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THE CAP AND ITS IMPACT ON THE THIRD WORLD

The Common Agricultural Policy (CAP) is under pressure, and changes in its operation are likely. Yet there is no guarantee that such changes will be in the interests of the Third World. On the contrary, there is a danger that developing countries (ldcs) will be forced to bear part of the burden of adjustment. But it is difficult to identify precisely what effects the CAP as presently constituted has on ldcs because of its complexity. This Briefing Paper is designed to help readers to assess whether the various reform proposals that will be put forward over the coming months are in the Third World's interests. It reviews the attempts that have been made to assess the overall impact of the CAP on ldcs and identifies the implications of the most likely future changes in European agricultural policy.

The CAP does not affect all ldcs in the same way: it depends upon the commodity composition of their imports and exports. Some gain from the direct effects, and some lose, but a major danger is that changes in the CAP introduced as a result of budget pressure will have a negative impact on almost all ldcs.

The CAP provides support to European agriculture in part through a very comprehensive system of trade protectionism. Critics and supporters of the CAP tend to base their case on different planes. Criticisms that the CAP is economically inefficient, for example, bring forth counter claims that it is socially desirable; accusations that it is causing disruption on world markets to the detriment *inter alia* of ldcs are countered on the grounds that surpluses help to feed the hungry, and so forth. Such confusion is testimony to the complex nature of the CAP which affects a wide range of agricultural products through a diverse set of mechanisms. Since the ldcs are also a heterogeneous group, attempts to identify the net effect of 'the CAP' on 'the Third World' are bound to be controversial.

This Briefing Paper takes the controversy piece by piece, examining the main arguments put forward by critics and supporters of the CAP in relation to its impact on ldcs. At a time when the CAP is under continuous scrutiny, it aims to equip readers to weigh up whether or not proposed reforms are in the interests of the Third World.

The principal argument that the CAP has had a harmful effect on ldcs is that, as a particularly effective form of protectionism, it has restricted the development of agriculture in the Third World. The contrary view is that, first, the CAP has had only a minor effect on the Third World (because most of the commodities covered are not directly competitive with ldc production) and, second, that this effect has been largely beneficial (because the CAP has increased supplies of commodities that ldcs import). There are serious flaws in this counter view, but it contains sufficient elements of truth, and is sufficiently widely held that it is important to examine with care the underlying analysis.

The balance between these opposing propositions depends crucially upon the commodity/country focus and on the breadth of the analysis. The effect of the CAP on ldcs which are net exporters of commodities produced in Europe is different from that on states which are net importers. Further, the CAP has affected the non-agricultural sectors of the European economy; if these indirect effects on ldcs are taken into account the picture changes.

Agricultural Trade Effects on the Third World

The CAP is essentially an inward-looking policy. Its basic tenets are outlined in Box 1. Its external trade effects have not been given much attention by the European policy makers most closely involved. Rather, the main operational objective of the CAP has been to provide income support to European farmers; trade has been treated simply as the consequence of decisions taken to achieve income objectives. In its early years this was achieved largely by import protection which enabled European farmers to supply an increasing share of domestic consumption. More recently, as European production has exceeded demand in a range of commodities, import protection has been supplemented by additional subsidies from the budget, including export subsidies, storage costs, and marketing aids.

Effects on agricultural exporters

Since its inception the CAP has been a source of international controversy and the EEC has been accused by other agricultural exporting states of disrupting world markets. The main source of this complaint is that in Europe production has grown much more rapidly than consumption. This resulted initially in the displacement of external imports, and then in growing competition on third party markets from subsidised European exports. Between 1973 and 1983 the EEC's agricultural exports increased by 42% in real terms. Between 1973 and 1982 self-sufficiency rose from 97% to 125% in wheat, 84% to 102% for beef, and 93% to 155% for sugar. The EEC is now the third largest exporter of wheat in the world, the largest exporter of sugar, a dominant exporter of dairy products and a significant exporter of beef.

Some ldcs have suffered from this increased competition. Sugar is a particularly marked example of this trend. Cane sugar exporters, for example, have seen their share of the UK market threatened and have lost markets elsewhere in the world to subsidised beet exports (Box 2). Third World exporters of other commodities have been affected in a similar manner (albeit often to a lesser extent) by a fall in EEC imports and a rise in exports. EEC beef exports have hurt Latin American and African exporters. Increasing European self-sufficiency in fruit and vegetables has put pressure on North African exporters. Yet not all Third World countries have seen demand for their agricultural exports fall as a result of the CAP. In

Box 1
The Basic Tenets of the CAP

The Treaty of Rome sets five objectives for agricultural policy: not only increased productivity, a fair standard of living for the farm population, and stable markets, but also security of supplies and reasonable prices for consumers. In practice, these partially conflicting objectives have not been pursued with equal vigour. Primacy has been given to achieving a certain level of European farm income, and other policies have been framed primarily to cope with the consequences that have flowed from the pursuit of this objective.

The CAP's provisions vary widely among products, reflecting both historical factors and differences in the organisation of markets. In general, however, the farm income objectives are achieved by high guaranteed prices, normally well above world market levels. A necessary corollary has been the protection of European output from foreign competition by various forms of import controls.

Levels of price support are normally decided annually during negotiations between the farm ministers of the member states on the basis of proposals put forward by the EEC Commission. In recent years these negotiations have become prolonged and difficult largely because of the impact of the CAP on the European Community budget. Surplus agricultural production imposes costs on the budget to subsidise sales (either for export or to promote domestic consumption) or to stockpile unsaleable surpluses. Agriculture accounted for 70% of the 1984 budget; of this aids to farmers absorbed 43% export refunds 37% and storage 20%. Since EEC expenditure has grown more rapidly than Community income, with the CAP the largest item, the annual price reviews have become locked into the wider debate over the European budget.

EEC (10 Country) Share of World Agricultural Trade per cent

	1974	*1976*	*1978*	*1980*	*1982*
Total Agricultural Exports	9.8[a]	9.3[b]	10.3	11.4	11.2
Sugar[c]	0.6	7.8	19.0	21.6	25.5
Wheat	2.8	4.0	5.1	10.8	11.6
Other cereals[d]	18.8	27.6	8.6	3.3	0.6

a 1973
b 1977
c exports to free market
d excluding rice

Source: BAE, EEC, *The Agricultural Situation in the European Community.*

some cases, demand has even increased (although the gains are vulnerable to EEC policy changes). Thailand's exports of manioc (tapioca pellets) for animal feed in the EEC, for example, only exist because domestic European feedstuff prices are so high.

In addition to these direct effects of trade competition there are also less easily identifiable indirect effects. Supporters of the CAP argue that ldc agricultural exporters are relatively little affected on the grounds that most of them do not export the commodities covered by the CAP. However, it is important to remember that temperate and tropical agricultural products are linked together by complex substitution possibilities. In this way the CAP affects world demand for ldc exports even of tropical products. The high price of EEC cereals for animal feed, for example, has stimulated production of USA soybean meal which, in turn, has increased output of soybean oil that competes with tropical oilseeds. Moreover, there is an undoubted (but hard to quantify) 'discouragement effect' on ldcs which do not initiate or increase exports of CAP products because of the competition from European output.

Supporters of the CAP also argue that the Third World is insulated to a significant extent from any protectionist effects because of the various preferences given to ldc exports in the EEC's import regime. But the complicated system of preferences looks more impressive on paper than it is in practice. Over 50% of total exports by ldcs to the EEC of dutiable agricultural items pay full most favoured nation rates.[1] Moreover, the EEC's tariffs tend to discriminate against the processing of agricultural products in ldcs.

Effects on agricultural importers

The effect of the CAP on the supply, and hence price, of foods imported by ldcs is the core of the claim that the CAP has benefitted rather than hurt the Third World. There are two elements to the argument. First, the food importing ldcs' balances of payments have gained from lower world food prices. This improvement in their terms of trade has contributed to overall economic development. Second, in countries facing large and growing structural food deficits (notably in Africa), the CAP has contributed to feeding 'the hungry of the world' by making food available on commercial and food aid terms. Both of these propositions can be challenged.

The beneficial effects of lower world prices are offset by the negative effects of increased instability in supply and price. By insulating a large share of the world's farmers and consumers from the price signals generated by global supply and demand changes, the CAP has had the effect of increasing instability on the residual world market. When there is a shortfall in world supply, for example, European farmers are not encouraged to grow more because they do not feel the effect of the resulting increase in world prices. Similarly, when there is a world glut Europe's farmers and consumers are protected from the effects of the fall in price. Since other industrialised countries also tend to insulate their farmers and consumers to a degree from the vagaries of the world market, it is precisely those countries that are poor and have weak administrations that have to bear the brunt of adjustment to changes in world supply and demand.

Furthermore, the depression of world market prices for food may only be in the interests of ldcs if current real price levels can be maintained in the longer term. Otherwise, countries may be induced to adopt development policies that devote agricultural resources to export crops rather than to food for domestic consumption only to find their agricultural terms of trade deteriorate in future as the costly policies that give rise to European surpluses are amended.

Hunger is a function not just of the availability of food but, more importantly, of income. While the fall in world prices occasioned by the CAP is one factor in the equation there are many others, and it is by no means the most important. Actions taken by the EEC (or other states) that alter ldcs' income can have a greater impact on the effective demand for food. While such action may occur in the agricultural sector, it may also occur in other sectors; hence protectionism in manufactures trade can also have a major effect on world hunger. Moreover, not all vulnerable groups within ldcs are affected significantly by world market prices. The current conventional wisdom is that the most effective way of relieving hunger among vulnerable groups in the rural areas of Africa, for example, is to enable small farmers to grow more food for their own consumption.

1. S. Harris, A. Swinbank, and G. Wilkinson, *The Food and Farm Policies of the European Community,* London, 1983

Weighing Costs and Gains

The CAP has a complex set of trade effects which can be positive, negative, or both depending upon the country. How can all these different effects be weighted to produce a single figure indicating whether the CAP overall is beneficial for ldcs? This task is made more complicated by the fact that the CAP has not affected just agricultural production; it has also affected other sectors of the European economy.

In general, if the analysis is confined to agricultural goods, the conclusion is that the net effect of the CAP on the Third World has not been very great either way: some studies show a small net gain to ldcs, others a small loss. If the analysis is broadened, however, to include non-agricultural trade, the negative effect on the Third World is seen to be much greater.

The analyses of the CAP's impact that are narrowly focussed on agricultural trade tend to conclude that the net effect is relatively small. One of the most extensive studies, for example, estimated that a full 50% reduction in the agricultural protection of all OECD states would result in a net gain to ldcs of only $400 million, since the benefits to food exporters (at $1 billion) would be partly offset by the losses of food importers (at $600 million).[2] One recent analysis indicates that the Third World has gained on balance.[3] These calculations do not take account of the cost to ldcs of the increased instability of the world market occasioned by the CAP.

If the analysis is cast more widely to include the indirect effects of the distortion to the EEC economy, the negative impact on the Third World is seen to be greater. Within Europe, the benefits of the CAP flow mainly to the rural sector while its costs are borne largely by the urban sector. Farmers gain from the price support of the CAP, and so do industries connected with farming such as manufacturers of agricultural machinery and of inputs. As a result, the CAP makes agriculture-related activities (such as investment, research and infrastructure) more profitable relative to non-agricultural activities than would otherwise be the case. Through their effect in raising the exchange rate, export subsidies provide an implicit subsidy on imports of other traded goods and a tax on other European exports.

According to its critics, this distortion of investment priorities constitutes the main economic cost of the CAP. One study, for example, has estimated that since 1973 the CAP has reduced Europe's manufactured output by 1.5% and its manufactured exports by 4%, has increased its manufactured imports by 5%, and has resulted in 1.5 million more unemployed than there would otherwise be.[4]

Analyses that try to take account of these broader effects suggest that even food importing ldcs suffer from the CAP. This is because their gains from cheaper food imports are more than offset by losses on non-agricultural imports that are more expensive than they would have been if the European economy had not been distorted against the non-agricultural sectors. Moreover, the slower growth of the European economy limits ldcs' growth opportunities. One recent analysis compares the situation in 1995 on two scenarios: one is that the CAP continues to develop in line with past trends; the other is that European agriculture is liberalised totally.[5] It concludes that real incomes in the ldcs as a group would be 2.9% higher on the 'without CAP' compared to the 'with CAP' scenario. To put this in perspective, it is of the same order of magnitude as the forecast gain to ldcs from the recent sharp fall in the price of oil. Moreover, although the extent of the benefit varies among countries, almost all the Third World regions would be better off on the 'without CAP' scenario.

Box 2
The Case of Sugar

Sugar presents a striking example of the EEC's transformation from importer to exporter — and of the consequences for ldcs. In the decade from 1973 the EEC changed from being a net importer of sugar to being the largest exporter to the world free market. This major shift was caused by the price incentives of the CAP, improved yields, new farm practices and, associated with these, a change in UK government policy.

Before joining the EEC, British government policy had been to limit beet sugar production and to supply the rest of the domestic market with cane sugar imported from the former colonies under the Commonwealth sugar agreement. One of the terms of British accession to the EEC was that the imports of cane sugar would continue. The EEC became committed to importing annually from certain African, Caribbean and Pacific (ACP) signatories of the Lomé Convention plus India 1.4 million tonnes of raw sugar at prices related to CAP levels, which are normally much higher than world prices. Despite this provision, cane imports to UK are far from secure. In the period 1972/4 — 1980/82, UK beet production rose by 50% while sugar consumption fell. The result has been competition for market share between the two forms of sugar in which, because of the structure of pricing, the cane sugar refiners have been at a disadvantage.

The beneficiaries of the EEC cane protocol have received high prices for part of their output (just over half of their total sugar exports in 1984) but they have suffered from low prices for their exports onto the world market, as have non-beneficiaries. The rapid growth of EEC exports has pushed down prices on the, always volatile, world market so that in 1985 they fell to historically low levels. The EEC refused to join any of the four international sugar agreements, which seek to regulate the world market, and was intimately involved in the disagreements that led to the collapse of negotiations for a fifth.

The accession of Portugal to the EEC will further damage ldc sugar exporters. Over a transitional period, Portugal's traditional imports of cane sugar from Africa are to be replaced by EEC beet and cane from the French départements d'outre mer.

Current Cause For Concern

These analyses of the overall impact of the CAP are revealing. Although the precise figures are controversial (because they depend upon many assumptions) the direction of the impact is clear: when all agricultural and non-agricultural factors are taken into account the CAP is seen to have an overall adverse effect on the Third World.

Yet, the political reality is that the CAP is not likely to be reformed fundamentally, let alone abolished. Rather, it will be amended at the margins in response to particular pressures. Of most important current interest is the way in which such marginal changes to the CAP would affect ldcs.

2. A. Valdes and J. Zeitz, *Agricultural Protectionism in OECD Countries: Its Cost to Less-Developed Countries.* (Washington, International Food Policy Research Institute), 1980. For a review of the various analyses of the Impact of the CAP, see C. Stevens and J. Verloren van Themaat, *Pressure Groups, Politics and Development: EEC and the Third World, A Survey 5,* 1985, Chapter 6.

3. A. Matthews, *The Common Agricultural Policy and the Less Developed Countries,* Dublin 1985.

4. Bureau of Agricultural Economics, *Agricultural Policies in the European Community,* Policy Monograph No.2 (Canberra), 1985.

5. Jean-Marc Burniaux and Jean Waelbroeck, 'The Impact of the CAP on Developing Countries: A General Equilibrium Analysis' in Stevens and van Themaat (eds), op.cit 1985.

Box 3
Food Aid

Food aid raises in an acute form the questions concerning the desirability of ldcs relying on subsidised EEC food exports. Supporters point to the role of EEC food aid in providing relief during famines and assistance to the balance of payments of food importing countries. Critics, by contrast, claim that it may undermine agriculture in recipient countries either directly by competing with local produce, or indirectly by enabling governments to neglect their rural sector.

Practice is more prosaic than theory. While food aid as a whole may carry these dangers, EEC food aid has a relatively minor influence. Possibly because the CAP is inward looking, the EEC has never developed an aggressive market development policy utilising food aid in the manner of the US. Consequently, EEC food aid is restricted in volume and subject to various administrative difficulties that limit its value. The Ten supply only some 20% (by quantity) of cereals food aid bilaterally or multilaterally. Moreover, the programmes are spread widely and thinly with many ldcs receiving only small allocations.

If EEC policy has encouraged some ldcs to become more dependent upon imported food than they would otherwise have been, this has been transmitted through commercial rather than food aid exports. This conclusion would change, of course, if the EEC adopted as a 'solution' to the CAP crisis the aggressive marketing of surpluses in the Third World using food aid.

Following the EEC Commission's substantial failure in 1985 to gain acceptance for its plans to reform the CAP, it is most likely that changes in the near future will be occasioned by budgetary pressure. A second source of pressure will be the GATT Round of trade negotiations.

Community budget expenditure has been growing more rapidly than income. The CAP is not the only item of expenditure that is increasing, but because it absorbs such a large proportion of the total (70% in 1984) and is obligatory, it is at the forefront of attention. The Community has several sources of income, but value added tax (VAT) is by far the largest (58% in 1984). Hence, the budget debate tends to involve the CAP on the expenditure side and VAT on the income side. The VAT element of the budget can only be increased following the approval of all member states' parliaments and the European Parliament. In 1985 an increase was agreed in the VAT ceiling from 1.0% to 1.4% providing a temporary solution. However, this ceiling is likely to be adjusted soon, following the fall in the value of the dollar.

Budget pressure will provoke a search for 'solutions' that reduce the cost of the CAP to the European Community budget. Two obvious candidates will be to restrict imports of competitive agricultural products, and to encourage farmers to diversify away from particular problem commodities.

The most likely candidate for further import controls are a group of products which, for historical reasons, are relatively lightly protected. The group includes oil seeds and cereal substitutes both of which are produced by ldcs. During the Dillon Round of multilateral trade negotiations in 1960-61 the US opposed the agricultural protectionism of the fledgeling CAP. One result of its opposition was that the EEC agreed to freeze protection of oil seeds, sheep meat and 'cereal substitutes' (e.g. manioc, molasses, fruit residues) at relatively low levels, and for these limits to be written into the GATT. The result has been a growing price gap between high cost domestic European feed stuffs and imports, with the latter growing rapidly. EEC imports of cereal substitutes quadrupled in the period 1970-82. There is pressure within the EEC to restrict these imports and so boost consumption of domestically produced feed-stuffs. Thailand has been forced to accept a 'voluntary' quota on its manioc exports, but further action has so far been prevented by the fact that the low EEC protection is written into the GATT and because of US threats of retaliation. Nonetheless, the EEC is likely to try to find ways around these obstacles.

Similarly, crop diversification within Europe might affect ldc interests. Within the budget context the most serious cause for concern at the present time is cereals. If farmers are given price or quota incentives to diversify out of cereals, they may move into sugar or oilseeds (notably oilseed rape). This would be doubly damaging to developing countries; ldc exporters of competitive products would face increased competition and food importing ldcs would feel the consequences of a fall in world cereal production.

The US is pressing for the inclusion of agriculture on the agenda for the next GATT Round of trade negotiations. Its aim will be, as a minimum, to avoid any cuts in current EEC agricultural imports from the US (such as cereal substitutes), and at best to increase the range of US exports to the EEC and reduce competition from the EEC in third markets. There is a danger that ldcs will be caught in the crossfire.

If the USA were to persuade the EEC to amend fundamentally the policies that give rise to complaints, the Third World might benefit. But a more likely scenario is that changes to EEC policies, if they occur, will be the result of US armtwisting. A collorary is that the EEC can be expected to offset concessions to the US by penalising third parties. For example, if the US is able to resist European moves to cut imports of its cereal substitutes, there will be pressure in the EEC to concentrate such cuts on the exports of those countries unable to retaliate effectively — ldcs.

The future shape of the CAP will continue to be determined by reaction to internal and external lobbies rather than by any attempt at economic rationality. Herein lies the main danger for the Third World. Ldcs tend to be relatively weak in their bargaining with the EEC. If European policy makers are forced by budgetary or external pressure to take difficult decisions, there will be a tendency for the burden of adjustment to be transferred whenever possible on to ldcs because they cannot retaliate effectively.

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