CAP Reform: The Effects on Irish Farmers and Food Processors

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Introduction

The main problem with the Common Agricultural Policy (CAP) is that it has resulted in an increase in agricultural production disproportionate to the rate of consumption in the EC. As a result, farmers and food processors have become increasingly dependent on intervention agencies as markets for their produce. This has made both farmers and food processors very vulnerable to any new reforms that may be introduced.

The EC Agriculture Commissioner, Mr. Ray MacSharry, has recently put forward proposals for the reform of the CAP. The aim of this paper is to discuss the possible impacts which such a reform package could have on Irish farmers and food processors if implemented.

Impact of reform on farmers

The main aim of Mr. MacSharry's proposals is to substantially reduce support prices for agricultural produce. Support prices for cereals, beef and milk will be most affected, falling by 35%, 15% and 10% respectively.

Compensation for the fall in support prices will be directed towards the small and medium sized producers. Since the majority of Irish producers fall into this category, Ireland should fare less badly than other EC countries such as France, where large producers dominate. It has been argued that the larger, more efficient producer will be penalised in Mr. MacSharry's plans. This contrasts with current CAP policy, where 80% of support goes to the largest 20% of producers. The reform proposals will subject them to a more market-based regime. At the same time, a complete market economy with no supports would virtually eliminate the small producer, and would have serious consequences for rural society which is already under threat. Mr. MacSharry's proposals envisage a more equitable distribution of funds where each producer receives a fair income.

Large producers will have to abide by compulsory set-aside requirements before they become eligible for compensation. Given that 5% of Irish producers account for 40% of our cereal production, this could have a significant impact on cereal output.

It is expected that the fall in cereal prices will reduce the price of inputs for producers in the dairy and beef sectors. However, because livestock production in Ireland is predominantly grass-based, the reduction in input prices would be smaller than for producers in those countries in which production is grain based. This may erode the price advantage enjoyed hitherto by Irish grass-based producers. It may also encourage more intensive farming. This would conflict with Mr. MacSharry's proposals for the environment. However, the fact that compensation will be conditional on a certain level of stocking density should curtail such a development.

The Economic and Social Research Institute (Fitzgerald and O'Connor 1991) forecast a fall in the value of gross agricultural output of almost 17% as a result of these price cuts. They also predict that the level of farm incomes will be 11.5% below that which they would be in an unreformed regime. A loss in farm employment and a decrease in the value of agricultural land are also plausible outcomes. The extent of these losses will be determined by the extent to which alternative uses can be found for land and farm labour. Given the rising demand for wood products, forestry is an area into which farmers may diversify. Increased incentives for the afforestation of agricultural land have been proposed in Mr. MacSharry's reform package.

Whatever reforms are finally implemented, their impact will be crucially dependent on how farmers react to the need to develop a more competitive approach. Thus, there is a need for research, innovation, education, grading and a programme to tackle the structural constraints in Irish agriculture. If Irish farmers prove more competitive than the average, output may increase, with consequential benefits for the food processing sector.

Impact of reform on food processors

The effect of lower support prices will be to reduce the volume of agricultural output. This will reduce the turnover of the food processing sector. The ESRI estimates that output from the food sector will fall by 4% in the medium term and by 7% when the full impact of the changes take effect. Some of the benefits of the CAP have been captured by the food processing sector in the past in the form of higher prices and higher margins. The fall in support prices will lead to a fall in profits and this in turn will lead to job losses.

However, the effect of CAP reforms depends largely on how food processors respond to the need to become more competitive in a changing environment. If Irish firms become more competitive than those in Europe, contraction may occur elsewhere.

Irish food processors are often criticised for their over-reliance on intervention agencies for their produce. For example, intervention purchases amounted to nearly 70% of total beef slaughterings for Irish industry in 1990. On the other hand, EC markets only account for 16% of total Irish beef markets. This situation is explained by the fact that higher returns are often available from intervention than from marketing products commercially. CAP reform will mean that this trend will have to be reversed, with Irish food processors becoming more market orientated, rather than production orientated.

In order to achieve this, processors will have to pay more attention to such factors as 'value added', convenience and product development. In terms of 'value added', Irish performance is relatively poor compared to major competitive countries such as Denmark and the Netherlands. However, there have been some efforts to ameliorate this situation. For example the CBF has recently introduced a new quality scheme aimed at increasing the penetration of Irish beef in European markets.

Food processors who orientate their production towards retail outlets will be less affected by CAP reform than those reliant on intervention agencies. At present it is impossible for the food processing industry to be totally market driven. For example, the beef processing industry is independent, to a certain extent, of commodity markets because of the seasonality of supplies and the low proportion of domestic consumption (20% of annual cattle slaughter).

Among the recommendations of the Industrial Policy Review Group is that problems such as seasonality should be tackled under a national plan for the food industry. Such a plan should also identify niches and segments where Irish food processors can develop competitive advantage. The Review also recommends that responsibility for the Irish food industry be allocated to one government department, and that efforts should be made to encourage more foreign investment in the food sector. The British market has been recommended as the 'key export opportunity' for the Irish food industry.

It is important to point out that some Irish food processors have been very successful in meeting these new challenges. For example, the Kerry Group has long pursued a strategy of developing strongly branded products for retail outlets in the UK. They have made at least five acquisitions relating to their meat operations in Britain since 1988. Because their operations relate to a number of activities which are spread over a broad geographical area, the Kerry Group is insulated to a large extent from the effects of the CAP reform.

Conclusion

Mr. MacSharry's proposals will involve some contraction of the agriculture sector, but exactly where this contraction occurs will depend on how competitiveness varies across Europe's regions. Therefore, the impact of CAP reform will be determined by whether the appropriate strategic response is taken by Irish farmers and food processors.

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References

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