

Advantages and disadvantages of the common agricultural policy



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In the most industrial countries, the competitive markets are rarely free from government intervention. Governments not only impose taxes and grant subsidies but also regulate the market in a variety of ways. Governments control the equilibrium price and quantity in competitive market to maximize the aggregate economic welfare. (Pindyck and Rubinfeld 2009). Such as price ceiling can cause the shortage which is the increased quantity of demand and quantity supplied to fall. Besides controlling the price by imposing minimum price, governments can sets market price of products above the free-market level by buying outputs that are required to maintain sudden price of a good (Pindyck and Rubinfeld 2009). The use of high minimum price and lump-sum subsidies in agricultural market will be discussed and compared later.

Agricultural market in Europe has been immensely influenced by government intervention program, called the Common Agricultural Policy (CAP). This can be well proved example of showing success of government intervention in the market for various agricultural market. In various forms of intervention such as high minimum price controls, and lump-sum subsidies, a number of farmers in Europe have been guaranteed with their agricultural products and their income. Agriculture covers major territories over the world and has been played key role in determining out health balance and rural revitalization like economy activation. Europe is world largest importers as well as major huge exporters of agricultural products. To protect this huge agricultural community, the European Economic Community (ECC) including six European countries, Belgium, France, Germany, Italy, Netherlands, and the Luxembourg had introduced the Common Agricultural Policy. Over past

years, the roles of CAP have been changed to encourage farmers not only produce better agricultural products but also make their countryside place better place to live, visit, and work. CAP, an agricultural assistance program, has encouraged an expansion of agriculture all over the Europe and lead them become biggest trader in agricultural market (<http://www.blacksacademy.net/content/3347.html>).

History of the Common Agricultural Policy

The Common Agricultural Policy has constantly evolved to match with period changes in both agriculture and social community as a whole. The CAP was created under the Treaty of Rome and operated in 1962. Farmers received subsidies and were guaranteed for their products with high prices from the CAP, and then farmers were motivated to produce crops more. The CAP also provides the financial assistances to restrict the farm. However, their plan did not always bring the best benefits to farmers as the expectations of citizens, consumer and farmers, so, it became unpopular late then. Here are the primary purposes of the CAP from Treaty of Rome, article 39.

(<http://webcache.googleusercontent.com/search?q=cache:EEJnO0zrWaMJ:www.civitas.org.uk/eufacts/FSPOL/AG3.htm+single+payment+scheme+lump+sum&cd=10&hl=ko&ct=clnk&source=www.google.com>)

-To provide food at affordable prices

-To ensure availability of food

-To ensure fair living standards for the agricultural community

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-To increase productivity

-To stabilize markets.

(From second reference) Over many years, CAP has been reformed, and first reform was performed in 1992 and further reform was in 2000. Both two of reforms did not bring big differences of level of subsidies. EU finally decided to make significant reform that farmers are not no longer subsidized, instead farmers receive the Single Farm Payment which is called lump-sum subsidies over the year 2007-13. So, farmers in EU are encouraged to produce according to demands. Now, farmers get paid not for how much they have produced, but for their role as guardians of the countryside.

Advantages and Disadvantages of the Common Agricultural Policy

Unlike the primary purpose the CAP encourages farmers to concern not only a quality of products demanded by the agricultural market, but also developments in agricultural production techniques such as renewable energy resources. The farmers now are required to play roles of harmonizing their traditional skills with modern technologies to provide great valuable products with affordable price in the market. Farmers should also be concerned with safety and welfare of natural environment as well as cleanliness of crops. The CAP has played many roles in society by looking after the welfare of rural community, preserving the nature welfare, and making farmers sure about their price of products with minimum price ceiling. Today, the CAP continues to support the EU agricultural markets by responding to the expectations of both farmers and citizens and will keep

reforming to promote the agricultural market and development of society as a whole.

Many critics argue about the cost of the agricultural assistance system, the CAP. The Organisation for Economic Co-operation and Development (OECD) says 39 billion pounds are supported to the CAP, and the money spent on the CAP is 34 billion pounds goes direct aids to farmers and rest of money are spent to price support, public purchasing products. The CAP's budget is accounted for 45.4% of EU's budget. As shown in Figure 1, the budget of the CAP is accounted approximately 50% of the EU's budget each year. At this point, the problem comes up to the surface that the CAP costs too much and benefits relatively very few people. Compared to number of people who benefits from the CAP, it cost too much to support the farmers. Experts criticize that the subsidies given to farmers still distort world markets, and affect the farmers in other developing countries because EU guarantees the prices of crops in Europe. However, supporters of the CAP argue that supporting the farmers is the only way for survival of rural society where more than half of EU citizens live. (From first reference)

Efficiency Implication of High Minimum Prices

As mentioned above already, million pounds of the CAP budget was spent on price support. The government guaranteed a minimum price for farmers' crop. Some grains (bread, wheat, and corn), daily products, sugar etc are major commodity in agriculture market. These products rely on floor price which guarantees the farmer's income. Figure 2 illustrates the high price minimum that government can regulate. In the picture the change in

producer surplus will be A-C-D and Consumer surplus is -A-B (Pindyck and <https://assignbuster.com/advantages-and-disadvantages-of-the-common-agricultural-policy/>)

Rubinfeld 2009). In this case, producers (farmers) may be worse off because while high minimum price encourages producer to supply more product, consumers demand less because of higher price of product than equilibrium price. The graph shows that high minimum price causes the producers worse off (Pindyck and Rubinfeld 2009).

S

D

Quantity

Price

B

c

A

D

P_{min}

P₀

Q₃

Q₀

Q₂

Figure 2. High Minimum Price (Floor Price)

At this point, whenever the prices falls below the floor price the concept of price support comes on the surface because to make producer better off government buys up quantity $Q_q = Q_2 - Q_1$ to maintain or increase a price PS above the market-clearing price, shown in figure3 (Pindyck and Rubinfeld

2009). Because consumers have to purchase the products at higher price PS, Rectangle A shows a loss of consumer surplus and for other consumers who decide not to purchase the goods, their loss of consumer surplus is given by rectangle B. Then total consumer surplus is $-A-B$ (Pindyck and Rubinfeld 2009).

The cost of covering up the minus producer surplus can be reduced by dumping some of its purchases like selling the products (crops) abroad in cheap price, then it can cover up some of budget. The cost government covers up is the speckled rectangle, $PS(Q_2-Q_1)$. As a policy in implemented the producers gain because they can sell the quantity Q_2 instead of Q_1 . Producer surplus can be expressed as $A + B + D$. Even though government can keep the price high and farmers are guaranteed with their income, the group that government tries to protect is only the domestic producers. The government concerns with only its own domestic producers. They hurt both the domestic producers who sell the products in foreign market and producers selling similar products in foreign countries. The total change in welfare can found by adding CS and PS, and subtracting the cost of government expressed as $D - (Q_2 - Q_1) PS$ (Pindyck and Rubinfeld 2009).

A**B****S****D + QQ****D****Quantity****Price****QQ****Ps****P0****Q1****Q0****Q2**

Figure 3. Price Support

D

Example of High Minimum Price

For example, according to European Commission Agriculture and Rural Development, the CAP offered subsidies to farmers and guaranteed high minimum prices for their products which gave them incentive to produce more. Financial assistance was given to farmers for the purpose of restructuring of farming. Farmers were able to adapt the economic and social condition as a whole by subsidizing farm investment in farm growth and management skills. The CAP was very successful until 1980s, however,

government suddenly had to deal with permanent amount of surplus they had to cover up, many of surplus were also stored and even disposed within the Europe. Because of ruinous amount of budgetary cost and distorting the foreign countries, it did not always bring best benefits, and then policy of high minimum price quickly got unpopular.

Efficiency Implications of Lump-Sum Subsidies to farmers

Lump sum subsidy is a form of government aid in which a fixed sum of money is given to producers regardless of the amount of goods they produce (Costa, Osborne, Zhang, Boulange, and Jomini 2009). For the farmers, it does not really matter how much they produce, every single farmers get same fixed sum of money P_1 even though they create different amount of products, illustrated figure 4. P_1 (market clearing price) also represents both average revenue and marginal revenue. By providing sudden amount of lump-sum subsidies to farmers, farmers can reduce fixed cost in other words farmers can reduce total cost as well as average total cost, ATC. And also they can increase the profits given by rectangle $A+B$ instead of just A without subsidies. In the graph, C_1 is the cost at ATC_1 before farmers are given subsidies, and Cost of producing products is reduced from C_1 to C_2 at the point ATC_2 produce (Costa, Osborne, Zhang, Boulange, and Jomini 2009). Since government offered lump-sum subsidies to farmers, unlike high minimum price (floor price) system, government does not have to concern and worry about permanent amount of surplus they have to purchase to cover up farmer's income. It is now farmer's job to make their money with chance of making more profits since they get paid sudden amount of money. And then the government would not have to concern about purchasing

surplus that producers make. Consumers are not affected by lump sum subsidies because in a perfectly competitive market, producers will not charge more than the market-clearing price.

C1

C2

Price

MC

ATC1

Quantity

P1

Q1

Figure 4. Lump-Sum Subsidies to Farmers

A

B

D= AR= MR

Example of Lump-Sum Price

As mentioned above, the use of high minimum price by the CAP became unpopular at a sudden moment. According to European Commission Agriculture and Rural Development the CAP reformed system and introduced lump-sum subsidies. This new system brought promotion of the

competitiveness of European agricultural market and encouraged many rural initiatives. With sudden amount of subsidies given to farmers, farmers could reconstruct farms and improve management techniques. It gives 100 % of freedom to farmers to produce how much they need. It can also cause the high cost of entrance fee into the market since some of the subsidies directly go to be capitalized into land and it make the land more expensive for new entrants produce (Costa, Osborne, Zhang, Boulange, and Jomini 2009).

Comparison between High Minimum prices and Lump-Sum Subsidies

It seems it is better of the use of lump-sum subsidies to farmers than the use of high minimum prices. The high minimum prices sometimes go out of control whenever there are permanent amount of surplus that government has to pay to cover up producer's income. Unlike the high minimum prices, lump-sum subsidies gives fixed sum of money to producers and leave the responsibility to producers how much they will produce(Costa, Osborne, Zhang, Boulange, and Jomini 2009). It is now better for famers to leave in agricultural sector than leaving rural because even though they loss the profits the subsidies given to farmers cover up the loss from farming. As illustrated above, EU has only sudden amount of budget (BBC news 2008), if the budgetary cost increases because of the floor price, it implies that this systems is not effective and it also leads to loss of welfare. As a result, lump-sum subsidies to farmers are more desirable means of tackling the problems of the free agricultural market.

Conclusion

Government intervention such as the CAP in the European Union is a good example of encouraging an expansion of agriculture sector in the Europe. Its support for the agricultural sector has been reducing world price for agricultural products. Its effort moves other sectors of economies to other sector of agricultural sector which come out with higher returns. Government intervention in the agricultural sector can result high level of welfare in rural communities. However, some forms of intervention lead to loss of benefits of farmers. Many have been tried by government such as high minimum prices, market support, lump-sum subsidies to farmers etc. Promoting the agricultural market and development of society as a whole by motivating farmers are required to benefits farmers and society. For the future the job governments have to do is to cover up the weaknesses in the present to make dramatic improvements in production level, increase the income of farmers, and reduce number of people leaving rural areas, placing emphasis on nature and animal welfare, at the same time producing high qualities of agricultural products.