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The Elimination of Structural Surpluses: Formula of the European Commission

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THE ELIMINATION OF STRUCTURAL SURPLUSES - THE COMMISSION'S FORMULA

I. Introductory remarks

At the end of this year the Council of the European Communities is faced with the task of deciding on the final form for financing agriculture in the EEC.

In order to solve this problem, which is of capital importance for the further development of the Community, it is essential that the financial handicap represented by the structural surpluses of farm products, in particular grain, sugar and milk products, should be eliminated.

The common agricultural policy must lead to a clear guideline on production and marketing; this will mean a revision of the policy on markets and prices applied to these three items in the first few years since the agricultural policy came into being. The Commission has come to the conclusion that a return to the basic principles of the common agricultural policy worked out in 1960 represents, in the light of the experience gained in the meantime, the best way to restore structural balance between production and sales. That these basic principles have been tampered with and distorted has led to an enormous rise in production and involved the Member States in sharply rising costs because of the need to finance the surpluses.

The common organizations of the agricultural market must be transformed into an organic whole, a system administered according to Community principles in which, once the transitional period expires, there are neither price advantages for particular countries nor other exceptions.

Any concept which departs from this principle, for instance such as the restriction of output through production quotas, artificial limitation of expenditure on the common agricultural policy or deficiency payments would be a step backwards. Such solutions are not consonant with the progressive integration of Europe but freeze the structure of agricultural production and leave the real crux of the problem untouched. A lasting improvement in the situation will be attained only by reinforcing the free market orientation of agriculture.

II. Present situation

A. Grain

1. Rearrangement of relative price levels

For grain in particular it has been found that neither the area sown, the manpower available nor the quantities consumed can be sufficiently influenced by short-term variations in the real level of farm prices. Price changes alone are therefore hardly suitable for restoring the balance of the market.

By way of contrast the relative levels of grain prices and the influence they exert on the pattern of production and consumption offer a good chance of influencing market equilibrium favourably, since in many respects the individual types of grain are interchangeable. In view of the present imbalance in the markets, measures to restore market equilibrium must be broken down into:

(a) Measures to bring about market equilibrium in the short term;

(b) Measures to align productive capacity on marketing prospects in the medium term;

(c) Measures to maintain a balance between supply and demand in the long term.

In a memorandum concerning the balance of the agricultural markets, submitted to the Council on 19 November 1969, the Commission estimated that if the present price policy is continued probably some 700 million units of account (= US dollars) must be spent in 1970/71 just on export refunds for grain and on denaturing wheat for use as feed. An analysis of the degree of self-sufficiency shows that these disbursements are due mainly to a surplus of common wheat. As the price elasticity of the various types of grain is very high, on the supply side as well as on that of demand, the Commission's proposal is intended to reduce wheat surpluses by changing the relative price levels of the various kinds of grain. The Commission considers that in view of the present position a reduction in these surpluses can be achieved only by cutting the price of wheat, maintaining that of barley and raising the threshold price of maize (on importation into the Community).

The extent to which the position of feed grain will have to be improved depends on the feed value of the various types of grain, especially the relation of common wheat to maize. The change would mean that more wheat will find its way into the feeding-trough without the Community having to maintain the present high premium for the denaturing of wheat or to pay large amounts in the form of refunds on wheat sold on the world market.

2. Further necessary measures

The Commission considers, however, that the problem of grain surpluses cannot be mastered merely by a change in the relative prices of the various kinds of grain. When the Community began to organize the common grain market in 1961/62, it was hoped that the wheat produced in the Community would be sold in the EEC's north-western deficiency area. The "regionalization" of the grain market was based on this north-western area with the town of Duisburg as the centre.

The whole EEC area was brought under a uniform regionalization scheme, in which however the derived prices (based on Duisburg) are frequently out of touch with reality. If therefore regionalization of the intervention price is to be maintained in future, it should be improved considerably. Because of political compromises the lowest derived intervention prices in some major producing areas were established at too high a level; those and other defects in the construction of the scheme have not subsequently been eliminated.

Meanwhile the Community's supply situation has undergone a decisive change. In 1962, when the common organization of the grain market was introduced, the Community's net import requirements still totalled over 10 million tons. Today the Community is increasingly becoming a gross importer, a circumstance which involves particularly high costs for the European Agricultural Guidance and Guarantee Fund.

Although the net demand for imports is still about 8 million tons despite the growth of production, there have been significant changes.

Not only does the Community produce surpluses of wheat, but it has also reached or passed the point of self-sufficiency in rye and barley.

One of the main features of the supply situation is that the demand for grain for human consumption is constantly shrinking while the demand for feed grains is increasing.

The wrong price relationship between wheat and maize together with the disadvantages arising from errors in regionalization mean that grain imports are still increasing instead of decreasing. This is in particular the case of maize, yearly imports of which have exceeded 10 million tons. At the same time for reasons of quality about 2.5 million tons of high quality wheat still has to be imported, so that the Community's total imports, inclusive of certain rye imports from the German Democratic Republic and imports of barley and oats into Italy, amount to about 18 million tons.

In the other direction, the Community exports about 10 million tons of grain to the world market (of which some 5.5 million tons of common wheat, 2.5 million tons of barley and 1.5 million tons of maize).

And so the Community must endeavour to restore the principle of an area tending on balance to more imports if excessively rising costs are to be avoided. In addition to adjustments in relative prices aimed at greater direct use of common wheat as feed, changes in the regionalization system are for this reason becoming urgently necessary.

The Commission believes that the best way of doing this is to propose that all basic and derived intervention prices be abolished and replaced by a single intervention price for grain valid for all grain-importing ports in the Community.

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Such a step will undoubtedly have a drastic effect on farm prices, particularly in those areas of the Community which are a long way from a market. But farmers must not forget that feed grain requirements are growing steadily, while the only grain being produced in larger quantities is wheat. The present pattern of grain utilization will have to be changed; more wheat will have to be fed to livestock on the farm particularly since productivity will probably increase further and the only form of consumption which is expanding is livestock feed.

The consumption of feed grain increases by 2 million tons each year. Human consumption of common wheat products is stagnating while at the same time production of common wheat is increasing by 500 000 to 600 000 tons on average each year. Because of this wheat can no longer benefit from the special position it has hitherto held as a bread grain and in areas far from a market must be in a position to compete with imported maize.

The changes envisaged can only win friends for the Community at international level, since a return to the net import principle will clarify the situation and do away with elements which disturb world trade.

B. Sugar

According to the Commission's calculations, Community intervention on the sugar market in 1969/70 can be expected to cost something like 100 million u.a. Furthermore the most recent figures available show that Community production in the 1969/70 sugar year will exceed consumption by some 1.1 million tons.

If quotas are left as they are, the only way of disposing of this surplus will be to reduce prices drastically. It is estimated that a reduction of about 30% would be needed to achieve the desired result.

Although the income and liquidity situation on sugar-beet farms is far better than on farms producing other crops, a one-third price reduction cannot, on economic grounds, be considered seriously.

An alternative to reducing sugar-beet prices would be to adjust the basic sugar quota to consumption.

What the European Commission would like to do, in the interests of agriculture, is to reduce the surplus from its present level of 1.1 million tons to 600 000 tons by combining these measures; this would mean reducing the basic quota by 5% and cutting the quantities for which market and price guarantees are given.

The 1 u.a./t price reduction (from 17 u.a./t to 16 u.a./t) sought by agriculture therefore represents an indirect approach. The Commission feels that because of their favourable income situation, sugar-beet farmers should be able to bear the risk of producing in excess of the basic quota allotted them in years when the harvest is exceptionally good. The Commission also feels that, between them, producers should be able to bear the continuing net losses of the EAGGF in proportion to their total production. To this end it proposes that an additional levy in favour of the Fund be introduced. This levy would not exceed one unit of account per ton of sugar beet which means that beet-growers would continue to be assured of a specific price, less 1 u.a.

C. Milk and milk products

If the present price policy is retained, expenditure on milk products by the EAGGF (Guarantee Section) will exceed 900 million u.a. in 1970. The high level of this expenditure shows that the situation is on the verge of crisis. It will not be long before new capacity has to be provided to store butter and powdered milk.

It is estimated that expenditure on milk products by the EAGGF (Guarantee Section) increases by about 100 million u.a. each year; but despite this expenditure structural surpluses are still growing.

The Council of Ministers must therefore take an early decision on the milk market. Drastic measures will be needed if control over the market is to be restored.

The Commission based its proposals on the following premises:

(a) The milk price hitherto applied is now considerably out of line with general farm price levels and this means that, in relation to other lines, the many ways of using milk have made dairy farming very attractive;

(b) The milk price must therefore be restored to its proper place in the farm price structure, so that the persistent tendency to over-production can be checked;

(c) The balance between production and consumption must be restored in lasting fashion, if a recurrence of this critical situation is to be prevented;

(d) The deficiencies in the structure of the Community's dairying industry (60% of dairy farmers have less than 5 cows) must be made good by substituting structural and social aid for pointless expenditure.

The Council has already decided to slaughter an additional 250 000 dairy cows and to switch a further 250 000 from milk production to fattening.[1] It has also charged the Commission[2] to introduce measures allowing butter to be sold at a reduced price. The

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[1] See Newsletter on the Common Agriculture Policy No. 8, October 1969.

[2] Official gazette of the European Communities No. L 283, 11 November 1969.

Commission empowers the various Member States to sell cut-price butter from public storage facilities for direct consumption.

These measures should have the effect of containing production and reducing existing surpluses. The amounts to be sold at cut prices are 20 000 tons of butter in Germany, 20 000 tons in France and 7 500 tons in Belgium. The butter is sold from cold store at a price which corresponds to the buying-in price in the relevant intervention centre on the day the decision came into force, less

34.15 u.a. per 100 kg in Germany
68.30 u.a. per 100 kg in France and
62.50 u.a. per 100 kg in the Netherlands.

This butter must have been stored prior to 30 April 1969.

Future developments depend largely on how the Council intends extending and intensifying the action already taken. It has not yet been decided whether the slaughtering of additional dairy cows is to be a once-only exercise, nor what more is to be done in connection with sales of cut-price butter.

In its memorandum concerning the balance of agricultural markets, the Commission pointed out that the situation had eased somewhat, that is to say, increases over the last twelve months had not been quite as high as originally expected.

The introduction of specific measures is the Community's only hope of gradually bringing the market under control again. Originally the Commission maintained that the only way of increasing consumption by 180 000 tons was to sell fresh butter at two-thirds of its normal price (representing a price reduction of 62.50 u.a. per 100 kg).

Since the Commission failed to secure the Council's approval for this measure, it is now prepared to amend its original proposals somewhat. Although the trend was slightly more favourable, milk production in 1969 was still more than 4 million tons in excess of consumption, and butter production is still some 200 000 tons in excess of consumption at market prices. Consequently, stocks of the two intervention products (butter and skim milk powder) have risen although stocks of butter have not reached the level originally expected.

So far no one has been able to suggest how consumption might be increased or surpluses cleared unless prices are reduced considerably.

When the Commission's original proposal was being discussed, it emerged that a number of Member States were prepared to agree to the intervention price for fresh butter being lowered by some 25 to 30 u.a. per 100 kg. And we have already seen that in 1969 the Commission, acting under the instructions received from the Council, brought the selling price of butter from Community cold stores to 16.25 u.a. per 100 kg below the intervention price.

A combination of the two measures could produce the drastic price reduction which the Commission holds to be necessary and lead to a considerable increase in consumption:

(a) Reduction in the intervention price for fresh butter (Council)	31.25 u.a./100 kg
(b) Additional reduction by the Commission in the selling price for butter from cold store	31.25 u.a./100 kg
Total reduction in the price of butter from cold store	62.50 u.a./100 kg

The Commission estimates that an additional 100 000 tons of butter would be consumed if the price were reduced in this way. It is important that the price reduction should be large enough to encourage increased consumption; it should not merely correspond to the decline in quality caused by a long period in cold storage.

Unless producers co-operate, however, these extremely costly measures will prove impossible to implement.

As far as producers are concerned, a 31.25 u.a. per 100 kg reduction in the intervention price for butter could be offset by a 15 u.a. per 100 kg increase in the intervention price for skim milk powder.

However, if producers are to make their contribution to the elimination of surpluses, full compensation would not be granted - the intervention price for skim milk powder would be increased by only 9.5 u.a. per 100 kg. The level of support for milk would therefore drop from about 9.6 u.a. per 100 kg to some 9.1 u.a. per 100 kg, which would mean that the price to producers would fall by 0.5 u.a. per 100 kg or almost Dpfg. 2 per kg.

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Survey of the measures proposed by the Commission

A. Grain

Last year's price proposals for 1970/71:

Comparative prices

	Existing		Proposed		
	1969/70	Index	1970/71	Index	Change
Target prices					
Common wheat	106.25	111.3	107.25	111.1	+1 u.a.
Rye	97.50	102.2	98.50	102.1	+1 u.a.
Barley	95.44	100	96.50	100	+1.06 u.a.
Maize	95.94	100.5	97.50	101	+1.56 u.a.
Intervention prices					
Common wheat	98.75	111.6	97.75	110.5	-1 u.a.
Rye	91	102.8	90	101.7	-1 u.a.
Barley	88.48	100	88.50	100	+0.02 u.a.

Durum wheat: No change in target price (125 u.a./t), basic intervention price (117.50 u.a./t) or minimum price (145 u.a./t).

Explanatory note

The Commission's proposal was designed to widen the gap between the target and basic intervention prices for all types of grain except maize:

Common wheat	from 7.50 u.a./ton to 9.50 u.a./ton
Rye	from 6.50 u.a./ton to 8.50 u.a./ton
Barley	from 6.96 u.a./ton to 8 u.a./ton

Effect

The proposal would have improved the price ratio between common wheat and feed grain and the lower intervention price for bread grain would have caused farmers to switch to feed grain production.

I. Commentary

The Commission no longer insists that this price proposal should be applied in full.

Wheat: The target price can be left at its present level of 106.25 u.a. per t. In order to maintain the gap of 9.50 u.a. per t between the target price and basic intervention price mentioned above, the basic intervention price would have to be lowered by 2 u.a. per t.

Rye: Production of this grain exceeds consumption. The Commission therefore recommends that here too the present target price of 97.50 u.a. per t be retained and that the basic intervention price be lowered by 2 u.a. per t.

II. A more radical proposal

The Commission suggests that all basic and derived intervention prices could be abolished and replaced by a single intervention price for all Community ports. This would be the same as the current derived intervention price for Rouen. Using present calculating procedures, based on the 1970/71 price proposals, the price for Rouen would be 93.48 u.a. per t (a reduction of 2 u.a. per t).

Grain offered for intervention in all Community ports would be bought at this price; but delivery could also be made in any town selected by the intervention agency. The owner of the grain would be responsible for the cost of its transfer, by the most favourable means of transport available, from the town in which delivery takes place to the nearest port.

Effect

Market prices for grain would follow supply and demand. There would be an increase in direct consumption as feed. The competitive position of common wheat vis-à-vis maize would improve.

The denaturing premium could be considerably reduced.

III. Intervention period

It is also proposed that the State's obligation to buy in grain in support of the market should continue to be confined to the last four months of the marketing year (May onwards).

Effect

The present practice of delivering two-thirds of the grain harvest at the beginning of the marketing year would cease. The grain would have to be marketed by the farmers.

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EXPENDITURE ON GRAIN

'000 000 u.a.

	1968/69	1969/70	1970/71	New proposal			
				1970/71	1971/72	1972/73	1973/74
Refunds	460	550	620	500	480	460[2]	440[2]
Intervention	42	105	120	100[1]	65	55	45
Denaturing	24	58	75	40	30	20	20
Subsidies for durum wheat and starch	180	180	180	180	180	180	180
	706	893	995	820	755	715	685

1 Includes the cost of switching from one system to the other (25).

2 This is probably an over-estimate, since no allowance has been made for the probable reduction in expenditure on refunds when Article 23 of Regulation No. 120/67, which provides exceptional concessions for Italy, expires; this reduction in expenditure on refunds is not therefore a result of the new proposal.

IV. Conditions for accepting delivery of the various qualities of grain offered must be made more rigorous.

B. Sugar

In the 1968/69 marketing year sugar production in the Community exceeded consumption by 870 000 tons. Since the very high initial stocks were run down to a normal level, the total surplus came to 1.1 million tons. Some of this total was exported (740 000 tons), some was denatured (350 000 tons) and some was made available to the chemical industry (20 000 tons). The estimated cost of marketing this tonnage must have been about 170 million u.a. Producers' contributions are estimated at 60 million u.a. and receipts from levies at about 10 million u.a., leaving some 100 million u.a. to be covered from the Fund.

The existing Community regulation makes provision for a guaranteed quantity for the entire Community; this is fixed at 105% of human consumption.

The new Commission proposals suggest that this guaranteed quantity be adjusted so that in future it will not exceed 100% of consumption.

Given a normal harvest, these steps should make it possible to bring Community surpluses down to 600 000 tons and to cut the EAGGF's financial burden to something like 50 million u.a.

Existing production quotas:		6 480 000 t
Forecast consumption:		
	1970/71	6 170 000 t
	1971/72	6 280 000 t
	1972/73	6 390 000 t
	1973/74	6 480 000 t

Producers to make a further contribution towards elimination of surpluses

Under the present quota rules producers are only partially responsible for surpluses; they pay a limited production levy on sugar produced in excess of the basic quota. Producers must be made to accept a little more responsibility and this could be done by introducing an additional levy payable to the EAGGF. In this way net losses of the Fund would be borne by producers, each producer paying in proportion to total production.

This additional levy could be kept at 1 unit of account per ton of sugar beet because this would, under normal circumstances, practically wipe out EAGGF losses.

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C. Milk products

Expenditure in the years ahead will be under two heads: first, the cost of marketing current production and, second, the cost of disposing of the surpluses which have been built up since 1965. If the proposed measures were put into effect, the marketing of current production would cost an estimated 720 million u.a. in 1970.

Total expenditure, however, would be 300 million u.a. higher. This additional figure represents the cost of storing and disposing of some of the surplus, and is therefore a direct consequence of developments in the previous years. Total expenditure on support for the milk market could be reduced by 120 million u.a.

Conclusions

The Commission proposes therefore that the single intervention price for butter be fixed at 142.25 u.a. per 100 kg and that the single intervention price for skim milk powder be fixed at 50.75 u.a. per 100 kg.

It also suggests that the subsidies for skim milk powder for calf-feed be fixed in such a way that the price for this product would be raised from 33 to 36 u.a. per 100 kg. This alone would mean a saving of 27 million u.a. on subsidies.

To sum up ...

If the measures described above were implemented, the saving on expenditure by the Guarantee Section of the EAGGF would amount, over the years 1970 to 1975, to between 3 500 and 4 000 million u.a.

Existing surpluses

By the end of 1969 butter surpluses will total 350 000 tons and stocks of skim milk powder will be in or around the 350 000 ton mark.

At the beginning of the 1969/70 marketing year, grain surpluses stood at 8 million tons. The 1969 harvest brought sugar surpluses to 1.1 million tons.

EAGGF expenditure in 1969/70 is estimated at 2 900 million u.a., more than 2 600 million of this being for market and price support.

III. The first round in the Council

At a meeting in Brussels on 25 November, the Council of Ministers fully recognized the basic need to restore equilibrium on the markets and use the funds available to the Community on something more worth while than constantly growing surpluses.

The Member States appreciated the frank way in which the Commission outlined the critical situation and indicated the possibilities of changing the situation.

Reduced prices and guarantees and increased producer responsibility for clearing surpluses were regarded with favour but the Council stressed that these measures should be accompanied by concrete social and structural action and by regional policy measures which would open up possibilities of alternative employment for farmers.

Farmers would have to be encouraged to understand the situation and to help restore order to the markets in a way which would benefit the economy as a whole and consequently agriculture itself. The member governments, the Commission and the leaders of the farming community must now work together to produce clear, responsible alternatives to help those farmers who have to leave the land.

In the agricultural sphere the Commission plans

1. To introduce urgent market and price policy measures;

2. To make an immediate start with a series of constructive measures in the structural field, aimed in particular at reducing the area of agricultural land and the number of persons engaged in agriculture. These measures will call for an increase in the Fund's resources to be used for structural improvements;

3. To work out financial estimates covering several years so that the rate of increase in expenditure should not exceed the growth rate of GNP;

4. The Commission feels that the distinction between prices policy and incomes policy should be sharper.

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