CHAPTER 6

Unilateral Trade Liberalization by the EC or the USA

6.1. Unilateral Trade Liberalization by the EC

6.1.1. Why trade liberalization by only the EC?

The CAP of the EC is often regarded as a policy that distorts global agricultural trade significantly. Since, as seen in Chapter 5, the OECD countries gain from agricultural trade liberalization, it is of interest to see what would be the impacts of a unilateral trade liberalization by the EC, globally and on its domestic situation. However, to appreciate the impact of the removal of the currently pursued CAP by the EC, one first needs to know the objectives of the CAP. These are (Commission of the EC, 1958):

(1) To increase agricultural productivity by developing technical progress and by ensuring the national development of agricultural production and the optimal utilization of the factors of production, particularly labor.
(2) To ensure thereby a fair standard of living for the agricultural population, particularly by increasing the individual earnings of persons engaged in agriculture.
(3) To stabilize markets.
(4) To guarantee regular supplies.
(5) To ensure reasonable prices in supplies to consumers.

In pursuance of these objectives the CAP has become more and more inward-looking and protectionist, attracting criticism from both inside and outside the EC. [A detailed discussion of the CAP can be found, e.g., in Engels *et al.* (1984), Buckwell *et al.* (1982), and the literature quoted therein.] In addition, an evaluation of the CAP must also consider Article 112 of the Rome Treaty,

which asks for international harmony in trade relations of the EC with the other countries.

Judged only from the EC's point of view, it is argued that the misallocation of resources due to distorted prices leads to welfare losses. Moreover, the CAP leads to income transfers that are not always intended: e.g., countries that are net importers of agricultural goods transfer financial assets to those countries that are net exporters of these goods (Ritson and Tangermann, 1979), and such transfers between countries are not intended by the CAP. In addition, though the CAP tries to ensure a minimum income to the agricultural sector as a whole, within the sector there is no provision for a guaranteed minimum income to individual farmers. Nor is income distribution within the agricultural sector considered as an important variable to be influenced. In fact, only some kind of "representative" income of farmers is used as a yardstick (von Witzke, 1979). In more recent years, another problem has surfaced: the EC has difficulties in raising the necessary money to pay for the increasing cost of the CAP.

Third world countries criticize the EC, especially for the impact that the CAP has on the world market and because it restricts entrance into the EC market. The rather rigid price policy of the EC under the CAP, which stabilizes domestic prices mainly through a system of variable levies, leads to a situation where the world market has to absorb to a large extent the annual changes within the EC in supply and demand balances in many agricultural products. In other words, the variations in quantities produced domestically are more or less exported by the EC on the world market as domestic prices are maintained, and demand for agricultural products adjusts but little in the EC. The impact of these policies on world market price stability varies from commodity to commodity. Empirical work indicates, however, that there are more destabilizing effects than stabilizing ones (see Schmitz, 1985, and the literature quoted therein). In order to sell the surplus quantities resulting from its high-price policy on the world market, the EC has to pay rather high export subsidies. This often makes it very difficult or even impossible for efficient exporting countries to compete with EC exporters.

Several attempts have been made to quantify the economic costs of the currently pursued CAP. One of the first to identify the cost of the CAP were Koester and Tangermann (1976), who calculated the costs for the Federal Republic of Germany (FRG) only. Their result indicates that about 0.3% of the national income is the cost of the CAP for the FRG (Koester and Tangermann, 1976, p. 198). More recent estimates are not confined to the FRG. Buckwell *et al.* (1982) estimate the welfare gains from a "free market" policy at 11051 million European Units of Account for 1980, which is approximately equal to 0.5% of GDP in that year (Buckwell *et al.*, 1982, p. 90, Table 6.2). In a recent study, de Veer (1985) estimates the benefits from liberalized trade of the EC to be 0.38% of the GDP (de Veer, 1985, p. 11, Table 2.5). Engels *et al.* (1984) assess the cost of the CAP to the consumer alone to be on the order of 36 billion ECU for 1982 by assuming an average protection for agriculture of 25% and using the value of