National Economic and Social Council
An Chomhairle Náisiúnta Eacnamaíoch agus Sóisíalach
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The Impact of Reform of the Common Agricultural Policy

No. 92

April 1992

NATIONAL ECONOMIC AND SOCIAL COUNCIL

Constitution and Terms of Reference

1. The main tasks of the National Economic and Social Council shall be to provide a forum for discussion of the principles relating to the efficient development of the national economy and the achievement of social justice, and to advise the Government through the Taoiseach, on their application. The Council shall have regard, inter alia, to:

   (i) the realisation of the highest possible levels of employment at adequate reward.
   (ii) the attainment of the highest sustainable rate of economic growth.
   (iii) the fair and equitable distribution of the income and wealth of the nation.
   (iv) reasonable price stability and long-term equilibrium in the balance of payments.
   (vi) the balanced development of all regions in the country, and
   (vi) the social implications of economic growth, including the need to protect the environment.

2. The Council may consider such matters either on its own initiative or at the request of the Government.

3. Members of the Government will meet regularly with NESC on their initiative or on the initiative of NESC to discuss any matters arising from the terms of reference and in particular to discuss specific economic and social policy measures and plans and to explore together proposals and actions to improve economic and social conditions. Any reports which the Council may produce shall be submitted to the Government, and shall be laid before each House of the Oireachtas and published.

4. The membership of the Council shall comprise a Chairman appointed by the Government in consultation with the interests represented on the Council, and

   Five persons nominated by agricultural organisations;
   Five persons nominated by the Confederation of Irish Industry, the Federation of Irish Employers and the Construction Industry Federation;
   Five persons nominated by the Irish Congress of Trade Unions;
   Nine other persons nominated by the Government, including one from the National Youth Council, the Secretary of the Department of Finance, the Secretary of the Department of Industry and Commerce, and the Secretary of the Department of Labour.
   Any other Government Department shall have the right of audience at Council meetings if warranted by the Council's agenda, subject to the right of the Chairman to regulate the numbers attending.

5. The term of office of members shall be for five years. Casual vacancies shall be filled by the Government or by the nominating body as appropriate. Members filling casual vacancies may hold office until the expiry of the other members' current term of office.

6. The numbers, remuneration and conditions of service of staff are subject to the approval of the Taoiseach.

7. The Council shall regulate its own procedure.

NATIONAL ECONOMIC AND SOCIAL COUNCIL

The Impact of Reform of the Common Agricultural Policy

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Part I

1. INTRODUCTION[1]

1.1 Agriculture is the single largest industry within the Irish economy. In terms of numbers employed, value of gross output, contribution to net export earnings and supplies of the raw material for the highly significant food industry, it represents a strategically vital element in the Irish economy. In addition, through its contribution to the economic and social fabric of rural Ireland, it is a sector of critical importance for objectives of regional and environmental policy.

1.2 The performance of the agricultural sector and the development of policy in its regard has been addressed by the Council in previous reports[2]. The Council's analysis contained in these reports highlighted the critical importance for the future both of the agricultural industry and for policy, of the reform of the COMMON AGRICULTURAL POLICY. The presentation of specific proposals for reform by the EC Commission, and the related process of negotiation on the extension of GATT to include agricultural trade, have added an urgency to consideration of the impact of CAP reform on agriculture, on the rural economy and on the country as a whole.

1.3 The Council is concerned with the future of the agricultural sector in the context of its potential to contribute to the achievement of the key economic and social objectives outlined in its report, A STRATEGY FOR THE NINETIES[3]. The Council's interest and approach is strategic in character. It is, of course, neither within the remit nor the competence of the Council to make specific recommendations concerning the conduct of negotiations on the present proposals for CAP reform. It is, however, appropriate that the Council should consider the principles which should inform the development of public policy regarding agriculture, including the basis upon which a negotiating stance should be developed.

1.4 In order to inform its approach to these issues, the Council commissioned four Consultants to prepare position papers on various

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1 Mr. Séamas Healy, Assistant Secretary and Mr. Tom Arnold, Chief Economist, Dept. of Agriculture and Food, participated in meetings during which this report was discussed. Their contribution is acknowledged.

2 This approach was developed in Report No. 83 *A Strategy for Development 1986-1990* and Report No. 88, *Ireland in the European Community*, while in relation to rural development Reports No. 41, *Rural Areas: Change and Development* and 42, *Report on Policies in Agricultural and Rural Development* are relevant.

3 Report No. 89.

aspects of the impact of the Commission's proposals for reform of the CAP. The Consultants were Dr. Gerry Boyle, Mr. Padraig Commins, Dr. Arne Larsen and Prof. Seamus Sheehy. In addition, a position paper on the food industry was prepared by Mr. Noel Cahill of the Council's Secretariat. These position papers are printed in Part II of this document. It is clear that the proposals published by the Commission in July 1991 are likely to undergo significant change, as indicated by the course of negotiations to date. Furthermore, the negotiations on a new trade round under the GATT, which are continuing in parallel, could very significantly affect the outcome. However, the Commission proposals provide a focus for consideration of the issues which are relevant to the ongoing process of CAP reform.

1.5 The Council in this report reviews the process of CAP reform, and the present Commission proposals, in the context of two assumptions:

- CAP reform is both inevitable and desirable;
- the long-run trend of public policy is towards greater liberalisation of agricultural markets.

The Council outlines five principles which should guide the development of policy:

(i) *proposals should be evaluated from an economy-wide rather than a sectoral perspective;*

(ii) *the direction of long-run development should shape the short-term conduct of policy;*

(iii) *trade-offs between conflicting policy goals should be recognised and a balance struck in the interests of strategic development;*

(iv) *the future of rural society requires a comprehensive policy approach which transcends the agricultural sector;*

(v) *the future of the CAP should be assessed in terms of the impact on convergence and cohesion with the EC.*

The context for this approach is the Council's assessment of the Irish agricultural sector, which is set out in the following paragraphs.

2. CHARACTERISTICS OF IRISH AGRICULTURE

2.1 The Council, in the reports referred to above, has identified a number of significant features of the Irish agricultural sector which should be reflected in the framing of policy at both domestic and Community levels. These are of relevance, not only for the performance of the primary production sector itself, but also for the food industry of which it is the base. They constitute structural problems which underlie the persistence of low and volatile incomes which, the Council has previously concluded, is the most significant problem in Irish agriculture.

2.2 The first structural characteristic is the significant dichotomy between a minority of farms, which have accounted for most of the increased output of Irish agriculture since accession to the EC, and the remainder, who operate at or below the margins of viability. The gap between the two elements of the farm sector coincides closely with age, educational and marital characteristics of farmers, as well as farm size and regional location. Thus, of the total of 188,000 farms not more than 69,000 are estimated to be capable of sustaining a full-time farmer, while only 78,000 farmers depend on agriculture for their main source of income.

2.3 Secondly, there has been very little adjustment over the last couple of decades in important aspects of the structure of farming. While there has been a continuing, gradual reduction in the numbers employed in agriculture there has been virtually no reduction in the number of farms. The decline in the agricultural labour force combined with the increased level of income from off-farm employment, has sustained the level of income per head. However, given that the minimum viable size of farm for grassland production has been increasing, the underlying farm structure is one which sustains inadequate income levels for a very significant number of producers. The Council has concluded that the land tenure system in Ireland contributes directly to this structural problem.

2.4 Thirdly, the seasonality of supply which characterises Irish grassland production is both a source of potential competitive advantage in the context of environment-friendly production, and a major constraint on the development of an industrial economy based on agricultural raw materials. The development of a food industry characterised by significant levels of high value-added products depends ultimately on the capacity of companies to develop products and markets which

yield adequate returns to pay for the higher costs of less seasonal production. However, many producers would lack the capacity to respond to incentives to produce on a less seasonal basis.

2.5 The Council, in reviewing the impact of the CAP on Irish agriculture, concluded that these structural problems prevented a large proportion of farms from responding to the incentives offered by the CAP. Furthermore, such a small proportion of the EC agricultural budget is devoted to socio-structural policy that, in effect, structural reform in agriculture is primarily an issue for national governments. The Council also noted that the operation of the common price policy, by yielding greater benefits to those with higher levels of output, channelled support to the larger, commercial producers.

2.6 In assessing the impact of the CAP on Irish agriculture, the Council concluded that "the Community system in agriculture was one which made adjustment partially avoidable, while at the same time rewarding the strong far more lavishly than the weak"[4]. As a result, it concealed the need for a range of long-term national policies concerning the role of agriculture in the overall development of the economy, and the need for national policies to achieve agricultural objectives which were not, and probably could not, be addressed by the CAP. A review of the performance of Irish agriculture within this context is set out briefly in the following paragraphs.

The Process of Adjustment in Agriculture in Ireland since 1977

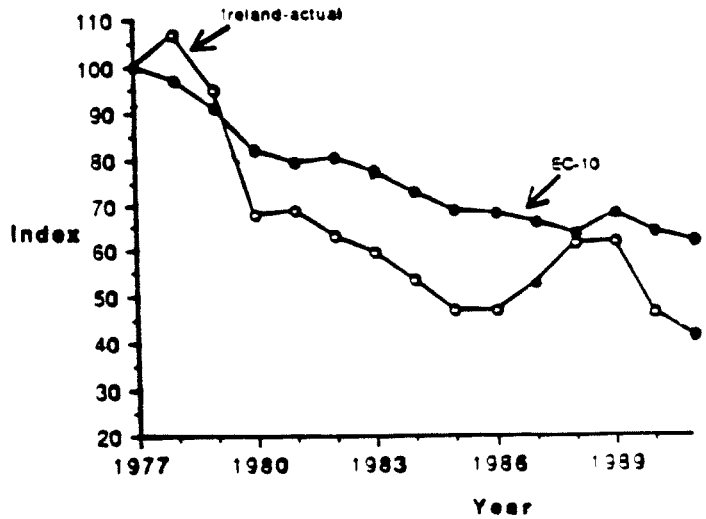
2.7 The experience to date shows that substantial change has already taken place within the CAP. Up to 1977 the EC budget grew fast enough to maintain prices in real terms. In 1977, a decision was taken to introduce a prudent price policy and generally since then real agricultural prices have been falling. The most comprehensive measure of price is the net price effect on gross value added[5]. Using this measure, the price effect for Irish agriculture has been a decline of 5.5% per year since 1977, a very substantial decline. This is considerably worse than the EC (10) average, where the price effect was a decline of 3.3% per year. These price changes are illustrated in Figure 1. In addition to real price reductions, supply control measures were also introduced. The most significant of these was the introduction of the milk quota and super-levy in 1983.

4 Report No. 88, paragraph 7 (iv), p. 214.

5 See the Position Paper by Professor Sheehy for definition of this measure.

FIGURE 1

Net price effect on Gross Value Added, Ireland and EC-10, 1977 = 100



2.8 Farmers have reacted to this price pressure by increasing productivity. Both output and input volumes grew more rapidly in Ireland than the EC (10). However, the family labour force in farming in Ireland fell significantly more rapidly than in the EC (10) in the period up to 1986. There has been considerable movement in family farm income since 1977. Despite very significant price reductions under CAP since 1977, real family farm incomes in Ireland have been maintained due to increases in labour productivity and increased direct payments of subsidies to farmers. The process of adjustment is described in more detail in the following paragraphs.

2.9 Faced with continuing downward pressure on prices, there are four basic ways in which farmers can respond:

(i) *They can adjust their farm business:* Sheehy has quantified the response among farmers using the National Farm Survey (NFS) and a specially commissioned survey. The outstanding result which emerges from these surveys is the huge diversity of response among farmers. In the NFS survey, there was an average increase in nominal income of 30% from 1984/85 to 1990/91. The worst group experienced a decline of 58% while the best group had an increase of 85% in nominal income. The

special survey covered a longer period: from the late 1970s to 1991. Again, there was a huge diversity of response. The worst third had a decrease of 46.1% in standard gross margins while the best third had an increase of 53.6%. This reflects the fact that there are in some respects considerable structural changes taking place. Farmers are diversifying the sources of their income with increasing specialisation in, for example, tillage and dairying.

(ii) *They can obtain off Farm Employment:* In Ireland, there has been a substantial increase in the proportion of farmers with other gainful activity off the farm, from 26.3% in 1980 to 37% in 1987. This compares with an EC (9) average of 29% in 1987. In 1987, farming only accounted for 54.2% of gross household income in all farm households. The remainder of income consisted of other direct income (28.2%) and transfer payments (17.6%). Since 1973, the earliest year for which these data are available, there has been a large increase in real terms in both direct income (4% per annum) and transfer payments (4.6% per annum) to farm households.

(iii) *They can migrate:* There has been a large fall in the family labour force. Since 1977, the number of family farm workers has fallen by more than 30%. However, most of this fall is accounted for by non replacement of retiring family members, rather than direct migration.

(iv) *They can fail to adjust:* Some farmers lack the ability or the opportunity to make any of the adjustments mentioned above. Therefore, they must rely on social transfer payments.

2.10 An ESRI survey carried out in 1986 highlighted that there is a substantial risk of poverty (35.8%) among farmers. The 1986 data are biased by low farm incomes in that year. The 1987 figure from the household budget survey was about 25%. However, the risk of poverty for farmers is more than double that for other self employed and six times that for employees. This poverty problem is concentrated on holdings of small and medium acreage where agriculture, mainly drystock, is the major source of income.

3. THE INEVITABILITY OF CAP REFORM

3.1 It can be argued that reform of the CAP is an ongoing process. Significant reforming measures in the past included the introduction of a prudent price policy and, subsequently, the introduction and development of supply management arrangements in the form of quotas. The extent to which the present Commission proposals, and the eventual outcome of negotiations based upon them, can be considered a continuation or a break with past trends remains to be seen. However, it is clear that significant changes in the mix of policy instruments which make up the CAP are inevitable. Insofar as they address serious threats to the viability of an effective COMMON AGRICULTURAL POLICY such changes are also desirable, not least from the perspective of a significant exporter of agricultural products, such as Ireland.

3.2 In evaluating the prospects for reform it is necessary to understand the basis for development of current policies. There are a number of reasons for the protectionist orientation of the CAP. Historically, it reflects the long tradition of support systems in the major countries of the original Six. Within the original Community there was very strong pressure for effective protection against world market prices, regarded as artificial and influenced by export subsidies operated by the United States in particular. The alternative strategy of deficiency payments would have posed very difficult budgetary problems for the new Community.

3.3 The principal objectives of the CAP are:

1. To support prices received by farmers and thereby support their income.
2. To promote economic growth and employment including a healthy balance of payments.
3. To ensure food security.
4. To preserve rural society.

3.4 Support for a number of the policy instruments employed by the EC to pursue these objectives is weakening. The distribution of price support is perceived as inequitable as more data are made available on the distribution of farmers' incomes. Excessive food stockpiles have

undermined whatever validity arguments for agricultural growth and food security may have had in the past. The concern for food security is also diminished by the receding memories of war and the improvement in international relations.

3.5 Further pressures which weaken the basis for agricultural protection are the general rise in support for free market policies worldwide and events in Eastern Europe. There is a conflict between the desire to protect EC farmers and the desire to assist in the reconstruction of the East. Such assistance, if it involves some improved market access, would mean increased competition within the EC.

3.6 Having regard to the impact of present policies in the context of the productive capacity of the European agricultural sector, the EC Commission has concluded that:

"Existing price guarantees, through their direct link with production, lead to growing output; this extra output could be accommodated only by adding to intervention stocks, already at excessive level, or by exports to already over-supplied world markets" (Commission, 1991, Page 3).

3.7 Further pressure for change in the current operation of the CAP is the desire to extend the framework of trade liberalisation under the GATT to agricultural products. The basis for this objective is discussed in the following section. From the EC perspective, there is a substantial interest in securing a positive outcome to the current round of negotiations under GATT. Further liberalisation of world trade, notably in respect of the supply of services, would be expected to contribute to growth in the world economy and to the opening of markets for European exporters. As a trading economy, Ireland has a very real interest in such an outcome. To the extent that agreement on liberalisation measures in the agricultural area are critical to success of the GATT negotiations, pressure for change in the CAP will continue.

3.8 Equally significantly, however, Community policy reflects a growing concern for the social and ecological role of the farming community which transcends its role as producer of food:

"Sufficient numbers of farmers must be kept on the land. There is no other way to preserve the natural environment, traditional landscapes and a model of agriculture based on the family farm as favoured by

society generally. This requires an active rural development policy and this policy will not be created without farmers. The Commission confirms then the approach taken in the 'Green Paper' and in the Communication on the Future of Rural Society" (Commission, 1991).

3.9 There are significant reasons why, from an Irish perspective, CAP reform is desirable, as well as being inevitable. *Firstly,* a viable and sustainable framework for agricultural production is of strategic importance to the performance of the Irish economy within the Community. Reform measures which result in a more secure policy framework are therefore inherently desirable. *Secondly,* a reformulated CAP could address more effectively than past policies the structural problems of Irish agriculture, including the problem of low and volatile incomes. *Thirdly,* a reorientation of policy measures could contribute to the development of the food industry, not least through assisting in reducing the current seasonal pattern of production. *Fourthly,* the distribution of resources from the Community's agriculture budget is quite uneven, with Irish producers receiving significantly lower levels of support than their more intensive (and economically more developed) counterparts in the Netherlands, U.K., Denmark and Belgium. A reorientation of support measures could strengthen the cohesive impact of Community agricultural expenditure.

4. LONG-RUN TRENDS IN AGRICULTURAL POLICY REFORM

4.1 The pressures within the Community for change in the CAP are echoed in wider, international pressures for greater liberalisation in agricultural trade. The proposal to extend the GATT framework to such products is the most obvious example of this. This pressure for reduction of agricultural support mechanisms reflects well-established trends in the markets for agricultural products. This concern is summarised in the following statement from the OECD Council of Ministers on future agricultural policy:

"The long-term objective is to allow market signals to influence by way of a progressive and concerted reduction of agricultural support, as well as by all other appropriate means, the orientation of agricultural production; this will bring about a better allocation of resources which will benefit consumers and the economy in general." (OECD, 13th May 1987)

4.2 Consider the *internal market* first. The fundamental market imbalance arises because aggregate demand for agricultural products is growing at 0.5% per annum, while agricultural output has grown at a rate of 1.8% per annum between 1977 and 1989 (although this growth rate has decelerated in recent years). There is not much scope for improvement on the *demand* side. Population growth is only 0.1% per annum. The markets for liquid milk, butter and skim milk powder, SMP, the core of Irish dairy production, are static or in decline. There is some buoyancy in the markets for cheese, yoghurts and fresh cream. The demand for beef is static and may well decline in the future (the industry hopes that falling prices and EC promotional efforts will reverse this trend). There is, however, a growing interest in the quality and safety of food which provides opportunities to promote a quality image for Irish produce. Turning to the *supply* side, the driving force here is technological change. Excess capacity exists for production of all major commodities in the EC. The level of output reflects the incentives to produce provided by the terms of the CAP.

4.3 With regard to the wider *international* market, potential demand is increasing because the world population is growing but most of this extra population lacks the purchasing power to participate in the market for food. This population can be supplied through food aid or if sufficient purchasing power is provided. Prospects for middle income countries are brighter. They are showing some signs of overcoming their debt problems and resuming growth. In the short term, there is likely to be substantial provision of food aid to Eastern Europe and the former USSR. However, Eastern Europe has great potential to expand production, especially in the commodities of greatest interest to Ireland.

4.4 The problem of chronic surpluses in agricultural commodity markets would, in conventional economic analysis, be regarded as evidence of a misallocation of resources due to distortion of the price signals through successive layers of intervention. Economic growth occurs when the factors of production - land, labour and capital - are able to respond to long-run price changes reflecting real market conditions. In the case of agriculture, the effect of price distortions is reinforced by inherently inflexible production characteristics, such as the nature of agricultural land and the age and skill levels of substantial segments of the farm labour force. However, the broad argument that is made is that a greater influence by price signals, and therefore market conditions, on agriculture production would ensure balance in agricultural markets, a more efficient and dynamic agricultural

industry internationally and, where appropriate a re-allocation of resources to other, more economically productive activities.

4.5 The application of these market-centred principles would be expected to result in a redistribution of agricultural production world-wide, in accordance with the comparative advantage of producers. In a European context this would almost certainly result in a fall in the level of agricultural output with an outflow of resources from the agricultural sector. In particular, the farm labour force would fall significantly. Consequential changes would occur in both up-stream and down-stream industries. The pace of such change would, of course, depend on the pace and extent of change in price-distorting policies, and on the availability of opportunities outside the agricultural sector. The scale of the likely change would impose very substantial social costs, especially on producer groups, even if the eventual outcome were to be an increase in overall living standards.

4.6 Given the scale of the problem of excess supply in mainstream agricultural commodities, and the resources devoted to supporting the level and price of agricultural output, it is not surprising that liberalisation policies should be endorsed by, for example, OECD Ministers[6]. It is striking, however, how little progress has been made in implementing such a strategy. For example, while countries such as New Zealand, Australia and Sweden have taken radical steps to reduce price-distorting supports to agriculture, levels of assistance within the OECD as a whole are substantially *higher* now than in the early 1980's. Furthermore the system of protection of markets through import barriers and export subsidies is largely intact, with a widening margin between prices paid by domestic consumers and border prices.

4.7 A number of reasons can be advanced for the slow pace of movement towards more liberal price and market policies. There are very substantial costs associated with the effects of such changes in policy, especially for producer groups. The risks of substantial dislocation during a transition period, and of ultimately failing to secure sustainable growth and employment in other sectors on a sufficient scale, are substantial. A considerable degree of caution on the part of policy-makers is thus to be expected. Furthermore, social policy considerations would require direct payments to non-viable producers in the medium-term were free market policies to apply; this is a substantial budgetary commitment which Governments may be loathe

6 See OECD Council of Ministers Communique, 13th May, 1987.

to undertake, particularly in times of cyclical downturn and fiscal adjustment. Finally, the potential beneficiaries of more market-oriented policies have, individually, relatively little to gain while those committed to the maintenance of established policies are effective in influencing the policy process.

4.8 The tension between the resource implications of sustaining growing surpluses of agricultural products, on the one hand, and, on the other, the painful nature of the structural adjustment required for effective market balance, is likely to ensure that liberalisation in agricultural trade will occur only in the long-run. Insofar as policies move in that direction it will be necessary to provide effective support for individuals who suffer losses as a result of reform and who cannot adjust. It will also be necessary to provide effective transitional measures to support adjustment, such as education and retraining and early retirement programmes. It is appropriate to view the process of CAP reform as an instance of this long-run trend in international policy for agriculture.

4.9 Ireland would clearly face immense problems in adapting successfully to any rapid programme of structural adjustment based on market principles. Indeed, for social and environmental reasons *it is difficult to envisage any situation in which free trade should form the basis of the Community's approach to agricultural production*. However, it is clear that, over time, Community policy will tend to reflect global trends towards more market-based agricultural policies. It follows that, in the short to medium term, policies should help to build the capacity of the agricultural sector to cope successfully with the inevitability of increased exposure to market signals in the long-run.

5. PRINCIPLES UNDERLYING THE COUNCIL'S APPROACH

5.1 The following paragraphs set out the Council's views on the principles which should guide this country's approach to CAP reform. These principles derive from the Council's analyses contained in the reports referred to earlier and from consideration of the position papers commissioned as part of the preparation of this report. The conclusions drawn by the Council from the application of these policy principles will be set out later in this report.

5.2 *Policy proposals for agriculture should be considered from an economy-wide rather than a sectoral perspective.* Although the operation of the CAP is driven by the needs of the agricultural sector,

its consequences are felt more widely. The primary impact of CAP reform will, of course, be felt in the farm sector, but the nature and scale of that reform also has significant implications for Ireland's food and farm input industries, for consumers generally, and for national macro-economic performance. It follows that, while the implications for agricultural producers should not be minimised, an overview of the national impact, rather than a narrow sectoral approach, should be applied in evaluating proposals for policy change. The Council has in the past commented on the negative consequences which have followed from treating the process of development of the CAP in an isolated, sectoral framework. One consequence of adopting a national perspective is that it highlights the need to build compatible and consistent policies for **all** elements of the agri-food complex. This involves balancing the needs and priorities of different elements of that complex, so that issues of primary production, development of the food industry and the future of rural societies are considered as integral parts of the same problem, rather than as discrete topics capable of being resolved in isolation.

5.3 *The direction of long-run development should shape the conduct of short term policies.* The Council has argued above that CAP reform is unavoidable and that the long-run thrust of future policy on agriculture within the European Community will be towards a more liberal market environment. It recognises that the pace of that change is likely to be quite slow and is unlikely to result in a free market in agricultural products. Despite this, the belief that the long-run direction of policy is towards greater liberalisation provides a vital context within which CAP reform must be assessed. In particular, it means that any proposals for reform must be evaluated in the light of their impact on Ireland's capacity to prosper in a more liberal trading environment. The Council's previous analysis has highlighted the extent to which concern for maximising the short term benefits of the CAP has diverted attention from the long-run development requirements of Irish agriculture and the food industry. In the current reform process, care must be taken to strike a balance between the desire to maximise legitimate and correctly identified short-run interests and the necessity of laying the foundations for long-run growth and development.

5.4 *Trade-offs between conflicting objectives of agricultural policy must be recognised, and a balance struck in the interests of strategic development.* The agricultural sector forms a vital element in the country's overall productive capacity and its development is crucial

to the effective use of our natural resources. One core objective of policy must, therefore, be to ensure that the development potential of the sector is realised. The Council has in the past pointed to the need for a combination of productivity policies, structural policies and programmes outside agriculture to address the development needs of the sector. These policies and programmes must take account of the requirements of a more competitive marketplace. They must, moreover, take as their objective the development of the *combined* agriculture and food sectors. This means that policies relating to agricultural production must take account of the potential implications for the food processing industry. In this regard, the Council's past analysis has shown that the CAP has in fact contributed towards the disappointing levels of value-added output by Ireland's food industry.

5.5 A second, crucial concern for agricultural policy, on social as well as economic grounds, is the problem of low and volatile farm incomes. The Council has previously identified an underlying and growing poverty problem within Irish farming as a result of structural and demographic factors. This is illustrated by the fact that households headed by a farmer accounted for 25% of all households below the poverty line in 1987, the largest group apart from households headed by an unemployed person. The problem is particularly acute within a category of approximately 35,000 farm households characterised in large measure by the presence of elderly farmers. The risk of poverty is also high for approximately 30,000 farm households operating at the margins of viability without significant off-farm income. Despite the substantial proportion of aggregate farm income now attributable to subsidies received in the form of direct payments through CAP, low income in farming remains a major problem.

5.6 In order to reconcile the various economic, social and environmental goals of agricultural policy, some compromises and trade-offs are required. The task in framing policy is to ensure that these trade-offs are acknowledged and that a balance is struck in the interests of overall strategic development.

5.7 *The future of rural society requires a comprehensive policy approach which transcends the agricultural sector.* Long-run trends in employment in agriculture, allied to the national unemployment problem, have resulted in a threat to the survival of many rural communities. Migration has tended to increase dependency ratios, deepen isolation and threaten the viability of mainstream public

services in some rural communities. The stabilisation of the population in rural areas at satisfactory standards of living requires that significant off-farm opportunities be created. Rural development is therefore a more extensive issue than the development of policy for agriculture. A policy framework which stimulates the growth and development of a variety of enterprises, including agri/tourism, forestry and non-conventional land usage is required to complement adjustment policies within agriculture itself. Such development strategies must also take account of the social requirements of rural communities. The potential to organise service delivery in innovative ways must be exploited to strengthen rural communities by making use of opportunities for applying new technology and developing multi-purpose, community-based structures.

5.8 *Proposals for the future of the CAP should be evaluated in terms of their impact on convergence and cohesion within the European Community.* The Council in Report No. 88 has evaluated the impact of CAP on Ireland in the context of the overall effects of membership of the EC. The Council emphasised the importance of community measures to secure positive integration. It follows that the objective of cohesion and convergence should be taken into account in the design and implementation of all Community policies through careful analysis of the regional impact. The impact of CAP reform measures on Ireland's economic performance relative to other EC countries must therefore be carefully considered.

6. THE ROUTE TO REFORM: PRICE REDUCTIONS VERSUS SUPPLY CONTROLS

6.1 There are two basic policy instruments available to tackle the problem of excess supply in agricultural markets: price reductions and supply controls. Historically, the two approaches have been used together, and the current reform proposals continue this trend, with elements of direct market management existing alongside stringent price policies.

6.2 From Ireland's perspective, the choice of policy instrument must take account of the following considerations;

(a) their effectiveness in resolving the problems which lie at the heart of CAP reform (i.e. by eliminating structural imbalances in agricultural markets and alleviating budgetary pressures within the CAP)

(b) their effect on incomes in Ireland, both at farm level and at the level of the national economy, and

(c) their potential impact on the long run development of the Irish food and agricultural sectors.

The paragraphs which follow set out the pros and cons of the two policy instruments, with a view to highlighting the issues which must be considered in deciding on the appropriate route to CAP reform.

6.3 *Supply Controls have a number of advantages*, both from a national and from an EC perspective. For the EC, three advantages stand out: First, supply controls offer a quick and effective means of reducing surplus production in the short-run. They impact directly and immediately on the supply of agricultural produce imposing in effect, a 'desired' administrative solution to the problem of market imbalance. By their nature, they constitute a "managed" solution, allowing for regulation and control of both the nature and extent of adjustment in Community production. Second, they enable one of the founding principles of the CAP, that of "Community preference", to be preserved. By making consumers bear the cost of price support, they minimise the budgetary costs of the CAP and reduce the direct burden on EC taxpayers. Finally, from an Irish perspective, successful supply management policies would reduce dependence on intervention and subsidised exports for Irish produce.

6.4 From Ireland's perspective the advantage of supply controls lies in their efficiency in maximising income levels, both at farm level and, crucially, at the level of the national economy. Sheehy (1991) has shown that, in a choice between uncompensated supply controls and (uncompensated) price reductions, Ireland's interest will be best served by the supply control option, at least in the short run.

Two arguments are advanced in support of this view:

(i) The fact that demand for most agricultural products is highly insensitive to changes in price, means that a cut in prices will reduce total farm incomes. This is because the amount of additional sales resulting from the price cut will not be sufficient to compensate for the loss in revenue on existing sales. For the farm sector, therefore, high prices on a restricted output level will be preferred to (substantially) lower prices on a (slightly) increased output.

(ii) For a net exporter of agricultural produce, such as Ireland, the farmers' preference for supply controls coincides with the national preference. With almost 80% of our agricultural produce being exported, the cost of supporting high agricultural prices under a supply control regime is borne primarily by overseas consumers. The gain in Irish farm incomes which results from the high agricultural prices substantially outweighs the loss to (Irish) consumers.

6.5 A further attraction of supply controls from Ireland's perspective is that they allow the process of change and development of the CAP to be managed and controlled, at a pace and with a structure acceptable to all EC members. The starting point for a supply management regime is the *existing* distribution of production and limits are, typically, imposed relative to that initial base. While not ideal, this procedure confers a degree of familiarity and certainty which enables producers to implement a planned adjustment to the new regime.

6.6 *The disadvantages of supply controls* relate primarily to concerns about their practicality as a *long-run* solution to the problem of surplus production. While an "administered" solution may prove effective in the short run, problems may arise in seeking to use supply controls as a means of establishing long-term sustainable balance in agricultural markets. This is because the very nature of supply controls serves to exacerbate the underlying forces which prompted the initial problem of excess supply. For example:

— by guaranteeing prices which are substantially above the market level, supply controls create an incentive for producers within the system to expand their output above market clearing levels. Although this problem can be tackled by introducing penalties for excess production (e.g. the super-levy), it is administratively cumbersome to have a system which, on the one hand, creates an incentive to produce and, on the other hand must introduce a counter-incentive to check production. In these circumstances, a constant tension on production limits is to be expected. The danger of fraud and malpractice must also be recognised in any price-support system.

— Second, the existence of high returns to producers within the system generates constant pressures from aspiring *new entrants*, who wish to avail of the same high prices. This issue is particularly relevant in the context of recent developments in Eastern Europe

and the enlargement of the EC. The management of a supply control strategy becomes increasingly difficult in a dynamic situation, where the pressures to increase supply are growing rapidly, but the demand for agricultural produce is lagging further and further behind. In such a situation, supply controls offer Irish farmers the rather bleak prospect of an ever-reducing share of a stagnant EC market.

— Finally, the fact that supply controls institutionalise production on the basis of existing products and market profiles gives rise to inevitable tensions over time, because it fails to contain within it any mechanism for identifying and responding to changes in market demand.

6.7 A second, and related, concern about supply controls stems from their potential impact on the long run development of Ireland's food and agriculture sectors. It has already been argued that the long term direction of CAP reform is towards a greater degree of liberalisation in agricultural trade. In such a context, success for Irish farmers and food processors will depend on their ability to compete more effectively in commercial markets. Viewed in this light, supply controls have a number of long-term disadvantages;

— By institutionalising existing patterns of agricultural production, supply controls suppress the incentive to increase competitiveness. If market shares are allocated by the political process, rather than as a result of commercial success, then the need for competitiveness becomes much less urgent.

— Supply controls act as a barrier to the entry of young farmers, thus removing an important force for dynamism and development at farm level.

— In addition, they impose substantial costs on the food processing sector, by reducing the availability of raw material supplies and by raising their price.

6.8 Finally, a disadvantage of supply controls which applies equally in the short-run and in the long-run, is the inequitable income distribution to which they give rise. Supply controls, by their nature, link income support directly to the level of output, effectively giving the producer a price subsidy *per unit of output*. This has two main distributional consequences: First, within the farm sector it ensures that the bulk of

the income support goes to the biggest farmers; Second, it constitutes a transfer of income from consumers to farmers and, as we have seen, directs that transfer primarily towards the larger farmers.

6.9 *The second major route to CAP reform is via price reductions.* The attractions of price-based strategies may be summarised, as follows: First, they impact favourably on market balance and resource allocation in the long-run. By allowing increased exposure to market signals, price reductions reduce the danger of a persistent mismatch between supply and demand in agricultural markets. They provide an incentive for producers to meet market demand with maximum efficiency, while at the same time supplying more accurate information about the nature and extent of that demand. They encourage a reallocation of production towards those regions and producers which are the most efficient, thereby creating an incentive to increase competitiveness and prompting the agricultural and food industries to adopt more market-led strategies. In sum, they generate a set of signals and incentives which are in line with the long-run trend towards greater trade liberalisation and provide a credible basis for a sustainable, long-term solution to the problem of surplus production in agricultural markets.

6.10 A second advantage of price reductions is that the consumer benefits through lower prices for agricultural produce. Food purchases constitute a major portion of overall consumer expenditure and their significance is highest among the lower-income groups. A reduction in agricultural prices which brought about a decline in the cost of retail food purchases[7] would raise the real income of consumers, and would do so in a manner which favoured the least well-off.

6.11 A final advantage of a price reduction strategy is that it allows for more equitable and efficient targeting of income support and reduces the risk of distorting competitive advantages between different regions and producers. Under supply controls, income support is built into the price received by producers and is linked directly to production. Under

7 A decline in producer prices will lead to a less than proportionate fall in consumer prices. This is because (a) producer prices constitute only one element, albeit an important one, of the final consumer price. Other elements include manufacturers', distributors' and retail margins; costs of advertising, etc. (b) the full extent of the fall in producer prices may not be passed back to the consumer, but may be captured by manufacturers, distributors and/or retailers in the form of higher margins. It is also true that, in the case of a major net exporter of agricultural produce like Ireland, much of the benefit of lower food prices will accrue to overseas (not Irish) consumers.

a price policy, income support is decided independently on the basis of agreed criteria, and can be targeted specifically at those regions, sectors or producers in greatest need. By decoupling income support from production, a price reduction strategy allows genuine production-level competitive advantages to assert themselves and minimises the risk of distortions in competition.

6.12 *A disadvantage of the price reduction strategy* is its relative ineffectiveness as a means of reducing excess supply in agricultural markets in the short run. Unlike supply controls, price reductions impact indirectly on the supply of agricultural produce, by altering the set of returns/costs faced by producers and consumers. Their effectiveness is determined by the degree to which these two groups (producers and consumers) respond to changes in prices. In theory, a reduction in prices should bring about a fall in excess supply, both by increasing consumer demand and by reducing agricultural output. In practice, empirical studies of the agricultural sector point consistently to a very low price elasticity among both producers and consumers[8]. This greatly limits the ability of price reductions to reduce excess supply in the short run.

6.13 A second disadvantage of price reduction strategies is that, by transferring the burden of income support from consumers directly on to the taxpayer, price policies increase the budgetary costs of the CAP. While this is essentially a problem of visibility rather than one of substance, it is not without its practical implications. In principle, the increased transparency inherent in a pricing policy with direct income support could work in Ireland's favour, if for example it made it easier to ensure that policies adhered to the principle of cohesion. In practice, there are concerns that the greater visibility of income supports to agricultural producers would make then vulnerable to reduction over time, leaving Irish agriculture and the economy generally exposed to the possibility of further reductions in income. There is also the possibility that budgetary pressures in the Community could result in a greater emphasis on national policies for support of primary producers. The capacity of the more affluent member States to provide adequate levels of income support to their proportionately fewer farmers would be much greater than Ireland's.

8 A recent OECD study (1991), which examined possible responses to a range of different policy regimes in the dairy secctor, suggested that even quite substantial price cuts (10%) may have little impact on production levels in the sector. If this is the case, then the extent of price reduction required to achieve a desired reduction in supply may be very large, with consequent serious implications for farm incomes.

6.14 From Ireland's perspective, the main disadvantage of a price reduction strategy stems from concerns about how well we would fare under a new regime of lower prices and increased competition. In the short run, and in the absence of off-setting compensation, price reductions would result in an unambiguous loss of income, both to the farm sector and at the level of the national economy. The reasons for this have been set out in paragraph 6.4 above. In the long-run, the income implications of pursuing a policy of price reductions are quite uncertain. The outcome will depend on a number of variables, including: (a) the ability of Irish agriculture to maintain or increase market share in the new, lower-price regime. This, in turn, will be determined by the competitiveness of Irish agriculture; (b) the degree by which prices need to fall in order to secure market balance, and (c) the extent to which income losses on production are off-set by other direct payments from the EC.

6.15 The implications for Irish agricultural *output* of pursuing a policy of price reductions depend critically on the competitiveness of the combined agri-food sector. If Ireland was to prove competitive in the new regime, it would be able to capture market share at the expense of other producers. The difficulty of increasing market share in such an environment should not be underestimated however. In a situation where overall market growth is low, prices are falling and existing producers are fighting to maintain (and indeed increase) their own share of the market, every increase in production will be hard-won. Moreover, it is clear that if Ireland were to prove uncompetitive in a large number of areas, a *loss* of market share would result with consequent negative implications for production.

6.16 It is clear, finally, that one of the drawbacks of a price reduction strategy is, in fact, the degree of uncertainty and anxiety which it generates. A policy of price reductions is likely to prompt a far greater degree of structural change than would occur under a supply control regime. Whether in the long-run this proves to be good or bad for Ireland depends on a range of factors which extend beyond the agricultural and food sectors. One of the adjustments which might be anticipated would be an acceleration in the rate of decline in agricultural employment, as farmers seek to increase efficiency and maximise per capita incomes by shedding labour and buying-up smaller farms. The implications of a substantial decline in the agricultural labour force for the future of rural societies, and for the Irish economy more generally, depend to a very large extent on the opportunities which can be developed *outside* the agricultural sector.

7. METHODS OF SUPPORTING EFFICIENT PRODUCERS

7.1 In the previous section we have seen that supply management policies have the potential to penalise efficient and competitive producers. Given that supply management is likely to feature in the CAP for the foreseeable future, it is desirable that measures to enable efficient producers to develop should be considered. This is of particular concern given that the long-run direction of agricultural trade will be towards greater liberalisation. The present dairy quota regime, for example, does not provide suitable preparation for such liberalisation. This section will examine ways in which quota regimes could be modified to provide some flexibility for efficient producers to expand.

7.2 In considering ways of permitting efficient producers to expand, it must be recognised that there is not necessarily a direct relationship between output and income. If higher output comes at the cost of lower prices on existing output, then income will not necessarily be higher.

7.3 It must also be recognised that, in introducing a competitive element into the quota system, there will be some degree of risk that output would fall should Ireland prove to be uncompetitive. However, there is also a risk attached to not introducing some flexibility to the quota system: the risk to long-run competitiveness and loss of market share to non-EC producers.

Tradeable Quotas

7.4 Much of the rigidity inherent in quotas could be eliminated if quotas were made freely tradeable on both an intranational and international basis. If quotas were freely tradeable *within* Member States then economic logic would predict that production would move towards those farmers who have a comparative advantage in dairying. Murphy (1988) has examined which categories of farmers in Ireland have a comparative advantage. The results were quite unambiguous. Larger farmers have a comparative advantage in dairying due to economies of scale in the use of family labour. If dairy quotas were freely tradeable, therefore, large farmers would be expected to expand while smaller farmers in disadvantaged areas would contract or disappear.

7.5 In considering the desirability of making quotas *internationally tradeable*, from the point of view of the national interest, the key question to be addressed is: would Ireland be a net buyer or seller of quotas? This depends on the competitiveness of Irish dairying. Keane (1991) has addressed this issue.

7.6 There are two factors which would affect a country's ability to be a net buyer or seller of quotas: its production costs and its ability to pay for milk. A country could be a net buyer of quotas even if it had higher costs, if for whatever reason (for example, lower processing costs) it could afford to more than offset this by paying higher milk prices. Keane calculates what the major EC dairy producers would be able to pay for milk under a regime of internationally tradeable quotas. (Significantly, no premium is assumed for a higher value added product mix or closeness to markets, on the basis that the *marginal* milk for most countries, most of the time, realises just intervention prices). Production costs were then subtracted from milk prices to obtain the expected margins:

TABLE 1

Expected Margins on Milk with Internationally Tradeable Quotas

	Milk Price minus Total Costs £/100 kgs
Germany	1.6
France	5.7
Belgium	8.5
Netherlands	5.3
Denmark	0.4
Ireland	6.8
UK	5.9

Source: Keane (1991)

7.7 These results would appear to suggest that Ireland would be in a strong position to be a net buyer of quotas but are subject to a number of caveats. Firstly, the Commission's reform proposals would reduce the prices of cereals more than grass based production and this could reduce Ireland's competitive advantage[9]. Secondly, and more importantly, the measure of costs used gives an indication of short/medium run competitiveness. Costs in these calculations include specific costs (e.g. seeds and fertilisers), overheads (e.g. energy costs), depreciation and other direct costs (paid wages, rent and interest).

9 Boyle (1991), argues that Ireland's competitive advantage would not be seriously eroded. The reduction in product prices will reduce the *opportunity cost* of grass. Boyle estimates that the net effect of the proposed changes on profits will not be significantly greater for Ireland than other member states.

Imputed costs (own labour, capital and land) are not included. Including imputed costs gives an indication of long-run competitiveness. On this basis, the evidence suggests that major structural changes in Irish agriculture would be necessary for long-run competitiveness. Therefore we must be cautious about the desirability of making quotas internationally tradeable in the immediate future.

Production Entitlement Guarantee

7.8 An alternative way to introduce some flexibility into the quota system would be the strategy of Production Entitlement Guarantee or PEG (see Boyle, Harvey (1989) and Riethmuller et al (1990)). We will firstly outline the basic concept of PEG and then some possible variations.

The Basic Model

7.9 Under this approach support prices are maintained above world price levels but distortion is minimised by confining support to a volume of output lower than that which would be produced if all production received only the world price. Hence production is not artificially stimulated. Production above the supported amount would only receive the world price. The support could be provided by consumers through higher prices or by taxpayers. If support is provided by consumers the measure will not be entirely trade neutral, since domestic demand is artificially depressed and exports are higher than they would otherwise be. If support is provided by taxpayers as a deficiency payment, then support would be trade neutral, since consumers would be free to purchase at world price levels.

7.10 Keane (1991) has calculated the milk prices payable in the EC if products were to receive world market prices. The prices paid would exceed specific costs (e.g. seeds and fertilisers) for the major EC dairy producers, including Ireland. The prices paid would not, however, cover all direct costs (e.g. paid labour). Therefore under a "pure" PEG we would expect a substantial reduction in EC production. The effect on farmers' income would depend on the extent to which the Commission used the savings from reduced price support to compensate farmers.

Support Limited to Internal (EC) Requirements

7.11 In the "pure" version of PEG, support is set at some level below the production which would occur at world prices. An alternative would be to provide support for a production level which is sufficient to meet EC requirements, taking account of import levels. Production above that level would be disposed of by the producer on world markets, and hence would receive the unsubsidised world price.

7.12 Such a system would not necessarily be trade neutral. The amount that would be produced to satisfy domestic requirements could exceed what would be produced if all production only received the world price. There would, however, be a merit in such a system. *Subsidised* surpluses would be eliminated. Production surplus to domestic requirements would only take place if the costs were below world prices.

7.13 This type of PEG system is similar to the current sugar regime. There are three classes of quota in the sugar regime. The "A" quota represents production sufficient to cover expected internal consumption. "A" quota production receives the full support price. The "B" quota provides a lower supported price and is designed as a buffer to allow for production variations due to weather. Production above these quotas is classed as "C" and must be disposed of at the producer's own expense outside the Community.

7.14 As with the basic model of PEG a substantial reduction in EC production would be expected under this system, with consequent reduction in employment and output in the processing sector. Since there is a net reduction in the surplus production, it would be possible for the Commission to compensate farmers for the loss in income and still have net savings.

Stabiliser Levy System

7.15 This concept has been formulated by Sheehy (1990). There are two variables in the PEG systems:

(i) the level of production to which full price support applies; and

(ii) the price which the extra production receives.

The Stabiliser Levy System would be a flexible instrument for modifying these variables. Sheehy has suggested that, initially, full

price support would apply to ninety five per cent of the present quota. Production above this level would be curtailed only by a stabiliser levy which would be set so that the extra production would earn something between the full support price and world prices (i.e. there would be reduced levels of export refunds). The levy would be adjusted over time in line with market developments. This would provide some scope for efficient producers to expand as efficient producers would be able to pay the stabiliser levy on extra production, while inefficient producers would find it penal.

7.16 The stabiliser levy could initially be set so as to maintain EC production. The impact on production in Ireland would then depend on the competitiveness of Irish producers. In view of the more incremental nature of the changes resulting from the stabiliser levy, it is more likely that the competitiveness indicated by the statistical evidence would, in fact, provide the basis for expansion of production in Ireland. Even if production increased, there would not necessarily be an immediate income gain, since there would be a reduction in the support price received for a proportion of existing output. However, the stabiliser levy would be a flexible mechanism which would give efficient producers the potential to take advantage of future market opportunities.

"C" Quota

7.17 One could introduce the facility to engage in "C" quota type exports, while leaving the present level of supported production unchanged. This would be a minimalist type of change. Less efficient producers could continue as before while more efficient producers would have the opportunity to increase production for disposal, unsubsidised, on world markets. Keane's results show that the milk prices payable if the products were to receive world market prices would exceed specific production costs for a number of EC countries, including Ireland. Therefore we would expect some exports to take place under this arrangement.

Assessment

7.18 This section has explored ways of reducing the inefficiency of the quota system and making it compatible with trends towards greater liberalisation. One way of dealing with this is to make quotas freely tradeable. If it was decided to proceed in this direction it would be prudent to start by making quotas tradeable within member States. One

disadvantage is that regions with concentrations of smaller farmers would be net sellers of quotas, with consequent negative upstream and downstream effects for these regions. For this reason, it might be judged desirable on regional policy grounds to impose some regional limits on trade in quotas. It would also be desirable to provide assistance to new entrants to farming in acquiring quotas, since such entrants would be at a disadvantage in competing with large, established producers.

7.19 The various PEG mechanisms can be ranked in order of decreasing levels of risk for agricultural output and income as follows:

(i) pure PEG, where full price support is limited to production below what would be produced at world prices;

(ii) PEG where full price support is limited to the EC's internal requirements

(iii) Stabiliser Levy Mechanism;

(iv) "C" quotas, without any other changes in support.

The Council believes that these mechanisms merit detailed consideration in the interest of providing opportunities for the Community's efficient producers.

8. COMPETITIVENESS OF IRISH AGRICULTURE AND FOOD

8.1 The likelihood is that in future there will be a reduced level of protection in agriculture. This raises the question as to how well positioned the Irish agriculture and food industries are to meet a more competitive environment. Boyle presents data on two measures of agricultural competitiveness. The first index, cash costs as a percentage of output, indicates the flexibility of the agricultural sector to withstand downward price adjustment relative to market rivals. The results indicate that Ireland could be well placed to withstand downward price pressure in almost every major commodity, both within and outside the EC (see Table 2). The second index, cash costs per 100 kgs of product volume, indicates where production should be concentrated if cash costs are to be minimised for a region or group of regions. It is an indicator of short/medium run competitiveness at farm level. The results using this second index are presented in Table 3 and indicate that Ireland may be competitive within the EC in every major

commodity, while globally we may be competitive in milk and cereals. It must be emphasised that this analysis is based on *current costs* of production.

TABLE 2

The Competitive Advantage of Irish Agriculture - cash costs as a % of Output (1989)

Country	*Milk*	*Beef*	*Wheat/ Cereals*	*Sheepmeat*
Germany	60	77	—	—
France	60	66	58	78
Italy	52	—	—	—
Belgium	46	—	—	—
Netherlands	57	—	—	—
Denmark	74	—	99	—
Ireland	*52*	*54*	*69*	*60*
UK	64	68	78	81
US	86/77	128	79	81
Australia	64	75	64	—
Canada	72/52	—	54	—
New Zealand	56/68	na	—	—
Argentina	—	79	na	—

TABLE 3

The Competitive Advantage of Irish Agriculture cash costs - IR£ per 100 kg of product volume (1989)

Country	*Milk Actual Solids*	*Beef Liveweight*	*Wheat/ Cereals*	*Sheepmeat Liveweight*
Germany	15.8	na	—	—
France	12.6	na	6.7	122.7
Italy	15.6	—	—	—
Belgium	10.0	—	—	—
Netherlands	14.7	—	—	—
Denmark	19.9	—	12.6	—
Ireland	11.3	na	7.1	84.1
UK	13.2	na	10.2	89.6
US	17.8	124.7	7.8	—
Australia	6.5	47.0	4.3	—
Canada	13.3/23.4	—	5.4	—
New Zealand	5.2/7.5	35.0	—	40
Argentina	—	42.0	3.0	—

Source: Boyle Position Paper

8.2 A major limitation of this approach is that it analyses competitiveness in terms of cash costs, which is an appropriate measure for the short/medium term only. For the long term, we also need to consider other factor costs (own labour, land, capital) to compute total economic cost. Such an index was discussed by Boyle. The conclusion reached was that "the results in all cases imply that Ireland will have to resolve fundamental structural impediments if it is to be competitive in the long run." It follows that *at farm level,* Irish producers may have a competitive advantage in the short/medium run in dairying and cereals (but not beef), *but major structural changes are necessary for long run competitiveness.*

8.3 The performance of the *food processing industry* must be examined in assessing whether competitiveness at farm level can translate into competitiveness in the market place. Unfortunately, competitiveness in the processing sector has not been researched in as comprehensive a manner as the agricultural sector.

8.4 The *dairy industry,* for example, has highly efficient processing facilities and has been diversifying its sources of earnings. However, there are two major concerns about the industry's position:

(i) *The product mix is highly concentrated in declining markets:* The evolving product mix of the industry is shown in Table 4. We see that the share of milk going into butter is around 70 per cent. About 60% of skimmed milk goes into SMP. The long run demand for these products is in decline.

(ii) *The industry is highly dependent on intervention and export refund/third country sales:* In 1990 over half of our butter and SMP went into intervention. With the recovery of dairy markets in the second half of last year there was less reliance on intervention. Nevertheless, 41 per cent of butter production went into intervention in 1991. Ireland's reliance on intervention and subsidised dried product exports reflects the dual impact of our location and the considerable surpluses which arise within the Community.

8.5 There are economic reasons underlying two related characteristics of the food industry: *product mix* and *market location.* Consider *product mix* first. World trade in dairy products, is for the most part, trade in commodity products. It is to be expected that a large exporter, such as Ireland, would have a commodity orientation in its exports. In addition,

TABLE 4

(A) WHOLE MILK UTILISATION IN CREAMERIES

PERCENTAGE	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
BUTTER	66.3	66.8	71.9	78.9	78.3	72.8	72.5	64.8	61.4	68.3	72.3	69
CHEESE	13.0	14.0	13.2	11.7	11.3	14.3	12.9	14.1	17.4	16.2	14.9	16
AMF	8.7	6.0	1.6	0.8	0.8	1.6	2.3	7.0	5.8	2.5	1.8	2
WHOLEMILK POWDER	6.6	7.1	6.8	2.7	4.4	4.2	4.1	5.7	6.0	4.0	2.1	4
CREAMS	2.6	3.6	3.9	3.0	3.0	3.6	3.5	3.4	3.9	3.8	3.7	9
OTHERS	2.8	2.5	2.7	2.3	2.3	3.4	4.7	4.9	5.4	5.2	5.2	
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

(B) SKIM MILK UTILISATION IN CREAMERIES

PERCENTAGE	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
SMP	54.0	56.0	52.2	51.8	52.7	45.8	45.7	40.1	33.3	44.2	59.9	59
CASEIN	22.0	19.4	21.2	22.3	18.2	28.2	31.7	38.7	44.0	36.7	26.6	27
ANIMAL FEED	10.4	12.0	11.9	11.4	10.6	7.5	4.0	5.1	8.1	5.7	2.5	
HUMAN FOODS	4.8	3.9	6.2	4.4	4.9	5.4	7.0	7.6	9.6	8.0	8.3	14
LIQ. FOR ANIMALS	8.1	7.9	7.8	9.3	11.5	9.7	8.9	6.0	2.1	1.3	0.5	
OTHERS	0.7	0.7	0.8	0.8	2.1	3.4	2.7	2.5	3.0	4.1	2.2	
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Bord Bainne, Annual Reports.

the seasonal milk supply provides a competitive advantage in the production of storable commodity products. Nevertheless, it is a major concern that the commodity products in which the industry is heavily specialised are showing a long-run decline in consumption. Were intervention support not limited to two particular commodities (butter and SMP) one would expect the industry to have diversified into other commodity or quasi-commodity products which are showing more favourable market trends, such as certain types of cheese. Since 1973-75, European Community cheese consumption has increased from 2.1 to 3.0 million tonnes in 1990 while over the same period butter consumption has declined from 1.8 to 1.1 million tonnes. (Keane 1991).

8.6 Regarding *market location*, economic logic suggests that Ireland, on the periphery of Europe, would tend to be reliant on sales of products to intervention/third countries when the European market for these products is in surplus. This has been formally illustrated by Keane and Lucey (1991) using a transport cost model. The model predicts that given (i) the objective of minimising transport costs, and (ii) surplus EC production, 99% of Irish dairy exports would be to third country markets or intervention. 99% of the export product mix would consist of butter, SMP and whole milk powder since these are dry products which minimise transport costs. For illustrative purposes the authors then imposed a reduction in production of 8.5% for each country. This helps to reduce the surplus production, which has a significant effect on the output of the model. With this assumption the model predicts that 18% of exports would be for the European Community market (compared with 1% before) and 24% of exports would consist of cheese and whole milk.

8.7 Similar issues arise for the *beef industry* in Ireland in facing the prospect of lower levels of protection in the future. Three major problems can be identified:

(i) *The industry has a low share of the stable and affluent European market* and a high dependence on the unstable, low priced third country market which depends on export refunds.

(ii) *High dependence on intervention:* In 1991 intervention represented about 77 per cent of export steer slaughterings.

(iii) *A low proportion (4%) of beef goes into further processed beef* (i.e. beyond deboning).

TABLE 5

Irish Beef Exports By Destination %

	1991
U.K	32
Continental EC	24
Third Country	44

Source: CBF. Calculations based on product weight.

8.8 This pattern reflects the fact that the net returns from commercial sales are often lower than the returns from intervention. Our peripheral location also places us at a significant disadvantage in exporting to Europe. For example, the cost of sending chilled vacuum packed beef to Paris amounts to about 5% of the product's value for an Irish export company, compared with only 1% for a competitor French company delivering beef from Normandy to Paris.

8.9 Another obstacle to increasing beef sales to the European market is seasonality. To establish ourselves in the secure European markets, it is necessary to supply beef on a year round basis. Our peak seasonal supply must be frozen and such beef is most suited to the low priced third country market. At the present time (March 1992) cutbacks in intervention have caused a problem for the sale of cattle, even though we are at the seasonal trough of supplies. However, this does not alter the fact that the development of commercial markets requires continuity of supply. It is essential that the current difficulties be resolved in a way which does not further discourage out-of-season production. Despite the various obstacles, there has been a steady increase in beef exports to continental markets in recent years. Such exports increased by 10 per cent in 1991 over 1990. This is a considerable achievement, particularly in view of the adverse market conditions.

8.10 The operation of the CAP has negative effects on the competitiveness of *beef processing*, defined as the processing of deboned beef to produce uncooked products, such as mince meat, and cooked processed meats, such as canned meats. The CAP increases the price of raw material (deboned beef) for beef processors. This would not be of great significance *if competitors faced the same price for raw materials*. However, this is not the case. Firstly competitors outside the Community have access to cheaper raw materials (including unprocessed beef exported from the Community with the aid of export

refunds). The importation of processed beef from outside the Community at low levels of duty restricts the development of processing within the Community. Secondly, processors in other member States have access to cheaper imported beef for processing. These imports to not enter Ireland for veterinary reasons (although such restrictions are due to expire at the end of 1992). Relaxation of such restrictions would, however, jeopardise the "white-listed" or disease-free status of Irish beef and thus potentially limit a strategy of export diversification, for example to Japan. In addition, export refunds do not take adequate account of the meat content of processed beef so that processed beef exports to third countries are not competitive with unprocessed exports. In the face of these obstacles it is extremely difficult for beef processors to develop in Ireland. The absence of an EC directive governing trade in comminuted meats also inhibits beef exports from Ireland.

8.11 The development of consumer markets depends on many factors in addition to the cost of raw materials. The quality and continuity of raw materials are important, as well as many non-agricultural factors. In many respects the challenges facing the food industry in diversifying from commodities and entering other markets are similar to the challenges facing other Irish industries. These issues have been dealt with in previous Council reports.

8.12 To conclude on the competitive position of Irish agribusiness: Ireland may have short/medium run cost advantages at farm level, but major structural changes are necessary for long run competitiveness. Adjustment is also necessary in the processing industry if it is to prosper in commercial markets. Structural changes in agriculture would help to strengthen the processing industry.

9. EVALUATION OF CURRENT REFORM PROPOSALS

9.1 The stated objectives of the Proposals for Reform of the CAP which were put forward by the EC commission in July 1991 (EC Commission, 1991), include the following:

— To improve market balance in key agricultural products, by controlling production and reducing excess supply

— To enhance the competitiveness and efficiency of EC agriculture

— To contribute towards a stabilisation of world agricultural markets

— To compensate farmers for lower prices

— To achieve a better distribution of support among farmers

— To encourage more environment-friendly farming

— To recognise the dual role of the farmer, both as a producer of food, and as manager of the countryside; and,

— To promote non-food land uses.

9.2 The key elements of the reform package comprise:

(i) *Price and Market Policies* designed to control production and improve market balance via a combination of real price reductions and direct supply control

(ii) *Compensation Policies* aimed at (a) offsetting the income losses suffered by farmers as a result of the policy changes, and (b) achieving a more equitable distribution of support among farmers

(iii) *Developmental/Adjustment Policies* designed to influence the nature of agricultural production towards more environment-friendly methods and to ease the adjustment process within the rural economy via a series of accompanying measures, covering environmental action programmes, afforestation programmes, and early retirement programmes

9.3 The interaction between the various policy instruments and objectives outlined above is complex. There is in particular, an element of trade-off between what may be seen as the *economic* policy objectives of the Commission (e.g. improving competitiveness, promoting efficiency, reducing excess supply) and the *social* policy objectives (e.g. maintaining farm incomes, developing the rural economy, protecting the environment)

9.4 The proposals of most direct relevance for Ireland are those affecting the four key sectors of dairy, beef, cereals and sheepmeat. The key proposals relating to these sectors are set out in Appendix I.

9.5 Assessments of the economic impact of the reform proposals depend critically on the position adopted with regard to three issues:

(i) *The "Alternative Scenario" assumed:* The Commission argues in its reform proposals that the maintenance of the status quo is not an option. On that basis assessment of the reform package should be made, not against the policy as it currently exists, but against other possible options for reform. Because of the difficulty of anticipating trends in performance under a set of alternative policy regimes, most of the analyses to date are based on a static evaluation, comparing the post-reform year to a base year (usually taken to be 1990). This approach implicitly assumes that the relevant point of comparison **is** a continuation of existing patterns of output and income. It tends, therefore, to exaggerate the negative impact of the current proposals.

(ii) *Static versus Dynamic Analysis:* Efforts to analyze the short-run impact of policy changes frequently adopt a static analysis, whereby everything is kept constant except those policy variables immediately under review. This has the merit of isolating the direct effects of those specific policy changes, allowing their initial impulses to be highlighted and understood. It does not, however, provide a good indication of the eventual *observed* impact of the policy changes, because it fails to take account of behavioural responses to the new policy regime. Thus, a static analysis of the current reform proposals does not take account of dynamic changes in farm outputs and inputs which would occur inevitably as farmers adjust to the new set of prices and costs which they now face. Similarly, it does not allow for any changes in market balance and prices which would result from the reforms. In general, the results obtained under a static analysis will be more pessimistic than those obtained under a (more complete) dynamic analysis.

(iii) *Scope of the Analysis:* The more comprehensive an analysis can be, the better its indication of the ultimate impact of the reform proposals. The Council believes that the appropriate level of analysis is the complete, economy-wide effect of the reforms.

Impact of the Proposals: Static Evaluation

9.6 Static assessments of the impact of the reform proposals attempt to quantify the direct effects of the proposed changes at farm level, comparing a single "post reform year" to a base year (taken in all cases to be 1990). Three effects are of particular importance:

(i) The impact on farm output, including changes in the value, volume and structure of production.

(ii) The impact on farm incomes,

(iii) The distributional implications, in terms of the winners and losers within the farm sector.

9.7 The immediate effect of the proposals would be to bring about a reduction in farm output, relative to the base year. This is inevitable, given that a key objective of the proposals is to reduce agricultural production, and that the instruments used to achieve this aim include a combination of substantial price reductions and direct supply control. The issue on the farm output side, thus becomes one of quantifying the extent of the decline anticipated, differentiating between the price and volume components of that change, and identifying the sectoral composition of change.

9.8 Two aspects of the reform package would help to off-set the income losses which would otherwise be associated with this decline in production. These are:

(a) the direct compensation paid to producers, and

(b) a reduction in input prices, which lowers farm costs.

Of these, it is the compensation payments which would be more significant in terms of alleviating the decline in farm incomes.

9.9 Estimates of the static impact of the proposals on agricultural output and income are presented in Table 6. Three sets of estimates are shown:

(i) Figures prepared by Dr. Gerry Boyle of St. Patrick's College, Maynooth,

(ii) Estimates prepared by the joint liaison group co-ordinated by the Department of Agriculture and Food, which resulted in two different scenarios being presented: Scenario 1, which represents in broad terms the view of the Department of Agriculture and Food, and Scenario 2 which is representative of the view of the farm organisations,

(iii) Teagasc estimates.

9.10 The differences between the various figures presented reflect differences in methodology and/or differences in the assumed implications of the CAP reform proposals. The analyses point to:

— A decline in the value of gross agricultural output of between £504 m and £560 m (-15.8% to -17.4% relative to 1990). This is made up of a volume decline of the order of 2% to 3%, and a price fall of 13.5% to 14.5%.

— Estimates of the decline in farm income resulting from the reform proposals range from a lower estimate of £56 m (G. Boyle) to an upper estimate of £164 m (Farm Organisations)[10]. The difference reflects differences in all three of the variables: farm output effects, level of compensation anticipated, and savings on farm input costs.

10 Professor Sheehy has estimated that aggregate farm income could increase in nominal terms by £3m, although in real terms a reduction would accur. He took as a starting point the Dept. of Agriculture's estimate of a £94m loss (see Table 6), and adjusted this figure to allow for: the reduction in the cost of home grown feed; the fact that the volume of beef output would not fall; the fact that 40% of the third beef premium might not be realised; analysing the sheep sector from a 1990 base, as per other sectors; a drop in the price of fertilisers and agrochemicals; and a reduction in the price of food for farm families. Sheehy also identified a number of other (unquantified) adjustments which he felt would further reduce the level of farm income loss.

TABLE 6

Impact of CAP Reform Proposals on Agricultural Output and Income

Static Evaluations

	Change Relative to 1990 Base (£m)			
	1	*2*	*3*	*4*
All Sectors	*G. Boyle*	*D/Agric & Food (Scen I)*	*Teagasc*	*Farm Organ. (Scen 2)*
Value of GAO	N.S	-504	-509	-560
Compensation	+260	+277	+256	+227
Sub-total	N.S	-227	-255	-326
Input Savings	N.S	+133	+139	+169
Net Effect on Aggregate Farm Incomes	- 56	- 94	-114	-164

9.11 The impact of the reforms would not be felt evenly throughout the farm sector. This is because of significant variations in the nature and rate of compensation proposed for different sectors (e.g. dairy, beef, sheep, etc.), and because of differences in the eligibility criteria to be applied in order to qualify for compensation. It also reflects differences in the form and scale of the initial policy changes proposed for the various sectors.

9.12 The biggest net loser at farm enterprise level would be the *beef sector*. This reflects primarily the stocking rate qualifications for compensatory payments. The losses which would be suffered by beef farmers are particularly disturbing for two reasons: first, in Ireland these are the very producers who suffer from a severe low income problem, and second, on the majority of beef producing farms in Ireland, the production system in operation is extremely environment-friendly. It could thus have expected more favourable treatment from the reform process, given the EC's stated objectives in relation to more environment-friendly farming.

9.13 The impact on incomes in the *dairy sector* would be less severe than in the beef sector. (Estimates of the income effects in dairying range from a small net gain in Boyle's analysis (+ £4m) to a net loss of the order of £50 m in the farm organisations' analysis). Incomes in the *pigmeat* and *sheepmeat* sectors would be relatively unaffected by the changes.

9.14 Detailed estimates of the likely *distributional implications* of the reforms have been prepared by Leavy and Heavey (1992). These suggest that:

An estimated 44% of farms would stand to gain while the remaining 56% would see their farm income decline if the proposals were approved in their original form. However, most farms would be only marginally affected by the proposals.

The restrictions based on enterprise size and on land use intensity would have the effect of directing compensatory payments to smaller and more extensive farms. As a result, the main losers from the proposals would be (a) larger farmers, and (b) intensive farmers.

The 30,000 farmers who would suffer the greatest decline in income (over £1,000 loss) are larger than average, have higher borrowings and make more efficient use of both labour and land. They represent 16% of the total farm population, account for 28% of the land, employ 40% of the workforce (including 64% of the hired labour), and produce 60% of the national farm output.

Impact of the Proposals: Dynamic Effects

9.15 The past fifteen years have seen major adjustments within Irish agriculture in response to changes in the economic, political and policy environment. These have been summarised in Section 2. Farmer responses to the current reform proposals would be likely to follow the same broad pattern as they have in the past, although the avenues for adjustment are becoming increasingly restricted. Adjustment responses would occur at three levels:

(i) Within the farm sector itself,

(ii) Within the food processing sector, and

(iii) Within the wider, non-farm economy.

9.16 In order to analyze the likely on-farm adjustment to the reform proposals, we require an understanding of the interaction between supply, demand, price determination, factor inputs and incomes in the agricultural sector. An econometric model of the agricultural sector has been developed by Dr. Gerry Boyle (Boyle, 1991). The model has been used to examine the way in which farmers might adjust to the CAP reform proposals. It points to the following principal responses:

(i) Despite the large price falls implied in the proposals, the fall in the volume of farm output predicted by the model is relatively modest (-1% relative to 1990). This is because the price elasticity of supply in certain key sectors (e.g. beef and cereal) is relatively low.

(ii) Input consumption would be expected to fall significantly. This is especially true of fertiliser usage, which has a large price elasticity.

The effect of these dynamic responses would be to reduce the impact of the proposals on both agricultural output and income. In Dr. Boyle's analysis, they reduce the farm income loss from £56 m (being the estimated static outturn) to an estimated £27 m (equivalent to a 1.5% reduction relative to 1990).

9.17 Another set of dynamic responses, which are more difficult to quantify precisely but which are nonetheless important, include the possible decline in land prices which might be expected to follow in the wake of a major decline in farm output prices, the "knock-on" effects of the price reductions on the price of competing products (e.g. the extent to which the price of red meat might be forced to fall even further, as a result of the gain in competitiveness by white meats), and the fact that farmers would seek to adjust their businesses in order to maximise their eligibility for compensation payments (e.g. by changing stocking rates), thereby minimising their income loss.

9.18 An issue which is potentially of major significance relates to the impact of the proposals themselves on *market balance* within the Community, and through this their effect on the level of post reform prices. All of the analyses adopt the simplifying assumption that the proposed changes in price and volume will translate directly into equivalent percentage changes, applied to the 1990 base year. Given that the main purpose of the reforms is to reduce the supply/demand imbalance, and given the magnitude of the price cuts and supply

9.23 The current proposals would provoke a negative, contractionary response within the food sector, as the industry responded to falling raw material supplies by cutting costs and shedding labour. The proposals do not provide any significant incentives or opportunities to break out of this cycle of contraction and retrenchment. While lower prices would reduce the relative return from sales to intervention thereby increasing the incentive for producers to find commercial market outlets for their produce, they provide no *positive* support for such a development. Indeed, one effect of the proposals would be to create additional incentives for seasonal production thus exacerbating the already strong obstacles to diversification and development. The need for the food industry to develop commercial outlets would have become more urgent, but its ability to respond to that need would not be improved by these proposals.

Economy-wide effects

9.24 While the impact of the reforms would fall predominantly on the farming community, the proposals would also have implications for *the economy as a whole*. The reforms would affect the economy through a variety of channels. They would directly affect prices, output volumes, and incomes in the farm sector. Because of the scale of the compensation payments proposed, the initial effect of the reforms on total incomes arising in Ireland would be broadly neutral, with the loss in farm income (after compensation) roughly corresponding to the gain in consumer income. The immediate effect on output volumes, although negative, would not be particularly severe: the volume of GAO would be expected to fall by about 2.3%, with an associated contraction of turnover in the food processing industry. It would, therefore, be the effect of the proposals on *prices* in the economy which would be the dominant influence determining their macro-economic impact.

9.25 The reforms would set in train a number of forces which would put downward pressure on the level of consumer prices in the economy: the proposed reduction in agricultural prices (13.4%) is itself sufficiently large, and the weighting of the products affected by the reforms sufficiently important (at about 10% of the CPI) to have a direct effect on the overall price level. Similar effects would occur throughout the EC, bringing about a reduction in the Community price level. Insofar as Ireland acts as a price-taker in world markets, this would force a downward adjustment in Ireland's industrial output prices. Import prices would also fall, reflecting the drop in the EC price

level. Finally, the decline in prices would itself feed through to wage rates, thus reinforcing the anti-inflationary tendencies. The combined effect of these forces could bring about a reduction in consumer prices of up to five percentage points, equivalent to reducing the rate of inflation by about 0.5% per annum over a ten year period.

9.26 While the reform process would contribute towards an easing of inflation rates throughout the EC, the *degree* by which prices would fall and the extent to which price reductions would *differ* between different member States of the Community, thus giving rise to differential competitiveness effects, is less certain. In Ireland's case, the degree to which the anti-inflationary tendencies set in train by the reforms would be carried through into actual reductions in the price level would depend, inter alia, on:

— the extent to which reductions in the price of primary produce and imports were passed back to consumers, or were captured by retailers, distributors and/or manufacturers in the form of increased profit margins, (although developments in competition law should have some influence on the scope for such behaviour).

— the degree to which, and speed with which, Irish wage rates responded to changes in the general price level brought about by the reforms.

9.27 Ultimately, the impact of CAP reforms on the Irish economy would depend on a series of behavioural responses, not just in Ireland but also, critically, in other EC countries and in the rest of the world. The absence of a macro-economic model capable of capturing the effects of the reforms on Ireland's *external* economic environment means that a number of often crude assumptions have to be made. These assumptions can have an important bearing on the conclusions drawn.

9.28 A base-line scenario could be envisaged in which it was assumed that: (a) the reforms would impact uniformly on inflation rates throughout the EC, so that there would be no change in competitiveness patterns within the Community, and (b) all prices in the economy, including consumer prices, wages and interest rates, would demonstrate some degree of responsiveness to changing economic conditions (i.e. flexible, rather than sticky, prices would be assumed for all categories of prices). *In such a scenario, the long-run impact of the proposals on the Irish economy would be likely to be quite modest.* Crude estimates of the long-run effect on Ireland's GNP point to a small loss, with the

volume of GNP reduced by perhaps 0.3% to 0.5% below the level which would otherwise have been expected.[11] This loss would be spread over a number of years, so that over, say, a ten year period, the average growth rate of GNP might be reduced by up to 0.05% per annum relative to what would otherwise have occurred.

9.29 If Ireland's inflation rate were to fall by more than the EC average, our competitiveness would improve and the impact on GNP would be more favourable than described above. If, on the other hand, EC interest rates were to prove "sticky" in the face of falling inflation, then the costs of CAP reform to the Irish economy would be much increased. This is because, in these circumstances, the reforms would effectively give rise to an increase in real interest rates, which would impact particularly severely on countries like Ireland with high levels of borrowing.

9.30 The ESRI's Medium Term Model of the Irish economy was used to track the macro-economic consequences of the reform package under this alternative set of assumptions (i.e. a gain in Irish competitiveness vis-à-vis the rest of the EC and sticky nominal interest rates). The results pointed to a somewhat greater loss in GNP than was suggested under the base-line scenario above. This is because the negative implications of sticky interest rates more than outweighed the positive implications of a gain in Irish competitiveness. The results suggested that, in the long-run, the volume of GNP would be 1.2% below the level which would otherwise have been expected. This would be equivalent to a reduction of 0.1% in the average growth rate of GNP over a ten year period. Over time it is likely that EC interest rates would adjust to reflect the new low inflationary environment. Estimates prepared on the basis of sticky interest rates are likely, therefore, to

11 Estimates have been prepared using the ESRI's Medium Term Model of the Irish economy, and based on the following assumptions: (i) EC interest rates to fall by 0.5% in response to the reduction in Community inflation; (ii) Irish price level to fall by *more* than the EC average; and (iii) the initial 'shock' imposed on the agricultural sector taken as calculated by the Department of Agriculture and Food (see page 38). The expected impact of the reforms under these assumptions would be as follows: the volume of GNP would actually increase marginally (up 0.2% above its 'expected' level), but would be accompanied by a deterioration in both the balance of payments (BOP surplus down 1.2%) and the public finances (debt/GNP ratio up 4.2%). Action to correct these difficulties would increase the long-run cost of the reforms to the economy and would result in a small *decline* in GNP relative to its 'expected' level (possibly of the order of - 0.2%). The 'base-line' scenario depicted in paragraph 9.28 above does *not* assume any gain in Irish competitiveness as a result of the reforms. The expected loss in GNP would, therefore, be shomewhat greater.

exaggerate the long-run effects of the reforms and could best be seen as an upper estimate of the effects on the economy.

9.31 The discussion above suggests that the macro-economic impact of the reforms as they were originally constituted in July 1991 would be likely to be negative, but might be only marginally so. Clearly, if the compensation payments proposed as part of the reform package were to be abolished or substantially reduced, *and if nothing else were to change*, then the costs of reform to the Irish economy would be increased. The effect would show up initially in an increased loss of farm income and a deterioration in the balance of payments. The reduction in farm incomes would depress consumer spending and reduce investment in the farm sector. The extent to which these influences would impact on *national* economic performance could, however, be relatively modest, given the low multipliers which have been estimated for consumer spending in Ireland.[12]

9.32 A more serious concern would be the long-run implications of such a move for the development of incomes and output in the farm sector. *Without compensation, the structure of the existing reform package would be damaging from an Irish perspective.* This is because the proposed mix of supply controls and price reductions would not allow Ireland to build on its areas of greatest competitive advantage. Two aspects of the existing structure would prove particularly detrimental to Ireland: Firstly, the elements of supply control in the package operate in precisely those sectors where Ireland's prospects of achieving commercial success are highest (i.e. dairy, cereals). Secondly, the very large price reductions for cereals would damage the competitiveness of Ireland's grass-based production systems, in the absence of compensation payments. It is clear, therefore, that if compensation were to be abolished or reduced without any adjustment in the other aspects of the reform package, the competitiveness of Irish agriculture within the EC would suffer, with consequent negative implications for incomes and output in the longer term.

12 Henry (1983-1984) estimates that the GNP multiplier for agriculture and food is 1.32. That is, every £1 million in the agriculture and food complex (this includes the direct and upstream GNP effect) supports an additional £0.32 million GNP eslewhere in the economy.

9.33 In practice, any decision to abolish or significantly reduce compensation payments is unlikely to occur within an unchanged policy environment. A move in this direction would have to be positioned within a wider reappraisal of the instruments and objectives of CAP reform. As noted above, the remaining elements of the existing CAP reform proposals would need to be reviewed, in the light of the changed circumstances. The removal of compensation payments would also have implications for wider elements of EC budgetary policy, in that alternative methods of supporting incomes in poorer regions of the Community would need to be found.

Impact on Cohesion within the European Community

9.34 A strategically important issue is the impact of the proposals on the *relative* economic performance of different countries within the EC. In particular, we are interested in the effect the proposals would have on the prospects for greater economic convergence and cohesion within the Community.

9.35 The CAP has acted as a *de facto* regional policy. This is a consequence of the operation of two of the basic principles of the CAP: a single market and financial solidarity. In order to provide a *single market* in agricultural support, the same system of agricultural support applies in all States. Under the principles of *financial solidarity* member States contribute to the funding of the policy broadly in accordance with their ability to pay.

9.36 Ireland has been a net beneficiary of the CAP. Irish producers have benefitted from FEOGA receipts and higher prices from EC consumers (as well as Irish consumers). Matthews (1988) has shown that these measures overstate the benefits to Ireland since in the absence of CAP and other systems of agricultural protection, world prices for agricultural commodities would be higher. Nevertheless, Matthews estimates that in 1986, for example, the net loss to Ireland from dismantling CAP and liberalising agricultural trade in all industrial countries would be 4.2% of GNP.

9.37 In considering the effects of the Commission's proposals on cohesion it is possible to identify effects which would both promote cohesion and effects which would hinder cohesion. The proposed increase in budgetary expenditure and its targeting on smaller producers would promote cohesion. The increase in expenditure on set-aside for cereals would, however, result in a larger share of direct payments going to

cereals producers who are concentrated in the core countries[13]. Nevertheless, it is clear that the proposals would result in substantially higher direct payments for Irish producers.

9.38 The other major factor which would affect cohesion is the impact of lower agricultural prices. These would benefit consumers in all member States. The benefits however would be greater to net importers of agricultural products. As a net exporter, therefore, Ireland would gain less than some other member States.

9.39 On balance, the likely short-run impact on Ireland's *relative* position would be likely to be negative, due to Ireland's net exporting position. The long-run effect on Ireland's relative position would depend on the competitiveness of the Irish agricultural and food processing industries. If Ireland did prove competitive and capable of adjusting to a more liberal trading environment, this could offset the short-run anti-cohesive effects.

9.40 In assessing the effect on cohesion, it is also necessary to consider the impact of alternative policies on cohesion. If the type of reform being proposed by the Commission is not accepted, the likelihood is that price and supply reductions will continue as before, without significant compensation. In this scenario it is likely that the richer member States would provide increasing levels of direct income support to certain categories of producers. This would represent a partial renationalisation of CAP and would be contrary to cohesion, since the member States whose farmers are most in need of direct income support are least capable of providing much support.

9.41 *If compensation were to be abolished or significantly reduced, the consequences for Ireland would be more severe than in other EC countries.* The size of Ireland's agriculture and food processing sectors relative to other EC countries, and the fact that Ireland is a substantial net exporter of agricultural produce, would result in a significantly greater income loss than would be felt elsewhere.

13 There has been some expenditure on direct pyaments for cereals producers to date, but it has been very limited. In 1989/90 2.4% of cereals acreage was set aside, accounting for 1.2% of production. In the 1991 preliminary draft budget 80 million ECU was allocated for small producer aid under cereals, a very modest sum in the agricultural budget (*Agricultural Situation in the Community, 1990*).

10. CONCLUSIONS AND RECOMMENDATIONS

10.1 The issue of reform of the Common Agricultural Policy is of prime strategic concern to Ireland because of the relative importance of agriculture to the Irish economy. For example, agriculture is more than three times more important to the Irish economy than the Community average, while dairying and beef are more important to Irish agriculture than any other member State. The principal issues which arise are:

(a) the impact on aggregate farm output and incomes

(b) the distributional impact on different categories of producers;

(c) the impact on the food industry;

(d) the net impact on the national economy.

(e) the consequences for economic and social cohesion within the Community.

10.2 As noted in paragraph 9.3 above, there is a tension within the Commission's approach to CAP reform between securing market balance and promoting efficient production, on the one hand, and maintaining the viability of the European model of family farming and promoting environmental and regional policy objectives, on the other. The tension is echoed at national level in public policy concerns regarding agriculture. These seek to promote the competitiveness of Irish agricultural output and build a food industry based on substantially value-added production. At the same time, policy seeks to address the income and development needs of existing producers, in a farm structure which is environmentally-friendly but extremely vulnerable to greater liberalisation of agricultural trade.

10.3 The Council has set out in Sections 4 and 5 above the assumptions and principles which it considers should guide the policy response to reform of the CAP. Inevitably, these principles point to the need for a balance of considerations in reconciling the conflicting objectives outlined above. Given the inevitability of CAP reform and the likely *long-run* movement towards a greater liberalisation of agricultural trade, particular emphasis must be placed on measures which are likely to assist in the transition to greater influence by market conditions by those vital sectors of primary production - and the food industry -

which must adapt and compete. At the same time, policy must secure the position of those who cannot achieve viability in any plausible measure of greater liberalisation, and whose income must derive largely from supports based on social and environmental criteria.

10.4 The CAP from its inception has attempted to balance these objectives. The process of change within the CAP, which is not new, has witnessed adjustments over time in the mix of instruments to reflect changing priorities. Reform of the CAP at this time requires a re-balancing of the elements of Community policy in the light of current pressures and priorities, not least the pressures for agricultural support policies which are less distorting of international trade. The heightened sensitivity towards the ecological and regional policy benefits of family farming is an equally important element in this re-balancing. The grass-based system of farming which characterises Irish production systems is particularly significant in this respect. The environmental significance of Irish production systems has not received sufficient attention.

10.5 The principal policy instruments available to address the objectives of CAP reform are price policies (and their accompanying support mechanisms) and supply management (through quotas and associated measures). In practice, the process of CAP reform will inevitably combine elements of both, as does the CAP at present. It is a matter of judgement whether any particular combination of measures can meet the twin criteria of satisfying the development requirements of Irish agriculture and the food industry, while gaining the support of the Community as a whole, not least with regard to the position of agriculture in the continuing GATT talks.

10.6 In general terms, the optimal mix of policy instruments for Irish interests would comprise a greater emphasis on supply controls in sectors where Irish agriculture is most vulnerable to increased competition, and greater emphasis on price reductions in areas where Irish producers are likely to prove competitive. This conclusion derives from the Council's analysis, outlined in Section 6 above, of the general effects of the two strategies. This analysis is summarised in the following paragraphs.

10.7 Price reduction policies:

(a) should lead to *long-term* balance in agricultural markets, based on efficient resource allocation and development of the most competitive producers;

(b) create a set of signals and incentives which are in line with long-run trends towards greater liberalisation in agricultural markets;

(c) increase market influence and provide incentives for producers to meet market demand with maximum efficiency.

(d) allow for a more equitable and efficient targeting of income support;

But: price reduction policies:

(e) tend to reduce total farm incomes in the short run because of the lack of responsiveness of demand for agricultural output;

(f) yield benefits which are mainly experienced by overseas consumers in the case of a significant agricultural exporter, such as Ireland;

(g) are relatively ineffective in securing balance in commodity markets in the short to medium term;

(h) impact on farm income in the long-run according to the competitiveness of Irish producers and exporters, that is whether they gain or lose market share, and the level to which prices must fall to achieve greater market share.

10.8 Supply management policies:

(a) broadly protect farm income levels by guaranteeing prices for pre-determined levels of output;

(b) are generally effective in securing market balance in the short term;

(c) ensure outlets for producers who might not prove competitive in a more liberal market context because of social or environmental factors which are unlikely to be reflected in commodity prices;

(d) are consistent with the fundamental principles of the CAP, particularly the principle of Community preference;

But:

(e) tend to institutionalise existing patterns of production with potentially negative consequences for new entrants and force efficient producers to operate below their potential;

(f) restrict the availability and increase the cost of raw materials for the food processing industry.

(g) may prove unworkable as a *long-run* solution to the problem of surplus production;

(h) give rise to an inequitable distribution of support, with the bulk of support going to the largest farmers.

10.9 In the case of both price and supply management policies, losses will be experienced by primary producers. In general, income from farming will be lower under a policy of price reduction. The response will tend to be some acceleration in the rate of decline of the agricultural sector. Recognising that transition by some producers will be difficult or impossible, proposals for both types of measure typically entail the payment of compensation in some form by public authorities to existing producers. The level of direct compensation is typically much greater in the case of price reduction policies, since supply management policies entail farm income levels being supported by consumers rather than by taxpayers. *The viability beyond the short-run of alternative policies is thus of critical importance. At issue is the durability of relatively large compensation payments with price policies, and the viability of supply management arrangements, especially import restrictions, when prices greatly exceed world market levels.*

10.10 The Council cannot attempt to assess the prospects of any particular outcome to the current negotiations on CAP reform. That is properly the task of those responsible for conducting the negotiations. The stance to be adopted by Ireland must reflect a balancing of the relative merits of the policy options outlined above in the context of the prospects of securing a framework for the future of the CAP which provides stability, a greater degree of cohesion, an opportunity to develop the potential of the agriculture and food sectors in Ireland and support for producers who cannot adapt to changed conditions.

10.11 The Commission's original proposals are clearly subject to amendment in the course of the negotiations which are continuing. It is, nevertheless, useful to examine their implications and the appropriate policy stance to be adopted in Ireland since: (i) they represent the basis for the changes which will emerge in the operation of the CAP, and (ii) the principles which shape the policy response to these proposals are relevant to whatever choices may arise in the course of negotiation. The analysis of the proposals set out earlier in the report is summarised in the following paragraphs. These outline:

(a) the likely impact of the Commission proposals on the farm sector, the food industry and the national economy;

(b) the likely effects of a reduction or removal of the compensation terms of the reform package

Impact of the Commission's Proposals

10.12 The Council has noted the various estimates of the impact of the proposals on the *agricultural production sector*. The differences between these estimates reflect differing assumptions about the application of the measures, including eligibility for compensation payments. There is relatively little difference between the estimates of the *short-term impact* on direct farm incomes. There are, however, significant differences when a *dynamic* approach is taken, that is taking into account the responses made by farmers to these measures, as well as the impact on market prices of the operation of these proposals. Not all of the dynamic responses are likely to be positive. It is also clear that, despite the compensation terms, some producers would incur significant losses under the Commission's proposals. However, the Council considered that, on balance, when account was taken of the dynamic response to the changes and the originally proposed compensation, the aggregate impact of the proposals in their original form on farm incomes would not differ greatly from past trends in farm incomes. It must be noted that income levels in farming are already relatively low and have fallen by 12% in nominal terms (17.5% in real terms) in the past 2 years. In addition, changes have been proposed in the package which would adversely affect the outcome for farm incomes, and which would limit the scope for any on-farm dynamic response.

10.13 The Council has highlighted the long-run process of downward adjustment in prices under the CAP and the negative effects on farm

incomes. The present proposals continue that trend. Apart from cereals, the rate of price reduction proposed is not significantly greater than that experienced in previous years. As outlined in earlier sections of this report, significant adjustment has taken place within the farm sector in response to this price pressure. There is very limited scope for positive on-farm adjustment in response to the original proposals for reform and recently-proposed changes would further limit the scope for positive adjustment. The prospects for a more satisfactory outcome for producers from the Commission's price proposals therefore rest crucially on the availability of compensation. For reasons outlined earlier, uncompensated price reduction policies would normally be expected to have a severely negative impact on an agriculture-exporting country. While the compensation terms, allied to the benefits flowing from reduced agricultural price levels for the rest of the economy, make the reform proposals more tolerable in the context of Irish national interests there will be an on-going economic loss. The threat to the compensation terms, notably in the context of GATT negotiations, is therefore of prime significance.

10.14 The impact of the Commission proposals would adversely affect *employment* both in agriculture and in the food sector. Estimates of the fall in total employment levels range from 6,000 to 14,000 over a five year period, as the economy responds to these measures. The long-run decline in the agriculture labour force would continue and, in some circumstances, could be accelerated. The variation in estimates of reduced employment relative to the status quo reflects differing assumptions but in all cases the fall is concentrated in the farm sector. The proposals would accelerate the trend towards rationalisation in the food industry because of reduced raw materials for processing.

10.15 Ireland's reliance on intervention is due to a number of factors: our self sufficiency ratio whereby we export over 80% of our agricultural produce; our peripheral location; and surplus in the Community market. Surplus in the Community market creates the need for intervention. Our peripheral position makes our market prices lower than the Community market. Therefore, the application of intervention across the Community will draw produce from Ireland in the first instance. Implementation of the Commission's proposals would improve market balance and thereby reduce dependence on intervention for all countries. Given the factors underlying our reliance on intervention, Ireland can be expected to be the first and

disproportionate user of intervention, whenever surpluses arise. However, the price reductions would reduce the *level* of incentives facing processors which favour intervention sales rather than market development. This would tend to increase the pressure to develop commercial markets. However, aspects of the proposals would tend to reinforce the seasonal nature of production. This, allied to reduced output, would have a negative effect on the industry. Insofar as the proposals accelerate the process of rationalisation within the food industry they might facilitate the achievement of a scale of enterprise which is more likely to be successful in the market. On balance, the Council considers that the Commission proposals fail to align the short run incentives facing the food industry with the type of change necessary for its long run development.

10.16 Estimating the aggregate effect on the *national economy* of the Commission proposals is quite difficult because of the many channels of influence through which the dynamic consequences of the proposed changes would be experienced and because of the difficulty in predicting how *other* countries, both within the EC and in the rest of the world, would respond to the new regime. On balance, a modest reduction in national income would be the likely net outcome, with annual GNP growth rates slightly lower than they would otherwise have been in the first few years following implementation. Even a modest reduction in growth rates is a matter of serious concern, given our unemployment level and the urgency of removing, not increasing, the gap between Irish and EC growth rates.

10.17 Compensation paid to producers, in tandem with price and quota reductions, is a constitutive element of the Commission's package having regard to its stated objectives. In particular, it is essential to the competitiveness of many producers, in the light of the extensive grass-based system of production in Ireland. Furthermore, it is the basis upon which the unique environmental and social roles played by small farmers can be maintained in an otherwise adverse set of policy developments. *If the compensation elements of the package were to be abolished or significantly reduced, the consequences for Ireland would be more severe than for other EC countries.* The size of Ireland's agriculture and food processing sectors relative to other EC countries, and the fact that Ireland is a substantial net exporter of agricultural produce, would result in a significantly greater income loss than would be felt elsewhere.

Assessing the Commission's Proposals

10.18 An assessment of the proposals for CAP reform is complicated by the uncertainty which has been created by the inclusion of agricultural trade in the scope of the current negotiations on the future of the GATT. It is clear that the outcome of these negotiations could have profound implications for the future of the CAP and for the current Commission proposals in particular. For example, one set of GATT proposals'[14] envisages reductions of 36% in expenditure on export subsidies, 24% in the volume of subsidised exports and 20% in domestic supports. In addition border measures would be converted to tariff equivalents which would be reduced and there would be a 5% minimum access requirement for each product by the end of the period 1993-1999, based on the average in the period 1986-1988. The critical issues from an Irish perspective, are: (i) whether the Community would be able to continue to operate support arrangements in a coherent fashion, and in particular whether the DAS payments and the compensation terms in the Commission package would be sufficient to support producer income, and (ii) whether these payments would be exempt from any reduction in subsidies under GATT. Compensation on the lines proposed by the Commission is essential if the Community were to reduce current price levels by the amounts proposed. The compensation would be inadequate if the Community cannot maintain a proper degree of border protection and its export capacity. However, both the level and form of compensation that have been proposed would be vulnerable if the proposals made by the GATT Director General were accepted as the outcome to the Uruguay Round.

10.19 Apart from the potential impact of an agreement under the GATT, it must be a matter of concern whether the Community would put in place and maintain an adequate budgetary framework to meet the cost of the compensation terms as proposed by the Commission. In their absence, the effect of the proposals on aggregate farm income would be considerably more severe than estimated above. Furthermore, the loss would be concentrated on the smaller and more disadvantaged producers whose position is an important element of the objectives of agricultural policy at both Community and domestic levels.

14 Presented by the Director General of the GATT in December 1991.

10.20 The supply control elements of the package would have negative effects from the perspective of the efficient development of the national economy in the long term. While supply controls help to achieve market balance while preserving producer incomes, they also impose substantial long run costs, preventing efficient, commercial producers from expanding, restricting the availability of raw material supplies to the processing industry, and removing the scope for new producers to develop. For example, the proposed reductions in the dairy quota would restrict the development of what may prove to be a competitive sector in the event of greater liberalisation.

Conclusions regarding the Scope of Reform

10.21 Accepting that maintenance of the status quo is not an option, the Council has examined the alternative feasible scenarios for the CAP. These amount to a continuation of downward pressure on prices within the CAP without any compensation (which has been the norm to date) or the development of more stringent supply control policies. Uncompensated price cuts have nothing to commend them as an alternative strategy to the present compensation proposals. As the Council has previously noted, supply control measures are useful because of their immediate effect on market balances and in obviating the need for significant price reductions for some products. The Council notes that the Commission proposals contain supply control measures as a necessary part of a strategy of restoring market balance. However, exclusive reliance on supply controls would be undesirable because of their adverse implications for efficiency and economic performance. It has also been suggested earlier in this paper that supply control measures on the scale required to restore market balance at current price levels may prove unsustainable in the long-run.

10.22 If, for reasons outlined earlier, in the long-run, policy development within the CAP is likely to involve a greater measure of market liberalisation than is contained in the current proposals, the prospects for Irish performance will depend on the competitiveness of agricultural production here relative to other member States and other competitors in world agricultural markets. As outlined earlier, there are indications that Ireland's underlying competitiveness is potentially strong in dairying and cereals but not in beef production. That potential, however, would be realised only with very significant structural adjustments in the organisation of farm production (fewer, larger farms with less seasonal output), as well as in food processing and marketing. Such adjustments could have serious negative

consequences, not least in relation to employment. The extent to which these adjustments will be necessary will depend on the pace and degree of market liberalisation.

10.23 The Council has therefore concluded that, *on balance, a strategy which contains a mix of supply management, price policy and, crucially, adequate compensation terms, has much to commend it*. The necessity of appropriate compensation in the Irish context is indicated by the strategic importance of agriculture to the economy. The interest of cohesion within the Community requires that changes in the CAP do not adversely affect Ireland's income level and economic base.

10.24 For the *food industry*, long-run viability requires a move away from dependence on the present range of commodity items which are characterised by declining market demand, low value-added, and dependence on intervention sales. This is not to suggest that the efficient production of the existing commodities cannot prove profitable. In a more liberal trading environment greater efficiency in their production would, as a result of greater competitiveness, tend to increase the size of markets for Irish produce. However, it is clear that the demand for these commodities is at best volatile and in any event tending to decline. The current product and market profile of the food industry is understandable, having regard to the availability of relatively high returns from intervention sales, the seasonality of supply and the remoteness from main markets. It is not, however, an attractive profile on which to base the long term development of the industry. Policy for the food sector should therefore seek to achieve a better balance between commodity and value-added production.

10.25 Diversification opportunities exist even within the commodity and quasi-commodity markets, for example in relation to cheese. However, the achievement of successful access to non-commodity consumer markets poses the same difficulties for the food industry as for other sectors of indigenous industry in Ireland. Barriers to entry in particular are very substantial. It is likely, as the Council has pointed out in previous reports, that diversification will require structured alliances with existing enterprises in export markets. A variety of strategies will be necessary to reflect the different characteristics of each product market. However, the core requirements of successful market research, product development, process development and overseas marketing will be necessary for the food industry as for other indigenous sectors. These requirements, and the industry's *capacity*

to meet them, are not significantly affected by the CAP or the present proposals. The *incentive* for the food industry to develop commercial markets is, however, critically influenced by the operation of the CAP.

10.26 In the short-run, continued access to intervention is a necessary feature of a strategy to maintain farm incomes. In periods where access to third country markets is curtailed (as has been the case for beef in 1990 and 1991), the disposal of additional produce on the European market, in the absence of intervention, would be very difficult and would tend to be destabilising. However, in the light of the long-run trend towards greater market liberalisation, it is to be expected that pressures will grow to restrict access to intervention for beef. The prospect of increased restrictions emphasises the necessity for the beef processing industry to adopt more market-based strategies.

10.27 Within the framework of the approach to reform outlined in the previous paragraphs, the Council recommends that public policy in Ireland should, having regard to the factors outlined in paragraph 10.3 above, seek the following adjustments to the Commission's published proposals:

(a) a lengthening of the transitional period during which changes would be applied;

(b) a commitment to the continuation of adequate compensation terms;

(c) measures to reduce seasonality and support diversification by the food industry;

(d) a greater emphasis on structural reform adequately funded from Community sources.

(e) adjustments to reflect the particular role of the CAP in promoting cohesion within the Community.

The proposals, and their justification, are set out below.

Recommendations on CAP Reform

10.28 If the agriculture and food industries are to respond to the changes brought about by CAP reform in a way which enhances their long-run position, *the terms of the proposals should reflect a realistic estimate of the capacity for change*. The Council therefore considers that it is

appropriate that changes be sought in the terms of the current reform proposals which would enhance their benefit to Ireland in terms of structural adjustment. This relates both to the *capacity* of the relevant economic agents to undertake such adjustment and the particular *incentives* which might be provided to stimulate appropriate adjustment.

10.29 It is essential that adjustment occur to meet the challenges of a more competitive environment for agriculture. *The Council's strong conviction is that movement towards greater liberalisation should be gradual so that the social consequences can be ameliorated for the farming sector, for the rural economy more generally and for the Irish economy which is highly dependent on agriculture*. The structure (if not the detail) of the current CAP proposals, through the compensation terms, together with the accompanying measures, could provide an opportunity to undertake a programme of structural development without the type of income loss for producers and the national economy which market liberalisation alone would certainly bring about.

10.30 *The period within which change, including price reductions, will occur should be extended, for example to co-incide with the transition period under a new GATT round.* A lengthening of this period would enhance the prospects of successful adjustment on the part of individual producers and minimise the difficulty in adopting modified production systems where this is appropriate. A more gradual phasing of the reforms would also reduce the negative impact on the national economy and on employment outlined above - which is significant in the early years - and provide a more realistic opportunity for the pace of development in other sectors to offset the negative effects of change.

10.31 While the Council recognises the role of supply control in achieving market balance, it is concerned at the negative effect of supply management policies on efficient, commercial producers. *The Council, therefore, proposes that detailed consideration be given to mechanisms to modify the effect of quotas on competitive producers.* These were outlined in Section 7 above.

Compensation

10.32 Having regard to the negative effects which would otherwise arise both for primary producers and for the Irish economy, the *Council strongly recommends that the duration of the compensation for CAP*

changes be maximised. Preferably, this would be achieved through agreement: (i) on a Community budgetary framework for the amended package, and (ii) that the compensation terms are accepted unambiguously in the context of the current GATT negotiations (through inclusion in the so-called 'Green Box'). It is equally imperative in the interests of cohesion that the future cost of making these compensation payments would be unambiguously a charge on the Community, without requiring national contributions other than through the normal aggregate budgetary process.

10.33 *The stocking rate restrictions* on compensation terms contained in the Commission proposals of July 1991, especially those proposed for the disadvantaged areas, should be eased to recognise the strong development potential of farmers whose systems of production do not pose environmental hazards.

10.34 As noted earlier, direct compensation payments can be targeted so as to meet criteria of equity and efficiency. In this regard the Council considers that it would be desirable that a ceiling, applied on a uniform basis across the Community, should apply to the total amount of direct income support which producers might receive.

Seasonality and the Food Industry

10.35 *Measures to reduce the seasonality of production* should be sought in the negotiations on the reform proposals. The seasonal nature of the key products is a major impediment to developing commercial markets in Europe and diversifying the output of the food industry. The CAP has deepened the inherent seasonality of grass-based production and the opportunity should be taken to develop incentives which would encourage year-round production. In the case of *beef*, the existence of a premium system provides a mechanism for doing so. Specifically, a slaughter premium payable during the spring months should be provided. While no similar ready-made mechanism exists for *dairying*, counter-seasonal incentives should be sought for winter milk. The Commission has previously recognised the critical importance of the dairy sector for Ireland through the authorization of higher intervention prices for butter. It would be more appropriate to provide this recognition in a form which strengthens the long-term viability of the dairy sector through appropriate diversification.

10.36 The adjustments to be undertaken by the *food industry* in developing market-led strategies and lessening reliance on intervention are

substantial. The Community's concern to reduce structural imbalances and pressures on intervention within agriculture, while strengthening cohesion, point to its vital interest in developing a more viable agriculture and food sector in Ireland. It follows that it is appropriate that *the Community should substantially underwrite the costs of adjustment* as part of a refocused CAP.

10.37 The opportunity should be taken to deal with a number of *anomalies affecting the beef industry.* In particular, the elimination of national trade barriers affecting mince meat portions of a type which are currently traded only under bi-lateral agreements with other member States would be a most valuable advance under the Single Market programme. Similarly, altering the co-efficient used to calculate export refunds on processed beef to take proper account of their meat content should be pursued.

Structural Reform

10.38 The viability of the CAP in the long-run is likely to depend in part on its capacity to strengthen the competitiveness of European agriculture. This implies a much greater emphasis on socio-structural policies at European level. The accompanying measures in the reform package - dealing with farm retirement and afforestation, could be of significance to the development of off - and on -farm opportunities to facilitate structural adjustment and the development of a viable economic base for balanced rural communities. The reform measures represent an attempt to address imbalances largely attributable to the operation of the CAP to date. It is therefore appropriate that investment in measures to diversify the agricultural sector and strengthen the rural economy should receive the same measure of Community support as the maintenance of agricultural market supports, even on the proposed modified basis. *The Council therefore considers that the accompanying measures proposed in this area should not require national funding.*

10.39 The Council's focus on the critical nature of the CAP reform process should not be regarded as diminishing the importance to be attached to *an integrated approach to rural economy.* This is indicated, for example, by the fact that income from farming accounts for only 54% of the gross income of farm households. Income from off-farm activity is more significant in the case of younger farmers, suggesting that the creation of employment opportunities in the rural economy is essential for a flexible and secure farm structure.

10.40 Following Ireland's entry to the EC, there was an implicit and unwarranted reliance on the CAP to solve the endemic problems of Irish agriculture: low incomes and poor structures. However, a notable exception to the eclipse of interest in policies for rural development in this period was the IDA's programme of industrialisation. This encouraged industrial activity in centres beyond the eastern metropolitan region. This policy had considerable success before the recession of the 1980s. Despite the very substantial fall in employment in agriculture, the rural population increased in all of the provinces, during the seventies.

10.41 With the recession of the eighties, this favourable trend was reserved. During the 1980s, outside the east and north-east regions, Galway and Donegal, non-agricultural employment declined. This decline, added to the fall in agricultural employment, clearly indicates that the rural problem is now one of regional economic decline, and not just an issue that arises solely or even mainly from the reform of CAP. The rising share of non-farm income in total farm household income reinforces the importance of development outside agriculture to the future of the rural areas.

10.42 There is a growing recognition of the importance of policies for rural development at EC level. While the Community, through the LEADER PROGRAMME, has already established an important role in this area, the primary responsibility rests with national authorities to develop appropriate strategies and structures. Since, outside the Dublin region, Ireland's population is predominantly rural, the issue of rural development is to a large extent the national problem of reducing unemployment and emigration. It is the Council's intention to address these issues in its work programme arising from the completion of the current CAP reform negotiations.

Cohesion

10.43 Under Article 130B of the Single European Act, common policies may be applied differentially in support of the objective of cohesion. This is reinforced in the Maastricht Treaty. The relative significance of agriculture to the Irish economy is much greater than for the Community as a whole in terms of employment, output and exports. The structure of the CAP limits the scope for expanding this important sector which is potentially internationally competitive. There is, therefore, a case for applying quotas and quota cuts differentially within the Community. This case, which was accepted by the

Community at the time of the introduction of the quotas on milk is based on:

(i) the importance of the dairy sector in the Irish economy;

(ii) the competitiveness of this sector;

(iii) the need to support less intensive production because of the environmental problems caused by intensive productive systems;

(iv) the merits of using the quota system as an instrument for assisting objective I regions.

Future Work by the Council

10.44 It is the Council's intention in the *second phase* of this project to examine the specific policies to be applied in the interests of (i) enhancing the productive efficiency of the agricultural sector, and (ii) developing the food processing industry in ways which secure and maximise economy-wide benefits for the long-run. Such policies would include measures to improve the human capital in agriculture through effective application of research, training and support policies. The Council will be addressing these issues in the light of the eventual outcome of the current discussions on reform of the CAP. *It is primarily a matter for domestic policy-makers to develop policies which address structural deficiencies in Irish agriculture.* The implementation of such policies may require a Community framework and Community support, but the scope of the necessary strategy to achieve this type of development is such that it can only be formulated effectively at national level.

Council's Views on the Future Role of the CAP

10.45 The Council, as noted above, regards CAP reform as inevitable. Moreover, the Council considers that CAP reform is desirable insofar as it leads to a more viable system of agricultural support. The Council does *not* favour dismantling the CAP. While recognising both the inevitability and desirability of greater liberalisation, the Council shares the Community's rejection of a 'free trade' solution for agriculture. It favours instead a solution which derives from the Community's traditional approach to market adjustment, that is an approach which recognises the social dimension of markets and the

social costs and benefits which are generated by adjustment to the exigences of market forces. In particular, *it is the Council's view that a reformed CAP must operate as an important instrument for achieving economic and social cohesion.*

10.46 The sustained effort to achieve a market-oriented production system and a more broadly-based rural economy, advocated by the Council, does not diminish the importance of the existing CAP - supported agri-business sector to Irish living standards. Neither does it alter the virtual impossibility for many farmers of achieving viable producer status. It is the balancing of these concerns which must determine Ireland's approach to negotiations on CAP reform.

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APPENDIX I

Main Effects of CAP Reform Proposals

MILK

- 3% quota cut.
- Price to be cut by 10% (15% for butter and 5% for skim milk powder).
- Voluntary milk cessation scheme and buy-up scheme.
- Compensation for farmers whose quotas are reduced and in respect of the first 40 cows per herd, subject to stocking rate criteria.

BEEF

- Intervention price to be cut by 15%.
- Increase in the special premium for male bovines from 40 ecu (£35.15) to 180 ecu (£158.18) per animal payable in three annual instalments. This applies to the first 90 animals per herd subject to stocking rate criteria.
- Increase in the suckler cow premium from 60 ecu (£52.20) to 95 ecu (£82.65) per cow for the first 90 cows per herd, subject to stocking rate criteria.

CEREALS

- Price cut of 35%.
- Compensation for income loss at the rate of 55 ecu (£48.33) per tonne, subject to a set-aside obligation for producers of more than 92 tonnes of cereals per annum.
- Stabiliser and co-responsibility levy arrangements to be withdrawn.

SHEEPMEAT

- A quota establishing entitlement to the ewe premium will be introduced based on 1990 numbers; the reference flock will have to respect a maximum size of 750 ewes in Less Favoured Areas and 350 ewes elsewhere.
- Rural World Premium of 5.5 ecu (£4.83) per ewe will be maintained.