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CENTRE FOR
EUROPEAN AGRICULTURAL STUDIES

GREEN MONEY
AND
THE COMMON AGRICULTURAL POLICY

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WYE COLLEGE
(University of London)
ASHFORD, KENT
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Ian G. Reid
Director

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GREEN MONEY AND THE CAP

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FOREWORD

"Green Money" concerns not only farmers, but also housewives, traders, food processors and Chancellors of the Exchequer. It must also be remembered that units of account are used not only in connection with the CAP, but with most other activities of the European Economic Community. The importance to agriculture of its unit of account stems largely from the common pricing principle which is the cornerstone of the CAP, and hence the raison d'être of "Green Money".

The EEC, and with it the CAP, was first established in a situation of economic and monetary stability. The first challenge to this stability was the devaluation of the French Franc in 1969, since when the situation has changed with dramatic speed into one of economic and monetary instability, leading to a complexity of arrangements and calculations essentially designed to preserve the system of common pricing and free movement of goods within the EEC.

With this background in mind, the Centre for European Agricultural Studies asked Mr. Ronald Irving and Mr. Howard Fearn to contribute to the current discussion of Green Money and the CAP. The authors are respectively Economic Adviser and Senior Economic Assistant working with the Ministry of Agriculture, Fisheries and Food. It must be emphasised, however, that the selection and interpretation of facts and any judgments expressed in their paper are entirely their own and do not represent the views of the Ministry of Agriculture, Fisheries and Food. Their everyday work has given them a unique opportunity to trace the developments in Green Money that have taken place over the past decade. But what of the future?

The Commission has stated in its "Stocktaking of the CAP" that the re-establishment of a single market must continue to be a fundamental objective of the CAP. "For the future, the Commission cannot accept the application of MCAs insofar as they constitute factors disrupting the unity of the market and generating distortions of competition. On the other hand, the compensatory amounts should continue to serve as instruments to prevent short-term fluctuations in exchange rates from instantaneously affecting agricultural prices expressed in national currencies". Does this imply that the Commission foresees the removal of MCAs through the aligning of green rates with market rates of exchange? Future discussion of Green Money might conveniently centre around two fundamental issues: the timing of the phasing out; and, more importantly, the definition and value of the market rates that might be used for this purpose. This numeraire will have significant repercussions upon at least four very interested parties: producers and their incomes, consumers and their food prices, traders and processors and the Exchequer.

This numeraire is composed under man-made rules. These rules underwent a basic change in June 1973 when the definition of the market rates of exchange between national currencies and the unit of account for MCA purposes was changed from a $US numeraire to the present joint float numeraire. The joint-float could be replaced by a more comprehensive "basket", a concept already used for units of accounts attached to other EEC policies and institutions such as the European Development Fund with its EURCO. The weighting within the "basket" could influence the burden of adjustment to be made by each country and hence its farmers, housewives and Exchequers. It can be seen that this is a rich field for debate and discussion amongst farmers, traders, politicians and academics. Thus this Occasional Paper is presented as a contribution to the on-going discussion of this vital subject. It is aimed at furthering the exchange of information and the development of ideas upon problems and opportunities facing European agriculture.

August 1975

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Director

GREEN MONEY AND THE CAP

INTRODUCTION

Green money - in particular the so-called green £ - has been the subject of a great deal of attention in recent months. Within the past year we have seen the green £, ie the separate sterling exchange rate for agricultural purposes, devalued on three occasions, the most recent devaluation being agreed by the Council of Agricultural Ministers in July 1975, with effect from 4 August 1975. Several changes have also been made to the values of other green currencies, all of which have significantly affected, in each Member State, the level of food prices, returns to agricultural producers, the cost of imported food, and returns from exported food raw materials; for the Common Agricultural Policy (CAP) itself, green currency changes have had implications for the size and operation of the Community Budget. Changes to the values of green currencies have, however, a longer history, going back to the late 1960s and for the UK, almost to the date of our adoption of the CAP in February 1973. Yet the principles underlying the operation of separate currency exchange rates for agricultural purposes are not widely understood and the extremely complicated mechanisms devised to apply the system to the production of, and trade in commodities, even less so.

Although the background to this important aspect of the CAP and the developments that have taken place over the last decade are highly complex, this paper reviews the main land marks in the system as it has evolved thus far. The paper also describes, in some detail, the methodology employed in the calculations of compensatory amounts applied to trade in agricultural raw materials and discusses the economic implications that the existence of green money has had for food prices, producer returns, trade, resource use and the cost of operating the CAP. Finally, some questions are posed about the Community's future policy in the field of green rates of exchange.

It must be emphasised that as the purpose of the paper is to provide a wide range of background material and not specific details of current monetary arrangements, those whose business operations involve them in the monetary complexities of the CAP should consult directly EEC Regulations (Appendix 5 lists some of the more important ones) rather than rely on the particular examples which are deployed here.

SECTION I THE NEED FOR AND ROLE OF THE GREEN MONEY WITHIN THE CAP

1. Green money - otherwise known as "agri-money", "official conversion rates for agricultural purposes" or, more recently, "Representative rates" - owes its existence to one of the basic features of the CAP - that of common prices. The introduction of the CAP created a need for a mechanism to achieve uniformity of prices throughout the Six original Member States, each of which continued with its own currency and exchange rate policy. This required a set of exchange rates between the currencies of the Member States that would be used to convert sums of monies (ie prices and attendant support measures) from one currency to another within the framework of the CAP. It also led to the need for a common denominator between these currencies so that sums could be fixed on a Community basis and subsequently translated into Member State currencies. The common denominator employed was the agricultural unit of account. The rates of exchange between the national currencies themselves and between these and the unit of account needed, of course, to be internally consistent in order to achieve common pricing. The exchange rates fixed for the purposes of the CAP were the original "green monies". For reasons discussed later the green money of the early 1960s did not, however, give rise to the problems associated with the green monies operating in the 1970s.

The unit of account

2. Since the unit of account is the corner-stone of the common pricing objective of the CAP and as such is the raison d'etre of "green money", it is worthwhile examining briefly its origins. Its primary function is to provide a common denominator between the various Member State currencies so that, for instance, farm prices can be fixed on a Community-wide basis in units of account. (It should be noted that several units of account exist within the Community for various purposes but here we are concerned with the agricultural unit of account). The unit of account is not a currency - and is not traded on foreign exchanges - but is rather an accounting device. Its legal basis is embodied in the EEC Regulation 129/62. This Regulation defines the unit of account in terms of gold and fixed its value at 0.88867088 grammes fine gold. This gold value attached to the unit of account was identical to the value at that time of the $US.