

AGRICULTURAL BRIEFING NO 1: THE MCAs

The Community's agri-monetary system had been the inevitable consequence of a series of currency realignments, but it now constitutes one of the main problems in connection with the common agricultural policy.

In March 1979, on the inception of the European Monetary System, a Gentlemen's Agreement was reached with a view to gradual dismantlement of the MCAs, but this has failed to yield the results sought.

In July 1983, the Commission, under the instructions given by the European Council in Stuttgart, submitted proposals for phasing out existing and future MCAs on the basis of a fixed timetable. The European Council in Athens failed to reach agreement on this proposal, which the Commission has, however, maintained.

In connection with its price proposals for 1984/85, the Commission has also proposed a further stage in dismantling existing MCAs, in line with the approach proposed in July 1983.

This briefing summarizes the historical, economic and technical aspects of the problem.

PART I: ORIGINS, DEVELOPMENT AND ECONOMIC EFFECTS OF THE MCAsBackground

The common organizations of markets, set up for the various agricultural products, are based on the principle of common prices. As there was no common European currency, the common prices were originally established in units of account (a notional currency created in 1962 on the basis of parity with the US \$), and since 1979 they have been denominated in ECU (a "basket" currency including all nine currencies of the countries then members of the Community).

In the '60s, exchange rates were fairly stable, so that the value of the unit of account when converted into national currencies showed little change until 1969, which was the year in which the French franc was devalued by 11% (August) and the German mark was revalued by 9% (October). On the face of it, these two parity changes should have entailed an increase in the common prices when expressed in French francs (since the franc had been devalued as against the unit of account) and, conversely, lower guaranteed prices expressed in DM in the Federal Republic. Such abrupt and sharp changes in farm prices would have had consequences which would have been economically and politically unacceptable for both countries. The two governments concerned therefore requested that their prices as expressed in national currencies should remain unchanged, which meant that they would no longer match the common prices expressed in units of account.

Thus, an unforeseen change in guaranteed agricultural prices during the marketing year was avoided, but also there were no longer single prices throughout the common market. The devaluation of the franc meant that there was a danger of disruption of trade between countries with different prices and that French farmers might immediately take advantage of the price increase by selling their crops directly to the intervention agencies of other Member States at the higher guaranteed price, with the corresponding danger that the agencies would be swamped with French products or with products from their own countries forced off the market by imported products. There was therefore no choice but to institute a special export levy on French products sold in other Member States in order to raise the French prices to the level of the other Member States. Imports of agricultural products onto the French market qualified for a corresponding subsidy.

Two months later, when the mark was revalued, the same operation had to be carried out in the opposite direction (introduction of a charge on imports and of an export subsidy to bridge the gap between prices in Germany and in the other Member States). This was the beginning of the monetary compensatory amount system, although at the time the plan was to get rid of the MCAs as quickly as possible.

Unfortunately, the MCAs persisted and spread as the authorities fought to retain a single market when all the European countries left the fixed parity system from 1979 onwards. The new "snake" brought relative stability for the currencies in it, but others were simply left to float. The period up to 1978 saw successive revaluations of the German mark and, to a lesser extent, of the Benelux countries, and a depreciation of sterling, the Lir and the French franc.

The establishment of the European Monetary System in 1979 brought greater currency stability, at least as between the countries in the exchange mechanism (1). The EMS was not, however, put an end to the need for realignments from time to time, most of which are in the same direction, at least for the German mark and the guilder on the one hand and the French franc and the Lira on the other. For ten years, the use of MCAs has remained, for most Member States, the rule rather than the exception.

#### The development of the MCAs

Two groups of countries can be distinguished

##### (1) Member States with positive MCAs:

- The Federal Republic of Germany has always had positive MCAs since 1971; they are generally somewhere between 5 and 10%, the present levels (10.8% for milk, 10.3% for cereals and 9.8% for other products) being much the same as in March 1979, on the inception of the EMS (10.8% for all products).

- The Benelux countries almost always have positive MCAs, but generally not exceeding 5%; at the present time, the Netherlands apply positive MCAs ranging from 6.6% to 5.8%, while Belgium (which had negative MCAs for the first time in 1982/83) applies a rate of zero.

- Denmark has always avoided recourse to MCAs or has phased them out as quickly as possible; at the present, it does, however, apply a positive MCA.

- The United Kingdom had very wide negative MCAs from its accession until March 1980, the rate ranging up to 45%; in March 1980, however, the "monetary gap" became positive, and has even exceeded 15%. As sterling is a floating currency vis-à-vis the EMS, the United Kingdom has not been prepared to contemplate revaluing its representative or "green rate" (i.e. the rate at which the ECU is converted into sterling for agricultural purposes).

##### (2) Member States with negative MCAs

- France was the first Member State to apply negative MCAs, and these were particularly large (20%) in 1977 and 1978.

- Italy had negative MCAs mainly in 1973 and 1974 and from 1976 to 1979, sometimes very large ones (sometimes more than 20%). Since then, they have been gradually phased out or kept low (less than 5 points).

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(1) I.e. All the Member States except the United Kingdom and Greece.

- Ireland had large negative MCAs from the time it joined the EEC until 1979, ranging up to 30% in 1976; since 1979, Ireland has had only modest MCAs for short periods.

- Greece's currency floats and has tended to float downwards, which has meant negative MCAs; the drachma was devalued at the end of 1982 and Greece has since endeavoured to eliminate the resulting MCAs as rapidly as possible.

At the present time, Germany, the Netherlands, the United Kingdom and Denmark apply positive MCAs, and France, Greece and occasionally Italy apply negative MCAs. Only the Belgo-Luxembourg Economic Union and Ireland now escape MCAs altogether.

### Economic implications

The MCA system was introduced to prevent price movements on an unacceptable scale following exchange rate changes, but the arrangements were supposed to be temporary, allowing gradual alignment of the green rates on the exchange rates actually applied. Whenever the MCAs introduced in this way are eliminated fairly rapidly, the system has no significant economic implications.

On the other hand, if, as a result a series of realignments, the MCAs become effectively permanent, the system can be harmful to Community agriculture.

There are several effects:

- As regards trade, the MCAs are designed to maintain unchanged farmgate prices of agricultural products, while the costs of farmers' inputs are affected very rapidly by changes in exchange rates. If the green rates are not adjusted without delay, there will be a competitive advantage for farmers in countries whose currencies have appreciated, who would receive higher guaranteed prices than those paid to farmers in countries whose currencies have depreciated, while the cost of imported inputs (energy, fertilizers, feed) will remain the same in both categories of country. This result is the opposite of what normally happens when there is a currency realignment, which usually gives a competitive advantage to producers in devaluing countries.

Also, farmers in a country the currency of which has depreciated, exposed because of the market situation to heavy pressure on prices, find it hard to accept that competitors in countries the currencies of which have been revalued enjoy not only higher guaranteed prices but also an export subsidy they feel to be unfair; this can cause great ill-feeling.

- With regard to production, the failure to align the green rates on the ordinary exchange rates may, as time goes on, also lead to distortion. In the countries with revalued currencies, where the agricultural prices are higher than elsewhere, there is a danger that outdated structures will be artificially maintained or, conversely, that the development of production by modern farms will be stimulated to excess. The result of this is a higher level of production than would otherwise have been the case, and this may generate unwelcome Community surpluses. For the countries with devalued currencies, a refusal to adjust the green rate can have a negative impact on production.

- With regard to the operation of the CAP, the MCAs may lead to distortions in the fixing of the common prices. As the negative MCAs are easier to eliminate than the positive MCAs, in that a devaluation of its green rate enables the Member State concerned to grant a larger price increase to its farmers, the result is generally an average increase in the common prices as expressed in national currencies higher than that approved by the Council for the prices as expressed in ECU.

The Council may also accept a larger increase in common prices as expressed in ECU to facilitate the dismantling of the positive MCAs (the revaluation of the green rate entails a reduction in the prices expressed in national currencies, if this is not offset by higher prices expressed in ECU). Lastly, the Member States may be tempted to manipulate the relativities between the common prices by requesting changes in their green rates, varied according to product, as happened when the prices were fixed for the 1983/84 marketing year (see annex).

Also, from the administrative and budgetary angle, the Court of Auditors has pointed out that the MCA system entails charges/payments covering a total of 1 to 2 000 m. ECU a year (the net cost is 500 m. ECU per year at the present time), and that this system is a strong incentive to speculation and/or fraud, with all the frontier controls that this necessitates.

However, the agri-monetary system is only one factor influencing production, farm income trends and trade. It is no easy matter to isolate the influence of the MCAs from that of other factors such as market situations, climate and soil, structural factors and methods of production, and the general economic situation.

The "league table" of Member States in terms of prognosis of farm incomes over the last ten years correlates very poorly with their agri-monetary situations(1): The Federal Republic has lost a lot of ground (-22%), as has France (-17%), while Belgium (+16%), the Netherlands (+9%) and Italy (+10%) have achieved improvements. Ireland (+1%) has fared better than the United Kingdom (-14%).

## PART II: ADJUSTING THE AGRI-MONETARY SYSTEM

### Technical procedures

Three definitions must be understood:

#### 1. The green rate:

The green rate is the unofficial name for the representative rate, used to calculate the value of the ECU in national currencies in the agricultural field; it is fixed by the Council on the basis of proposals from the Commission. The green rates are normally changed either on the occasion of a currency realignment (to prevent the introduction of MCAs or to keep their size small) or when the prices are adopted each year (the change normally takes effect at the beginning of the marketing year for each product).

#### 2. Monetary gap:

The gap between the green rate and the exchange rate of each currency, i.e. either the central rate (for currencies in the exchange mechanism of the European Monetary System (EMS), except the Lira) or the exchange rate recorded on the markets (for the Lira, sterling, and the drachma).

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(1) Sectoral income indices 1973-83, published by EUROSTAT (net added value at factor cost per labour unit in real terms).

### 3. Monetary compensatory amounts (MCAs)

The MCAs are simply bridging the monetary gap, minus a "neutral margin" of 1 percentage point (positive MCAs) or 1.5 percentage points (negative MCAs); a positive MCA acts as an import levy and an export subsidy, while a negative MCA constitutes an import subsidy and an export levy. The MCAs are fixed by the Commission (any changes are announced on the Wednesday for the following week).

The green rate is used to determine the guaranteed prices expressed in national currency. For example, the intervention price for butter and skimmed-milk powder in the Federal Republic of Germany is now 11.8% higher than what it would be if the common prices were calculated according to the central rate, while in France it is 4.9% below what would otherwise be the figure. This means that the guaranteed price is 17.5% higher in Germany than in France. In addition, French exporters must pay a charge, while German exporters qualify for a subsidy of a corresponding amount (after deduction of the "neutral margins"). The present situation is shown in an annex.

The MCAs apply to three classes of product:

1. Basic products subject to a strict intervention system, for which the market prices are not appreciably different from the intervention level. These are as follows (1):

- cereals
- sugar
- wine and skimmed-milk powder
- beef/veal
- pigmeat.

The MCAs are normally calculated on the basis of the intervention prices, minus the neutral margins.

2. Products derived from basic products covered by a common organization. In this context, it should be pointed out that eggs and poultry rank as products derived from cereals.

The MCAs are calculated on the basis of the MCAs for the relevant basic products by application of standard coefficients.

3. Processed products not covered by the CAP (2). The MCAs are calculated on the basis of the MCAs for the basic products entering into the merchandise, on the basis of coefficients, with a standard reduction of 10% and a neutral margin to eliminate very small MCAs.

(1) No MCAs are applied to the following products, for which there has been no deflection of trade :

- oilseeds and protein plants
- fruit and vegetables
- sheepmeat
- rice
- olive oil
- cotton and other textile fibres.

(2) Products not listed in Annex II of the EEC Treaty.

How are the MCAs to be eliminated? A fixed timetable

In connection with its proposals for the adaptation of the common agricultural policy, the Commission proposed, in July 1983, the introduction of a fixed timetable for the dismantling of the MCAs (1) :

- New MCAs resulting from any future currency realignment would be phased out over three stages by a reduction of the "monetary gap"
  - by one-third on the realignment,
  - by one-third at the beginning of the new marketing year,
  - by one-third at the beginning of the following marketing year;
- Existing MCAs would be phased out over two stages by the reduction of the monetary gap
  - by half at the beginning of the 1984/85 marketing year,
  - by half at the beginning of the 1985/86 marketing year.

Although the Athens European Council failed to reach an agreement in December 1983, the Commission made practical proposals along these lines for a further stage towards the dismantling of existing MCAs in connection with its price proposals for the 1984/85 marketing year (2). The result would be larger increases when expressed in national currencies in those countries having to devalue their green rates (France and Greece), and lower common prices when expressed in national currencies in those countries whose green rates would be revalued (Germany, United Kingdom, Netherlands and Denmark). The results of the proposed dismantlement are shown in an annex.

The Commission has never denied that adaptation of the CAP could entail reductions in the guaranteed prices as expressed in ECU and in national currencies. It is, however, clear that revaluation of the green rates of the positive MCA Member States, combined with a virtual freeze in prices and with other economy measures necessitated to safeguard the operation of the CAP, entails very difficult decisions for the countries concerned, particularly the Federal Republic, although inflation is much lower in these countries than elsewhere.

Parliament, while endorsing the Commission's general approach, felt that the existing MCAs should be phased out over a maximum period of three marketing years rather than two. It endorsed the Commission's proposal that the Member States should be free to pay declining or temporary compensatory aids to farmers whose incomes would suffer from the adaptation of the green rates.

(1) COM(83)500, 28 July 1983.

(2) COM(84)20, 17 January 1984.

### An alternative solution?

The Commission has also considered, but not formally proposed, an alternative solution, under which the MCAs would be calculated not by reference to the ECU as such, but by reference to the green rate of the currency which had appreciated most (1).

This would mean:

- A zero MCA for the country having the strongest currency, and thus no creation of a new positive MCA on the occasion of a currency realignment;
- The application of negative MCAs for all the other Member States. This would not entail:
  - any change in the levels of the guaranteed prices as expressed in national currencies, since the green rates would not be affected,
  - any change in the monetary gaps between any two green rates and thus in the amounts of the MCAs applicable to trade between the countries concerned.

Exports from countries with depreciated currencies would still attract a charge and exports from countries with appreciated currencies would still attract a subsidy of the same amount as before, the only difference being that the subsidy would be collected by the importer.

The advantage of the new system would be to facilitate the dismantling of the MCAs, since the problem of the revaluation of the green rates of the positive MCA countries, entailing lower guaranteed prices as expressed in national currencies, would no longer arise.

The dismantling of the negative MCAs does not raise the same difficulties, since the devaluation of the green rates must necessarily always entail an increase in the prices once translated into national currency.

The Commission preferred not to propose the adoption of this system, which could entail the creation of rather high negative MCAs and the risk of inflationary pressure if the green rates were to be realigned too rapidly.

However, some Member States, including the Federal Republic of Germany, showed an interest in this idea.

### Reviewing the calculation of the MCAs

Alongside the proposals for the dismantling of the MCAs by alignment of the green rates, the Commission made a set of proposals for amendments to the rules for calculating the MCAs on various products, in order to reduce their impact (2):

#### Sugar:

The MCAs would be calculated on the basis of the intervention price for white sugar, ignoring the storage levy.

#### Wine:

The MCAs would be confined to the wine-growing Member States, with application of the "contraction" rule for negative MCAs (the rates applied are the highest rates minus the lowest rate). However, the accession of Greece has made this rule practically impossible to apply, because of the frequent, and unforeseeable changes in the MCAs applicable in the main wine-growing countries.

(1) COM(83)500, 28 July 1983.

(2) COM(83)635, 21 October 1983.

The Commission proposes that the impact of the MCAs on wine be reduced in two ways:

- by using the guaranteed minimum price as basis for the calculation (82% of the guide price), nearer the market price than the activating price (91.5%) now used (reduction of the basis of calculation by about 10%);
- by increasing the "neutral margin" to 5 percentage points for all the positive and the negative MCAs, which would have the effect of eliminating the MCAs in this sector (except Germany).

#### Milk:

For butter and skimmed-milk powder, the basis of calculation would remain the intervention price, but for derived products, the MCAs would be calculated henceforth only after full deduction of all processing costs. At the present time only up to 75% of processing costs are deducted (except for fresh milk, where all such costs are deducted).

#### Beef/veal:

The basis of calculation, namely the intervention price, would be reduced by 15% to reflect more accurately the level of market prices (the present reduction is 10%).

#### Pigmeat:

The basis of the calculation has been gradually adapted, from 85% to 78% of the basic price (in 1978), and then to 90% of the latter price (in 1983), but is still linked to the intervention price. In fact, this price is now purely theoretic, since the intervention facility has practically never been used in the last 20 years, and the Commission has proposed that it be discontinued. Accordingly, the Commission proposes that for the purposes of the calculation of the MCAs, pigmeat should rank as a cereals-based product, like eggs and poultry. The calculation of the MCAs would then be based on the difference in feed costs with reference to the quantity of feed grain deemed necessary, and this would lead to a reduction of about 50% in the relevant MCAs. This measure, which could be introduced in two stages is all the more justified in that the protection arrangements made under the common organization of the markets (import levies and export refunds) and also based on the feed ration and not on the institutional prices.

#### Eggs and poultry:

The feed ration referred to for the calculation of the MCAs and of the levies could be adjusted to allow for productivity progress.

Lastly, the Commission proposes that application of the MCAs be modified, in particular for derived and processed products. Thus, the "neutral margin" for these products could be increased to 2 percentage points. Also, the minimum amount which would not be applied would be fixed at 0.50 ECU/100 kg for basic products and 1 ECU/100 kg for derived products. The "non-cumulation" rule (application of an MCA of 1 whenever the MCA applicable after deduction of the "neutral margin" is between 0 and 1.1) would be discontinued.



Financial implications

If no change is made to the current rates, the MCA system will cost the Community nearly 500 million ECU in 1984. Implementation of the Commission's proposals on the dismantling of the existing MCAs would yield savings estimated at 152 million ECU in 1984 and at 352 million ECU in 1985. The alternative solution (calculation of the MCAs in terms of the currency which has appreciated most, to avoid the creation of positive MCAs) would have a very limited direct impact, but would entail an increase in expenditure should the negative MCAs thus created be dismantled.

A N N E X E

Propositions agri-monétaires

|       |          | <u>SITUATION ACTUELLE</u> |                 |          |                              | <u>NOUVELLE SITUATION</u> |                 |          |            |           |  |
|-------|----------|---------------------------|-----------------|----------|------------------------------|---------------------------|-----------------|----------|------------|-----------|--|
| PAYS  | SECTEURS | TAUX                      | ECART MONETAIRE |          | Démantèlement en points      | TAUX                      | ECART MONETAIRE |          | RE-/DE-    | INCIDENCE |  |
|       |          | VERT                      | REEL            | APPLIQUE |                              | VERT                      | REEL            | APPLIQUE | VALUATION: | PRIX      |  |
|       |          |                           |                 |          |                              |                           |                 |          | %          | %         |  |
| D 1)  | Lait     | 2,54273                   | + 11,833        | + 10,8   | 0,987 + (1/2x10,846) = 6,410 |                           |                 |          | + 7,271    | - 6,778   |  |
|       | Céréales | 2,52875                   | + 11,346        | + 10,3   | 0,5 + (1/2x10,846) = 5,923   | 2,37039                   | + 5,423         | + 4,4    | + 6,681    | - 6,262   |  |
|       | Autres   | 2,51457                   | + 10,846        | + 9,8    | (1/2x10,846) = 5,423         |                           |                 |          | + 6,083    | - 5,734   |  |
| NL 1) | Lait     | 2,73327                   | + 7,585         | + 6,6    | 0,8 + (1/2x 6,785) = 4,193   |                           |                 |          | + 4,537    | - 4,340   |  |
|       | Céréales | 2,72149                   | + 7,185         | + 6,2    | 0,4 + (1/2x 6,785) = 3,793   | 2,61464                   | + 3,392         | + 2,4    | + 4,087    | - 3,926   |  |
|       | Autres   | 2,70981                   | + 6,785         | + 5,8    | (1/2x 6,785) = 3,393         |                           |                 |          | + 3,640    | - 3,512   |  |
| F     | Porc/Vin | 6,77297                   | - 1,500         | 0        | 1,500                        | 6,87456                   | 0,0             | 0        | - 1,478    | + 1,500   |  |
|       | Lait     | 6,55400                   | - 4,891         | - 3,4    | (1/2x 4,891) = 2,446         | 6,71049                   | - 2,445         | - 1,0    | - 2,332    | + 2,388   |  |
|       | Autres   | 6,49211                   | - 5,891         | - 4,4    | (1/2x 5,891) = 2,946         | 6,67790                   | - 2,945         | - 1,4    | - 2,782    | + 2,862   |  |
| DK    | Tous     |                           |                 |          |                              |                           |                 |          |            |           |  |
|       | Secteurs | 8,23400                   | + 1,129         | + 1,0    | 1,129                        | 8,14104                   | 0,0             | 0        | + 1,142    | - 1,129   |  |
| UK 2) | Tous     |                           |                 |          |                              |                           |                 |          |            |           |  |
|       | Secteurs | 0,618655                  | + 7,682         | + 7,6    | (1/2x 7,682) = 3,841         | 0,593946                  | + 3,841         | + 2,7    | + 4,160    | - 3,994   |  |
| GR 2) | Tous     |                           |                 |          |                              |                           |                 |          |            |           |  |
|       | Secteurs | 77,2479                   | - 4,117         | - 3,0    | (1/2x 4,117) = 2,058         | 78,8003                   | - 2,059         | - 1,0    | - 1,970    | + 2,010   |  |

1) Secteur du lait et des céréales: y compris les engagements pris lors de la décision du Conseil sur les prix 1983/84

2) Période de référence du 14 au 20.12.1983