdom claimed that there was a 'fundamental link' between the budget problem and the level of farm prices, which was bound to generate surpluses. Britain argued that the 'proposed measures would probably push up the costs to be supported by approximately 200 million ECU and would therefore represent an additional burden on the United Kingdom and the Federal Republic of Germany'.<sup>41</sup> The British delegation, thus, claimed that any majority decision taken by the Council was likely to damage its interests and, therefore,

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<sup>39</sup> See Official Journal of the European Community. Information and Notices. Court of Auditors. *Record of Payments by recipient Member State and by market*. Various issues.

<sup>40</sup> Contra Graham Avery, 'Europe's Agricultural Policy: Progress and Reform', *International Affairs*, 60 (1984) p. 653. Avery's article was written before the beginning of the battle waged by the Federal Republic against the European Commission's proposal for a reduction in cereal prices.

<sup>41</sup> Draft minutes of the 771<sup>st</sup> meeting of the Council (17- 18 May, 1982), p.5.

required the enforcement of the 'Luxembourg Compromise' of January 1966.<sup>42</sup> It must be recalled that in January 1966, France having withdrawn for six months from Community institutions (the so-called 'empty chair'), the Council agreed on the application of a unanimity rule whenever vital interests of a member state might be considered at stake. This meant that in the absence of a general consensus, no majority vote could be taken on issues considered fundamental by a member. It is arguable that the UK expected the Federal Republic's backing.

The British manoeuvre backfired.<sup>43</sup> The Italian and French delegates promptly counterattacked claiming that the 'Luxembourg Compromise' did not allow a member state to paralyse the normal functioning of the Council in a sector of negotiation, in this instance, agriculture, to obtain satisfaction in other negotiating areas: that is, regarding a change in the United Kingdom contribution to the EC budget. Only Greece and Denmark backed the British request not to put to the vote the regulation on the 1982-83 farm prices, noting, nevertheless, that this was just 'for political reasons and that any delay in price fixing could seriously disturb the EC agricultural system'. The other participants, among whom the Germans, proceeded to vote and the price fixing for the 1982-83 market year was adopted by majority vote.

Great Britain, however, continued to try to restrain farm expenditure and to pursue a revision of its contribution to the EC budget.<sup>44</sup> The great pressure on the budget caused by soaring surpluses, induced by the generous price increase agreed by the Agriculture Council in 1982 (10.5 per cent on average) led the Commission to propose a more moderate 4.8 per cent price increase for the following market year which the Council accepted.<sup>45</sup> The United Kingdom, however, had called for a price freeze on those products on structural surplus like milk, wheat and wine.

The Stuttgart European Council of June 1983 adopted a declaration engaging the member states to negotiations on the improvement of Community

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<sup>42</sup> Ibid., p.6.

See in particular, Martin Vasey, 'Decision Making in the Agriculture Council and the Luxembourg Compromise', *CML Rev*, 25(1988) p.725, which reproduces the text of the 'compromise'.

<sup>43</sup> Draft Minutes of the 771<sup>st</sup> meeting of the Council, pp.7-9.

<sup>44</sup> The time for decisions: Britain's Foreign Secretary on the future of Europe, *Financial Times*, November 23, 1982, p.14

<sup>45</sup> The Agricultural Situation in the Community. 1983 Report, p. 113; *Financial Times*, May 18, 1983, p. 3.

policies, the focus of which was the question of how to increase the Community's financial resources, especially in view of its imminent enlargement. The fact that the decision was taken under German presidency was a clear signal that the Federal Republic, the main contributor, was ready to bear a large share of the prospective costs despite expectations of a growing negative net contribution. The Declaration of the heads of State and government concurrently stressed the need for budgetary discipline and, regarding the CAP, provided that the review of the Common Agricultural Policy should result in steps 'compatible with market conditions' to ensure 'effective control of agricultural expenditure'<sup>46</sup> The Commission was requested to submit its proposals by 1 August, which it dutifully did.

In its new proposals the Commission tightened the reins further.<sup>47</sup> Whereas previous communications had excluded nominal price cuts, though admitting them in real terms, now the European Executive suggested a restrictive price policy which implied a freeze or even a reduction of the common prices expressed in ECU. No mention was made, however, of prices in national currencies, affected by the MCA mechanism, which determined farmers' revenue in member states. Besides, with the declared aim of reducing the gap between supply and demand for butter and olive oil, the Commission called for the adoption of a non-discriminatory tax on fats and oils other than the mentioned produce, irrespective of origin. The measure, despite its non-discriminatory enforcement, was likely to impact more on imported products, simply because they comprised the bulk of the Community supply. A strong reaction was, therefore, to be expected from the exporters, especially the United States. The Commission also suggested the renegotiation of the excessively import friendly duty regime applied to cereal substitutes to ensure a satisfactory observance of Community preference.

The European Commission called for the adoption of a quota system for the milk sector where the disequilibrium between supply and demand was stronger and which accounted for over 26 per cent of the EAGGF- Guarantee expenditure, arguing that the only alternative way to avoid a growth in supply

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<sup>46</sup> Bull. EC 6-1983, paras. 1.5.1 et seq.

<sup>47</sup> Communication from the Commission to the Council. *Common Agricultural Policy – Proposals of the Commission*. Com (83) 500 final. 28 July 1983.

above the guarantee threshold was a price cut of at least 12 per cent in nominal terms. The latter alternative was bound to impact heavily on milk producers' income and above all would have been politically impracticable.

Finally, the Commission recommended that MCAs be phased out in three stages by altering the green rate. This was welcomed by the French farmers but not by their counterparts across the Rhine, who had already borne severe reductions in income.

In Stuttgart the Heads of State and Government had hoped that negotiations could be successfully completed during the summit scheduled in Athens at the end of the Greek presidency in December 1983. Their hopes were destined to be bitterly disappointed as the Athens European Council ended up in disagreement on almost all aspects of the reformed European construction, epitomised by the quarrel between Mrs Thatcher and France's president, François Mitterrand.

In the absence of a framework agreement worked out by the heads of government, the CAP was temporarily rescued by their Ministers of Agriculture who accepted the proposals tabled by the Commission in July 1983, though reshaping them in a carefully balanced compromise. In January 1984 the Commission submitted its proposals for market year 1983-84 price fixing, which almost amounted to a price freeze.<sup>48</sup> The price freeze request was joined by a call for a quota system for milk. However, it had the political defect of presenting the member states with a marked variance in the price in national currencies if coupled with the dismantlement of MCAs. Particularly, farmers in countries with positive MCAs like West Germany, the UK, the Netherlands and Denmark were bound to suffer severe cuts in nominal prices, and even more in real prices, while farmers in countries with negative MCAs like Belgium, France, Ireland and Italy would enjoy a nominal rise. The worst hit would be farmers in the Federal Republic.<sup>49</sup>

A package of mostly unpalatable measures had been proposed for a difficult bargain between member countries. A fundamental role in facilitating the deal was played by Michel Rocard, French Minister for Agriculture, who presided over the Council during the French semester in the first half of 1984. Rocard tried

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<sup>49</sup> *Financial Times*, January 13, 1984 p.1; *Financial Times*, January 17, 1984, p.3.

to strike a balance not only between member states but also between conflicting interests within France. The main bones of contention were the introduction of a quota system and the MCAs dismantlement.

In France the introduction of dairy quotas met with the opposition of the powerful Fédération Nationale des Syndicats d'Exploitants Agricoles (FNSEA) with which the French Socialist government was trying to mend fences after a period of disastrous confrontation under Mr. Rocard's predecessor, Mrs Cresson. In particular, the National Federation of Milk Producers (FNPL), an affiliate of the FNSEA, under pressure from the North West producers, wanted to catch up with its more advanced competitors in Northern Europe.<sup>50</sup> The introduction of quotas, by limiting any supply increase to an additional percentage of a benchmark established with reference to previous years would have blocked that process. However, the FNPL did not favour the importation of grain substitutes since imports gave a cost advantage to its Northern competitors located close to major European harbours. Here the FNPL policy was in keeping with the interests of the General Association of Wheat Producers (AGPB), also affiliated to the FNSEA. Left wing farmers' associations, instead, considered direct governmental aid to farmers as the key to a solution of the small farmer's predicament. All favoured the abolition of MCAs to boost French farmers' income and competitiveness.<sup>51</sup>

In Germany the Agriculture Minister, Kiechle, and the German Farmers Union (DBV) favoured the quota system, deeming it the best way to prevent a fall of milk producers' income, the only alternative put forward by the Commission being a drastic support price cut. On the other hand, the DBV and its staunch ally in the government were opposed to the MCAs dismantlement, as this would have brought about a steep decline in support prices in Deutschmarks.<sup>52</sup> The Germans, thus, tabled a proposal aimed at smoothing over the controversy on MCAs with France, without affecting their farmers' income. The proposal centred on the establishment of a direct link between the ECU used to fix farm prices and the strongest currency in the ECU basket, the Deutschmark. It had the advantage of eliminating or reducing positive MCAs in Germany and in other strong

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<sup>50</sup> See Michel Petit et al., *Policy Formation in the European Community. The Birth of the Milk Quotas and the CAP* (Amsterdam: Elsevier Science Publishers, 1987) p. 38 et seq.

<sup>51</sup> *Le Monde*, March 16, 1984, p.2.

<sup>52</sup> Gisella Hendriks, Germany, p.70.

currency countries, while raising prices paid to farmers in weaker currencies. However, as the Agriculture Commissioner Poul Dalsager pointed out defending the Commission's proposal, 'such solution would also have consequences for the Community budget'.<sup>53</sup> The farm organisations in the Nordic countries were opposed to the imposition of quotas, though they soon started to feel that growing cracks in the CAP fabric would make it impossible and, perhaps, fruitless to oppose the measure. Nordic Governments, on the other hand, favoured it. In particular the Dutch executive feared that excessive strain on the EAGGF – Guarantee section could compromise the preservation of the CAP. For the British government, with no audible dissenting voice in the Department of Agriculture, budget discipline in farm sectors meant fairer distribution of the contribution burden. Only Ireland, whose agriculture, especially dairy, had a paramount weight in the national income, still opposed the new regime, on any level. Germany and the Nordic countries had no wish to renegotiate concessions on trade substitutes in the GATT, because this could encourage trade retaliation and increase input costs for dairy products.<sup>54</sup>

The package the Agriculture Ministries agreed on March 31, 1984 largely accepted the Commission's proposals first embodied in its Communication of July 1983. However, the member states were able to introduce some flexibility into the implementation process which it more palatable to their farm constituencies. Firstly, the Council agreed that the guaranteed threshold for milk be implemented by supply quotas imposed either on the producer or the dairies. The quota allocated among member states was secured by a super levy on overshoots equal to 75 per cent of the target price for milk in the case of producers' surplus and 100 per cent in dairy overruns.<sup>55</sup> The advantage of the quota over the previously applied producer levy resulted from the imposition of an insuperable ceiling fixed for a five-year period on the basis of each member state's production in 1981 plus 1 per cent. However, despite the fact that the quota was below the level of deliveries in 1983, which totalled 104 m tonnes, the agreed ceiling of 99.5 m tonnes a year fell far short of the 97.2 m tonnes target proposed by the Commission and was much higher than the Community's consumption of about

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<sup>53</sup> Bull. EC. 2-1984, para. 21.96.

<sup>54</sup> Michel Petit et al., *Policy Formation*, op.cit. p.54 et seq.

<sup>55</sup> Draft minutes of the 921<sup>st</sup> meeting of the Council. March 26-31, 1984., p. 25; The Agricultural Situation in the Community. 1984 Report, p. 22 et seq.

85 m tonnes, thus allowing exports and other forms of disposal that had to be financed by the Community budget.<sup>56</sup> Implementing regulations gave further room for manoeuvre to the member states, though provisionally, allowing producers and dairies to transfer the unused share of their quotas to other producers and dairies within a region. These permitted overrun of the quota at individual levels provided it was offset by corresponding savings.<sup>57</sup> Principally, as Lord Brittan remarked, in their efforts to square the circle, that is, controlling production and budgetary expenses, while preventing farmers' income from falling, the European Commission and the Council created a kind of cartel among member states, a far cry from a system based on domestic and international market forces.<sup>58</sup>

The MCA reform that emerged from the 'compromise' incorporated most German requests. The so-called Green ECU used for CAP purposes was worth 3.4 per cent more than the ECU otherwise used by the Community. This eliminated positive MCAs in the Netherlands and the UK and reduced the German MCA which was to be dismantled by 5 percentage points by 1985 and completely phased out by the 1987/88 market year. The resulting price reduction for German farmers was to be compensated by a Value Added Tax rebate equal to 3 per cent of the price paid on farm products, with effect January 1985, to be financed partly by the Germans and partly by the Community.<sup>59</sup>

The Council accepted the Commission's price freeze proposal. The result, however, was not so negative for farmers' income as initially expected since while prices in ECU declined on average by 0.5 per cent, prices in national currencies increased by 3.3 per cent. However, the nominal increase was more than offset by the rate of inflation.<sup>60</sup>

The adoption of the package was not welcomed by EC farmers, particularly the French. Violent demonstrations marked the spring of 1984, especially in the north western France.<sup>61</sup> Thus, one could conclude that in

<sup>56</sup> Graham Avery, 'The Common Agricultural Policy: a Turning Point', *CML Rev.*, 21(1984), p. 493; *Financial Times*, April 2, 1984, p.2

<sup>57</sup> European Parliament. *Interim Report drawn up on behalf of the Committee on Agriculture and Food on certain aspects of implementation of the dairy quota arrangements in the Community*. Rapporteur Mr Eisso P. Woltjer. Pe Doc A2-85/85 (1.8.1985).

<sup>58</sup> The Wrong way to reform the EEC, by Samuel Brittan. *Financial Times*, April 5, 1984, p. 27.

<sup>59</sup> Draft minutes of the 921<sup>st</sup> meeting, p. 23.

<sup>60</sup> The Agricultural Situation in the Community. 1984 Report, p. 23

<sup>61</sup> *Le Monde*, 16 March, 1984, p.2 ; *Le Monde*, 30 May 1984, p. 1

mediating the complex agreement of March 1984 Michel Rocard ignored the vociferous demand of the most affected sector of French agriculture. Indeed, the farm agreement made it possible for François Mitterrand, to end France's semester with striking political success at Fontainebleau in June. With no agreement to hold farm expenditure in check, Mr. Mitterrand would have been unable to strike a deal on the thorny question of the budgetary refund to Great Britain and on the medium-term increase in resources available, which, in turn, facilitated the entry of Portugal and Spain to the European Community by January 1986.

The European Council agreed that the level of expenditure would be fixed as a function of available resources and that expenditure related to the agricultural market, on a three yearly base, would increase at a lower rate than available resources.<sup>62</sup> On the other hand, Rocard managed to secure certain goals of French farm policy: preventing a disruptive crisis of the EAGGF, of which France was the main beneficiary; and securing outlets for its most dynamic produce, particularly cereals. The Agriculture Council, despite the Northern cattle breeders' reservations, gave its green light to GATT negotiations 'to stabilise cereal substitutes' as suggested by the Commission.<sup>63</sup> The Commission's proposal for a non-discriminatory tax on oils was withdrawn.

The Federal Republic's aim was the defence of its farmers' income, whatever the cost, and all in all it succeeded. The main items of the agreement reflected the German attitude, from the adoption of milk quotas to prevent severe price-cutting, to the reform of the MCA mechanism, along with the authorization of direct fiscal aids, through VAT rebates, to German farmers, partly with EEC financing. At Fontainebleau, the German chancellor, Helmut Kohl, accepted the VAT contribution increase from 1 per cent to 1.4 per cent and the abatement of the British contribution. Thus, Germany, which already provided approximately 30 per cent of available resources, would foot the largest share of the new bill.<sup>64</sup> In exchange Kohl got the date of VAT compensation to German farmers brought

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<sup>62</sup> Bull. EC 6-1994, points 1.1.1 et seq.

<sup>63</sup> *Financial Times* April 17, 1984, p.46.

<sup>64</sup> See Geoffrey Denton, 'Restructuring of the EEC Budget: Implication of the Fontainebleau Agreement', *Journal of Common Market Studies*, XXIII (1984) n. 2, p 132 et seq.

forward from January 1985 to July 1984, raising it from 3 to 5 percentage points.<sup>65</sup>

As a nonmarket-oriented solution was found to stem the tide of farm expenditure in the milk sector, cereals, particularly wheat, became the fastest growing component of the EAGGF-Guarantee section. The market-oriented remedy envisaged by the Commission centred on the gradual alignment of EC prices with world market prices, a course previously established and helped by the strength of the EC currencies vis-à-vis the dollar. However, soon after the Fontainebleau summit, the German Minister of Agriculture, Ignaz Kiechle, a member of the Bavarian-based Christian Social Union (CSU), started complaining of the deteriorating situation of his farm constituency under the double weight of the MCA removal and the implementation of dairy quotas. The German Minister's protest clearly aimed at preventing further income reducing measures. In February 1985, the Commission's proposals for the 1985-86 price fixing called for a limited reduction of cereal prices in nominal terms. Initially this was a 3.6 per cent reduction, obtained by combining a nominal increase of 1.5 per cent with the maximum 5 per cent guaranteed threshold penalty provided by the Council's regulation of 1982. Actually, the 1984 bumper harvest caused the average of the three previous years to exceed the guaranteed threshold by 8 per cent.<sup>66</sup> The United Kingdom called for a more severe 5 per cent price cut.<sup>67</sup> France sided with the Commission. The Republic as the main EC exporter, followed by the UK, saw this cut as a precondition of continuous expansion in cereal exports, based on the alignment of EC prices with its main competitors', and with the prevention of a dangerous exhaustion of agricultural guarantee funds.

Conversely, Kiechle insisted that the main goal of EC farm policy be the defence of small family farmers by buoying up their income. The German minister also argued that the price cut suggested by the Commission was counterproductive as it stimulated greater supply to compensate the loss of revenue on the price side.<sup>68</sup> Kiechle was not isolated in the German government. Chancellor Kohl sent a message to the new president of the European

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<sup>65</sup> *Agra Europe*, June 29, 1984, n. 1008, E/1.

<sup>66</sup> See Section 1; *The Economist* 23 March 1985, p. 60.

<sup>67</sup> *Agra Europe* March 15, 1985, n. 1124, E/1.

<sup>68</sup> Martin Vasey, 'The 1985 Farm Price Negotiations and the Reform of the Common Agricultural Policy' *CML Rev.*, 22 (1985), p. 659.

*Financial Times*, 29 May, 1985, p. 22. *Agence Europe*, 28-29 May, 1985, n. 4097.

Commission, Jacques Delors, requesting his assistance to Germany on the cereal issue.<sup>69</sup> In other words, Germany, which had already committed itself to meeting the increase in budget available resources did not need to be constrained by collective financial prudence, especially when the Christian Democrats had recently performed badly in the elections in some Länders with strong farm constituencies. Besides, further domestic support to farmers would prove more costly and its implementation dicier since authorization from Brussels was required.

In a series of compromise proposals made by the Italian Presidency and by the Commission, the price cut was reduced to a modest 1.8 per cent. Yet, in May the German minister replied that he could only accept a price reduction not exceeding a symbolic 0.9 per cent, accompanied by a shorter deadline for intervention payments to farmers, and declared that 'in the matter of cereals...major national interests were at stake for the Federal Republic of Germany'.<sup>70</sup> In the following session the German delegation formally invoked the Luxembourg Compromise and this time it was not overruled. Belgium, Italy, Luxembourg and the Netherlands voted for the last draft regulation put forward by the Presidency, but without securing the qualified majority. The other delegations did not participate, as they refused to impair their right to invoke, in turn, the Compromise, just to rebalance supply and demand in a specific farm sector and not to strain available resources.<sup>71</sup>

The standstill was not overcome, as Germany did not withdraw its veto in the following sessions. However, the Commission pressed ahead with the implementation of its compromise proposal, using its executive powers to ensure that the market functioned smoothly even without a Council decision. Prices were nominally cut by 1.8 per cent, though the actual reduction was less than 1 per cent, as the Commission concurrently adopted some of the German requests, specifically a two-month reduction in intervention payment delay.<sup>72</sup> Only in April 1986, during price fixing for the 1986-87 market year, did Kiechle

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<sup>69</sup> *Agence Europe*, 15 May, 1985, n. 4085.

<sup>70</sup> Draft minutes of the 1002<sup>nd</sup> meeting of the Council (13-15 May, 1985) p.5.

<sup>71</sup> Draft minutes of the 1014<sup>th</sup> meeting of the Council (11-12 June, 1985) p. 5; Gisella Hendriks, 'Germany and the CAP: national interests in the European Community', *International Affairs*, 65 (1989) p. 84 et seq.

<sup>72</sup> Draft minutes of the 1022<sup>nd</sup> meeting of the Council. (15-16 July, 1985).

unofficially drop his veto, though vociferously opposing the Commission's proposal for a new price freeze.<sup>73</sup>

## **5) Overview of further developments and conclusions**

In June 1985, during the grain price crisis, the Commission issued a further Communication on the 'Perspectives of the Common Agricultural Policy' (the 1985 Green Paper) followed by new CAP guidelines.<sup>74</sup> The Communication and the Guidelines set out available options to the Community, which centred on:

- 1) control of production growth, either through suitable price adjustments or institutional curbs on output levels;
- 2) promotion of alternative production lines, like replacement of arable surplus crop with extensive crops;
- 3) alternative forms of surplus crops utilisation, like non-food uses of starch and sugar, and use of bioethanol as fuel;
- 4) curbs in the budgetary cost of exports, particularly through increases in export risks borne by producers, and in the longer run by a reduction of support prices at levels closer to those of other exporters.
- 5) changes in the import regime by negotiating trade-offs in the GATT between highly protected commodities and less protected ones without changing the average level of protection.

As noted by a sceptical scholar, the key points suggested by the Commission were merely a refinement, with certain additions, of former proposals. Above all they relied on variables mainly out of the Commission's control.<sup>75</sup> Quotas which were not the option preferred by the Commission were difficult to implement in sectors other than dairy. Support price reductions, as shown by the confrontation with Germany, had to be accepted by all member states and this usually implied a compromise bound to dilute the Commission's proposal. Besides, to be effective in stemming overproduction, price cuts had to be promptly implemented. Not an easy task. The renegotiation in the GATT of

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<sup>73</sup> *Financial Times*, April 26, 1986, p.1.

<sup>74</sup> Communication from the Commission to the Council and the Parliament. *Perspectives on the Common Agricultural Policy*. Com. (85) 133 final. 15.7.1985.  
Commission Guidelines following the consultations in connection with the Green Paper. Com (85) 750 final. 18.12.1985.

<sup>75</sup> Rosemary Fennel, 'Reform of the CAP: Shadow or Substance?', *Journal of Common Market Studies*, XXVI (1987) n. 1, p.65.

## **CHAPTER V**

### **AGRICULTURE ON THE ROAD TO THE URUGUAY ROUND**

#### **1) The first US attempt to launch a new round of trade negotiations**

In keeping with its free market philosophy the Reagan Administration promptly called for new tasks for the GATT. In its Economic Report on the year 1981 the President argued that 'the General Agreement faced new challenges because of increasing protectionist pressures worldwide and because the effectiveness of GATT rules, which formally include all goods has tended in practice to be limited to manufactures'.<sup>1</sup> The US Executive, therefore, claimed that the GATT must address areas of international concern where existing norms were non-existent or inadequate, such as trade in services, investment and agriculture. Regarding agriculture the Administration was dissatisfied with the achievements of the Tokyo Round and considered new negotiations necessary. Actually, the Republican Administration marked a success when the GATT member states unanimously decided on 25 November 1981 that the 1982 annual session should be convened at ministerial level to support and 'improve the system for the benefit of all nations'.<sup>2</sup> A ministerial meeting, the first after nine years, was the precondition for the launching of a new Round. The Community expressed its full support.<sup>3</sup>

The stumbling block, however, was the agenda of the prospective round. The developing countries, led by India and Brazil, were definitely opposed to the inclusion of services and investments, along with intellectual property rights among the subjects for discussion, feeling that liberalisation could restrict their autonomy in the management of the economy and hinder the development of their fledgling service industries, particularly finance and insurance. The European Community, was not prepared to reopen discussion on a subject like agriculture that, it felt, had already been dealt with just a few years earlier, acknowledging the legitimacy of the Common Agricultural Policy. Concerning its compliance with the existing rules on trade in agriculture the Community took care to stress that its

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<sup>1</sup> Economic Report of the President, February 1982, p. 185.

<sup>2</sup> GATT Activities in 1981, p. 2.7.

<sup>3</sup> Bull. EC 11-81, point 2.2.33.

share of the world market had only increased in those sectors, like wine, sugar, beef and veal, which were not of interest to the United States.<sup>4</sup>

The United States' attention was focused on the EC export subsidies, i.e. the export refund mechanism, which it felt erased US competitive advantage and dumped European surpluses on the world market, depressing prices. Obviously, though unofficially, the attack was primarily directed against the main beneficiary of export refunds, France. This explains why, although according to the Rome Treaty trade negotiations must be carried out by the European Commission on behalf of member states, The French Trade minister Michel Jobert played a very active role, withstanding American efforts to start formal discussions on agricultural trade. France had the support of its fellow member states though the latter were unenthusiastic about such an uncompromising attitude which prevented progress elsewhere. 'Ils ne l'ont pas lâchée' (they did not desert it) wrote the columnist of the French *Le Monde*<sup>5</sup>

The Geneva conference was on the brink of collapse till its very end. Jobert dismissed it as 'of no use and inopportune', while the American delegates threatened an all out trade war if the EC did not stop subsidising its farm exports.<sup>6</sup> The compromise text worked out at the eleventh hour did not mask the bitter disagreement between the parties. The Community rejected the idea of a new round in the short run and stressed that the CAP was not negotiable.<sup>7</sup> The declaration issued at the end of the 38<sup>th</sup> GATT session in November 1982 was, therefore, much less binding than the United States had hoped. A chapter was dedicated to trade in agricultural products, recognising the need for lasting solutions with regard to measures affecting market access and subsidies affecting agriculture, particularly export subsidies, along with trade measures adopted under exceptions and derogations. The first two seemed to refer mostly to the European Community, while the latter could also address United States' policies, such as the maintenance of quotas for sugar and dairy products. However, no mention of new multilateral negotiations was made, and the declaration only

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<sup>4</sup> *Europe- Agence Internationale d'Information pour la Presse*, November 15, 1982, n. 3486 ; *Agra Europe*, July 16, 1982, n. 988, A/2.

<sup>5</sup> *Le Monde*, November 26, 1982, p.37.

<sup>6</sup> *Financial Times*, November 26, 1982, p.1; *The Economist*, December 4, 1982, p. 75.

<sup>7</sup> Bull.EC 12-1982, point 1..3.1.