

CHAPTER 3

THE COST OF FOOD AND BRITAIN'S MEMBERSHIP OF THE EEC

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Introduction and Caveat

Recent public discussion of the rising cost of food in the UK and of the current policy options has been very confused. The impression is sometimes conveyed that sterling depreciation implies that food prices in the UK have been increasingly 'subsidised' by other EEC members. Alternatively it is suggested that we could buy food much more cheaply if we were not members of EEC and had free access to world markets.¹

This chapter is an attempt to assess the results of current policy and the effects of alternatives. Great difficulties arise in obtaining and interpreting the material. The price support system is extremely complex administratively and no single agency provides an overall view or accounting framework which ensures consistency; as a result some of our estimates may be quite seriously incorrect. However, presenting the material in a comprehensive and relatively comprehensible form should provide a foundation for a more accurate analysis and a better informed public discussion.

The tentative conclusion we shall reach is that food prices are now, prior to the upward adjustments currently under discussion, on average perceptibly higher than they would be if we could buy freely in world markets; also that the total balance of payments cost to the country of buying relatively expensive food and of making a net contribution to the community's agricultural budget is currently running in excess of £600 million per annum.

A conceptual framework

Stripped of the complexities of administering the Common Agricultural Policy (CAP) the main public issues are simple. How are food prices in the UK determined, and how are they affected by alternative policies and by world prices? How much is the *British government* paying as a net contribution to the Community's agricultural budget (FEOGA)² and how will this vary under alternative assumptions?

Further it is legitimate, indeed essential, to attempt some assessment of the situation were we not members of EEC. The total net cost to the UK of joining, ignoring the effect on the internal distribution of income, particularly between farmers and the rest of the community, is equal to the cost of food imports as EEC members compared with the cost as non-members *plus* the net contribution of the British government to FEOGA. This total is the net balance-of-payments cost, part of it being met by consumers directly, the rest indirectly through taxation. The answer to this question becomes ever more uncertain as time passes. It is important to note that the

¹See for instance the *Guardian*, 14 January 1977, where it is suggested that buying food at world market prices would save the UK £700 million per annum.

²FEOGA is the part of the EEC Budget devoted to agriculture.

position if we had never joined is different from the position if we now left, because the pattern and scale of production, trade and agricultural investment have already changed as a result of membership.

The chapter has three main sections. The first shows for a single commodity, butter, how levies, sterling depreciation, food subsidies and adjustment to full EEC membership affected prices paid by UK consumers at the end of 1976. Butter is chosen as a relatively homogeneous commodity; the analysis can be succinctly presented and provides a useful model. The second section attempts to measure the position for food prices as a whole, and offers a broad estimate of the effect of alternative policy assumptions. The final section speculates briefly on the net cost of being members of EEC, considering the UK's transactions relating to food in isolation. It is important to emphasise that what is presented here is not only hypothetical in certain respects but strictly limited in scope. Only one aspect of EEC membership is considered, and no conclusions are drawn about policy. The main objective is to clarify the public discussion, making explicit assumptions which others may modify according to their interpretation of a changing situation.

The price structure for butter

The simplest procedure is to describe how prices denominated in spot, that is ordinary, pounds, or any other spot currency, are determined in the various markets. Using this method clarifies issues and avoids irrelevant factors. In particular it becomes possible, and indeed advantageous, to ignore the whole system of levies and compensatory payments associated with trade between countries at different controlled prices. Naturally the calculation and administration of such payments is very complicated.

The derivation of prices in Table 3.1 (except the 'world price'), is relatively simple, as shown in the right-hand section.

The price of butter is set by the Council of EEC Ministers in terms of agricultural 'units of account' (u.a.'s), which have what may be termed a spot or 'parity' value denominated in terms of an unweighted average of 'snake' currencies. In 1976 the *full* intervention price for butter was fixed at 2238 u.a.'s per tonne for EEC members. For the UK, still in its transitional phase, the full intervention price was abated by 472 u.a.'s to 1766 u.a.'s in 1976. The EEC guaranteed a price of 1072 u.a.'s to New Zealand for its butter exports to the UK.

In the absence of the arrangement which has come to be known as the 'green currency', u.a.'s could simply be translated into spot currencies by converting them at spot rates, which of course move proportionately with conventional rates of exchange. Thus in Decem-

Table 3.1 Price structure of butter at the end of 1976*
All prices in spot currencies per tonne

		Derivation
1. German price in Germany	DM7790	2238 u.a.'s ÷ [0.32 × 0.91]
2. Ditto translated into spot sterling ((1) ÷ 4.1)	£1900	2238 u.a.'s ÷ [1.30 × 0.91]
3. UK price	£1010	1766 u.a.'s ÷ [1.30 × 1.35]
4. Price guaranteed to NZ for its quota	£825	1072 u.a.'s ÷ 1.30
5. 'World price'	£600	

Table 3.2 The price of butter at the end of 1976 (£ spot sterling /tonne)

	With green pound not devalued	With green pound fully devalued
As transitional members	£1010 (1766 ÷ [1.30 × 1.35])	£1360 (1766 ÷ 1.30)
As fully adjusted members	£1274 (2238 ÷ [1.30 × 1.35])	£1720 (2238 ÷ 1.30)

*Figures are rounded and it has been assumed for simplicity that market prices equal intervention prices.

ber 1976 to convert into pounds sterling at spot rates it would have been necessary to divide u.a.'s by 1.30; to convert into DMs u.a.'s should be divided by 0.32 (implying, correctly, a spot rate of exchange of $\frac{1.30}{0.32} = 4.1$ DM to the pound).

Now, when the spot rate changes by say $x\%$, for purposes of conversion of agricultural units of account into agricultural prices, the new rate is first multiplied by a coefficient¹ equal to $1/(1-x\%)$, i.e. by an amount which exactly offsets the spot change. As in December the coefficient was not far off 1.35, this implies a depreciation of spot sterling of around 26% (compared, roughly, with 1975). The German coefficient was about 0.91, implying, by comparable reasoning, an appreciation in the spot DM of about 10%.

It is now a simple matter to translate the agricultural u.a.'s, in terms of which prices were originally fixed, into spot rates. The UK intervention price in December was $1766 \div [1.30 \times 1.35] = \text{£}1010$ per tonne²; the German price was $2238 \div [0.32 \times 0.91] = \text{DM } 7790$ per tonne.

Line 4 of Table 3.1 shows the price guaranteed to New Zealand by the EEC for its 1976 quota. This is also denominated in units of account, and the sterling equivalent can always in practice be calculated by converting at the *spot* rate; so New Zealand last December received $\text{£}825$ per tonne $= 1072 \div 1.30$.

The figure of £600 shown in line 5 as the 'world price' is an estimate of how much we would have had to pay for butter as non-members, but is extremely unstable because 'free' market prices cover only a small proportion of total world trade. It is, however, close to the price at which the EEC is known to have sold butter to third countries and 25% above the price of EEC butter sold recently to Russia.

Table 3.2, derived from Table 3.1, gives the UK price at the end of 1976 on various alternative assumptions.

Table 3.2 shows that had we been fully adjusted members of the EEC in December 1976 and had the green pound been fully devalued, the price of butter

¹The coefficient is very close in magnitude and concept to the so-called 'monetary coefficient' used for operating community transactions.

²The product of the spot rate and the monetary coefficient ($= 1.7556$) is known as the 'representative rate' or sometimes simply as the 'green rate'. As implied by the argument, the 'green rate' does not change automatically when spot rates change, but only as a result of an agreed decision.

would have been over 70% higher than it actually was.

To complete the picture, Table 3.3 gives estimates of quantities and values of imports together with their source in 1976. Prices are those shown in Tables 3.1 and 3.2 and the calculations involve three assumptions: first, the current situation; second, the position as transitional members with a fully devalued green pound; and third, as fully adjusted members with a fully devalued green pound.

The first three lines need no further explanation; they show how much the UK as a country paid, or would pay under various assumptions, for its imports. Payments by the consumer (line 4 of Table 3.3) are always at the full intervention³ price, the difference between this and line 3 corresponding to levies which, until the UK is a full member, are retained by the UK government.

The final three lines show, on a set of assumptions, how much gain or loss arises for the main parties because the UK is an acceding member, compared with how things might be if we were not a member at all. Thus, if it can be assumed that the UK could have bought the butter at £600 a tonne – and that the EEC could have sold 290,000 tonnes for £600 a tonne – Table 3.3 shows that, although the green pound rate remained at 1.7556 in December, the EEC was £115 million per annum better off through selling its butter to UK above world prices, the UK £145 million per annum worse off and the UK consumer £170 million worse off, having to buy butter above world prices. The UK as a whole suffered a loss of £145 million per annum, because the British government retains the levy on butter.

This same situation is frequently represented by comparing columns 1 and 2, i.e. by showing how different the situation would have been if the green pound rate was equal to the current spot rate. Thus line 1, column 2, shows that with a devalued green pound the EEC would have received an extra £100m for butter exports (under these assumptions) and this is often represented as being a *subsidy* to the UK. The estimated figures in the last three lines imply however that devaluation of the green pound, far from 'removing a subsidy', would have raised the benefit from butter alone to EEC from our membership from £115 to £215 million and the cost to the UK from

³Actually at market price, but assumed to be negligibly different from intervention price.

Table 3.3 The cost of UK butter imports in 1976; volumes and values* (£ million)

	At Dec. 1976 prices	Assuming transitional membership and fully devalued green pound	Assuming full adjustment and a fully devalued green pound†
1. UK imports from EEC (290,000 tonnes @ £1010, £1360, £1720 per tonne)	290	390	500
2. From NZ (120,000 tonnes @ £825)	100	100	100
3. Total imports (410,000 tonnes)	390	490	600
4. Cost of butter to UK consumer (410,000 tonnes × £1010, £1360, £1720)	415	560	705
5. Levies received by UK government (4-3)	25	70	105
6. Cost of imports at 'world prices' £600/tonne	245	245	245
7. <i>Prima facie</i> cost of membership to consumer ((4)-(6))	170	315	460
8. <i>Prima facie</i> cost of membership to country ((7)-(5))	145	245	355
9. <i>Prima facie</i> gain to EEC from UK membership ((1)-(290,000 tonnes × £600))	115	215	325

*The table excludes the extra cost to the consumer of UK produced butter, which totals about 70,000 tons—under 15% of total consumption.

†As a full member, the UK would not be entitled to retain the levies on imports from third countries. However, it cannot simply be assumed that under this assumption the UK would in reality be £105 million worse off (taking butter by itself) than shown in this column, as the basis for calculating our contribution to the FEOGA would then be different.

Table 3.4 Imports and domestic production of food in 1976 (£ billion)

Total imports of food (including duties)	4.5	
of which levy products from EEC		1.6
of which levy products from other countries		0.9
Total levy products imported		<u>2.5</u>
Total UK food production	5.5	
of which levy products		<u>4.2</u>
Total imports and domestic production	<u>10.0</u>	
of which levy products		<u>6.7</u>

£145 to £245 million. If the benefit the UK receives by holding the agreed 'green rate' is legal, if not wholly in the original spirit of the CAP, the benefit of sterling devaluation can hardly be regarded as a 'subsidy' from the EEC to the UK.

It is emphasised that our predominant purpose is to present a comprehensible framework which may be used to make conditional predictions of various kinds. It must be conceded that the case of butter (chosen because the facts were relatively easy to obtain) is only one example. The situation may differ for other commodities. For instance, last year the UK intervention price for sugar was *below* the effective price guaranteed to the ACP (African, Caribbean and Pacific) countries.

The aggregate effects of changing community prices, exchange rates and adjustment

In order to estimate the effects of changing existing arrangements it is necessary to estimate how large are total imports plus domestic production of 'levy products', defined as those goods which are subject to

intervention arrangements comparable to those described for butter. The relevant magnitudes are shown in Table 3.4.

These estimates give the total value of 'levy' products which are covered by the intervention scheme and actually or potentially attract levies. Measured at the farm gate price (or c.i.f. price including levies and duties) the total comes to £6.7 billion for 1976, if domestic production and produce from third countries are included.

Consider, first, that as Britain moves to full membership at the beginning of 1978 the abatement 'ACA' on the intervention price of most produce in recognition of our accessionary status will be removed. Rough estimates suggest that this will add some 5% on average to the price of levy products between now and this time next year.

Consider, second, the proposal that on average intervention prices denominated in u.a.'s are to be raised by 3%; and that furthermore the green pound rate is to be revalued by 8 points – i.e. that the monetary coefficient is to be reduced from about 1.35 to

1.27, implying a new 'representative' or 'green' rate of 1.651 ($=1.30 \times 1.27$).

All these changes together seem to imply an average increase in intervention prices denominated in spot sterling of about 15%. Thus, suppose at present a commodity is priced at 100 u.a.'s, its price in sterling would be $\frac{100}{1.30 \times 1.35} = \text{£}57.0$. Under the stated assumption

the new price would be given by $\frac{103 \text{ (u.a.'s)} \times 1.05}{1.30 \times 1.27}$

$= \text{£}65.5$. Not all of this increase would take place immediately; the 5% rise caused by removal of the abatement given to the UK as accessionary members would take place in stages through the year.

Suppose the green pound were fully devalued, the price increase would become $\frac{103 \times 1.05}{1.30} = \text{£}83$.

The effect of the proposed changes on retail food prices

As shown in Table 3.4 the total value¹ of levy products is about £6.7 million; this appears to be nearly 40% of the retail value of all food, including retail sales, catering and exports, of over £18 billion. Thus at one extreme, assuming no change in absolute margins, a 15% increase in levy product prices would result in a 6% increase in food prices. However, since retail and manufacturing mark-up tends to be a constant percentage of input prices, the increase in food retail prices could be about 10% (compared with what would have happened, everything else being given, if none of the proposed changes were made). By comparable reasoning, full devaluation of the green pound in combination with the other proposals might add around 36% to the cost of levy products, or at most 22% to retail food prices (about 5% on the RPI).

The costs of being in the EEC (for the food sector alone)

In an earlier section it was suggested that the UK could buy butter at well below the present UK intervention price, but had recently imported sugar on relatively favourable terms. This is no longer true of sugar, which is tending towards world surplus. The present intervention price for sugar is 267 u.a.'s or £152

per tonne. This appears to be about £20 a tonne *above* the world market price, so that if the UK could buy at this lower price the import bill would be reduced by some £40 million. In fact, because of mounting surpluses, the world price of sugar is likely to fall even further in the near future. As far as the other commodities are concerned, taking one with another, it would appear that the effect on our balance of payments of differences between world and EEC prices is at present negligible.

It cannot be assumed that the UK, as such a large purchaser of food, could immediately meet requirements at present world market prices. Nevertheless, it seems quite likely that the long-run world supply schedule for some of the main products (dairy products and sugar, though *not* cereals) has not drastically changed within the last four or five years.

Taking the calculation on butter and sugar, together with some very rough calculations, based on recent levies and subsidies paid on other products, our *guess* is that the net *direct* cost to the country of membership through higher food prices is at least £200 million, particularly if comparison is made with a situation where world supplies had had time to adjust.

But the *total* cost to the balance of payments must also include the net contribution of the UK exchequer to the FEOGA budget. In principle this contribution is determined during the transitional period by a formula² which yields a sum of money, denominated in sterling, which does not alter when either spot or green rates change. This formula implies a net contribution of about £450 million for 1977. Thus, taking the consumers' contribution together with that of the government, we reach a total of at least £650 million.

If the 15% price increase is agreed, the net additional cost to the country (all of it paid by the consumer, since the budgetary contribution is fixed) would be very roughly £250 million, i.e. 15% of the value of levy products imported from the EEC. This would take the total cost of membership to £900 million or more.

¹The price which the wholesale trade pays at the farm gate or port of entry.

²The formula specified that the UK should in 1977 pay a gross contribution of 19.24% of the FEOGA Budget provisionally estimated at 6574 budgetary units of account which are *not the same* as the agricultural units of account. They may be converted into sterling (devalued or not) by dividing by 2.4. About 15% of the gross contribution is deducted to cover costs of collection and sundry flowbacks.

