

## COMMON AGRICULTURAL POLICY REFORM AND NATIONAL COMPENSATION STRATEGIES\*

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### ABSTRACT

While providing income support to producers the Common Agricultural Policy also redistributes resources between EC member states. As a net agricultural exporter Ireland is a significant recipient of resource transfers in this way. Irish strategy in the past has been to maximise these transfers by supporting as high a level of price support under the CAP as possible. A reduction in agricultural support is one of the objectives of the Uruguay Round of GATT negotiations now underway. If successful, this would adversely affect the size of the transfers provided through the CAP. This paper quantifies the benefit to Ireland from the CAP in recent years and looks at possible compensation options if CAP transfers were reduced.

It argues that switching resources from CAP to non-CAP spending within the EC budget could leave this country better off in real terms while also being desirable on other grounds.

### 1. INTRODUCTION

EC agricultural policy has come increasingly under attack on a variety of grounds. Critics point to its high budget costs, its inability to maintain farm incomes, the skewed nature of the support it does provide, its regressive regional effects, the burden it places on consumers, its contribution to distortions in world trade, its environmental costs and its damaging effects on employment in the non-agricultural sector. Many simulation studies indicate that, for the EC as a whole, significant economic benefits would accrue from a reduction in agricultural support and a liberalisation of agricultural trade policy (Bowers and Cheshire 1983, Buckwell et al. 1983, Bureau of Agricultural Economics 1986, Commission 1981, European Parliament Socialist Group 1983, OECD 1987, Stoeckel and Brechling 1988, Tyers and Anderson 1988).

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The major reason why the EC has been slow to adopt reform is because the gains from reform, while widely spread, are relatively small in per caput terms, while the costs, in terms of lower farm incomes and asset values, are highly visible and concentrated on a relatively small group. The BAE study estimated that the average transfer arising from the Common Agricultural Policy (CAP) to each person engaged in farming in 1983 was 5,930 ECU, while the average burden was 202 ECU per person in the population at large. Tracing the way in which the agricultural producer lobby continues to attract a high level of transfers, despite declining absolute numbers and in the face of the criticisms above, is a fascinating exercise in political economy. It is widely argued that, if more far-reaching reform is to become a reality, it must be accompanied by measures which compensate at least existing producers for reduced support. There has been growing attention in the literature to the issue of 'decoupling' income support from price and markets policy (Grennes 1988, Dicke and Rodemer 1983). Direct income support schemes, however, still remain tentative and lack credibility in the eyes of their intended beneficiaries.

The CAP not only redistributes income from consumers and taxpayers to farmers, but also, because of the principle of common financing, between member states. Internal CAP prices generally exceed the level of world prices, so net agricultural exporters benefit from the CAP while net agricultural importers lose. National perspectives on CAP reform may be opposed to an EC-wide perspective for this reason. The case for compensation applies equally to member states of the EC as well as to producer groups.

In a previous paper to this society, Sheehy (1982) provided evidence of the costs to the Irish economy of diluting CAP price support. He explored the implications of three alternatives under the assumption of budget neutrality: a continuation of high prices combined with supply restrictions; higher co-responsibility levies to finance increasing export surpluses; and lower producer prices. Under all alternatives Ireland as a whole was shown to be worse off than with unchanged policies, with the alternatives generally ranked (in order of the least damaging to the Irish economy) as quotas, increased co-responsibility levies and common price reductions. The Sheehy paper did not consider the possibility that reduced agricultural expenditure might be compensated by increased receipts from other Community funds.

Since the Sheehy paper, major changes have been made to the CAP. These include the introduction of milk quotas in 1984, the dilution of intervention support and the various stabiliser agreements concluded in 1988. The Community has also undertaken a thorough-going budget reform, involving both changes in the way the budget is financed and, on the expenditure side, a greatly enlarged role for the various structural funds. An integral part of these reforms is a ceiling on the future growth in agricultural spending. Despite these changes at the margin, the fundamental objectives of the CAP to provide income transfers to agriculture through commodity price support within stated budgetary limits has not altered.

In the current Uruguay Round of the GATT, however, negotiations are underway which, if successful, would have very considerable implications for the conduct of EC agricultural policy. The goal of the negotiations, accepted by all partici-

pants including the EC, is to achieve greater liberalisation of trade in agriculture through improving market access and by increasing discipline on the use of all direct and indirect subsidies and other measures affecting directly or indirectly agricultural trade.

The US, broadly supported by the Cairns Group of developed and developing country agricultural exporters, has called for the complete elimination of all agricultural subsidies and import barriers over a ten-year period (with the important exceptions of income subsidies unrelated to production and bona fide food aid and food assistance programmes). The EC, supported to varying degrees by Japan and the Nordic countries, prefers to argue for immediate measures to strengthen world prices, to be followed by a second stage which would lead ultimately to a 'significant, concerted reduction in support' (see Matthews, 1988a for further discussion). The GATT participants meet in Montreal in December for a mid-term review of progress to date. Although the agricultural negotiations appear deadlocked at the time of writing, it would be foolish to assume that no progress will be made and that the CAP can continue as before.

The GATT negotiations provide the most favourable moment to make changes in the CAP, if change there must be. First, through multilateral negotiations the adjustment costs for agricultural producers (and net exporting countries) can be reduced; the more countries that liberalise simultaneously, the more the consequent rise in world prices will offset the effects of reduced support. Second, because the changes are negotiated at a point in time, rather than piecemeal, the case for compensatory policies can be argued with more hope of success.

Ireland, as a net exporter of CAP commodities, obtains a substantial balance of payments gain from a Community-financed high-price agricultural policy. Enthusiasm in Ireland for changes in the CAP has been muted as a result. There has been virtual unanimity across the political spectrum that Ireland's interests are best served by defending as long as possible the high price policy (O'Malley, 1988 is a rare exception). The Minister for Agriculture and Food recently announced the formation of a special group representing agricultural and food interests to lobby against the US and Cairns Group proposals (GIS 1988). His statement explicitly drew attention to the benefits arising from free access to the relatively high priced EC market, in addition to the transfers received from FEOGA, the Community's Agricultural Fund.

This paper attempts to broaden the range of options which Ireland might consider during the GATT talks to include compensation policies. The feasibility of trading agricultural support for alternative mechanisms to redistribute resources from the richer EC member states to Ireland was discussed in general terms in Matthews (1980). This paper seeks to evaluate the terms of the trade-off between reduced agricultural support and increases in other forms of Community spending in order to examine under what circumstances such a trade-off might be made favourable to Ireland. The focus is on the issue of national compensation and whether it is possible to decouple the resource transfer advantages of the CAP from its efficiency and distributional consequences. The issue of how producers might be compensated for any reduction in support is addressed in only the most general terms.

The paper proceeds as follows. Section 2 provides estimates of the net receipts from the CAP in recent years and places these in the context of other Community receipts. In Section 3 the size of the loss to Ireland from possible changes in the CAP is calculated. Section 4 describes recent changes in the CAP and in budgetary discipline and evaluates their likely effects for CAP transfers in the future. Section 5 examines the terms of the trade-off between reduced expenditure and increased non-CAP expenditure. The conclusions of the paper are brought together in Section 6.

## **2. IRISH NET RECEIPTS FROM THE CAP**

This section of the paper presents estimates of Ireland's net receipts from the Common Agricultural Policy. The series presented is comparable to an earlier series prepared by O'Connor et al. (1983) covering the years 1973-81. These receipts are made up of two elements:

- (a) the net budgetary effect, which is the net transfer of resources to Ireland through FEOGA. FEOGA is the EC's Agricultural Fund, with two components, the Guarantee and Guidance Sections. Included here are export refunds on sales to third countries, net MCA payments, payments under schemes for structural improvement and modernisation of farms, etc. while Ireland's contribution to the cost of the CAP, including various co-responsibility levies, is deducted;
- (b) the trade transfer effect which arises because, on trade with other Community countries, prices for commodities protected by the CAP are different (usually higher) than on world markets. It is measured as the difference between EC and world prices multiplied by the value of net exports to other Community countries.

The sum of the two effects represents the net receipts by Ireland due to the operation of the CAP.

### **2.1 The Value of FEOGA Transfers**

Total FEOGA receipts by Ireland in the period 1979-86 are shown in Table 1. Net FEOGA receipts are obtained by deducting Ireland's national contribution to the costs of the CAP. This is calculated as the total of import levies on CAP products plus sugar levies together with a proportion of the VAT and customs duties paid corresponding to FEOGA's share in total Community expenditure.

**Table 1: Estimated Irish receipts from, and payments to, FEOGA Guarantee and Guidance Sections, 1979-86, £ million**

	1979	1980	1981	1982	1983	1984	1985	1986
Guarantee Section	397.9	377.4	305.1	344.3	441.7	644.6	836.6	884.0
Guidance Section	18.5	31.8	41.9	59.6	63.7	49.3	55.8	46.6
Total FEOGA receipts	416.4	409.2	347.0	403.9	505.4	693.9	892.4	930.6
Estimated FEOGA contribution	47.1	66.5	70.3	89.6	127.6	148.8	158.8	161.0
Net FEOGA receipts	369.3	342.7	276.7	314.3	377.8	547.1	733.6	769.6

Source: See Appendix 1.

## 2.2 Value of the Trade Transfer

To assess the value of the trade transfer effect to Ireland Irish producer prices must be compared to world prices and net exports to other EC countries multiplied by the resulting price gap. The choice of prices to use in this comparison is not an easy one. Price comparisons should be made for products of the same quality, at the same marketing stage and at the same location. O'Connor et al. used the level of export refunds as their measure of the price gap for beef and dairy produce, while for other commodities they compared Irish prices with world offer prices recorded by the EC Commission (op. cit. p. 67).

Considerable work on the measurement of agricultural support has taken place under OECD auspices for different countries (OECD 1987). It has defined a measure of support called the Producer Subsidy Equivalent (PSE) which, in addition to measuring the price gap we require, embraces domestic subsidies as well. PSE estimates have been made by the EC Commission for the OECD study. Its estimates of the gap between EC and world prices (which is just one element in the PSE), together with comparable Irish prices, are shown in Table 2. Appendix 2 contains a detailed description of the product definitions used.

**Table 2: Price comparisons for selected commodities, 1979-86**

		1979	1980	1981	1982	1983	1984	1985	1986
Wheat	EC	109	111	123	131	141	133	127	131
	Irish	93	89	106	109	130	120	91	105
	World	82	91	100	97	125	128	89	58
Barley	EC	99	100	113	123	135	132	122	122
	Irish	86	84	93	99	125	117	93	102
	World	60	93	113	118	108	130	110	74
Maize	EC	103	159	174	190	201	205	196	189
	World	66	87	90	92	134	137	96	59
Sugar Beet	EC	23	26	25	27	33	33	30	32
	Irish	27	27	30	31	34	32	35	35
	World	9	26	18	11	14	10	9	9
Milk	EC	135	145	159	176	193	195	202	210
	Irish	113	111	127	139	152	155	160	165
	World	31	49	90	116	115	114	100	79
Butter	EC	1883	1976	2196	2348	2517	2372	2252	2306
	Irish	1864	1904	2114	2152	2438	2448	2366	2218
	World	597	702	1199	1516	1539	1485	1149	814
SMP	EC	789	819	905	976	1050	1167	1211	1241
	Irish	775	821	915	1008	1070	1204	1245	1275
	World	286	397	632	716	670	700	631	537
Beef	EC	1622	1638	1854	2041	2129	2065	2090	2160
	Irish	1509	1524	1820	1990	2196	2290	2218	2123
	World	1109	1102	1137	1174	1216	1155	1076	1170
Pigmeat	EC	907	932	1047	1184	1148	1206	1202	1092
	Irish	856	884	1018	1132	1123	1159	1139	965
	World	757	882	1013	1124	1050	1193	1114	855
Sheep	EC	2152	2012	2429	2550	2642	2667	2623	2694
	Irish	1930	1736	2192	2138	2219	2188	2060	2216
	World	887	1035	1618	1294	1186	1363	1402	1239
Poultry	EC	686	723	838	850	931	1004	990	1011
	Irish	541	553	618	650	671	740	704	708
	World	557	657	793	714	685	822	786	711
Eggs	EC	572	658	750	699	769	879	777	707
	Irish	635	715	854	779	781	908	816	683
	World	405	538	672	632	622	753	679	501

Source: See Appendix 2.

A feature of Table 2 is the variation in world prices during the period covered, resulting in considerable changes in the price gap for most commodities from year to year. The variability in world prices is partly explained by changes in the

global supply–demand balance for the commodities concerned. Another important factor in recent years has been fluctuations in the EIR/US dollar exchange rate, given that most world prices are quoted in US dollars.

A second striking feature is that Irish prices are, for most commodities, below average EC levels. The way the Irish price gap should be measured for the purpose of calculating the size of the trade transfer effect depends on the explanation for these differences.

If Irish/EC price differences are due to the imposition of MCAs, or because the coefficients used in calculating export refunds on semi–processed products are inappropriate to this country, or to barriers to trade (natural transport barriers as in the case of liquid milk or technical barriers such as prevent the export of minced meat to the continent), then the lower Irish prices represent genuinely lower support. The difference between Irish prices and the world prices as estimated by the EC represent the appropriate measure of the price gap. However, if lower Irish prices are due to poorer product quality, or to a less valuable product composition, or to higher processing or transport costs, then these factors should also be reflected by lowering the world reference price used for comparison.

The problem of finding an appropriate world price is particularly acute for beef and dairy products, partly because these products are the most important contributors to the total value of the Irish trade transfer, and partly because the fragmented nature of the world market for these products gives rise to various possible world price measures. Following O'Connor et al., export refunds have been used as the measure of the Irish price gap, implying considerably lower world prices than those shown in Table 2. A full discussion of alternative world price measures for beef and dairy products can be found in Appendix 2 where it is noted that the use of the EC's world price estimates would seriously underestimate the degree of price support provided.

Table 3 gives details of net exports to other EC countries by commodity. The figures for meat, dairy products and eggs are from CSO supply balance sheets, while those for cereals and sugar are own approximations due to the unavailability of CSO data. The figures are multiplied by the estimated price gap derived in Appendix 2 to give estimates of the value of the trade transfer in Table 4. The commodities included are the same as in O'Connor et al., except that other cereals and other dairy products have been omitted. Commodities not included in the table include both imports (rice, fruit and vegetables) as well as exports so the net effect of their omission will be small.

Finally, Table 5 brings together the estimated value of FEOGA budgetary and trade transfers and expresses them as a proportion of GNP at factor cost. The value of FEOGA receipts is adjusted to exclude both ACAs (Accession Compensatory Amounts) and MCAs (Monetary Compensatory Amounts) in order to avoid double counting with the value of trade transfers, for reasons explained by O'Connor et al. (pp. 88–89). Minor payments for fisheries purposes are also excluded.

**Table 3: Net exports of selected commodities to other EC countries, 1979-86, '000 tonnes**

Commodity	1979	1980	1981	1982	1983	1984	1985	1986
Wheat	-108	-160	-164	-95	-227	-228	-288	-311
Barley	188	167	33	106	20	101	131	169
Maize	-169	-186	-184	-158	-136	-111	-86	-77
Sugar (white)	4	15	13	32	31	52	38	24
Cheese	58	34	38	38	41	47	49	59
Butter	72	43	40	50	47	93	83	68
SMP	52	24	34	47	61	151	153	78
Beef	276	336	220	182	153	191	215	223
Pigmeat	43	34	25	23	27	17	13	14
Sheepmeat	9	13	12	15	15	17	25	23
Poultry	-1	1	-4	-1	-1	-3	-6	-6
Eggs	-4	-10	-13	-15	-13	-12	-11	-9

Source: Appendix 1.

**Table 4: Value of trade transfers between Ireland and other EC member countries, 1979-86, £ million**

Commodity	1979	1980	1981	1982	1983	1984	1985	1986
Wheat	-2.2	-1.1	-2.8	-2.2	-4.1	-3.6	-3.2	-19.3
Barley	6.6	-0.2	-0.4	-1.2	0.6	-0.1	-1.0	6.4
Maize	-6.3	-13.2	-15.5	-15.5	-9.0	-7.5	-8.6	-10.0
Sugar	0.4	0.1	0.9	4.0	3.9	6.9	6.1	3.9
Cheese	47.2	21.2	14.1	8.9	15.2	18.9	29.6	50.6
Butter	93.2	37.4	28.6	44.6	49.9	90.2	94.2	96.7
SMP	25.6	6.5	8.4	14.9	24.0	83.1	92.0	53.7
Beef	223.8	288.3	210.5	187.6	176.6	216.6	241.0	266.0
Pigs	4.2	0.0	0.1	0.2	2.0	-0.6	0.3	1.5
Sheepmeat	9.4	9.1	6.9	12.7	15.5	14.0	16.5	22.5
Poultry	0.0	-0.1	0.7	0.0	0.0	0.2	0.5	0.0
Eggs	-0.9	-1.8	-2.4	-2.2	-2.1	-1.9	-1.5	-1.5
Trade effect	401.2	346.3	249.2	251.7	272.5	419.3	465.9	471.1



**Table 5: Net receipts from the CAP, 1979-86, £ million**

Commodity	1979	1980	1981	1982	1983	1984	1985	1986
Net value of FEOGA receipts	369.3	342.7	276.7	314.3	377.8	547.1	733.6	769.6
Trade effect	401.2	346.3	249.2	251.7	272.5	419.3	465.9	471.1
Less adjustment	-73.1	-13.6	-2.0	-3.7	-1.1	-2.1	-4.8	-39.1
Net value of CAP receipts	697.4	675.4	523.9	562.3	649.2	964.9	1194.7	1201.0
Net CAP receipts as per cent of GNP at factor cost	9.8	8.3	5.5	5.2	5.5	7.4	8.6	8.2
Real value of net CAP receipts, 1980 = 100	122	100	65	59	62	84	99	96

Source: Receipt figures from Tables 1 and 4. To avoid double counting the trade and budgetary receipts are adjusted for ACA and MCA payments and fisheries receipts are excluded. GNP at factor cost figures from National Income and Expenditure, 1986 and 1987.

A similar pattern is shown by both the budget and trade transfer series. The value of transfers fell between 1979 and 1981 reflecting a reduction in beef exports and a rise in world dairy prices (which cut the size of the price gap to be covered) in those years. Both sets of transfers recovered after 1981, with a particularly spectacular rise in the value of FEOGA budgetary transfers between 1981 and 1985. There is also evidence of a relative shift from trade to budgetary transfers in the total, reflecting the greater importance of third country markets for Irish agricultural exports in recent years. The overall pattern of transfers over time is confirmed by looking at the trend in the importance of CAP receipts relative to GNP at factor cost, where they have fluctuated at around 8.0 per cent in recent years. Of this FEOGA Guidance Section payments accounted for 0.4 per cent annually, so the share of Guarantee transfers alone in gross national income can be obtained by deducting this figure from the percentage values in Table 5.

The real value of CAP receipts (adjusted for inflation) is shown in the last row of Table 5. It shows a sharp fall in the real value of these receipts between 1979 and 1982 with some recovery since then. Finally, the results in Tables 4 and 5 can be compared with those in O'Connor et al. for the years 1979-81 which are common to both studies. Their figures are reproduced in Appendix 3 for convenience. The two sets of estimates are broadly in agreement in absolute terms, although expressed as a proportion of GNP at factor cost the figures in this paper are slightly lower than those reported in O'Connor et al. (9.8, 8.3 and

5.5 per cent as against 10.4, 8.8 and 6.3 per cent for the years 1979–81 respectively), possibly because of revisions to the national accounts in recent years.

The value of CAP receipts estimated in Table 5 can also be compared with receipts from other European Community funds. There is particular interest in the comparison with receipts from the so-called structural funds – the Regional, Social and FEOGA Guidance Funds. For this purpose the value of FEOGA Guidance Section transfers must be separated from the value of CAP transfers – the resulting figure is called the value of price support transfers. A second adjustment is required because structural fund receipts are expressed in gross terms, so the estimated Irish contribution to the cost of the CAP must be added back to give the gross value of price support transfers (Table 6). The table shows that CAP receipts have dwarfed receipts from the structural funds through the mid-1980s.

**Table 6: Ireland's gross receipts from the EC structural funds in comparison to the value of CAP price guarantee transfers, £ million**

Year	Regional Fund	Social Fund	FEOGA Guidance Section	Total Structural Funds	Gross value of price support receipts
1979	25.5	28.8	18.5	72.8	726.0
1980	46.4	46.7	31.8	124.9	710.1
1981	54.6	45.3	41.9	141.8	552.3
1982	66.1	73.2	59.6	198.9	592.1
1983	58.2	92.7	63.7	214.6	713.1
1984	65.2	84.3	49.3	198.8	1061.8
1985	76.0	141.3	55.8	273.1	1297.7
1986	77.1	124.5	46.6	248.8	1316.0
1987	87.0	193.0	67.9	347.9	n.a.

**Note:** The value of CAP price support receipts is obtained by subtracting FEOGA Guidance payments from the estimated net value of CAP receipts in Table 5, while adding back Ireland's estimated contribution to the cost of the CAP. It also includes the trade transfer effect.

**Source:** The Single European Act, Stationery Office, May 1987; latest years from the relevant Departments.

### 3. THE EFFECTS FOR IRELAND OF CAP REFORM

Ireland's net receipts from the CAP are sometimes quoted as what Ireland would lose from the removal of CAP price support (for example, Sheehy, 1988 uses O'Connor et al.'s figures in this sense). Only under very particular assumptions would this be the case. The costs to Ireland of agricultural trade liberalisation will generally be very much lower. This section explains why this will be the case and quantifies these costs.

The impact on Ireland of CAP reform can only be defined by reference to the alternative policy which would be put in place in the absence of the CAP. One alternative scenario is to assume that agricultural price policy would continue to be implemented as at present both in Ireland and in other Community countries but that it would be financed nationally rather than by the Community. Because support prices remain unchanged there would be no change in the quantities supplied, demanded or traded in this alternative scenario. The impact on a member state arises solely because of the renationalisation of financing arrangements. The calculation of Ireland's net receipts from the CAP in Section 2 implicitly assumes this scenario. The benefit of the CAP to Ireland is defined as the benefit of having agricultural policy financed by the Community rather than by the national Exchequer.

A second alternative scenario is to compare the present situation of price support with a situation of no support brought about by agricultural trade liberalisation. Supplies and demand as well as prices will change under free trade. The impact of the CAP on a member state is measured as the change in economic welfare (including the separate changes in producer, consumer and taxpayer welfare) due to the CAP compared to free trade (an example of this approach is Buckwell et al. 1982). The free trade scenario could be based on unilateral liberalisation by the EC alone, or on multilateral liberalisation by all OECD countries, or by the world as a whole. The size of the gain or loss due to the CAP for individual member states will depend on the particular free trade scenario considered as the alternative policy regime.

A third alternative scenario is to envisage a situation of agricultural free trade but where the resulting savings in the Community budget are transferred to other Community expenditure programmes. An obvious candidate would be some form of compensatory payment programme for producers adversely affected by the change in policy regime. Alternatively, further increases in the structural funds targeted on the disadvantaged regions of the Community might be sought. The impact of alternative Community expenditure programmes on Ireland will depend on the criteria used to distribute these funds and how large a share of this expenditure Ireland would obtain.

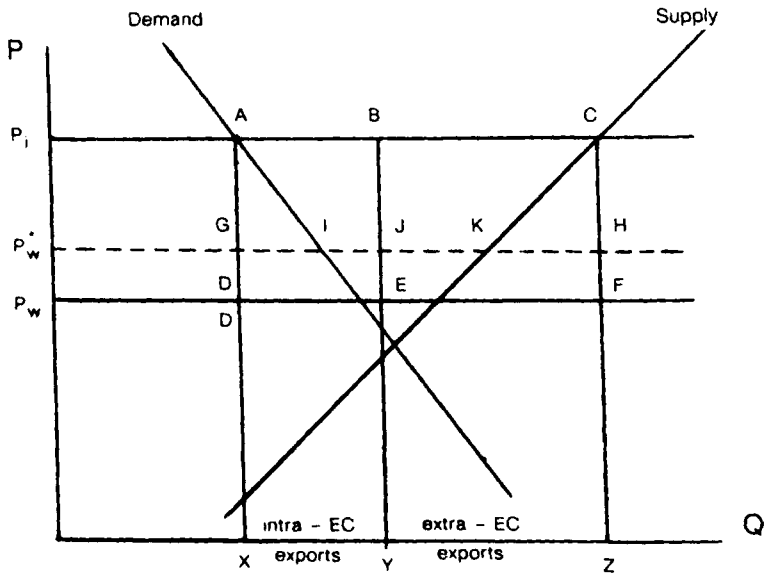
In this section the costs to Ireland of agricultural trade liberalisation are estimated. Ireland's loss from a move to national rather than Community financing of agricultural policy is referred to as the renationalisation loss. Its loss from a move to a policy of liberal agricultural trade by the Community is referred to as the trade liberalisation loss.<sup>1</sup> It will be shown that the size of the trade liberalisation loss is smaller than the renationalisation loss because various compensatory mechanisms come into play. If further compensation in the form of in-

creased spending by the Community budget is undertaken, the liberalisation loss is further reduced and, under certain conditions, Ireland could be made better off. This last possibility is explored in Section 5.

The difference between the renationalisation loss and the trade liberalisation loss is elucidated in Figure 1. Ireland is depicted here as a net agricultural exporter at the support price  $P_i$ . Total exports  $XZ$  are made up of exports  $XY (=DE)$  to other EC countries and exports  $YZ (=EF)$  to third countries. The Community pays export refunds on exports to third countries equal to the difference between the Irish price and the world price  $P_w$  and the total budgetary transfer on these exports is given by  $BCFE$ . the value of the trade transfer on intra-Community trade is given by  $ABED$ . The value of CAP receipts is the sum of export refunds and trade transfers, or  $ACFD$ , plus other budgetary receipts to reimburse the cost of intervention plus aids to private storage.

These receipts exaggerate the loss to Ireland in the case of trade liberalisation because three compensatory mechanisms come into play. The first is that a reduction in Community agricultural support will tend to increase the level of world prices. Community production would be reduced and consumption increased, so that its level of net exports to the rest of the world would fall. With a lower level of export supply to the world market, world prices must rise to restore equilibrium. This is shown in Figure 1 as a rise in the level of world prices to  $P^*w$ .

Figure 1. How Ireland benefits from the CAP



The second compensatory mechanism is that productive resources in Ireland will be reallocated and consumers will revise their purchasing decisions to take advantage of the new price relationships. Irish resources employed in low productivity agricultural production (when measured at world prices) would be redeployed to more productive sectors (giving rise to a gain  $CKH$ ), while consumers would benefit from a widening of their consumption opportunities (equal to the area  $AGI$ ). Taking these two mechanisms together, the loss to the Irish

economy of a move to liberal agricultural trade is equal to the area ACKI which will always be smaller than the area ACFD.

A third compensatory mechanism which will cushion the loss of CAP transfers arises because not all of the existing receipts represent a net addition to Irish welfare. The mechanisms used to support farm prices at present impose real losses which would be avoided if support was removed. The main loss is the purchase of prime beef into intervention and its conversion to the much less valuable product of frozen beef.<sup>2</sup>

In addition, some FEOGA Guarantee payments are a reimbursement for services provided, e.g. storage, rather than an unrequited transfer. If the resources used for storage can be otherwise employed in the absence of intervention or private storage schemes, the welfare impact of the loss of these payments is quite different to the impact of the loss of untied transfers such as export refunds. This is the same distinction as between exports, which require domestic resources to produce, and grants and remittances from abroad which add directly to national income.

O'Connor et al. argue that a storage industry was created on the basis of intervention sales which would not have existed otherwise. However, even if the labour input, which in storage is rather small, would have been otherwise unemployed, the capital involved in the operation of storage and in the financing of stocks has a full market-related opportunity cost. We feel justified, therefore, in removing the cost of operating intervention and aids to private storage from the estimated loss to Ireland of eliminating price support. Only losses on intervention sales are retained as the true EC transfer. While this procedure may underestimate the gain to Ireland of being paid to provide storage services, it overestimates the gain by ignoring the wholly wasteful write-down in the value of beef in intervention storage.

The size of the savings in intervention and storage costs is easily found from the relevant FEOGA budgetary expenditure. Quantifying the size of the compensation which would follow from the reallocation of productive resources and of consumer purchases requires knowledge of the responsiveness of producers and consumers to changes in the relevant prices. For the purpose of the estimates below, price elasticities of supply and demand of 0.4 and -0.4 respectively have been assumed. Quantifying the size of the compensation provided through the lift in world prices requires the use of a simulation model. Estimates from an influential study by Tyers and Anderson (1988) for the years 1980-82 are shown in Table 7. Their results bring out clearly that the greater the number of countries liberalising, the stronger the world price effect.

**Table 7: Real world price effects of a liberalisation of agricultural markets in industrial countries, 1980-82**

Liberalisation by:	Wheat	Coarse grains	Beef/lamb	Pork/poultry	Dairy products	Sugar
	Percentage difference					
EC-12	6	5	22	4	33	11
EFTA	1	1	3	0	6	0
Japan	1	1	5	4	11	2
United States	1	- 4	3	- 1	28	3
All industrial economies	10	3	27	8	61	11

Source: Tyers and Anderson, 1988.

If the assumption is made that the liberalisation of agricultural policy would have had the same percentage effect on world prices in each of the years 1979-86 as Tyers and Anderson estimate for 1980-82 the size of the compensation provided by the lift in world prices can be derived from the estimates of the value of CAP receipts in Section 2. This amounts to the area GJED in the case of intra-EC trade and JHFE in the case of extra-EC trade in Figure 1.

These various adjustments to the renationalisation loss are made in Table 8 in order to arrive at the trade liberalisation loss to Ireland. As noted earlier, the size of the lift to world prices would depend on the number of countries participating in the liberalisation move. Two scenarios are included in Table 8. The first represents a unilateral move to agricultural trade liberalisation by the EC. The second simulates the outcome of a GATT agreement in which all industrialised countries agree to liberalise agricultural trade. This second scenario is the one which minimises the loss to Ireland compared to the existing situation.

Too much weight should not be placed on the results for individual years. The world price effects are the result of reducing 1980-82 protection levels and protection levels in other years will have been different. As there is evidence that protection in the mid-1980s was higher than in the early 1980s (OECD 1988), the loss to Ireland from foregoing agricultural price support in those years would be further reduced by higher world price effects than those allowed for in calculating Table 8.

**Table 8: The cost of Ireland of CAP reform under two liberalisation scenarios, £ million**

	1979	1980	1981	1982	1983	1984	1985	1986
Net value of CAP receipts less FEOGA	697.4	675.4	523.9	562.3	649.2	964.9	1194.7	1201.0
Guidance receipts	- 18.5	- 31.8	- 41.9	- 59.6	- 63.7	- 49.3	- 55.8	- 46.6
Net value of price support receipts	679.9	643.6	482.0	502.7	585.5	915.6	1138.9	1154.4
<b>Less UNILATERAL LIBERALISATION OFFSETS</b>								
Cost of Intervention Compensation from world price rise	6.6	22.7	21.4	20.5	38.8	54.5	92.6	100.8
Extra-EC trade	42	116	118	90	90	100	96	107
Intra-EC trade	94	109	96	98	94	148	140	112
Total	136	225	214	188	184	248	236	219
Reallocation gains	86	54	59	83	121	145	164	170
Total offsets	229	302	294	292	344	448	493	490
Loss from unilateral trade liberalisation	451	342	188	211	242	468	646	664
<b>Less MULTILATERAL LIBERALISATION OFFSETS</b>								
Cost of intervention Compensation from world price rise	6.6	22.7	21.4	20.5	38.8	54.5	92.6	100.8
Extra-EC trade	60	165	155	129	119	152	139	134
Intra-EC trade	132	151	142	149	149	243	224	168
Total	192	316	297	278	268	395	363	302
Reallocation gains	70	31	30	53	85	108	131	144
Total offsets	269	370	348	352	392	558	587	547
Loss from multilateral trade liberalisation	411	274	134	151	194	358	552	607
Multilateral trade liberalisation loss expressed as per cent a proportion of GNP at factor cost	5.8	3.3	1.4	1.4	1.6	2.7	4.0	4.2

**Methodological notes:**

Savings on extra-EC trade calculated by multiplying commodity export refunds in each year by the estimated percentage change in refunds following liberalisation. Based on dairy, beef and sheepmeat only. Savings on intra-EC trade calculated by taking the difference between actual and estimated world price levels following liberalisation, and multiplying by the volume of net exports to other EC members. The reallocation gains are estimated by the following formulae:

$$\text{Producer surplus gained} = 0.5 * Q * P_i * 0.4 * (P_i - P^*w)/P_i$$

$$\text{Consumer surplus gained} = 0.5 * C * P_i * 0.4 * (P_i - P^*w)/P_i$$

where Q = Irish production, C = Irish domestic uses,  $P_i$  = Irish price level before liberalisation,  $P^*w$  = world price level after liberalisation. The reallocation gains calculated only for dairy products, beef and sheepmeat as the savings for other commodities are trivial.

#### 4. THE IMPLICATIONS OF REFORMS ALREADY UNDER WAY

The estimates in Section 3 of the loss to Ireland from agricultural trade liberalisation quantify the situation as it existed in the first half of the 1980s. A more pertinent question might be to ask what the magnitude of the loss might be in the future. This will depend on the evolution of the level of Community prices relative to the level of world prices over the next few years. Current indications are that the reform of the CAP which has been gathering momentum in recent years will continue. 1992 is taken as the year on which to focus future projections.

In February 1988 the European Council adopted a further package of measures known as 'agricultural stabilisers' designed to curb production and expenditure growth. The key to the arrangements is the new reference framework for agricultural expenditure adopted within the context of budgetary discipline measures. Under this framework the annual growth rate of FEOGA Guarantee expenditure (less certain specified reductions) cannot exceed 74 per cent of the annual growth rate of Community GNP. The reference basis for this calculation is taken as 27,500 million ECU in 1988. A monetary reserve of 1 billion ECU is established to cover developments caused by significant and unforeseen movements in the dollar/ECU market rate compared to the rate used in drawing up the budget in any year. Savings or additional costs resulting from movements in the rate will be credited to or debited from the reserve without being included in the FEOGA Guarantee expenditure guideline.

Sceptics will say that decisions regarding budget discipline have been taken before. At the end of 1984, for example, the Council of Ministers agreed on new budget guidelines whereby the agricultural budget was to grow more slowly than the Community's own resources. Any unplanned expenditure was to be recouped the following year, mainly by making savings in the market organisations concerned. Despite this commitment the share of FEOGA Guarantee spending in the total budget was greater in 1988 than in 1984.

On this occasion the Council has tried to copperfasten its resolve by requiring the Commission's price proposals each year to be consistent with the limits laid down by the agricultural reference framework. The stabiliser mechanisms put in place for each product, in theory, give the Commission the necessary authority in this regard. These arrangements are described in detail in *Commission* (1988).

The way in which the value of Irish receipts from the CAP will be affected by these arrangements in the period to 1992 will depend on their impact on the level of



farmgate prices. In addition, the value of receipts will be determined by the volume of net exports and by the trend in world prices. Each of these three elements can be examined in turn.

The new arrangements will have their greatest price impact on cereals, where reductions of 6 per cent annually in real terms could be in prospect. Cereal growers will be adversely affected, but because Ireland is a net importer of cereals the impact on the value of CAP receipts will actually be positive. The key issue is what will happen to dairy and beef prices. Because dairy production is limited by the quota regime, the Commission has greater flexibility in setting its institutional prices for milk. A reasonable assumption is that these will be kept constant in nominal terms, and possibly some small increases granted, in the years to 1992. Of greater importance will be the relationship between farmgate and institutional prices, where the relative scarcity of milk supplies in Ireland may lead to a considerable strengthening of farmgate prices even with unchanged institutional prices for milk. Between 1984 and 1988 milk prices in Ireland increased by 24 per cent (Boyle 1988) compared to an inflation increase (CPI) of only 16 per cent and a 1.5 per cent increase in the EC target price for milk. On the other hand, the new arrangements for beef and sheepmeat will lead to a reduction in the farmgate value of these commodities though the precise impact is difficult to quantify (Fingleton, 1987 has a discussion of the implications of the new sheep regime).

The second element in the value of CAP receipts is the volume of net agricultural exports. Forecasts of the volume of agricultural output by Kearney and Boyle (1987) are shown in Figure 2 against the background of historical output trends. One observation on this figure is that the underlying trend rate of growth appears remarkably steady and unaffected by the wide variations in either real farmgate price levels or farmers' terms of trade over the period. The sharp break in the trend which occurred in 1984, and the subsequent fall in output forecast to continue until 1991, is due entirely to the imposition of milk quotas and the knock-on effect of reduced dairy cow numbers on the output of cattle. Kearney and Boyle estimate that gross output in 1991 will be 2 per cent below that in 1986 for these reasons. While a fall in domestic consumption could permit a slight increase in net exports even with unchanged production, it would not appear unreasonable to assume that net exports in 1992 will be unchanged from their 1986 level. Within this total, a shift away from dairy products (with their higher level of EC support) would tend to reduce the overall value of CAP receipts.

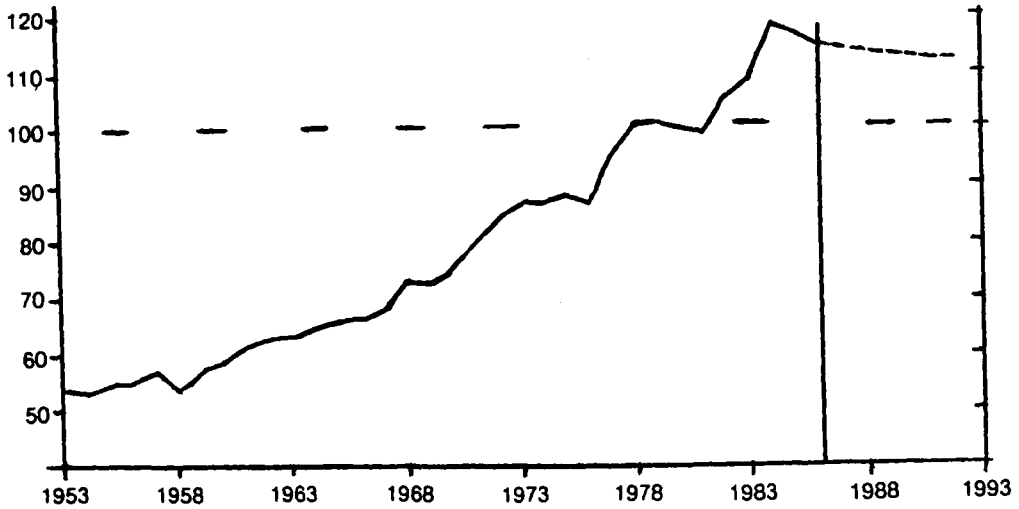


Figure 2. Volume of Irish agricultural output, 1953-91 . Source: Kearney and Boyle, 1987

The most difficult variable to forecast is the future level of world prices. Even with the stabiliser agreements exerting downward pressure on farmgate prices, the value of CAP receipts could still increase through 1992 if the level of world prices (in Irish pounds) fell by even more. At the time of writing world prices have increased significantly because of the impact of the American drought. The value of CAP transfers in 1988 will record a sharp fall as a result, for reasons which have nothing to do with the restrictive policies being pursued by the EC. Past experience (look again at Table 2) should warn against a continuation of this trend. In the absence of a breakthrough in the agricultural trade talks in the GATT, the continuation of high levels of agricultural support will tend to push world prices down again.

This section has reviewed recent developments in the CAP with the intention of trying to quantify their impact on the value of CAP receipts in the years to 1992. Our conclusions suggest that their most important effect will be to limit the possibility of expanding net agricultural exports. Their impact on farmgate prices will be less severe than might be expected (the key here will be the future movements in milk and beef prices) and, in the case of cereals where large price reductions are forecast, will have a positive impact on the value of CAP receipts.

The impact of internal CAP developments, however, are less important than what will happen to world prices because of the much greater variability in the latter. Because of the uncertainty in predicting world price developments to 1992, forecasts of the value of CAP receipts in that year are very risky. A benchmark estimate might assume unchanged net exports and unchanged farmgate and world prices in nominal terms in 1992 compared to 1986. In these circumstances the value of CAP receipts will be reduced by the rate of Irish inflation between the two years. Assuming an inflation rate of 3 per cent annually, then

the net value of price support receipts would be around £850 million (in 1986 prices), a fall of £205 million or 19.4 per cent compared to 1986.

Ireland's gain from the CAP compared to a trade liberalisation scenario will also be reduced under the same assumptions by 1992. Deducting £200 million from the estimated loss to Ireland under the two scenarios in Table 8 gives an approximate measure of the expected loss from the introduction of free trade in 1992.

## 5. COMPENSATION STRATEGIES

### 5.1 Compensation through Increased Structural Fund Expenditure

It was clearly established in Sections 2 and 3 that Ireland benefits from the operation of the CAP. The magnitude of this benefit depends on the alternative situation which would exist in the absence of the CAP. Reducing agricultural prices, if other things remain unchanged, has an adverse effect on the Irish economy. But lowering or eliminating agricultural price support will make EC budget resources available for alternative programmes which could be used to compensate Ireland and other member states adversely affected for this loss.

In this section the impact of switching EC expenditure from agricultural to non-agricultural programmes is investigated. In these circumstances, whether Ireland will lose or gain depends on the benefit it receives from expenditure under each heading. One possible alternative to CAP spending in the EC budget is increased structural fund expenditure. Ireland's share of spending of the three structural funds and its gains from CAP price support expressed as a proportion of FEOGA Guarantee Section expenditure in recent years are shown in Table 9.

For the structural funds both commitment and payment appropriations are shown. For some years Ireland's share of total EC commitments was greater than its share of total EC payments while in other years this is reversed. The differences are accounted for by variations in the timing of the start-up of major commitments both in Ireland and abroad, as well as by the speed with which projects which have been promised money are actually implemented on the ground. A sharp fall in the percentage received from all three funds is evident after 1985, arising from the accession of Spain and Portugal to EC membership. This was partially compensated by an increase in the total size of the funds, so that Ireland's receipts in absolute terms fell relatively little (Table 6).

Ireland has been most successful in the past with respect to the Social Fund, obtaining in one year (1983) over 15 per cent of the payments made in that year. In this the country was aided by its status as a 'super priority' region for Social Fund purposes. Ireland has also done relatively well from the FEOGA Guidance Section, obtaining on average around 10 per cent of all funds available. The country has been least successful with respect to the Regional Fund, obtaining only just over 6 per cent on a commitments basis although rather more in actual payments terms. Unlike the other funds, the distribution of Regional Fund monies was controlled throughout the period, first by fixed quota allocations and subsequently by a somewhat more flexible system of indicative ranges.

Ireland's 'share' of FEOGA Guarantee spending is also shown in Table 9. To change FEOGA Guarantee spending means changing the level of support prices

and this in turn will impact on Ireland through its effect on the value of both trade transfers as well as budgetary receipts. Thus in calculating what Ireland gains from Guarantee spending both the trade transfer effect and the budgetary effects must be taken into account. Two alternatives are shown in the table. In one alternative, the ratio of the multilateral trade liberalisation loss to Ireland from removing CAP price support to total FEOGA Guarantee expenditure is taken as the measure of Ireland's share of Guarantee expenditure benefits. In the other alternative, the ratio of Ireland's gross receipts due to CAP price support to total FEOGA Guarantee expenditure is taken.

What is striking about the comparison of the gain from Guarantee expenditure compared to Ireland's share of spending under the structural funds is that Ireland has done consistently better under the latter. Table 9 demonstrates that if savings in Guarantee expenditure arising from lower price support had been switched to increased spending under the three structural funds, the country as a whole would have benefited in each of the years shown. Even if savings in the CAP had been applied to increasing Regional Fund spending, Ireland would have gained in each year. Conversely, if Ireland pressed for additional CAP expenditure at the expense of increased resources for the structural funds, the country as a whole would be poorer as a result.

**Table 9: Ireland's share of particular EC spending programmes**

		1982	1983	1984	1985	1986
		EUR 10		EUR 12		
		percentage				
FEOGA Guidance Section	CA	11.4	10.6	9.0	9.7	8.4
	PA	13.2	11.7	9.9	10.6	8.8
Social Fund	CA	9.5	9.7	11.8	12.3	9.3
	PA	12.7	15.1	8.2	12.1	8.7
Regional Fund	CA	6.2	5.0	6.8	6.3	3.8
	PA	9.6	7.5	7.7	7.3	3.2
Total structural funds	CA	8.4	7.8	9.0	9.2	6.4
	PA	11.6	10.9	8.3	9.7	6.3
Gain from Guarantee expenditure (1)		1.8	1.8	2.7	4.0	4.3
Gross price support receipts (2)		7.1	6.5	9.6	9.3	9.4

**Notes:** CA = commitment appropriations  
PA = payment appropriations

- (1) The benefits from the CAP compared to multilateral trade liberalisation expressed as a proportion of FEOGA Guarantee expenditure.
- (2) Ireland's gross receipts from price support (including the trade transfer) expressed as a proportion of FEOGA Guarantee expenditure.

**Source:** Court of Auditors' Reports; Commission, Agricultural Situation in the Community.

This conclusion is based on the assumption that Ireland benefits or loses equally from all changes in FEOGA Guarantee expenditure. This is clearly not the case. Ireland's gross gain from additional Guarantee expenditure will be higher in the case of products of particular interest to Ireland. It may still be worthwhile to press to maintain or increase the level of support for milk or beef production, for example, even if increased structural fund spending was the alternative use of this money.

The methodology here could in principle be used to calculate the gain from expenditure on particular commodities. However, the aggregate approach can be defended on the grounds that possible Community bindings in the GATT would tend to apply broadly across all commodities, and an a la carte approach to agricultural support policy would not be possible.

It should be pointed out that the comparison in Table 9 is an all-or-nothing one. The marginal benefit/loss to Ireland from changes in Guarantee expenditure may well differ from the average share shown in Table 9. In particular, as price support is reduced, the trade gains will come to dominate the budgetary gains and the ratio of Ireland's receipts or gain to total FEOGA expenditure will increase. Although the statement that Ireland could be better off by foregoing agricultural price support if the budgetary resources saved were transferred to the structural funds is supported by the evidence in Table 9, it could also be true that some modest level of agricultural support would be even more advantageous. Quantification of this optimal level of price support is not pursued in this paper.

The conclusion that structural fund spending could ensure as large a resource transfer to Ireland as agricultural price support is shown to be a robust one by looking at the gross receipts from Guarantee expenditure in the last row of Table 9. Although the use of gross receipts is theoretically inappropriate in this context, it provides an indication of the maximum possible loss to Ireland from eliminating CAP price support, without making any allowance for world market price effects or resource reallocation following CAP reform. Apart from 1986 (which is affected by the enlargement of the Community in that year) the gross receipts from agricultural spending were no greater than what might have been expected from a corresponding increase in structural fund spending.

The importance of this finding is that it shows the possibility that Ireland could be compensated for the loss of CAP support within the existing EC budget size. It would not require, as is usually argued, an increase in this budget which might be hard to realise.

How robust is this conclusion with respect to future trends? This depends on the likely evolution of Ireland's share of EC spending under each heading. There is some degree of clarity about Ireland's expected receipts under the structural funds following the adoption of the framework regulation on the structural funds in June 1988 and the accompanying directives now under discussion (COM(88)500). It was agreed to increase the commitment appropriations for the structural funds (7,700 million ECU in 1988) by 1,300 million ECU a year (in 1988 prices) over the period 1989-92 to 12,900 million ECU in 1992, and to continue the effort to ensure that in 1993 the figure would be double the 1987 level.

Our interest here is not in the absolute size of the funds but in Ireland's likely share of structural fund spending under the new arrangements. This will be influenced by three other commitments contained in the framework regulation. The first is that structural fund contributions to a defined list of priority regions should be doubled by 1992. These regions, which include both Ireland and Northern Ireland, generally have a per caput GDP less than 75 per cent of the Community average. There is a further commitment to make 'a particular effort' to assist the least prosperous regions within this priority list. Finally, the Commission will try to ensure that up to 80 per cent of Regional Fund commitments will be directed towards the priority regions.

I have argued elsewhere that these commitments are not as generous as they sound (Matthews 1988b). However, given the expectation that the resources received by the least developed regions will be doubled by 1992 compared to 1987 and that the Government is satisfied that this commitment also applies to Ireland within this group, then Ireland's share of total structural fund resources will rise slightly from the 6.5 per cent of commitments received in 1987 (this will occur because the proportion of funds going to the least developed regions will increase a little faster than the volume of funds in total).

It was argued in Section 4 that the absolute growth in FEOGA Guarantee spending in future will be constrained by the new stabiliser arrangements. Again, however, it is Ireland's share of whatever expenditure is made available (where 'share' is broadly interpreted to include the consequential trade as well as budgetary transfers) which is critical to evaluating the relative advantages of switching expenditure between programmes. In contrast to the structural funds, the adjustment of FEOGA Guarantee spending in 1986 to the consequences of Spanish and Portuguese membership had hardly begun. It must be expected that over time the balance of Guarantee spending will shift in favour of more support for Mediterranean-type products and that Ireland's relative share will fall. It is not possible to predict the quantitative importance of this effect, but it tends to confirm the conclusion that this country's interest lies in a greater relative emphasis on non-CAP spending.

The relative merits of substituting non-CAP for CAP spending are not solely a matter of the overall flow levels. One advantage of CAP spending is that it is both automatic and fully financed by the Community. In order to draw down EC structural funds, projects must be submitted and approved and, more important, the national exchequer must be prepared to meet part of the cost. In the 1980s, when the EC share of structural fund spending was often as low as 25 per cent, this implies that to attract £500 million of structural funds the Irish Government would have to find £1,500 million of counterpart financing. This constraint is mitigated although not eliminated by the higher share of EC funding of structural fund programmes agreed under the framework regulation.

There would also be distributional implications of switching expenditure. At present, the bulk of CAP benefits go to a relatively small number of well-off farmers with incomes above the national average. Structural fund spending would be more widely spread and would have a more egalitarian impact. Structural fund spending would also be concentrated more on investment projects with greater long-term benefits for the economy as these projects came on stream. These

distributional implications are concealed by the use of the change in national income as the sole criterion of which spending alternative is more advantageous from the Irish point of view.

## **5.2 Compensation through Direct Income Aids to Farmers**

This paper has deliberately confined its attention to the consequences of alternative spending decisions at EC level for the overall Irish economy. The impact of reduced agricultural support on the distribution of income, and on farm incomes in particular, has not been investigated. It would be desirable to accompany reduced agricultural support with some assistance to those adversely affected by such a move. The precise mechanics of how compensatory income payments might be made to producers would need to be thoroughly investigated. There are two broad alternatives: either the payments are made to farmers on the basis of some definition of need independent of (decoupled from) their production, or payments are made on the basis of production, perhaps up to specified quantities per farm (examples include premiums, deficiency payments and headage payments). The EC now has considerable experience with payments of the latter kind (the Commission's approach to direct income payments is discussed further in *Commission*, 1988).

In the spirit of this paper, the details of compensatory income schemes are not pursued here. Instead, attention is focused on the macroeconomic implications of such schemes. Instead of seeking compensation at the national level through increased structural fund spending (some of which will benefit agriculture and rural areas), a direct income support scheme at Community level could be sought. In a paper which deserves to be better known, the Socialist Group in the European Parliament (assisted by a group of experts which included Dr. M. Cuddy as the Irish representative) indicated how such a scheme might work (EP Socialist Group 1983). As before, the key to the net effect of the policy change towards liberal agricultural trade plus direct income payments to producers would depend on the Irish share of Community spending under such a programme.

The Socialist Group paper envisages that income support for farmers would be a national responsibility, but that the weaker agricultural economies should receive a contribution towards the cost of national support measures from the savings in the Community's agricultural budget as a result of the move to free trade – the effects of distributing 75 per cent and 50 per cent of such savings are examined. Its proposal envisages that the budget available for Community financial assistance for national income support programmes would be allocated to member states in proportion to the value of a coefficient based on (a) national per caput income, as an indication of a country's ability to pay income supports to its farmers, and (b) the national agricultural income per worker and the number of agricultural workers, as an indication of the need for income transfers to the farming sector. On the basis of these indicators for the Community of Ten, 34 per cent of the total Community contribution would be allocated to Greece, 10 per cent to Ireland and 56 per cent to Italy.

The net balance between the loss in agricultural gross value added (GVA) and national income as a result of trade liberalisation and the gain from Community

financial participation in the cost of national farm income support schemes is shown in Table 10. The loss in agricultural GVA is defined in this study as the loss in producer surplus resulting from the removal in support. The national loss (gain) is defined as the sum of the change in producer and consumer surplus, less the gain from lower EC budgetary contributions. Price reductions in EC common prices of 20 per cent for cereals, sugar beet, beef and milk, of 9 per cent for other livestock products and of 13 per cent in feed prices are assumed. The study is based on production, consumption and trade data for 1980. The results show that, under the assumed share-out of Community funds, Ireland as a whole would be better off under either size of Community programme. Indeed, Irish producers are shown to be better off if the larger budget is available for redistribution. Updating this study might show that the price reductions implied by a move towards free trade would now be larger than it assumed, and the resulting producer and national losses greater than it assumed. Nonetheless, it provides useful corroboratory evidence of the argument in this paper that Ireland could be adequately compensated for reduced agricultural price support within the confines of existing budget ceilings, without requiring an unrealistically high assumption regarding Ireland's share of the compensatory spending which would replace spending on price support.

**Table 10: The impact of the redistribution of budgetary savings in the form of Community financing of national income aids to farmers in Greece, Ireland and Italy**

Impact on agric. GVA	Consumer savings	Before redistribution of budget savings			After redistribution of budget savings			
		Savings in budget costs	National income effect	Savings in budgetary costs		National income effect		
				75%	25%	75%	25%	
		mio ECU						
B	359	312	293	106	175	87	156	
D	-456	178	-88	61	100	-205	-166	
Fr	-3170	1747	88	597	980	247	630	
G	-3637	2062	2486	616	1098	1036	1518	
Gr	-575	95	207	1740	1168	1816	1280	
Irl	-346	48	-200	510	357	262	109	
I	-2514	1057	1849	3130	2438	3922	1230	
NI	-963	450	-57	156	254	-351	-253	
UK	-2160	629	1761	-292	15	840	1147	
EC	-14180	6590	7659	6590	6590	7659	7659	

**Note:** Luxembourg is not included

**Source:** EC Socialist Group, 1983.

Lest this section of the paper be misunderstood, it is important to make clear that it is not arguing that Ireland does not benefit from higher agricultural price support and additional CAP spending under present arrangements; clearly it does. What the section does argue is that when resources devoted to agricul-



tural price support substitute for other forms of EC spending, or when savings in agricultural spending can be switched to other programmes, the evidence suggests that Ireland could be better off pursuing the non-CAP options. This conclusion is based on a comparison of Ireland's share of spending under major non-CAP programmes with the national gain from similar expenditure on the CAP. The crucial assumption is that such a choice actually exists in practice. This issue is taken up in the final section.

## 6. CONCLUSIONS

Ireland benefits from the operation of the European Community's Common Agricultural Policy in two ways: consumers in other EC countries pay higher-than-world-market prices for the Irish food products they buy and the EC pays export subsidies on Irish food exports to countries outside the Community. The sum of these trade and budgetary transfers is one measure of the extent to which Ireland benefits from the CAP. It implicitly assumes that the alternative to the CAP is nationally-financed agricultural price support at the same level as under the present CAP. This paper estimates that the net value of CAP receipts (deducting Ireland's contribution to CAP expenditure) increased from £700 million in 1979 to £1,200 million in 1986. These amounts represented 9.8 per cent and 8.2 per cent of Irish gross national income in the two years respectively.

The paper argues, however, that these figures overestimate the extent to which Ireland would lose from a reduction in EC farm prices. Offsetting mechanisms would come into play in such an event. World market prices would increase because of lower CAP support and Irish resources would be reallocated to minimise the adverse effects of lower farm prices. Also, not all FEOGA payments add to the welfare of the Irish economy. Based on particular assumptions regarding the extent to which world prices would increase following a liberalisation of the CAP, the loss to Ireland in 1986 would be between £600 and £700 million, or 4 to 5 per cent of Irish gross national income. Because of the various stabiliser arrangements now in place for agricultural commodities in the EC, the value of these transfers is expected to fall in the years to 1992. The paper suggests a benchmark loss of around £200 million compared to the above figures, although the actual figure could be greater or less depending on the trend in world prices between now and 1992.

Talks are currently taking place within the GATT with the objective of bringing about a reduction in agricultural support on a multilateral basis. Initial reactions from the Irish Government are to oppose these moves because of the losses implied both for Irish farmers and for the economy as a whole.

This paper examines an alternative option and asks how, from a national viewpoint, we would be affected if the EC budget savings resulting from reduced agricultural support were channelled into other EC spending programmes. The benefit to Ireland from different EC programmes in the past is examined. The paper estimates, taking the year 1985 as an example, that Ireland obtained £100,000 of every £1 million spent by the EC through the FEOGA Guidance Section; £120,000 out of every £1 million spend by the EC's Social Fund; £73,000 out of every £1 million spent by the EC's Regional Fund; but only benefited by £46,000 for every £1 million spent by the EC's Agricultural Fund.

The precise figures vary from year to year, but the trend throughout the 1980s is consistent in showing that this country overall would have benefited from a greater emphasis in the Community budget on structural fund spending instead of higher agricultural support. Likely trends in Ireland's share of different Community spending programmes in the future reinforce this conclusion.

How realistic is it to envisage such a trade-off taking place? If agricultural support is cut in piecemeal fashion, it is extremely difficult to insist on special compensation arrangements at every stage. This is particularly the case under EC institutional rules where the competence of EC Agricultural Ministers who make the cuts does not extend to other budgetary areas. Nonetheless, the principle of compensation even within the agricultural budget has been accepted in the past, e.g. the introduction of special structural schemes or the beef premium scheme.

It is easier to argue for compensation at a time of discrete change, when a clear alteration to the 'marriage contract' between EC member states is in prospect. One example was the provision of interest subsidies on the introduction of the European Monetary System in 1979 to ease the adjustment costs of weaker economies. A more pertinent example is the trade-off contained in the Single European Act, where the agreement by weaker countries to the completion of the internal market was linked to the stronger commitment to economic and social cohesion and the eventual doubling of the structural funds. A GATT-negotiated reduction in agricultural support is such a moment of discrete change which provides the opportunity to press the case for compensatory policies. Compensation might be sought through further increases in the structural funds after 1992, or through a new Community-funded scheme of direct income support for farmers in need of income assistance. The crucial finding is that full compensation could be made to Ireland, on plausible estimates of Ireland's share of any compensation scheme, without any increase in the present size of the EC budget.

The paper argues the case for switching EC resources from CAP to non-CAP spending largely on macroeconomic grounds, but other considerations are briefly mentioned. The automaticity of CAP payments and their full 100 per cent financing by the EC stands in their favour. On the other hand, the bulk of CAP benefits go to a relatively small number of better-off farmers and increased structural fund spending would potentially have a more egalitarian impact. Also, structural fund spending would be concentrated more on investment projects, with greater long-term benefits for the economy as these projects mature.

## FOOTNOTES

1. These distinctions were suggested by Prof. Sheehy in his discussion of the paper.
2. This point was raised by Dr. Riordan in the subsequent discussion.

## Appendix 1

### Data Sources

#### Table 1 sources:

FEOGA payments to Ireland are given in the Department of Agriculture, Annual Reports, various years. Specific payments not broken down in the Annual Reports obtained directly from the Department of Agriculture. The breakdown of Ireland's payments to the Community obtained from the Department of Finance. FEOGA's share in the EC budget obtained from Agricultural Situation in the Community.

#### Table 3 sources:

Figures on net exports to other EC member states for meat, dairy products and eggs obtained from CSO supply balance sheets for these commodities. Net export figures for cereals obtained from the CSO Trade Statistics by combining the following items. For wheat, the sum of 04120 (other wheat unmilled) plus 04601 (wheat flour) multiplied by a factor of 1.4 to convert to wheat equivalent, plus 04602 (groats plus wheat pellets) multiplied also by 1.4. For barley, the sum of 04300 (barley unmilled) plus 04811 (other worked cereal grains) and 04820 (malt), each multiplied by 1.4. For maize, 04400 (unmilled). For sugar, 06120 (refined sugar) total exports and imports of sugar in white sugar terms are available from the CSO balance sheets on a crop year basis. Trade in refined sugar with non-EC countries is deducted from these figures, and it is assumed the balance is trade with EC countries.

## Appendix 2

### Methodology of Calculating Irish Commodity Price Gaps

To calculate the value of trade transfers to Ireland arising from intra-EC trade at higher than world prices, it is necessary to compare Irish prices with world prices. The prices shown in Table 2 have been used to make these comparisons, unless otherwise noted below. The prices used and their sources are described in this Appendix. References to Eurostat codes are to the Eurostat volume Agricultural Price Statistics 1977-86. The source for prices otherwise unspecified is the PSE submission by the EC Commission to the GATT Secretariat.

**Wheat:** Both EC and Irish prices are the prices received by producers ex-farm for all qualities (Eurostat A.01). The world reference price is the price for EC standard wheat, fob Rouen, as determined under the system of export tenders to various destinations. Irish wheat would have to be dried, with weight and other losses of up to 20 per cent to be comparable to the French wheat price at Rouen<sup>1</sup>. On the other hand, the EC world reference price is an export price, while Ireland is a net wheat importer. Thus the price of transport from the nearest supplier would have to be added to the French price to make it an appropriate Irish reference price. As these two factors offset each other, the price gap is taken as the difference between the Irish price raised by 10 per cent and the world prices shown in Table 2.

**Barley:** Both EC and Irish prices are the price received by producers ex-farm for all qualities of feeding barley (Eurostat A.04). The world reference price is the EC export unit value (NIMEXE 10.03.90). As for wheat, Irish prices would need to be increased by around 20% to take account of weight and other losses during drying to bring it to export quality standard. As most Irish barley exports go to Northern Ireland, and there is some degree of natural protection for the island as a whole, Irish export prices would generally be slightly above the average EC export unit value. As these factors offset each other the price gap is taken to be the difference between the Irish price raised by 10 per cent and the world prices shown in Table 2.

**Maize:** The EC price is the price received by producers ex-farm for all qualities (Eurostat A.07). The world reference price is the price of USA Yellow Corn No. 3, cif Rotterdam. It is assumed this price gap reflects the additional cost to Ireland of having to import maize under the CAP from the EC compared to a no-protection regime.

**Sugarbeet:** Both EC and Irish prices are for standard quality sugar beet at 16 per cent sugar (Eurostat C.02). The world reference price is derived from the price of white sugar, Bourse de Paris, fob EEC, converted to sugar beet equivalent. This is also taken as the appropriate Irish reference price.

**Dairy products:** EC and Irish whole milk prices at standard fat content have been taken from Eurostat (F.01). The world milk price is derived from world reference prices for fat and skimmed milk derived from New Zealand export prices for butter and SMP, weighted by the share of milk fat and skimmed milk in EC whole milk production.

World butter and SMP prices are New Zealand export prices. EC butter and SMP prices are ex-factory prices. Irish butter and SMP prices are intervention prices (in ECU, from *Agricultural Situation in the Community*) converted to Irish currency using a monthly average of the representative rates prevailing in each month.

Export refunds available for butter and SMP at particular times are quoted in ECU in Bord Bainne Annual Reports. These were converted to annual figures by averaging export refunds paid in each month (if export refunds changed in a month, the refund available for the greater part of the month was used) and converted to Irish pounds using the representative rate prevailing in that month. If these export refunds are subtracted from the Irish intervention price, an imputed world price is derived which can be compared to the New Zealand export unit value for butter and SMP. The two series for both commodities are shown in Table A.1. They move closely together although there are significant differences in individual years. Export refunds are used to measure the price gap in this paper, rather than the difference between Irish and world prices shown in Table 2.

**Table A.1 Alternative World Price Quotations for Dairy Products, 1979-1986**

Butter	1979	1980	1981	1982	1983	1984	1985	1986
	£/tonne							
Irish intervention price	1864	1904	2114	2151	2438	2448	2366	2218
Export refund	1295	870	716	892	1061	970	1135	1422
Imputed world price	569	1034	1398	1260	1377	1478	1231	796
New Zealand butter price	597	702	1199	1516	1608	1485	1148	814
<b>Skim Milk Powder</b>								
Irish intervention price	775	821	915	1008	1070	1204	1245	1275
Export refund	493	271	247	316	393	550	601	689
Imputed world price	282	550	668	693	677	654	644	586
New Zealand SMP price	286	397	632	716	670	700	631	537

The price gap for cheese was based on the difference between the Irish and world milk prices shown in Table 2, multiplied by ten.

**Beef and veal:** The EC price is an unspecified wholesale market price, liveweight, converted to carcass equivalent by applying a coefficient of 1.85 to the liveweight price. The Irish price is the liveweight price of bullocks between 500 and 549 kg delivered to auction marts (Eurostat A.04), and converted to carcass equivalent by applying a coefficient of 1.92. The world reference price

shown in Table 2 is the EC export price of live animals free-at-Community frontier offer price, liveweight converted to carcass equivalent. The Commission warns that this price is not necessarily representative of all beef and veal exports from the EC.

The Commission's world reference price is compared to an imputed price obtained by deducting the Irish export refund from the Irish market price in Table A.2. EC export refunds differ by destination and by type of animal, and the refund used is that for live male animals to North African markets, converted to carcass equivalent by multiplying by 1.92. The source used was the CBF Weekly Market Intelligence Bulletin, and annual refunds were calculated by taking a simple annual average of the first weekly quotation in each month. Some error is introduced by this procedure as Irish beef and cattle exports are not evenly distributed throughout the year, but the error is small as the refunds change relatively little during a year. The imputed price differs from the EC's world reference price, but the latter may be influenced unduly by exports to other European countries where the export refund payable is much lower. Irish export refunds were used as the measure of the price gap in this study.

**Table A.2 Alternative World Price Quotations for Beef Cattle, 1979-86**

	1979	1980	1981	1982	1983	1984	1985	1986
	£/tonne							
Irish market price	1509	1524	1820	1990	2196	2290	2218	2133
Export refund	811	858	688	892	106	1970	1135	1422
Imputed world price	698	666	1132	1098	1135	1320	1083	701
EC world reference price	1109	1102	1137	1174	1216	1155	1076	1170

**Pigmeat:** The EC price is the producer price for pigs, class II, carcass weight, either ex-farm or market or ex-slaughter house (Eurostat B.03). The Irish price is the average liveweight price for bacon pigs delivered to market (Eurostat B.01), converted to carcass equivalent by applying a coefficient of 1.33 to the liveweight price. The EC world reference price is an implicit price obtained by deducting the excess cost of feed used in pigmeat production. The difference between the Irish and EC world reference price is taken as representative of the Irish price gap.

**Sheepmeat:** The EC price is the (unspecified) producer price for mutton and lamb in carcass weight. Because of the existence of the variable premium in the UK, a direct comparison with the Irish price cannot be made. The Irish price is the liveweight price for sheep between 50-59 kg ex mart (Eurostat C.04), converted to carcass equivalent by multiplying by 2. The EC world reference price is the EC, cif UK border, New Zealand lamb (frozen) grade PM net of slaughter and freezing costs, plus 30 per cent adjustment coefficient to account for fresh/fro-

zen and quality differences. The difference between the Irish EC world reference price is taken as representative of the Irish price gap.

**Poultrymeat:** The EC price is the producer price for live fowls, top quality, converted to carcass equivalent by dividing the liveweight price by 0.75. The Irish price is the price for broiler chickens, ex-farm (both series from Eurostat D.01). The EC world reference price is the EC external trade unit value, NIMEXE 02.02.03, chickens 70 per cent. The difference between the Irish and EC world reference price is taken as representative of the Irish price gap.

**Eggs:** The EC price is the price of fresh eggs from the producer to the trade, average weight 57.5g. The Irish price is the price per 100 eggs from the producer to the packing station for all sizes, also converted to weight using an average weight of 57.5g (both series contained in Eurostat G.01). The EC world reference price is the unit value egg export price, NIMEXE 04.05.14. The difference between the Irish and EC world reference price is taken as representative of the Irish price gap.

The price gaps used in the calculating of the trade effect of CAP price support are shown in Table A.3.

**Table A.3 Price Gaps for Selected Irish Commodities, 1979-86,**

	1979	1980	1981	1982	1983	1984	1985	1986
	£/tonne							
Wheat	20	7	17	23	18	16	11	62
Barley	35	-1	-11	-11	30	-1	-8	38
Maize	37	71	84	98	66	68	100	130
Sugar	110	8	72	124	126	133	162	163
Cheese	814	623	371	234	371	402	604	857
Butter	1257	858	688	892	1061	970	1135	1422
SMP	621	273	243	316	393	550	601	689
Beef	811	858	957	1031	1154	1134	1121	1193
Pigs	98	2	5	8	73	-33	25	110
Sheep	1042	701	574	844	1033	825	658	977
Poultry	-16	-104	-174	-64	-14	-82	-82	-2
Eggs	229	177	182	147	159	155	136	172



## Appendix 3

### Two Estimates of Net Receipts from the Cap, 1979-81, £ million

	O'Connor et al			This paper		
	1979	1980	1981	1979	1980	1981
Guarantee Section*	322.2	344.8	303.0	324.8	363.8	303.1
Guidance Section	26.4	38.0	54.8	18.5	31.8	41.9
Total budgetary	348.6	383.8	357.7	343.3	395.6	345.0
Trade transfers	405.3	363.6	273.4	401.2	346.3	249.2
Common wheat	-4.7	-4.6	-1.8	-2.2	-1.1	-2.8
Barley	5.4	3.3	0.2	6.6	-0.2	-0.4
Maize	-14.3	-11.7	-4.2	-6.3	-13.2	-15.5
Sugar	3.2	-1.2	0.5	0.4	0.1	0.9
Cheese	40.4	23.0	24.4	47.2	21.2	14.1
Butter	90.5	36.9	27.5	93.2	37.4	28.6
SMP	32.3	6.6	8.3	25.6	6.5	8.4
Beef	216.7	282.2	199.5	223.8	288.3	210.5
Pigmeat	9.3	7.8	5.9	4.2	0.1	0.1
Sheep	6.0	9.3	9.3	9.4	9.1	6.9
Eggs	-0.6	-1.3	-1.7	-0.9	-1.8	-2.4
Poultry	-0.2	0.3	-1.2	0.0	-0.1	0.7
Estimated FEOGA contribution	-49.7	-71.2	-75.6	-47.1	-66.5	-70.3
Net receipts	704.2	675.3	555.6	697.4	675.4	523.9

\* Excluding ACA and MCA payments and fisheries receipts

## FOOTNOTE

1. The earlier figure of 10 per cent used for both wheat and barley was altered to 20 per cent in this version in the light of Prof. Sheehy's comments in the discussion.

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## DISCUSSION

**S.J. Sheehy:** I wish to compliment Alan in presenting a paper which is well up to his own usual high standards. Indeed, there are two papers for the price of one in this contribution because the CAP transfers topic alone would have been a substantial paper without the addition of the compensation topic which could well be a separate paper.

### CAP Transfers or Gains

The updating of the O'Connor et al. estimates of transfers is a very valuable contribution providing a series from 1975 to 1986. Since the O'Connor et al. estimates link rather well with the Matthews' estimates, it would be useful to show the full data series in this paper.

Broadly, I have no criticism of the methodology employed in deriving these estimates. Indeed, the volume of work that is concealed in Table 2 should be noted.

The distinction depicted in Figure 1 between the adverse effects of CAP arising from *re-nationalisation* of agricultural policy and the adverse effects from *agricultural trade liberalisation* (Table 8) is also useful.

The difference between the two magnitudes – the *nationalisation* effect and the *trade liberalisation* effect – depends on (i) consumer and producer response within the EC to free trade prices and (ii) the level of world prices in free trade, as is evident from Figure 1. The consumer and the producer responses could well be as little as half those assumed by the author thus reducing the “deadweight costs” proportionately. The world price effects are taken as the Tyers–Anderson estimates for 1980–82. These depend, among other factors, on how depressed world prices are to start with; the weaker world prices are the greater the trade liberalisation effect as is shown in the Tyers–Anderson study itself.

Since world market prices have become more glutted since 1980–82 and are projected by Tyers–Anderson to become even more glutted again into the future, the 1980–82 results are an underestimate of what would happen now or in the future. For example, the rise of 33% in dairy product prices for 1980–82 as shown in Table 7 of Matthews' paper becomes a rise of 59% in the Tyers–Anderson markets of 1995. At the same time the EC price level would be forced downwards by the constrained FEOGA budget while supply and demand would also be shifting. The net effects of these various influences on the size of both the *nationalisation effect* and the *trade liberalisation effect* cannot be judged *a priori* but are worth some further consideration by the author.

But accepting the author's estimates, the protection gains from CAP – and therefore potential trade liberalisation losses – are £611 million in 1986 and some £200 million less than that in 1992. My own crude estimate arrived at by applying the projected Tyers–Anderson price declines to Irish agricultural output and input would be of a similar order of magnitude (Sheehy, 1988).

### Compensation

I heartily endorse the author's attention to compensation in Section 4 of the paper. I have always argued that agricultural economists generally express their

free trade bias in emphasising the gains from liberalisation to the virtual exclusion of attention to the losses (Sheehy, *ibid*). Matthews presents a coherent if provocative analysis that full *national* compensation could be funded from the budgetary savings in agricultural trade liberalisation. Implicit in the analysis are a great number of assumptions including:

- (i) that Ireland's negotiating stance actually influences the ultimate policy outcome;
- (ii) that funds saved by moderating the cost of CAP could be transferred to the Structural Fund;
- (iii) that the size of that Fund cannot be increase independent of CAP reform;
- (iv) that for every £1 transferred from FEOGA, the Irish government could receive a substantially greater sum (of around £1.75 based on Figures in the paper) from Structural funds to compensate for the trade losses as well as the FEOGA losses;
- (v) that the indirect and induced impacts of the respective flows – which are not mentioned at all in the paper – would be similar.

Point IV is by far the most important of these as it relates to the core on the analysis. The necessity to increase the total Structural budget to enable the trade as well as the budgetary transfers to be covered in compensation is submerged in the discussion surrounding Table 9. Indeed, it seems to be contradicted where it is asserted "that Ireland could be compensated for the loss of CAP support within the existing EC budget size"; this could happen only if Ireland received a portion of the FEOGA savings arising from other Member States *in addition* to that arising from Ireland itself.

Even if *national* compensation were fully taken care of, there is still a major consideration involved in the domestic redistribution as between producers and consumers. Direct income payments are the obvious instrument to achieve this but there are no serious proposals on the table to operationalise a comprehensive scheme of such payments. Producers' organisations are therefore justified in discounting such compensation.

There are a few technical points to finish on:

1. The peculiar outcome in Table 2 where in some years some Irish prices are shown to be below world prices begs comment;
2. The impact of cereal price reductions would not benefit Ireland when its interactions with other commodity prices are taken into account;
3. The trend rate of growth in the volume of GAO shown in Figure 2 is not quite as "remarkably steady" since 1953 as claimed; closer examination will show an annual growth rate of just under 2% in the 1953 to 1966 with a distinct acceleration thereafter to 3% until the milk quota was installed;

4. If there is a concern about the distribution of CAP receipts then it is a domestic issue for the Irish government to deal with; dismantling the CAP to address the problem is hardly an efficient – and may not be an effective – way of dealing with the problem.

## Reference

**Sheehy, S.J. 1988.** "The Impact of Agricultural Free Trade on Ireland", *Proceedings of Agricultural Economics Society of Ireland* (forthcoming).

**B. Kearney:** It gives me great pleasure to second this vote of thanks to Alan Matthews for his timely, thought provoking, and challenging paper to the Society. I think we have all come to expect the best from Alan Matthews, and not alone that, but he must be counted among the most prolific analysts and researchers in the country. His treatment of this topic tonight is very broad ranging, perhaps overly so, but I suppose he felt that with the confluence of 2 major developments, namely the Uruguay round and the doubling of the Structural Funds, he had to take both on board for an adequate treatment of the subject.

He makes an interesting point at the outset. The reason why the EC has been slow to adopt major reforms is because of the gains from reforms, while widely spread are individually small, while the costs in terms of lower farm incomes and asset values are highly visible and quite concentrated, is well taken. I like in particular the clear distinction he makes between the value of CAP transfers with its two components (the net budgetary effect and the net trade effect) and the gain from the CAP to Ireland.

I would not cavil with his analysis but I wonder if the assumption about the effect of the rise in world prices arising from the removal of protection and the liberalising of trade would be as great as indicated in this quota-free and tariff-free world? What for instance would the effect of a freeing in trade and even some increase in world prices on the response of producers in some of the Cairns group of countries (such as Brazil, Argentina, Australia, New Zealand, Canada) which have considerable potential for growth and development? What is the elasticity of supply in these countries? Could not the last state be nearer the first and might not the loss of IR £607 million shown in Table 8 be correspondingly greater? Indeed the freeing of trade might particularly enhance the growth of production of precisely the commodities of most interest to Ireland namely, beef and dairy products.

In the same vein I wonder if some Irish resources, now employed in low productivity agriculture would be redeployed to more productive sectors? What, is likely to be the case, if these resources were in the form of marginal land or elderly human resources with a low level of skills? The section dealing with recent CAP developments and their implications for Ireland is quite useful, but I feel that if the CAP proposals relating to the beef market regime were fully implemented it would have a more serious impact on prices than assumed, this weakening the value of CAP transfers to Ireland. It should be noted here however that the EC is gradually going down the road of more direct aid to producers as a compensatory mechanism.

Coming to the compensation strategies for CAP reform, Alan Matthews investigated the impact of switching EC expenditure between agricultural and non-agricultural programmes. The relatively greater shares accruing to Ireland from the structural funds are shown, but I don't think we are really comparing like with like when we talk about the effect of transferring a particular sum from Guarantee to Guidance, when expressed in terms of net value to the country. For instance the full cost of Guarantee is recovered from Brussels while for much of the structural funds especially Guidance and ERDF the country of ten had to invest over IR £3 for every IR £1 received from the Community.

Furthermore, from a purely sectional standpoint the doubling of structural funds, as a quid pro quo for higher price support, could bring little or no advantage to the agri-food sector and could leave it considerably worse off. In 1987 of the IR £348 million in structural payments to Ireland, the Guidance, ERDF and ESF contributed IR £68 million, IR £87 million and IR £193 million respectively. ERDF is largely used for co-financing investment in industry, telecommunications, roads, sanitary services and such other projects as harbour development. The task of sharing out the funds could be a delicate political exercise given all the interests involved!

Despite these comments, which I hope will be helpful to the author, I have to say that his paper is a commendable effort and he has put in a prodigious amount of work on it in a relatively short time. It was most refreshing indeed to hear an analysis of a broader range of options which Ireland might consider during the GATT talks, and this has clearly shown that the gains to Ireland from CAP are somewhat less than conventionally estimated. He undoubtedly deserves the gratitude of the Society for his paper and I have great pleasure in seconding the vote of thanks to him tonight.

**E.B. Riordan:** I join those complimenting Alan Matthews on his paper. His helpful estimates of the impact of the Common Agricultural Policy (CAP) on Ireland inevitably raise questions such as:

1. Are not his estimates of FEOGA transfers to Ireland inflated by the inclusion of receipts that cover losses in the Commission's management of their market operations such as the loss in value of the beef that is frozen for intervention storage?
2. When it comes to considering reform of the CAP and reallocation of spending, would it not be wholly appropriate to consider all spending including that excluded from the estimate of 'transfers', such as spending on intervention storage operations?
3. How big an impact on the rest of the economy would follow a fall in agricultural prices and output such as that in Scenario 3?
4. Are there not benefits of the CAP other than elevated prices, to be safeguarded in the reform process?

By leave I will now enlarge on matters raised by these questions.

1. Estimates of the FEOGA transfers assume that the EC is paying Ireland to do what the Government would have had to do to achieve the observed



level of agricultural prices. Calculations in the paper, and Government practice before EC entry, were to pay export refunds and avoid the buying of produce for storage at public expense. In the EC, public intervention storage of beef, butter and skim milk powder has on the whole only deferred the day of export out of the EC with payment of the normal export refunds – a deferral that has cost dear. The cost has been paid out of the FEOGA Guarantee Section in the following ways:

ITEM	1986 IREM
Depreciation of stocks	32
Losses on sales	<u>197</u>
Total recorded loss	229
Expenses of storage, handling, financing and processing	71

**Source:** Annual Report of the Minister for Agriculture: 1986.

Most of the losses on sales were due to the low prices obtained for frozen beef sold out of storage relative to the prices at which it was purchased. The loss for bone-in-beef was put at 1 600 ECU (IR £1,250) per tonne and for boneless beef at 1 424 ECU (IR £1,110) per tonne for all Member States in 1987 and the Commission raised its estimates by 27 per cent in 1988 (Commission EC 1988). Sales out of Irish intervention stocks in 1986 amounted to 49,672 tonnes of bone-in-beef and 75,371 tonnes of boneless beef indicating a loss on sale in excess of £150 million. Other ways of disposing of surplus products, especially skim milk, also imposed a cost on FEOGA in excess of the level of Export Refund. Thus the net FEOGA transfer in 1986 of IR £630 (Table 1) could be said to be overstated by the IR £229 million shown above.

In like manner there could be said to be a similar over statement of the losses to Ireland from foregoing the CAP price guarantee (Table 8).

2. When it comes to examining gains from changes in EC policies there are a number of good reasons for using gross expenditure on the CAP (Table 6) including the fact that these figures show the overall level of spending. The very costliness of the CAP, especially its intervention measures, raise the prospect of achieving greater welfare gains by greater efficiency in the use of FEOGA monies that were spent on the price guarantee. In this regard it is clearly relevant to include expenditure on storage, handling and financing of intervention purchases.

3. The paper interestingly shows how a diversion of money from spending on the price guarantee to policies of agricultural income support or structural measures could be of benefit to Ireland. Alan Matthews points out that such changes would have 'a positive distributional effect' and 'that Structural Fund spending would be concentrated more on investment projects, with longer term benefits to the economy'. However is it not also necessary to note the strong links between agriculture and the rest of the economy, especially links with the food processing industry and input supply industries. These linkages transmit a large part of changes in the level of agricultural output to other parts of the economy. Thus more than farmers would suffer from a reduction in agricultural output such as that in Table 8, Scenario 3. Many other industries do not have these strong links with the rest of the economy of Ireland, they have to be export oriented and many are far more reliant on imports than agriculture. John Fitzgerald has estimated that in the long run the import propensity of agricultural exports was 9 pence per IR £1 of exports, while the import propensity of industrial exports was 49 pence per IR £1 of exports (Fitzgerald 1987). In addition John Fitzgerald estimated that the long run import propensity of investment, excluding buildings, was 60 pence per IR £1 of investment.
4. In such comprehensive treatment of the major CAP topics of price level and FEOGA expenditure, there was probably no room to deal with other sources of welfare gains from the CAP. However, there is a mention of price risks. The value of price stabilisation under the CAP would be hard to estimate, yet it is a benefit to be preserved in the process of reform – a process notably helped by the paper Alan Matthews has read tonight.

## References

**Commission of the European Communities 1988.** *Seventeenth Financial Report on the European Agricultural Guidance and Guarantee Fund 1987: Guarantee Section and Food Aid*, COM (88) 563; p. 116, Commission, Brussels.

**Fitzgerald, J.D., 1987.** *The Determinants of Irish Imports*, Economic and Social Research Institute, Paper 135, Table 7.8 p. 100, Dublin.

**J. Brady, S.J.:** I found this paper a welcome and liberating treatment, in as much as it provides a framework to think constructively about Irish agriculture without seeming to be disgracefully unpatriotic. Like many, I have long had doubts about the price support policies of CAP. It does not seem reasonable for the farmers of Ireland not only to insist on getting a large amount of support, but also in getting it in a way that involves the EEC taxpayer in a vast amount of additional expenditure on storage and eventual disposal of surplus stocks at very low prices. The preponderance of EEC agricultural price support funds go to large farmers who, by any standards, are very wealthy men, both in terms of capital value and of income. It would in my view be much more sensible to work on a deficiency payment system to small farmers. It would be possible to have a

system in which in effect one would say to a small farmer: "We estimate that your holding, well farmed, could provide an income of £5,000 per annum. You should however have an income of £8,000 per annum, so here is a cheque for £3,000." To do this as a means of supporting farm income would be far less costly than what is being done at present and it would be much fairer.

In demonstrating that there is a serious case that Ireland might in fact do better in the event of a switch of emphasis of EEC funding to the Social Fund and the Regional Fund, the author has opened up a very interesting line of thought, and deserves our gratitude.

**E. Murphy:** The emphasis that Alan Matthews placed on the possibility of compensation to Ireland, *within the present European Community budgetary limits*, for the national losses that would be incurred consequent upon the dismantlement of the Common Agricultural Policy (CAP), is important. Liberalisation would be a positive sum game for the European Community in the sense that the gains to the budget and to the consumer would be greater than the losses to the producers. However most independent studies show that budgetary gains would not be greater than producer losses, in other words it would not appear to be possible to fully compensate producers in the Community for losses incurred within existing budgetary limits. This is an argument used by those groups opposed to liberalisation since they doubt that the political will would exist to tax consumer gains in order to fully compensate producers for losses incurred.

The flaw in this argument is that it ignores the importance of the efficiency of the transfer mechanism. The cost of a scheme does not necessarily represent its benefit value to producers. Independent studies have indicated that for every £1 transferred to producers it costs £1.40. Hence if reform of the CAP involves a more efficient mechanism for compensating producers, such as direct payments, it may be possible to effect compensation within existing budget constraints.