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**Study on alternative strategies for the development of relations
in the field of agriculture between the EU and the associated
countries with a view to future accession of
these countries**

(Agricultural Strategy Paper)

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Abbreviations

AMS	Aggregate Measure of Support
CAP	Common Agricultural Policy
CECs	Central European Countries
CEFTA	Central European Free Trade Agreement
EAGGF	European Agricultural Guidance and Guarantee Fund
EU	European Union
FSU	Former Soviet Union
GDP (pc)	Gross Domestic Product (per capita)
MFN	Most Favoured Nation
PPP	Purchasing Power Parity
WTO	World Trade Organization (former GATT)

1. Introduction

In June 1993 the European Council agreed during its meeting in Copenhagen "that the associated countries in Central and Eastern Europe that so desire shall become members of the European Union. Accession will take place as soon as an associated country is able to assume the obligations of membership by satisfying the economic and political conditions required".

The Essen European Council of December 1994 in its pre-accession strategy noted that "agriculture represents a key element of the pre-accession strategy" and requested that the Commission present in the second half of 1995 a study on "Alternative strategies for the development of relations in the field of agriculture between the EU and the associated countries with a view to future accession of these countries".

Agriculture has been identified as an important issue for future accession because of its relative size in some of the Central European Countries (CECs), and because of the difficulties there might be in extending the Common Agricultural Policy (CAP) in its current form to these countries.

In the first half of 1995 a series of ten country reports on the agricultural situation and prospects in the CECs (Poland, Hungary, Czech Republic, Slovak Republic, Slovenia, Romania, Bulgaria, Lithuania, Latvia, Estonia) were produced by the services of the European Commission in collaboration with national experts from the countries concerned and with the help of scientific advisers from the EU. The reports attempt to provide an objective analysis of the current situation in agriculture and the agro-food sector in the CECs and an assessment of the developments to be expected in the medium term. They were not meant to provide policy recommendations, but to serve as an analytical basis for policy considerations.

The present report builds on the work carried out so far. It tries to identify the main challenges for the future of agriculture and agricultural policies in the CECs and in the EU and to assess the impact of an enlargement within the present CAP framework. It sketches first broad outlines for the future development of the CAP and suggests a number of ideas and measures on how to improve relations in the field of agriculture during the pre-accession phase. It is based on the belief that everything possible should be done to help the CECs to develop their agricultural - and in an even broader sense their rural - economies. In addition, as far as the specific agricultural and economic problems and challenges allow such an approach, an increasing compatibility in the orientation and the conduct of agricultural and rural policies should be favoured, taking into account that both, the CECs and the EU, have to respect and to adapt to a common international system of multilateral trade in the framework of the WTO.

2. **Situation and Outlook CECs**

2.1 **Agricultural Economies**

Combined the ten Central European Countries have a population of about 106 mio and a land area of 1.1 mio square km. This is about 29% of EU-15 population and 33% of EU-15 area.

General economy

The economy of most CECs is showing signs of recovery after having experienced a significant contraction in output in the first years of transition. Fuelled by an increase in private sector activities, which in most countries now represent over half of all economic activity, growth prospects in 1995 for most CECs are favourable. Lagging somewhat behind are Hungary, which is experiencing problems in stabilizing the economy, in particular public finances and the current account, and Romania and Bulgaria, which in addition seem less advanced in their transition to market economies.

Importance of agriculture

In terms of area, contribution to GDP and in particular share in total employment agriculture is relatively more important in the CECs than in the EU. On average over 25% of the work force is employed in agriculture, ie a total number 9.5 mio (compared to 6% or 8.2 mio in the EU). Agriculture still contributes 8% to GDP (compared to 2.5% in the EU).

Agricultural output developments

Although there are signs of a start of recovery, in particular in the crop sector, agricultural output is generally still much below pre-transition levels in all CECs except Slovenia and Romania. Output was affected by the fall in demand as consumer subsidies were removed and the general economic situation deteriorated and by the price-cost squeeze agriculture faced (ie input prices rising much faster than output prices).

Agriculture and environment

The main environmental problems related to agriculture and inherited from the communist period are soil erosion and compaction, water pollution by agro-chemicals and manure disposal in areas with a heavy concentration of animal production.

Agrofood trade

Most CECs, with the exception of Hungary, Bulgaria and Estonia, have become net importers of agricultural and food products in recent years. The most important trade partner for many CECs is the EU, in particular on the import side, but also as export

market. All CECs except Hungary are net importers of agrofood products from the EU. The agrofood balance has been developing in favour of the EU, moving from a deficit in 1992 to an increasing surplus in 1993 and 1994. Nevertheless all six associated countries increased their exports to the EU in 1994, which is partly a reflection of better use of the tariff quotas under the Europe Agreements, although utilization still falls some way short of maximum take up. For many CECs the share of agrofood exports going to the FSU increased again in 1994, after having dropped in the early transition years.

Structural reform

In most CECs in the pre-transition era nearly all cultivated land was in hands of collective and state farms. The only exceptions were Poland, which kept an important private sector in agriculture even under central planning, and Slovenia, which had a small "socially owned" sector of agriculture and a large number of small part time farmers, occupying over 90% of agricultural area.

As in the wider economy, one of the main objectives of reform during transition was to decollectivise agriculture and to re-establish private property rights. Putting land and other farm assets into private ownership or private operation took a number of different forms, leading to different degrees of fragmentation of ownership and of farms.

A general feature in the countries, which had a predominantly collectivised agriculture in the pre-transition era, appears to be that the dualistic character - very large scale collective or state farms on the one hand and very small individual or private plots on the other - is slowly diminishing. This tendency can be expected to continue in the future and to contribute to increased efficiency as the larger units reach more manageable proportions and the smaller ones acquiring more land can benefit from economies of scale. For the medium term, however, the forms of private producer cooperatives or associations, which have emerged, will most likely continue to play an important role in agricultural production and the focus of the smaller farms will continue to be production for own consumption and local markets. The rate of structural reform will also depend on the emergence of functioning land markets, which so far has been hindered by the delay in most countries of the definitive settlement of property rights.

The degree of privatization and demonopolization achieved in the up- and downstream sectors differs between countries. Delays in the privatization and in the breaking up of the large state monopolies in the up- and downstream sectors was one of the reasons for the price-cost squeeze the farm sector experienced in the first years of transition. A return to profitability of farming will to a large extent depend on a competitive downstream sector and on a reorganization of the farm sector itself, eg in bundling supply and strengthening its negotiating position vis-à-vis the food processing industry and distribution channels.

Support policies

In most CECs measures have been introduced to stabilize the agricultural sector, in the wake of the disruptions the early years of transition brought. Depending on the country support to agriculture has taken various forms ranging from CAP like intervention and border measures to administrative controls.

When considering the relatively low level of farm gate prices in the CECs, the downstream inefficiencies in many countries should be taken into account, eg for wheat a doubling or more of the farm gate price to get the product to the border is not exceptional.

The low dairy and beef prices reflect the decapitalization of herds (the costs to maintain production potential in quantity and quality terms are not being met) and for beef also the lower quality of production based on dairy herds as most CECs have no specialized beef herds.

Over time the price gap can be expected to be eroded to a certain extent by a relatively high inflation (not fully compensated by currency depreciation) and by a rise in domestic agricultural prices as food demand recovers somewhat more quickly than supply. In a situation of rising output, production costs will be more fully reflected.

GATT

Further agricultural policy developments in the CECs will be conditioned by their GATT Uruguay Round commitments on domestic support, market access and export subsidization.

The Aggregate Measurement of Support (AMS) commitments might become constraining for those countries which have bound their AMS in national currencies. Tariffs have generally been bound at higher levels than the protection applied at the beginning of the transition, but are for most products and countries still lower than in the EU. Potentially the most constraining are the export subsidy commitments, in quantity as well as budget outlay terms.

Conclusion and outlook

The general income growth in the CECs will lead to a certain recovery of demand for agricultural products, in particular for livestock products, although the pre-transition levels of per capita consumption will likely not be reached. A rise in animal production will also increase the feed demand for cereals.

In most countries completion of land reform and restructuring of the food chain will take at least till the end of the decade, while farm structures could be expected to evolve even slower as the capability of agriculture to attract investment will remain limited.

In view of the budgetary constraints in many countries state support to agriculture is not expected to increase much above current levels, limiting the possibilities of market intervention and structural aid. Import protection has been increased recently when the Uruguay Round results were implemented. The increased protection, which stays within GATT limits, is expected to remain stable in the future as the scope for domestic price rises is limited by the still high share of household income spent on food and by the still excessive inflation rates in most countries.

The use of inputs is recovering and will contribute to an increase in productivity, but is not likely to attain pre-transition levels, when taking into account the development of input-output price relationships and the waste of inputs previously.

By the end of the decade supply and demand patterns in CEEC agriculture could be expected to have adjusted to the transition shock. In the crop sector there would be a certain shift towards cereals and oilseeds with an increased net export potential compared to the pre-transition situation.

In the livestock sector the recovery would be less marked. For dairy the net export potential would be significantly lower than in the pre-transition period, while for the meats supply and demand would be more or less in balance, but at a lower level than in the pre-transition period.

Agricultural production can thus be expected to continue to grow in coming years, albeit at a slow rate. Undoubtedly, the CECs have a significant production potential. The big structural difficulties to realize this potential in the foreseeable future should however not be overlooked. Three key problem areas can be distinguished in this regard:

a) Lack of capital

Although investments are urgently needed to modernize production and to improve the rural infrastructure there is no money. The self-financing capacity of most enterprises is weak. The possibilities of the countries concerned to assist with public money are very limited. The demands for credit exceed the availabilities and the farm sector is relatively unattractive for investors due its low profitability. The delay in the definitive settlement of property rights makes it difficult to use land as collateral. For the same reason no functioning land market exists in most countries and administrative regulations make it difficult for potential investors, in particular those from abroad, to invest in agriculture.

b) Farm structural problems

In the early years of transition agriculture served in some CECs as an employment buffer (and partially still does) as industry was being restructured. This contributed to the creation or reinforcement of micro scale farming for subsistence purposes, which in the longer would probably only be viable as

additional source of income, but at the same time complicates the task of modernizing agriculture. Furthermore, in some countries overdimensioned structures continue to exist, which in the longer run would not seem to be economically viable. To these economic and social problems, to which the polarization of structures can lead, can be added a qualitative problem in most countries. Farmers, in particular in the small holdings, are relatively old in comparison to the average age structure of the population, with little training and hardly prepared for a market economy environment.

c) Downstream structural problems

The privatization and reorganization of the food industry is slowly progressing in most countries, but the urgently needed foreign investment and know how is often lacking. With the exception of some sectors the general picture is still that of an industry weighed down by inefficiency. In several countries the downstream sectors closest to agriculture are still semi-state controlled with monopolistic tendencies. In many cases the international competitiveness seems to be lacking. In spite of low producer prices, around or below world market levels, exports are often subsidized.

The to some extent still low producer prices in the CECs should be seen in relation to the deep economic recession of the last five years. With the growth of incomes and rising demand and the adaptation to higher quality standards, as well as the border protection allowed under GATT, prices should rise further in coming years.

There are however limits to a price rise. As long as food expenditure still makes out 30 to 60 % of household income and as long as inflation rates still lie above 10 to 30 % (and even higher) a rapid increase in agricultural and food prices would be economically damaging and socially dangerous. The price gap between the CECs and the EU can therefore be expected to continue to exist for the foreseeable future, even if it will decrease more or less noticeably, depending on the product.

When taking all these elements together the CECs would be less in need of a high level of price and income support for their farmers, than of targeted assistance for the restructuring, modernization and diversification of their productive capacity in agriculture and the downstream sectors and for improvement of their rural infrastructure.

The EU is already today the most important financial contributor assisting the CECs to reshape their economies. During the period 1990-1994, total assistance (grants and credits) provided by the EU and its Member States amounted to 38745 mio ECU, representing 68 % of the assistance provided by the G-24 countries. In agriculture and rural development, EU assistance amounted to 578 mio ECU, mainly through grants of the PHARE programme, representing 81 % of G-24 assistance.

2.2 Veterinary and Phytosanitary Aspects

In general terms, the veterinary and phytosanitary situation in much of the CECs is good and in some cases higher than parts of the Union. Technical knowledge and expertise is of a similar level to that of the EU-15. For the Community, the greatest threat is the importation of live animals and certain animal products from adjacent high risk countries, particularly where inadequate border controls exist.

The recovery in animal numbers and the increase in private ownership mean there will be greater incentives to import animals than in the past and this may lead to the relaxation of in some cases very strict rules on imports.

There are also other areas for concern, for example vaccination (for classical swine fever) still occurs in some areas where it is not allowed in EU-15 and recent live imports from some countries have tested positive to controlled diseases. Diseases which are largely eradicated in EU-15 or for which there are elaborate control measures are still prevalent in some of these countries and systems of animal identification are not always up to EU-15 requirements. In some cases, the appropriate mix of legislation and compensation is not always sufficient to ensure the cooperation of livestock owners or hunters (in the case of wild animals) for the eradication of disease, the passing of ownership from public to private hands also being significant in this respect.

Most of the CECs would appear to have sufficient numbers of technical personnel, for example there appear to be sufficient veterinarians to implement legislative requirements. However satisfactory supervision and control may prove to be difficult. Specifically, implementation of existing and future legislation will be hampered by inadequate supporting structures and the essential technical backup, for example testing laboratories for disease detection, IT equipment and inspection and animal holding facilities at border posts. Although at a superficial level, the basic administrative structures could be argued to be present, in order to implement EU standards of control, improved management arrangements and investment in technical support facilities would be required. The development of an improved legal framework, at least in the Visegrad countries, is progressing, although comprehensive implementing legislation is some way off as is the development of the necessary administrative structure.

Most of the CECs have to a different extent been conducting discussions with the Commission designed to lead to equivalence agreements in the field of veterinary, plant health and animal nutrition controls. These discussions in both the veterinary and phytosanitary sectors have led to a good understanding on each side of the others situation. Good communications exist at the technical and administrative level as to what steps need to be taken to reach equivalency. However equivalency status still falls short of what is required in the context of an internal market and further progress will be necessary particularly in the area of administrative procedures.

The Community seeks to attain and maintain a high status of animal and public health and plant health with the overriding principle that measures should be based on the

best available scientific knowledge. Harmonising to the highest health status is the objective at all stages in the production of animals and animal products from the farm through processing, transport, storage and preparation.

In the veterinary field, Community policy is based on non-vaccination and eradication, through the stamping out of infected herds and flocks, controlling the movement of live animals and animal products, vehicles and any substance likely to harbour the disease agent. Member states must notify the Commission and other Member States of any suspicion of serious animal disease, and of the measures being taken to combat the situation in accordance with Community legislation.

As regards public health (principally hygiene) requirements, some establishments meet EU standards and are recognized to export to the EU. Some CECs can already export pigmeat (Hungary and Czech Republic). However these exports are from EU inspected premises which represent only a small proportion of establishments. The general situation is in many cases well below EU standards and inspection systems, training and supervision arrangements are also largely inadequate.

Significant investment will be necessary to improve production standards. Where no approved drugs residue testing programmes exist (Baltic States), exports to the EU cannot be allowed.

The Union has always striven to ensure the welfare of animals and the protection of animals is an integral part of the CAP to guarantee free trade and prevent distortions in competition. Animal welfare requirements are largely non-existent in the CECs although some have legislation. Different philosophies on animal welfare might well exist also in the CECs. In any event, the necessary administrative structures for inspection and control will be necessary.

In a general sense, the situation in the plant sector is unlikely to pose as many difficulties as in the veterinary sector. Plant quality legislation is already in many cases aligned with the EU, eg in seed certification where equivalence has already been granted. Trading experience suggests that there are generally few implementation problems. In other fields, equivalence is not yet granted eg propagating materials, or the necessary administrative structures are largely absent as is the case for the accreditation of nurseries.

As in the veterinary sector significant changes in existing controls and practices will be required for which administrative, training and technical support will be needed. Again the level of technical expertise is generally good.

Pesticide and pesticide residues are not likely to be a problem in the medium term (time is required for the legislation in place to be adapted) although the administrative structure and trained staff are lacking for EU type registration schemes.

For the plant sector as in the case of the animal sector, it is likely that trade of some animals and plants and their products will continue on the Eastern borders of these CECs and it is here the biggest risks lie in disease terms and where sufficient infrastructure such as adequate inspection facilities and rapid communication between border posts and to the central authorities are not yet always adequate.

3. Situation and Outlook EU

3.1 The 1992 Reform

Over the last few years agriculture in the EU has been through an important adjustment process following the CAP reforms of 1992. Major progress was achieved towards an improvement of market balances in the reformed sectors, and, according to recent estimates by the Commission's services and others, agricultural incomes developed favourably and much better than they would have done in a scenario without reform.

Production remained even below the expectation of 1992. However in the case of cereals, in addition to the effects of the reform, there were also unfavourable climatic conditions in some regions of the Community. In the case of beef meat it was the combination of the effects of the reform and of a cyclical downswing which occur more or less regularly in this sector.

A major success of the 1992 reform in the field of cereals was an increased competitiveness of Community cereals. During the 1980s and early 1990s, home grown cereals continuously lost market share on the internal market for animal feed. A simple continuation of past trends over the 1993/94 to 1995/96 period would have led to a reduction of the cereals uptake in animal feed of some 5 to 7 million tonnes. Instead of such a continued loss, cereals gained some 6 to 8 million tonnes in animal feed uses.

On the external markets, the improved price competitiveness led to much lower refunds for all cereals. In the case of wheat, the most important Community cereal, a relatively tight world market situation has currently led to world market prices around the EU market price level so that no refunds have had to be paid during the last few months. However, this is expected to be a temporary phenomenon, although, on the whole, longer term prospects would not appear to be unfavourable.

3.2 Medium Term Market Outlook

When the 1992 reform proposals were introduced, the Commission underlined that they would represent a stable policy framework, on which Community farmers could rely for the foreseeable future. Forecast analyses undertaken by the Commission's services and some external research institutions indicated that the expected results of the reform would be, broadly speaking, compatible with the obligations of the Uruguay Round. Some uncertainties existed, however, in the case of beef meat.

In fact, according to the latest medium-term forecasts by the services of the Commission, beef meat production could well start to increase again. On the internal market, beef meat still suffers on the demand side from a relatively low price competitiveness as compared to other meats (in particular poultry meat and pigmeat), difficulties which are increased by image problems in at least some countries.

If consumption were to suffer, there is a risk that stocks could tend to increase again towards the end of the decade as possibilities to export with subsidies diminish.

In the case of cereals, too, the situation could well deteriorate in the medium-term (end of this decade/early next decade), as some positive effects of the reform will progressively fade away. Cereal yields will continue to increase, although at a growth rate below the long-term trend of the 1970s and the 1980s. The 1992 reform decisions led to intervention price reductions which were smaller than the initial proposals by the Commission, and the applications of the switch-over mechanism in 1992 and 1993 had in addition the effect of new price increases which reduced the potential price competitiveness of home grown cereals further (as compared to the initial reform proposals).

As far as world market prospects are concerned, a number of experts and world forecasting institutes today foresee relatively favourable developments for wheat exporting countries in the long run.

World demand and world trade of wheat (more than of other cereals) are expected to increase and world market prices could be relatively firm. If this is the case, it would become crucial for the Community (enlarged or not) to be able to export without subsidies in order to participate in world market growth. This challenge of improved competitiveness - on the internal market as well as on export markets - holds also for a number of other products, and has to be seen in the broader international trade and trade policy context of the coming years.

3.3 Challenges for the Future

The Uruguay Round Agreement which is now being implemented foresees new negotiations to start in 1999. It is, of course, still too early for any reliable forecast of how the international debate will develop, but it can be expected to broadly follow the lines of the Uruguay Round: further reductions of support, increase of market access (eg through further reductions of tariffs and tariff equivalents), and further reductions of export subsidies and subsidized export quantities, are certainly subjects that will appear on the agenda. Other topics may be added such as environmental concerns, but the overall objective will be that of more trade liberalization.

Even independent of the Post-Uruguay Round discussions, significant growing pressures to liberalize agricultural trade and to facilitate market access can be expected, be it in the field of bilateral or of regional (free trade) agreements. Competition from outside will increase, also in the field of agriculture.

