

MRS G. O. EVBUOMWAN

# CENTRAL BANK OF NIGERIA

## ECONOMIC AND FINANCIAL REVIEW

Volume 29

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A Review and Appraisal**

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## **THE COMMON AGRICULTURAL POLICY OF THE EUROPEAN COMMUNITY: Principles and Consequences.**

By

Julius Rosenblatt, Thomas Mayer, Kasper Bartholdy, Dimitrios Demekas, Sanjeev Gupta,  
and Leslie Lipschitz, 70 pages IMF Occasional paper, No. 62, November, 1988 (c)  
International Monetary Fund, Washington, D.C

### INTRODUCTION

A review of the Common Agricultural Policy of the European Community has become very imperative now that the countries of Europe have proposed further integration of their economies come 1992. This is more so when one of the general concerns outside the European Community is that the developing countries, especially those in Africa, will suffer most since such integration might usher in an era of difficult economic relations with the community as trade transactions might have to be conducted over high tariff wall. Thus a review of this article "The Common Agricultural Policy of the European Community: Principles and Consequences" will certainly make one more conversant with the operations of the policy and therefore be in a position to offer suggestions that could be considered to protect the Nigerian agricultural sector (if need be) from the general concern expressed the world over (outside the European Community) on the probable adverse consequences on the developing countries of a further integration of the European Countries economies in 1992.

### SUMMARY OF THE PAPER

The paper is divided into five sections. The first section captioned, Introduction and Conclusions provides a very brief introduction to the origin of the Common Agricultural Policy (CAP) of the European Community (EC). It notes that CAP was incorporated in the Treaty of Rome which came into force in 1958 and laid the foundation for the EC. The CAP was listed among the steps that needed to be taken to establish a "Common Market" without customs duties or quantitative restrictions between member states and a common commercial policy toward third countries.

The second section captioned Operations of the CAP described the origins and principles of CAP, the institutional setting and, public expenditure on agriculture. This section presents the objectives and the main features of the CAP as stated in Articles 39 and 40 of the Treaty of Rome. According to the paper the main objectives are to raise productivity; ensure a fair standard of living for the agricultural community; stabilize markets, guarantee food security and reasonable prices for consumers. Among the measures for attaining these objectives were; regulation of prices, aids for the production and marketing of various products, storage and carry-over arrangements and, common arrangements for exports and imports to underpin the price regime. The adopted strategies involved mainly intervention in the agricultural commodities markets through specialised entities, either public or private professional organisa-

tions for the main purpose of stabilising producer prices while at the same time improving productivity through structural policies.

The common characteristics of the policies for structural improvement was the adoption of common public investment strategies for infrastructural support such as transportation, education and subsidized credits for investments. With regards to pricing and subsidies there is an elaborate system of price support for about 91 per cent of agricultural products. This operates through intervention prices which seek to protect producers in each EC country from undue competition either from within or outside. As such both consumer and producer prices are guided or predetermined through three prices; the target price, which is the upper end of the range within which producer prices are left to fluctuate; the threshold price, which is the lowest price at which imports may be made, and the intervention price at which public bodies buy in to support the market. The intervention price remains by and large a minimum price guaranteed to producers. For some products, however, there are co-responsibility levies, designed so that producers themselves finance part or all of the disposal of excess supplies and also to serve as disincentives to production. Moreover, the entitlement to CAP benefits may be limited to a specified volume of output (production quotas) or be reduced somewhat, with a time lag, when a specified volume of output has been exceeded (guarantee threshold).

Imports are subjected to levies that are broadly calculated as the difference between the relevant threshold price and the corresponding prices abroad, quoted in the world markets or in selected supplier countries. Because prices within the community are usually below their targets, import levies tend to make imports more expensive than domestic production. There are however, preferential import quotas for a few products and voluntary export restraints for mutton. Variable subsidies, known as "refunds", are used to help exporters to overcome the handicap of lower world market prices. The system of variable levies and subsidies referred to as "Community Preferences" can also serve to shield the Community against world market prices that are higher than those at home, and it has been used to this effect in some rather brief episodes of relatively high external prices.

One of the principles of the CAP is that institutional prices expressed in ECUs, should be uniform throughout the Community in order to avoid trade distortions. If a common price level is to be maintained in the face of exchange rate changes within the Community, administered prices will have to be adjusted in inverse proportion to the exchange rate changes against the ECU, which is the unit of account in agricultural pricing. Specifically, a country with an appreciating currency will have to reduce its prices, a country with a depreciating currency will have to raise prices. After an adjustment period, a common price level was achieved in mid-1967 but was upset in 1969 following parity changes by two member states. After having been restored briefly, it was again disrupted and its re-establishment has proved contentious and elusive ever since.

Public expenditure on agriculture in the Community is undertaken by the European Agricultural Guidance and Guarantee Fund (EAGGF), which is the financial arm of the CAP and by national authorities. The EAGGF is divided into two "sections". Guarantee and Guidance. Guarantee which accounts for more than 90 per cent of spending, includes the expenditure incurred by the market organisations in the member states for price stabilization, which comprises the refunds on exports to non-member countries and the cost of intervention.

The Guidance section finances measures of a structural nature, be they schemes available to individual farmers or general programs, notably those undertaken to modernize agriculture in regional context. There is a major financial difference between the two sections. Guarantee expenditure is determined by the appropriations entered in the common budget. Guidance expenditure, in contrast, is firmly under the control of the budget authorities.

Section III "Effects of the CAP on EC Member Countries"; as the title implies examined the economic effects of the CAP on EC member countries. Using a general equilibrium model, the authors, used empirical evidence from the Federal Republic of Germany to establish the effect of CAP on output, employment, and trade flows in agriculture and other sectors of the economy; and on economic welfare. Results of the model simulations were said to have given a broad indication of the direction and size of the effects of agricultural support policies on the national economy.

The simulation indicated a rather strong response of the Germany economy to the abolition of agricultural price support in Europe. In agriculture output dropped by  $5\frac{3}{4}$  per cent, employment by  $11\frac{1}{2}$  per cent and exports by  $8\frac{1}{2}$  per cent. The losses in agriculture were however more than offset by gains in other economic sectors. Competitiveness of industry and the traded services sector improved due to lower agricultural prices which reduced nominal wages via lower consumer prices. Therefore output and employment in these sectors increased significantly. Output and employment in the non-traded services sector increased by  $3\frac{1}{2}$  per cent and  $5\frac{1}{2}$  per cent, respectively due to higher aggregate domestic demand and lower production costs. The new macroeconomic effects of these sectoral development were significantly positive. The consumer price level declined by about  $1\frac{3}{4}$  per cent owing to lower agricultural prices. Aggregate employment increased by  $5\frac{1}{2}$  per cent as the other sectors provide more jobs than are lost in agriculture. Real income and domestic demand, therefore, increased by about 3 per cent.

Aside from these results, other evidences presented by the authors broadly confirmed that the CAP had had negative effect on EC member countries. It has maintained agricultural prices in EC countries above world market prices; it has encouraged production of certain products to the extent that net importers of these products have become net exporters; it has failed to maintain the income of small farmers while at the same time gave rise to large windfall profit for large farms; and finally; it has contributed to larger agricultural net exports (and undesirable stock building) by the EC than would have occurred in its absence, all of which had negative effects on the economic welfare of EC member countries. The authors however cautioned that these results are not conclusive.

Section IV examines the Effects of the CAP on the rest of the World. In this Section, the authors contended that, the EC as a group is the leading importer and the second largest exporter of agricultural commodities in the world. Naturally, therefore, decisions taken in Brussels on agricultural prices and levies to control output growth end up influencing world prices and over a period of time, the growth of the farm sector in the rest of the world. Although the authors failed to establish clearly the impact of CAP on the rest of the world, Studies by Burniaux and Waelbroeck (1985) and Loo and Tower (1988) suggested that a removal of the CAP would result in a gain for the developing countries as a group when all general equilibrium effects are taken into account. Moreover, if barriers to trade in agricultural commodities were

removed in all OECD countries, the trade gains for developing countries would probably be more significant. In concluding the section, the authors stated that, the second benefit of liberalization would arise from greater price stability in world market; since there is convincing evidence that world agricultural prices are indeed destabilized by the EC trade barriers.

Section V is captioned "The Approach to Reform". In this section, the authors reviewed the progress made to date to reform the CAP in the continued effort to manage surplus production and to curtail its budgetary and international implications. Among the reforms initiated were those of 1968 which attempted to lower prices and enhance collective investment. In recent times specifically since 1985, it has taken the form of a broad discussion of systemic issues termed "green paper" which recommends the reduction in market supports in order to curtail protective spendings on agriculture and to support the emergence of free markets. Where supports are in place, a measure of "producer co-responsibility" should be adopted to share the burden of intervention. The most recent reforms, that of 1988 introduced a budgetary guideline to ensure stricter adherence to commitments on restraints. It limits the increase in agricultural support spendings to not more than 74 per cent of the annual growth of the community's GNP, and set ceilings on spendings per product in addition to limiting the degree of intervention both in time and volume. Given the extent of the 1988 reforms, the authors concluded that the European Community had made determined efforts to bring agricultural expenditure under control, both because support policies are recognised to be inefficient and in order to free additional resources for structural policies for regional development, social policy and, last but not the least, agriculture itself. While the reforms is intended to help attenuate friction among industrial countries, there is no intention of going as far as dismantling the CAP. It is an integral part of the policy of full regional integration of European Communities, which according to the authors is taken into consideration even in the negotiations on agricultural protectionism conducted in the context of the Uruguay Round.

### COMMENTS

The authors displayed a thorough understanding of the CAP of the ECs: its objectives, strategies, problems and current reforms in a manner that could guide both readers and policy formulators to understand the full implications of market integration within a regional context. The fact that the issues facing policy makers and the arguments put forward in the discussion on policy have remained largely unchanged since the inception of the CAP points to the very complex nature of agricultural support policies on a regional scale. It also reveals the enormous difficulties and challenges which developing economies are likely to face in attempting to embark on regional price support programmes of this magnitude. The authors conclusions that CAP has been less than fully effective at attaining its goals and that its instruments have entailed very costly inefficiencies makes it mandatory that nations or community of nations intending to dive into the type of agricultural integration policies operated so far by the EC be very careful.

However, the fact that the EC has no intention of going as far as dismantling the CAP is another food for thought. In the Nigerian context however, apart from crude oil, cocoa, represents the only non-oil commodity that is exported in appreciable quantity to the EC and it is mainly to the United Kingdom with which we have had a long standing relationship. Since

these products do not conflict with those that are covered by the CAP (almost exclusively temperate zone products) there may be no cause for concern as EC protective policies could be beneficial to Nigeria. However, efforts to diversify exports into non-traditional crops like, soyabean which the EC imports in large quantities (the EC accounts for 51.4 per cent of world import of soyabean and produces nothing) may also benefit Nigeria, provided our exchange rate is right.

A very important lesson that is worthy of note to Nigeria from the revelation in this article is that government intervention (though a problem to the EC that was battling with surplus output) is a very effective tool for increasing agricultural production. One is therefore akin to feel that the attempt by the Nigerian Government to hand off agriculture when the country is still faced with a large food deficit (particularly proteinous food) may be premature. What we really need to do at this stage of our agricultural development, may be, is to formulate price support and structural policies that will encourage the private sector rather than leave everything to market forces. The authors also alluded to the fact that free trade in agriculture proved an elusive objective with considerable intervention by most governments, therefore, if government in the advanced economies are not leaving agriculture to the mechanism of free market forces what do we stand to gain by leaving our helpless farmers to such elusive ideals.

In conclusion, the article has really enlightened me and I recommend it to all those interested in agricultural development policy particularly farm support policies.

G.O. EVBUOMWAN (MRS.)  
SENIOR ECONOMIST  
AGRICULTURAL STUDIES OFFICE  
REAL SECTOR DIVISION  
RESEARCH DEPARTMENT