Common Market Levies and International Agreements

Two schools of economic thought dominate the agricultural scene throughout the world. One is that free markets should be allowed to operate, allowing price movements to stimulate adjustments in supply and demand. The other is that regulation of price or supply, or both, can reduce or eliminate conditions which may, at one point, devastate producers, and at another point, become an economic burden to consumers.

The latter school of thought is subscribed to in all parts of the world, to a greater or lesser degree, by those who have assumed the responsibility "to do something about it." This seems to be an occupational hazard of those in positions of power. In the United States it is referred to as, "Potomac Fever," so named because Washington D.C., is on the Potomac River.

Political minds cannot bear the pressures of low prices to producers or high prices to consumers. For after all, producers and consumers do complain to their government officials when they are unhappy and officials who wish to stay in power will try to please as large a segment of the populace as possible.

It must follow, therefore, that a framework of mechanisms will be developed which will attempt to placate both factions. Neither will be really happy because both will know that, from their respective points of view, things could be better, but they also know that things could be worse.

These mechanisms also encounter unexpected complications, so additional mechanisms are superimposed on the original plan, which will improve the situation for a while. Then something else goes awry and additional panaceas are applied. Eventually the whole apparatus becomes so complicated and so expensive that no one is content anymore. Finally, it is the politicians who are devastated. Consider the agricultural heroes who have been discarded in both the United States and Russia as illustrations of two diverse political systems that have followed various methods of agricultural price and supply control. Supporters of those programs say things would have been worse without them. Opponents say things could have been much improved if the supposedly temporary relief programs had not become so permanent.

Common Market Programs

Before examining the Common Market (EEC) levy proposal on oils and meals, it would be well to look briefly at the total farm program in that area. In 1962 the Common Agricultural Policy (CAP) came into existence. This attempted to make more uniform the agricultural production and marketing economy of the six member nations as a part of the total economic structure. The stated objectives are to increase agricultural productivity, insure a fair standard of living for producers, stabilize markets, guarantee regular supplies and insure reasonable prices for consumers.

One method for reaching these objectives involves "structural reform." This means greater economies of production by consolidating small farms, and a shift in production area for various crops to make better utilization of soil and climate adaptability.

The other method is to subsidize producers to achieve for them a higher standard of living. This means domestic prices higher than import prices, so an import levy scheme is employed. Wheat, for example, costs the miller in EEC countries almost twice the price at which it is landed at port. The proceeds of this levy scheme are paid out partly to EEC farmers and partly to subsidize wheat exports. Because of many quality differences, wheat and other commodities are both imported and exported. Consequently, the import levy must carry a double burden; it must pay farmers an adequate subsidy and then pay exporters the difference between the domestic price and world price.

In 1964 it was estimated that the costs for both phases of this program might increase to $800 million by 1970, split one third for structural reform and two thirds for subsidies. So far, the structural reform measures are still being conducted by the individual member states, and not by the EEC as a unit. In 1967 the several countries spent a total of almost $2 billion on structural reform. Since July 1, 1967, the subsidy program has been operated by the EEC as a unit. During its first 12 months these expenditures were $1.3 billion, for the current 12 months these are estimated at $2.2 billion, and from July 1, 1969 to June 30, 1970, they are expected to reach $2.8 billion.

For butter alone, the subsidy cost during the current fiscal year will be nearly $600 million and will soon reach $1 billion a year if policies are not changed.

Levy on Oils and Meals

This brings us to the current proposal, presented last winter, for a use-tax on oils and meals consumed in EEC countries. The purpose of the oil tax would be to raise its cost so as to discourage demand, especially for margarine, while at the same time using the tax income to reduce butter price and encourage its demand. The meal tax would discourage demand for meal as a dairy feed ingredient, encourage greater demand for domestic feed grains and dried milk by way of reduced price, and reduce milk production by cutting back on protein content of feeds. Some of the tax proceeds would also be used to liquidate dairy herds, encourage expansion of beef herds, and relocate dairy farmers in other occupations. Common Market officials claim this scheme does not violate GATT and other international trade treaties because it would apply also to domestically produced oils and meals. Officials of countries doing an export business to EEC claim it is a treaty violation because it will effectively restrict EEC imports of oils, meals and the raw materials from which these commodities are made. Retaliation by the U.S. and other countries has been threatened.

Just what transpires will be carefully watched around the globe because the EEC countries comprise one of the best cash markets for oils and meals and the raw products used in their manufacture. Furthermore, effective retaliation may be very difficult to achieve, perhaps impossible for political reasons. The fact remains that so far the EEC has been able to circumvent most previous objections from other countries through one means or another.

A recent case in point is the situation in tallow. In GATT negotiations the EEC agreed to eliminate the 2% tax on inedible tallow and reduce the edible tallow tax from 10% to 5% over a five year period. Many of these concessions have been made void, however, by new veterinary inspection fees and other changes, plus new import policies which will grant preferences to less developed countries.

As originally set forth, the EEC use tax would be $60.00 per ton on oils and $30.00 per ton on meals. These figures both represent an increase in price of approximately 30%. It is safe to assume that the plan finally adopted will not be as simple as originally presented

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because simple solutions are seldom applied to complex problems. Furthermore, there will be very involved political considerations.

Since butter and the dairy industry are chiefly involved, we can expect a plan to evolve which will place the bulk of the tax burden on consumption of margarine and on protein meals in dairy feeds. This would partially alleviate the distress of oil and meal exporting countries, for there would still be a substantial market for these goods aside from the margarine and dairy feed industries.

This will involve preferential treatment for some countries and for some oils and meals, while others are slighted. The current levy system on sunflower oil from Eastern European countries is a case in point and the preference shown certain African countries for some oils is another example.

Oilseed crushers in the EEC will not be forced to shut down. They may have to reduce operations, but they are in the business to crush and they will continue to do so. If demand for their products is reduced within the EEC, they will attempt to export their products to other countries. The proposed levy is assessed on the product user, not on the crusher. He will still be able to buy the raw product and sell in the oil and meal in other countries in much the same way as now.

This will result, however, in a chain reaction of protective measures on the part of the third countries if their markets are jeopardized. Already Finland is considering complete prohibition of imports of fats and oils for margarine use, because of surplus butter in that country. And, Finland's butter problem is aggravated because England recently decided to drastically cut back on imports of Finnish butter because of her own butter surplus.

Where it all will stop is anyone's guess and no one can be certain. But, it is obvious that market planning is certainly more complicated and more expensive than free markets which move readily in response to real demand and supply. Even the planned market economists must eventually reckon with supply and demand, but it is human nature to hang onto a pet policy until the problem becomes so monstrous that it has gotten completely out of hand. It's also human nature for farmers to continue to produce for a fictitous market when the price is suitable, even when their better judgment tells them that eventually the whole scheme will collapse unless it is modified.

International Oil Agreements

A discussion of this problem would not be complete without touching on the proposal to institute an International Agreement on Fats and Oils. This proposal is very much alive, but has probably been given little consideration by trade interests at least within the U.S.

A study group within the framework of the Food and Agriculture Organization of the United Nations has been at work on this subject for several years and is still refining its definition of the problem and what to do about it.

Common Market leaders have also stated that in the long run the major hope for a solution to their problems may be an International Agreement on Fats and Oils as a part of the General Agreement on Tariffs and Trade.

Examination of reports from the study group of FAO on this topic indicates one major theme running throughout, that is to establish world market prices at a level which will return a profit to producers with highest cost and least efficiency. In order to compensate the high cost producer, the plan would tax the export sales of producers with lowest cost and greatest efficiency. There exists, however, the probability that such a tax is self-defeating in that income would diminish as exports of developed countries decline and therefore would not be sufficient for the subsidy needs of developing countries.

Another study group proposal would be the accumulation of so-called "buffer" stocks in periods of surplus, which is supposed to provide a "floor" for world prices. This proposal seems to ignore the current problem with butter stocks in Europe and grain stocks in the U.S., Australia, Canada and elsewhere. "Buffer" stocks continue to over hang the market, serving as price depressants and becoming very costly in storage payments. They seldom solve anything, but instead become part of the problem, making it even worse.

The result of such policies would be to encourage production where it is not needed, further aggravating the supply situation. One has only to look casually at previous and existing schemes which have taken the same route and which have become a burden on world markets.

The FAO study group recognized that the oils proposal would necessarily be more complicated than any tried so far, partly because oils are one product of the crushing industry, whereas sugar, coffee and wheat are primary commodities. Furthermore, they point out that these named commodities are more homogeneous than oils, which is true, but the study group report seems to imply that these international agreements are operating successfully.

In the same edition of the Wall Street Journal (April 25, 1969) we find these quotes regarding sugar and coffee:

"Heavy selling sent world sugar futures 12 cents to 18 cents a 100 pounds lower yesterday . . . Some sugar people began to question whether traders had been too optimistic about the ability of the new international sugar agreement to bolster prices in the world 'free' sugar market."

"Brazil has instituted an export levy of 13 cents a pound on its soluble coffee . . . The tax was announced by the Brazilian Finance Minister who termed it a 'reluctant move' to meet demands by the U.S. The U.S., however, had asked for a 37 cent levy . . . The U.S. asserts that this poses unfair competition to the soluble industry here without an equalizing export levy by Brazil. The new international coffee agreement has a provision calling for equal taxation of soluble and green coffee."

And who has a kind word to say for the current International Grains Agreement? The National Association of Wheat Growers, in the Report from Washington of April 11, 1969, sums up the current dilemma this way:

"Stocks have weighed upon the market and kept prices bumping the minimum, and the prediction of trouble in maintaining the agreement has been borne out. The fierce competition among the wheat exporting nations over shares in the over-supplied market has caused cracks to appear in the exporters' ranks. The temptation to utilize some of the imperfections in the agreement to circumvent the minimum price levels has proven irresistible, and a substantial amount of wheat has moved at below minimum prices."

These quotes are presented to illustrate that some very real problems exist in international agreements even in commodities which are primary and which are in some ways more homogeneous in nature than are fats and oils. No stretch of the imagination is necessary, therefore, to expect that an International Agreement on Fats & Oils would be an even greater "exercise in futility."

An editorial in the Wall Street Journal of April 10, 1969, puts it very well:

"The basic problem in wheat is that there's just more of it around than people are eager to buy. International agreements or not, when supply presses on demand it becomes awfully hard to prevent a fall in prices.

"In these circumstances it's a little amusing to hear one official suggest that the Grains Agreement can be saved only if the wheat supply falls to around the level of demand. In other words, the agreement will work just fine if there's no need for it at all."

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