

Final Report

# Pre-accession agricultural policies for central Europe and the European Union

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## **Executive Summary**

- 1** The enlargement of the European Union (EU) to include the countries of Central and Eastern Europe (the CEECs) is perhaps the greatest challenge facing the EU and the CEECs in the next decade. Among the sectors where mutual adjustments will be most needed, and have the largest benefits, in both the EU and the CEECs is agriculture. However, adjustments need careful preparation to ensure that they are mutually consistent. The absence of foresight, or of the will to act in advance to forestall problems, could seriously jeopardize the process of integrating the CEECs back into Western Europe. This report is an attempt to lay out the options facing the CEECs and the EU as the issues of agriculture come into focus. It concentrates on the six CEECs which have Association Agreements with the EU.
- 2.1** In the CEECs, agriculture is large relative to other sectors of the economy. When the CEECs join the EU, overall GDP of the Union will increase by around 3 per cent, but agriculture will expand by around one third. Hence agricultural issues will become more important in the enlarged EU.
- 2.2** CEEC agriculture has been under an enormous economic stress since transition began and output has declined significantly. It is sometimes assumed that this decline is irreversible. Yet, the downturn in CEEC agricultural production can be explained by a number of factors, most of which are closely related to the fundamental adjustments taking place during transition. The majority of these factors are of a transitory nature.
- 2.3** There is a good chance that CEEC agriculture will recover once the process of transition approaches completion. One indication is the fact that agriculture has proven more robust than industry in the turbulence of transition.
- 3** Agricultural policies in the CEECs have kept changing since transition began. In particular, the Visegrad countries have gradually moved towards higher levels of agricultural support and protection. They all now have more or less rigid price guarantees for core agricultural products, though at a level substantially below that of the EU. These policies have been in response to the economic difficulties in agriculture during transition. In future, a clear priority for CEEC agricultural policies should be to improve competitiveness in agriculture and, in particular, in the upstream and downstream sectors. Measures which interfere heavily with market forces cannot achieve this aim. Priorities for policies in the immediate future include market stability, social security in rural regions, better employment opportunities, and environmental sustainability. Major constraints on CEEC agricultural policies are the need for macro-

economic stabilization, including fiscal restraint, the limited purchasing power of consumers, existing international trade agreements, in particular the GATT Agreement on Agriculture, and the need to avoid wrong expectations of market participants.

- 4 Among CEEC farmers the CAP is often seen as a panacea. In those product sectors where the CAP provides firm price support, CEEC agricultural producers would benefit from inclusion in the CAP. However, in other sectors, such as e.g. pork and poultry, CEEC farmers need to be rather efficient in order to compete successfully with EU farmers. Most important, though, is the need to improve competitiveness in the food industry before accession to the EU. The EU food industry is a particularly competitive sector by international standards, and the CEEC food industry will not benefit from any form of protection once a single market is established between the CEECs and the EU. CEEC governments should not assume that the *acquis communautaire* of the CAP remains unchanged until eastward enlargement of the EU. As part of the process of making the CEECs "pre-members" of the EU, engaged in a policy dialogue with the EU, mutual policy adjustments can be discussed. However, in financial terms the CEECs will not be covered by the CAP before accession, and this has decisive implications for their policies. An important issue to be discussed between the CEECs and the EU in the near future is the treatment of the CEECs under CAP supply controls on accession. Incentives to establish "property rights" to CAP quotas in the CEECs should be avoided.
- 5.1 One of the central issues in CEEC agricultural policies for the years to come is the choice of an appropriate level of support and protection. As current levels of support are still below those under the CAP, there is the issue of whether and when to align CEEC prices with the CAP.
- 5.2 One option would be a rapid price alignment. This strategy might be welcome in some parts of CEEC agriculture, but it would harm other sectors, in agriculture as well as in the food industry and the overall economy. Real incomes of consumers would suffer and government budgets would have to bear a high burden.
- 5.3 A less unrealistic option is a gradual price alignment with the EU, to reach CAP prices in, say, the year 2000. A quantitative analysis of the implications of this policy strategy for the Visegrad countries suggests that it would result in substantial surplus production of some agricultural products. For the products included in the quantitative analysis presented here, export subsidies required to dispose of these surpluses would amount to some 4.3 billion ECU in the Visegrad countries. More budget expenditure would result from other elements of market policies needed to pursue this strategy. Total expenditure on agricultural market policies would be around 9 billion ECU in the Visegrad countries. Budget spending for agriculture at that level is beyond that which is compatible with

macro-economic requirements in the CEECs. Moreover price alignment with the CAP by 2000 would be inconsistent with the commitments the Visegrad countries have accepted under the Uruguay Round Agreement on Agriculture in the GATT.

- 5.4** As a conclusion from these considerations, the preferable strategy for the CEECs, from their own domestic point of view, is to keep price support low until accession to the EU. Another advantage of this strategy is that it is not yet clear what the level of CAP prices will actually be by 2000. Hence it is best for the CEECs not to create wrong expectations among their farmers.
- 6.1** In the years to come, the outlook for the CAP will be conditioned by a number of pressures. Rising budget costs will soon exhaust the guideline for FEOGA spending. Environmental concerns and issues of income distribution will affect the political climate in which the CAP is pursued. The EU's GATT obligations are unlikely to have a marked impact, but will guard against slipping back in the process of CAP reform. Enlargement to include EFTA countries may influence the political balance in CAP decision making. The main threat to the stability of the CAP is accession by the CEECs.
- 6.2** Avoiding action in this changing environment and waiting until a crisis occurs is the least preferable option for the CAP. Most importantly, it would essentially preclude the extension of the CAP to the new entrants from Central and Eastern Europe. With all six CEECs included in an unreformed CAP, FEOGA guarantee expenditure would increase by around 20 billion ECU, i.e. by more than one third. At the same time, GDP of the EU, i.e. the basis of the guideline for FEOGA spending, would grow by only three per cent. Also, the Union's GATT commitments would probably not allow the extension of an unreformed CAP to the CEECs. A modest continuation of the MacSharry reform of the CAP, to include more products and to eliminate shortcomings in the current regime of compensation payments and set-aside, would improve things, but would not fundamentally change the agricultural policy environment to which the CEECs accede. It would not sufficiently solve the problems that CEEC accession would create for the CAP. The preferred strategy for the EU therefore is to complete the process of CAP reform, by reducing support prices to close to world market levels, decoupling compensation payments completely from production, making payments transferable, and by handing financial responsibility for decoupled payments over to the member states, with appropriate adjustments to their contributions to the EU budget. In the process of eastward enlargement, the EU anyhow needs to reconsider its approach to agricultural compensation payments. The policy changes indicated here can be implemented in a gradual fashion and do not need to be regarded as a "reform of the reform".

- 6.3** If the CAP opts for inaction until provoked by crisis, the delayed policy changes will either go in the proper direction, in which case the delay will have been costly, or they will be of a less desirable nature. In particular, more reliance on supply control would distort the allocation of resources and make EU agriculture less internationally competitive and more reliant on government policies. A completion of CAP reform along the lines indicated would lay the foundation for a competitive agriculture for a Union of about twenty countries. A CAP made viable only by quotas is a recipe for non-competitive, segmented agricultural markets.
- 7.1** In previous rounds of EU enlargement, different approaches have been adopted for transitional arrangements. After creation of the Single Market, transition arrangements which would have allowed for a gradual transition on agricultural markets were not considered appropriate in EU enlargement to include EFTA countries. In a borderless Europe it would not have been acceptable to use accession compensatory amounts granted or collected at the border.
- 7.2** When it comes to eastward enlargement of the EU, a number of options for transitional arrangements can be considered. One option would be to exclude CEEC agriculture altogether from the Single Market in the EU. For the enlarged Union, sacrificing the principle of the Single Market would be a serious economic disadvantage. For the CEECs, this option would constitute "second-class citizenship". Less pronounced, but similar in nature would be the problems created by a long transition period for agricultural prices in the CEECs. Border controls would have to be maintained between the new entrants and the rest of the EU, just for the sake of avoiding inevitable decisions in agricultural markets. A third option would be to establish a "single market" with the CEECs, but to avoid the budgetary and trade implications of extending an unreformed CAP to the east by subjecting CEEC agriculture to firm supply controls. This option would not allow CEEC farmers to compete on an equal footing with farmers in the rest of the EU. It would also be a particular irony to suggest that countries which have recently escaped from central planning should move all the way back to state controls in agriculture at the very time of joining the EU. For all these reasons, the preferred option is a rapid transition of the CEECs to common CAP prices on accession, on a truly Single Market without border controls. However, this option is feasible only if CAP reform has been completed fully by the time of accession, along the lines indicated above.
- 7.3** The choice of an approach for transition also has implications for trade with third countries and for budgetary arrangements with the new entrants. A decision has to be taken whether there should be an *a priori* limit to net transfers to the new members. If such a limit is not imposed, as in earlier rounds of enlargement, then incentives to expand

agricultural production in the CEECs could be distorted. Potential problems can, however, be reduced if CAP prices are sufficiently close to world market prices.

- 8.1** CEEC agricultural policies for the immediate future should complement a strategy of low support and protection. To improve stability on agricultural markets, the scope for action by private market participants should be widened, for example by better price information, easier access to storage capacity and short term credit, and support for the establishment of commodity exchanges and futures markets.
- 8.2** In order to overcome liquidity problems in agriculture, it is important that rural banking in the CEECs is improved, land registration is speeded up and the functioning of land markets is strengthened. Farmers and farm workers need to have access to a reasonable social safety net. Regional policies can help to improve employment opportunities in rural regions. Monitoring systems should provide better information on economic and social conditions in agriculture.
- 8.3** The CEECs should work towards the establishment of a common agricultural market amongst themselves, which would have a number of important economic and political advantages. The EU could support such a move by allowing preferential quotas under the Association Agreements to be jointly utilized by all CEECs.
- 9.1** The EU should increase its financial and technical assistance to CEEC agriculture substantially. Major areas where increased EU support would be useful are improvement of agricultural institutions and infrastructure in the CEECs; support for training programmes for displaced agricultural workers; assistance to agro-business and food processing industries; help to establish the institutional and legal conditions necessary to implement the CAP.
- 9.2** In the area of agricultural trade, it has sometimes been suggested that the EU should no longer subsidize exports to the CEECs, so as to avoid a further deterioration of their agricultural balance of trade and price depression on domestic CEEC agricultural markets. As trade data show, EU export subsidization has probably had less influence on rising CEEC agricultural and food imports than is sometimes assumed. It would be more useful for the CEECs if the EU were to reduce its subsidized exports to third country markets to which the CEECs export, in particular in the former Soviet Union. The EU could assist the CEECs in their efforts to gain better access to those export markets by offering export credits and credit guarantees to the CEECs.
- 9.3** Under the Association Agreements with the CEECs the EU should expand preferential quotas for agricultural and food products. The implementation of agricultural quotas

under the Association Agreements could be greatly improved, such that benefits flow to the CEECs rather than to EU importing companies. Such amendments to the quota implementation would help the CEECs without doing harm to EU farmers.

## **1 Introduction**

The enlargement of the European Union (EU) to include the Central and Eastern European countries (CEECs) is perhaps the greatest challenge facing the EU in the next decade. That it is also the most worthwhile development from both a political and an economic viewpoint makes the challenge even more important. Among the elements in that challenge is the impact that CEEC accession will have on existing policies in the EU. Where these policies require adjustment to make them compatible with the new shape of the Union this should ideally be done with foresight. Where the acceding countries can in turn anticipate problems and make adjustments in the five or more years before membership this should also be encouraged.

One of the sectors in which these mutual adjustments during the pre-accession period will be most needed and have the greatest benefits is agriculture. With adequate preparation, keeping in mind longer term objectives, this process can be productive. It is in the interests of both existing and new members to strive for a Union agricultural sector that is competitive and profitable without excessive government intervention in either marketing or production decisions. To achieve this requires that agricultural policies of the CEECs be put on a path which will lead towards this objective. It will also mean modifications to the present Common Agricultural Policy (CAP) of the EU. These mutually consistent adjustments need careful preparation. The absence of foresight, or of the will to act in advance to forestall problems, could seriously jeopardize the process of integrating the CEECs back into Western Europe.

The report submitted here is an attempt to lay out the options facing the CEECs and the EU as the issues of agriculture come into focus. CEEC agriculture has gone through a traumatic change in the last five years, as have other sectors in the economies in transition. Farmers and governments alike are searching for a foundation of stability on which to build. The present CAP offers high farm policies and market stability in the short run but not a high degree of policy certainty in the medium run. The CAP itself has undergone an impressive but partial reform, moving significantly in the direction of delinking market price management from farm income support. Farmers in the present EU are also seeking a stable basis for future policy, without the constant uncertainty which comes from being in the spotlight of budget and trade negotiations. A viable CAP is therefore a necessary cornerstone for both the present EU agriculture and that of the CEECs. The options considered here are aimed at putting in place that cornerstone before the edifice collapses.

The report begins by discussing reasons for the decline of agricultural output in the CEECs since transition began, with a view to their implications for future agricultural potential

in the CEECs (Chapter 2). It then considers priorities and constraints for future agricultural policies in the CEECs (Chapter 3) and some fundamental issues related to integrating CEEC agriculture with the EU (Chapter 4). Against this background, alternative options for pre-accession agricultural support and trade policies in the CEECs are discussed, with an emphasis on different approaches to price alignment with the CAP (Chapter 5). Turning to EU policies, the report then considers alternative options for the CAP in the pre-accession period (Chapter 6). Assessment of alternative policy options for both the CEECs and the EU depends, among others, on which post-accession transitional arrangements are considered feasible (Chapter 7). After treatment of such policy options for the medium term, the report then makes a number of suggestions for policy action in the immediate future, for both the CEECs (Chapter 8) and the EU (Chapter 9).

This report, commissioned by DG I of the European Commission, had to be drafted in a short period of time, and its scope is therefore limited. It deals exclusively with the six countries in Central and Eastern Europe which at this time have Association Agreements with the European Union, i.e. Bulgaria, the Czech Republic, Hungary, Poland, Romania, and the Slovak Republic.<sup>1</sup> At some points, the analysis is confined to the four Visegrad countries, i.e. the Czech Republic, Hungary, Poland, and the Slovak Republic. Because of the limited scope of the study, differences among the individual CEECs were taken less into account than would have been desirable. No firm assumption is made concerning the exact date at which the CEECs could accede to the Union, though the implicit assumption is that accession could occur within the coming ten years. Also, it is not assumed that all CEECs would necessarily join the Union at the same time. The report concentrates on policy adjustments which may be made, or should be made, before accession takes place.

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<sup>1</sup> In this report, the term "the CEECs" refers to these six countries.

## **2 Agriculture in the CEECs: Issues and Prospects**

### **2.1 The Importance of CEEC Agriculture**

The countries in Central and Eastern Europe differ widely in nearly all aspects of their historical, cultural, political, economic and social situation. For example, in terms of basic economic indicators such as GDP, or more generally standard of living, they occupy different positions in the continuum between less developed and industrialized economies. While Romania's GDP per caput is similar to that of middle-income developing countries, the Czech Republic and Hungary enjoy incomes closer to those of the poorer EU member states. It is for such reasons that few general statements can be made, with any degree of accuracy, about the situation in "the" CEECs. Equally it would be misleading to treat agriculture in "the" CEECs as if there were no fundamental differences between individual countries regarding natural conditions, yield levels, output composition, ownership patterns, factor prices, institutional framework, policy instruments, and all the other structural factors which characterize the situation of agriculture in a given country. However, in spite of this highly differentiated situation, there are some features which agricultural conditions in most CEECs have in common. These have mainly to do with the effects which past agricultural policies under the centrally planned system have had, and with developments which have taken, and are still taking, place during the process of transition.

One of these features is the fact that agriculture in the CEECs was, and to some extent still is, large relative to other sectors in the economy. As can be seen from Table 2.1, the share of agriculture in both GDP and employment is much higher than on average in the EU-12. In part this is related to the level of economic development, as is clear from comparing the EU-12 average with the member states at the lower end of the GDP scale in the EU. However, there may also be an element of policy induced overexpansion of agriculture in the CEECs, related to the particular role which agriculture was made to play under the centrally planned system to provide abundant supplies to meet local needs. This policy induced feature may be particularly apparent in the high share of agriculture in overall employment. To the extent that there was indeed overexpansion of agriculture in the past, the CEECs are likely to see a "natural" decline of the relative importance of their agricultural sectors in future, in particular a reduction in employment opportunities in agriculture. Some part of the difficult and painful process of structural adjustment from which CEEC agriculture is now suffering may be due to precisely this factor. This has important implications for future policies, as will be discussed below. However, independent of future trends, the fact that agriculture is still such an important sector

in the CEECs makes it important to think very carefully about the role of agriculture within the overall society and economy in Central Europe when it comes to preparing for CEEC accession to the EU.

**Table 2.1: Share of Agriculture in Total GDP and Employment, 1991**

	Share of agriculture in	
	GDP	Employment
Bulgaria	15.0 %	19.0 %
Czech Republic	7.4 %	8.2 %
Hungary	9.9 %	15.8 %
Poland	6.2 %	27.3 %
Romania	19.0 %	28.9 %
Slovak Republic	6.6 %	11.0 %
EU-12	2.8 %	6.2 %
Portugal	4.7 %	17.5 %
Greece	16.1 %	21.5 %
Ireland	8.1 %	13.8 %

Source: Jackson and Swinnen (1994) for CEEC; European Commission (1993) for the EU.

CEEC agriculture is large not only relative to other sectors in CEEC economies, it is also large relative to agriculture in the EU-12. As shown in Table 2.2, depending on the indicator chosen, the size of CEEC agriculture is roughly one third of the size of EU-12 agriculture. In other words, if all six CEECs were to join the Union now, the importance of agricultural issues would increase substantially. On the other hand, given the still low level of overall income in the CEECs, the size of the overall economy of the EU would grow by only slightly more than three per cent if the six CEECs were to join the Union now. Hence, when they accede to the Union, the CEECs enlarge EU agriculture much more than they enlarge the overall economy in the EU. A very obvious implication is that in the EU the agricultural consequences of Eastern enlargement require priority consideration.

## 2.2 Transition Problems

However, any debate about the future of agriculture in the CEECs is enormously complicated by the fundamental changes through which CEEC agriculture is going since the beginning of the transition process. Of course, change is taking place everywhere in the CEECs. Yet, it may appear on the surface that agriculture is one of those sectors where

adjustments are particularly severe in the process of transformation, and that this is the case in essentially all CEECs. One of the many indications of this fundamental process of adjustment in CEEC agriculture is the pronounced decline of agricultural output which has occurred in all CEECs, as illustrated in Graph 2.1. The drop in output has varied among different products, but has generally been most pronounced for livestock products.<sup>1</sup>

**Table 2.2: The Size of Agriculture in the Six CEECs Relative to the EU-12, 1993**

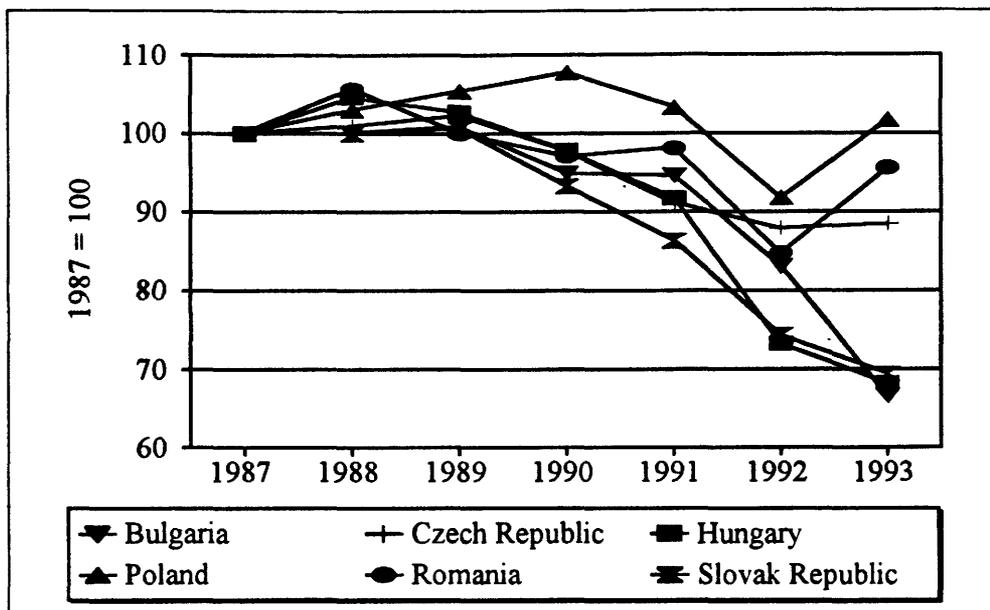
Indicator	CEEC-6 as per cent of EU-12
Arable land	37.6 %
Employment	112.2 %
Cereals production	37.2 %
Pork production	31.0 %
Milk production	23.0 %
Beef production	15.4 %
Overall GDP	3.5 %

Sources: OECD (1994c); ZMP (1994); European Commission (1993).

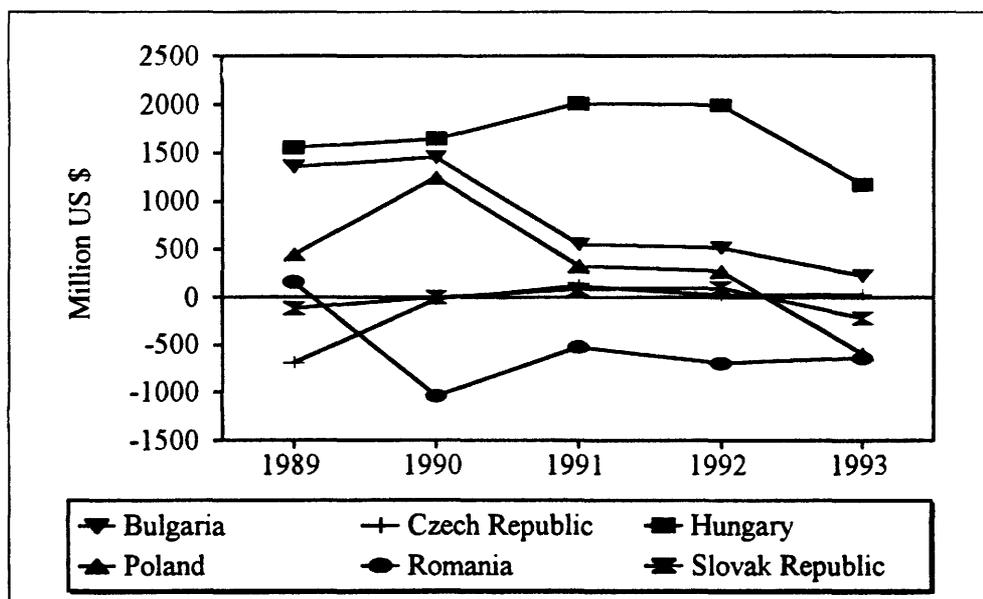
At the same time, exports of agricultural and food products have decreased, and imports have increased. To some extent this was a corollary of the decline in agricultural output, though domestic consumption of agricultural products has also declined during transition. In any case, weak export performance and rising imports have tended to result in a worsening of the balance of trade in agricultural and food products in most of the CEECs (see Graph 2.2).

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<sup>1</sup> The reasons for the more pronounced decline of livestock production are discussed by Jackson and Swinnen (1994), pp. 57ff.

**Graph 2.1: Gross Agricultural Output in the CEECs During Transition**

Source: Jackson and Swinnen (1994)

**Graph 2.2: Trade Balance (Export Value minus Import Value) in Agricultural and Food Products for the CEECs**

Source: Jackson and Swinnen (1994)

This study cannot provide a detailed analysis of the many factors which have been behind the downturn in agricultural production in the transition economies.<sup>2</sup> However, some of the more important elements of the adjustment process going on in CEEC agriculture must be mentioned in order to prepare the ground for a discussion of prospects for the future, and of the policies which may help to prepare for accession to the EU by the CEECs. The major factors to be considered here can be grouped in the five categories of privatization and restructuring; decreasing agricultural policy support; decline in market demand for agricultural products; difficulties in upstream and downstream sectors; and problems with financing agricultural activities. In addition, weather played a role.

The structure of agriculture has differed widely among the CEECs, with respect to farm sizes, property rights, management organization, and division of labour among different types of farms. As a result of these different starting conditions, but also due to different political priorities in the transition process, privatization and restructuring have been pursued along different lines in the individual CEECs. For example, because most of agriculture had never been collectivized in Poland, privatization and restructuring means something completely different in Polish agriculture from what it means in Romania where essentially no private agriculture had remained after collectivization. As another example, physical restitution of land to previous owners in Bulgaria is a process very much different from the Hungarian approach of auctioning land to, among others, holders of coupons denominated in traditional gold crowns. However, in spite of the rather different approaches to privatization and restructuring adopted, the process of fundamental structural change has, wherever it occurred, made it difficult if not impossible to continue production along traditional lines. Farms have been physically split; boundaries of fields were redrawn; acreage traditionally used to produce feed has been separated from livestock herds; barns could not easily be subdivided when land was returned to previous owners; farm assets were sold or distributed; old farm managers were sacked and new ones did not always have the same knowledge and experience; on the other hand, where farm managers from the old period continued to operate the farm, they were not always prepared to cooperate friendly with the new owners; ownership of land and assets remained unclear in many cases; members of collectives needed to find agreement on how to proceed; etc. . It cannot come as a surprise that output should decline in an agricultural sector which has to undergo so far reaching structural change, involving so many uncertainties.

At the same time, governments of countries in Central Europe were persuaded to reduce agricultural support and protection drastically, as part of their efforts to achieve macro-

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<sup>2</sup> For a more detailed discussion of the fundamental changes going on in agriculture during the transition process and in particular of the reasons for the decline in agricultural output see Jackson and Swinnen (1994) and the references cited there.

economic stabilization. For example, as an aggregate measure of government support to agriculture, the producer subsidy equivalent (PSE) in Hungary's agriculture had been 34 per cent of the value of agricultural production in 1988, and was reduced to 8 per cent in 1992.<sup>3</sup> In Poland, the PSE declined from 24 in 1988 to 16 in 1993.<sup>4</sup> With this decline in government support, incentives to produce weakened.

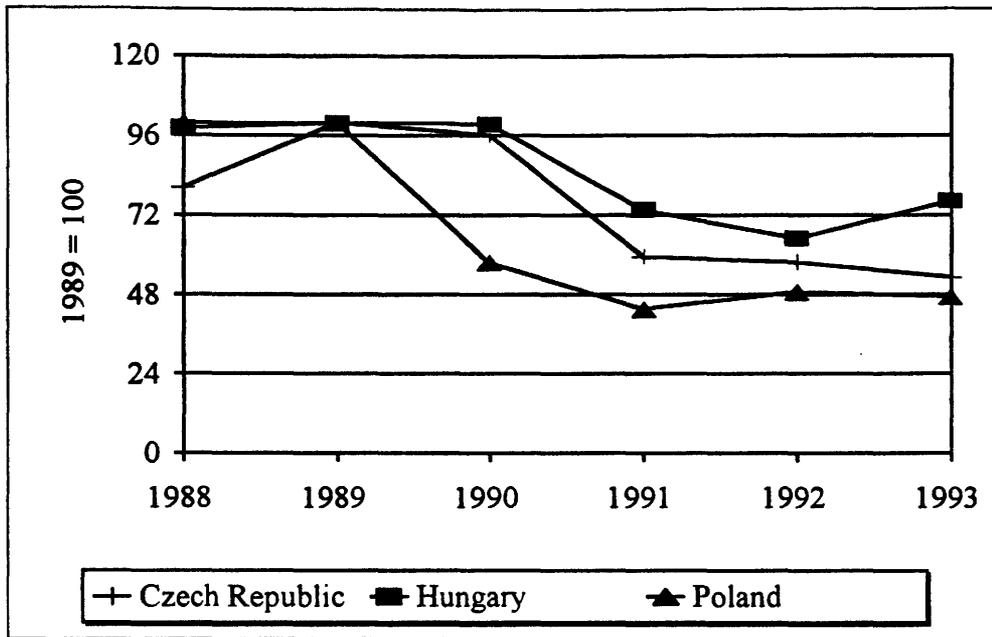
Structural change and declining government support were accompanied by a dramatic drop in demand for agricultural products in the CEECs. Domestic food consumers were hit by rising food prices as governments eliminated the huge food subsidies which used to be a general feature of policies in the CEECs. At the same time, cuts in other subsidies, overall inflation and rising unemployment reduced real consumer incomes in general, and added to the drop in food demand. Moreover, new consumer products became available on markets in the CEECs, and attracted consumer expenditure, away from food expenditure. In some cases, it became a fashion to consume processed foods from Western Europe, rather than domestically produced foods. On top of this decline in domestic demand came the breakdown of the CMEA, and the resulting drop in agricultural exports to other countries in Eastern Europe, and in particular to the former Soviet Union. This large decline in both domestic and export demand for agricultural products in the CEECs added to the reduction in government support, and resulted in a pronounced downturn of agricultural producer prices, relative to other prices in the CEEC economies (see Graph 2.3). There is no doubt that this decline in real producer prices exerted significant economic pressure on CEEC agriculture, and discouraged production.

Moreover, a number of economic difficulties in upstream and downstream industries around agriculture added to the problems faced by farmers in the CEECs. In the past, many of these industries had been allowed to operate at low levels of efficiency, and to produce inferior qualities. Under soft budget constraints (i.e. government coverage for financial losses), there was not much of an incentive to avoid technical and economic inefficiencies. Marketing efforts were not really required of food industries operating essentially like state agencies, often in monopoly structures. Outdated equipment and lack of concern for consumer preferences got into the way of producing better qualities. When privatization and restructuring of the input and food industries began, efficiency, market orientation and quality could not be expected to improve overnight. Indeed, this process is far from over. Though progress differs significantly among the CEECs, privatization of the food and input industries is far from being complete.

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<sup>3</sup> OECD (1994a), p. 192.

<sup>4</sup> OECD (1994b), Annex 1, p. 70.

**Graph 2.3: Real Producer Prices<sup>a)</sup> in CEEC Agriculture**

<sup>a)</sup> Producer prices relative to the overall consumer price index.  
Sources: National statistics.

In many cases, "privatization" has so far meant to change the legal status of the companies concerned (e.g. to joint stock format), but not yet to sell the shares to private owners. In some cases, public monopolies have been turned into private monopolies. Improvement of technical efficiency and product quality often requires new investments, which is difficult to finance in a fragile market situation. All this is not to say that remarkable progress has not been made anywhere. In some cases, successful enterprises have been created, which begin to operate competitively even on international markets. In many instances, foreign investors have entered the food and input industries, bringing all their know how, technology and capital. However, on aggregate the food and agricultural input industry in the CEECs still needs time to become competitive by international comparison. Until that time, processing and marketing margins in the food industry of the CEECs are higher than in Western countries, and qualities produced have difficulties competing successfully. As a result, prices received by farmers are less than what they could be. At the same time, input industries working below optimal efficiency charge farmers more than necessary in the long run. As another element of the upstream and downstream sector, market infrastructure, market institutions, price information etc. are still far from being fully developed, and this adds to farmers' difficulties with selling their products at attractive prices.

Finally, agricultural credit and finance is still a serious bottleneck in the CEECs. To some extent the credit problem is a generic feature in economies with high rates of inflation, with

governments hard-pressed to engage in macro-economic stabilization, and with a banking system which lacks the traditions, experiences, managerial capacities and infrastructure existing in market economies. In agriculture, however, these difficulties are reinforced by at least two additional factors. With privatization not yet completed and serious administrative difficulties in land registration and issuing titles, there are still uncertainties regarding property rights in agriculture. New land owners often have difficulties proving their ownership, and land markets are only beginning to emerge. As a consequence in many cases collateral cannot effectively be used to underpin credit in agriculture. Moreover, with many new small farms coming into existence, the old infrastructure of banks is often insufficient to deal with this new clientele. These specific difficulties in agriculture combine to make banks often reluctant to engage more thoroughly in giving credit to farmers. The result is a serious shortage of finance in agriculture, such that farmers find it difficult to finance current inputs and investments.

In addition to these transition factors, recent changes in agricultural output of the CEECs have been affected by weather. 1992 was a drought year for most CEECs, and crop production, in particular output of cereals, has been below "normal" levels. In 1993 (and also in 1994), Hungary and the Slovak Republic have again suffered from a serious drought.

Given all these difficulties in CEEC agriculture it cannot come as a surprise that there was a significant decline in agricultural output since the transition process began. Also, as the process of transformation is far from being completed, there are more difficulties ahead, and it is not inconceivable that output of some agricultural products in some of the CEECs may further decline for some time. For an analysis of the implications of future accession to the EU, however, one important question is whether the new lower level of agricultural activity in the CEECs is likely to be typical of the agricultural potential in the CEECs or whether there is a probability that output may increase again. If the CEECs should turn out not to have dynamic agricultural sectors with potential for substantial growth of output, then the agricultural implications of eastern enlargement of the EU would be much less dramatic.

### **2.3 Potential for Growth**

In order to get a better impression of the future agricultural potential of the CEECs it is useful to make an attempt at interpreting the recent decline of agricultural output in these countries, trying to understand whether the factors which may explain that decline are likely to be permanent or transitory. However, before asking that question it is necessary to put developments in agriculture in perspective by comparing them to what has happened in the rest of CEEC economies. After all, transition has affected all sectors severely, and fundamental changes are going on everywhere in the CEECs. As a result of the adjustments taking place,

and in the new macro-economic climate which characterizes the CEECs, output has dropped in essentially all sectors of the CEECs.

Surprising as it may be given the large decline in agricultural output, agriculture has fared relatively well in this process. In particular, industrial output has fallen even more than output in agriculture, in most of the CEECs. As shown in Graph 2.4, from 1989 to 1993 agricultural output rose relative to industrial output in all six CEECs, with the exception of Hungary in 1993. Indeed, in some cases relative agricultural output is now fifty per cent or more above what it used to be. From this perspective it appears that agriculture in the CEECs has proven a remarkably robust sector, buffering the forces of fundamental change more successfully than industry. This relative success in agriculture can be interpreted as an indication of strength and stability in CEEC agriculture, providing a good base for future recovery.

Moreover, because of the possibility of statistical errors in both the pre-transition period (when output was probably over-reported) and the post-transition period (where output is probably under-reported), the absolute decline of agricultural output may in reality have been less than official statistics suggest.<sup>5</sup> Of course, such statistical errors are likely to affect reported industrial production as well, and it is probably impossible at this time to say whether the relative performance of agriculture in comparison with, say, industrial output was better or worse than official statistics suggest. In any case, developments in CEEC agriculture during transition have probably been less dramatic than the absolute decline in recorded agricultural output would suggest.

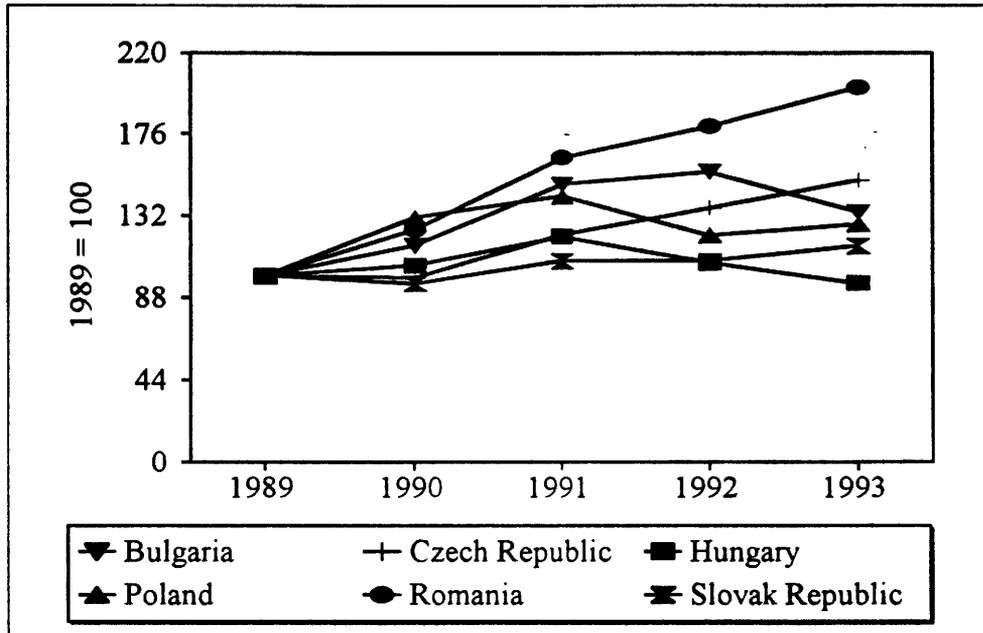
Factors behind recent CEEC agricultural developments which are clearly transitory in nature are those directly related to changes in the structure of enterprises resulting from transition to a private market economy. Privatization and restructuring, both in agriculture and in the upstream and downstream sectors, will at some stage be completed. It will take some time until this is achieved, and the speed of this process will differ significantly among individual CEECs. It is difficult to make any projections of the time it will take to complete transition in any individual country, not the least because the political process behind transition is far from linear. However, at some stage the dust of transition will settle, and a privatized and restructured agricultural sector and agro-industry will have emerged. With new enterprise structures, with enhanced human capital among the new entrepreneurs, and with a more productive physical capital stock there is a real chance that output will be higher, product qualities will be better and marketing will be more successful. Western countries, and in

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<sup>5</sup> See the enlightening discussion of this issue in Jackson and Swinnen (1994).

particular the EU can do a lot, and probably more than is already being done, to speed up this process.

**Graph 2.4: Gross Agricultural Output Relative to Industrial Output in the CEECs**



Sources: Jackson and Swinnen (1994); OECD, Short Term Economic Indicators Transition Economies, var. issues.

At the same time, as ownership patterns become clearer in agriculture and as property rights are settled and clearly documented, incentives to engage more effectively in agricultural activities, to improve production technologies and to make investments will strengthen. Also, with better defined, documented and enforceable property rights there are improved opportunities for financing agricultural activities and investments. In parallel with this process, the structure of the banking sector will improve, and rural credit will be more easily available. Lower rates of inflation and a more secure macro-economic climate will make it easier to take investment decisions. An improved marketing infrastructure, better market transparency and more easily accessible market information will make it easier to gear agricultural production to market conditions. This will eliminate some of the need to invest activities into unproductive search procedures on not yet fully functioning markets. With better product qualities and more experience in marketing, the food industry in the CEECs will be better able to compete with imports, and be more successful on export markets. At the same time, improved efficiency in upstream and downstream industries will allow for lower marketing and processing margins in these sectors, and some resulting economic gains will materialize in the form of better sectoral terms of trade for farmers in the CEECs.

How market demand for CEEC agricultural output will develop is less clear. The decline in domestic food consumption which occurred during transition may turn out to be a permanent feature. Food consumption in the CEECs prior to transition was high relative to food consumption in Western countries at comparable levels of living standards. Clearly, with rising consumer incomes there will again be some growth in food consumption. However, this demand growth may concentrate on products which are not primarily produced in the CEECs, such as tropical fruit and beverages, and highest quality dairy products. Moreover, the change in price relativities resulting from de-subsidization in the food sector is likely to be permanent, leaving prices of livestock products high relative to those of food products based on crops.<sup>6</sup> Hence there may be only limited growth of domestic demand in the CEECs. Future demand on export markets may be equally limited. Agricultural trade among the CEECs will be constrained as long as tariff barriers among them remain as high as they are currently. Exports to countries of the former Soviet Union have already begun to recover somewhat, and what used to be mainly barter trade immediately after the breakdown of the CMEA is gradually being transacted in convertible currencies again. However, given the massive economic difficulties in nearly all of the CIS, prospects for agricultural exports to that region may not be very promising for some time to come. Potentially attractive markets for agricultural exports from the CEECs exist in the EU. The extent to which the CEECs will find these markets accessible depends entirely on future EU trade policies under the Europe Agreements, and on the CAP in general. Some major issues in this area will be discussed below.

A factor which, at least at first glance, appears permanent, rather than transitory, is the massive decline in agricultural support which occurred during transition in the CEECs. However, even in this regard the situation is less clear-cut than some analyses would suggest, for at least two reasons. First, it is not really clear to what extent agriculture was indeed subsidized under the old regime, and hence whether the apparent decline in government support to CEEC agriculture during transition was really as pronounced as sometimes stated. The major empirical basis on which it has been argued that agriculture was supported before transition, and is much less supported now, are estimates of producer subsidy equivalents (PSEs) for the CEECs which have been produced by various institutions. These estimates, carefully as they may have been made, are potentially subject to various methodological problems when applied to non-market economies, and their results must therefore be interpreted with much caution.<sup>7</sup> Second, after the rather low levels of agricultural support and protection to which the CEECs have moved at the beginning of the transition process, higher levels of import protection and an increasing number of domestic support measures have later been

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<sup>6</sup> See Jackson and Swinnen (1994), pp. 43 ff.

<sup>7</sup> See Jackson and Swinnen (1994), pp. 51 ff, and Tangermann (1993b).

introduced at least in the Visegrad countries, and most recent developments indicated that this process has not yet come to a halt.<sup>8</sup>

How the process of agricultural policy making in the CEECs may evolve in the future will be one of the main topics for the rest of this study. Expectations regarding accession to the EU, and preparations for adopting the CAP after accession, will be among the major driving forces in this process. Whether agricultural policies in the CEECs will eventually be characterized by high support and tight protection, or whether agriculture in the CEECs will continue to operate under moderate levels of support and protection will not the least depend on the signals the EU sends to the CEECs. These signals will therefore also determine the rates of future output growth in CEEC agriculture.

In spite of all the difficulties faced by agriculture in the CEECs, and partly because of these current difficulties, there is reason to believe that the CEECs have a good potential for agricultural growth. The decline in CEEC agricultural output during transition, to the extent that it has really occurred, can well be explained by the dramatic turbulence through which the CEECs have endured in the last five years. This turbulence has shaken the foundations of the production system during the early stages of transition, and it is still far from being over. What is surprising is not so much the decline in agricultural production which may have taken place in this period, but the fact that this decline was not even more pronounced. Relative to industrial production in the CEECs, agriculture has done remarkable well, and compared with what might have happened in the more sophisticated and therefore possibly less robust agricultural systems of Western countries under a similar stress, CEEC agriculture has so far proven rather strong. Once more stable conditions can be created, both institutionally in the agricultural sector and economically in the rest of the economy, there is a potential for growing levels of production in CEEC agriculture. This is not to say that assistance is not needed in CEEC agriculture. There is certainly a lot that can be done to make it easier for farmers in the CEECs to use their productive potential. However, once that potential is better used, much care must be devoted to finding a proper answer to the question of how much support and protection should be granted to CEEC agriculture. This question is important for the CEECs from their own domestic perspective. However, it is also extremely important from the perspective of finding an appropriate balance between Eastern and Western Europe when it comes to integrating the CEEC agriculture with that of the EU.

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<sup>8</sup> See for example OECD (1994c) and Münch (1994).

### 3 Priorities and Constraints for Agricultural Policies in the CEECs

Given all the stress which agriculture in the CEECs has had to survive since transition began, and in view of the economic difficulties farmers in the CEECs are still facing it is tempting to argue that one of the major tasks for agricultural policies in the CEECs is now to provide some stability and support for agriculture, and to make sure that low-price imports which other countries have dumped on the world market cannot make life even more difficult for domestic farmers. Indeed, this is what agricultural policies in some CEECs have begun to do, in particular in the Visegrad countries.

Levels of support and protection in agriculture now differ noticeably among the CEECs. On average, agricultural support in the CEECs is still low compared with the EU and many other Western countries. However, it has been on the increase in recent years, after it had generally been rather low at the beginning of the transformation process. There are significant pressures on governments in the CEECs, stemming from their agricultural constituencies, to raise the level of protection and support. As in other countries, CEEC governments do not always find it easy to resist these pressures, and they have repeatedly given in to them. This process has started as early as 1991 (with the introduction, e.g., of higher tariffs in Poland). More recently, market regimes have been institutionalized for some agricultural products in some CEECs, and it has frequently been observed that some CEECs are about to introduce "CAP-like" policies. This process is still continuing. Instances of most recent increases in levels of protection are the introduction of extra import levies (somewhat misleadingly referred to as "countervailing duties") on a number of agricultural products in Poland in summer 1994, and the significant increase in import duties on 279 agricultural and food items in Hungary on November 1, 1994.<sup>9</sup>

As a result of this process of raising support and protection in agriculture, some CEECs now have a more or less comprehensive system of agricultural market and trade policies in place. This is particularly true for the Visegrad countries. For core agricultural products they all have some form of more or less rigid price guarantees, generally implemented through some variant of intervention buying. For a surprisingly large number of agricultural products there is now the possibility, occasionally used in practice, to grant export subsidies. Tariffs on agricultural imports have generally been raised in recent years, and have in some cases been

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<sup>9</sup> These new higher tariffs introduced by Hungary, on items where tariffs were previously not yet bound in the GATT, are identical to those which Hungary has bound under the Uruguay Round Agreement on Agriculture. In other words, rather than introducing these tariffs on January 1, 1995 (the beginning of the implementation period under the Uruguay Round Agreement), Hungary has brought the introduction of these tariffs forward by two months.

complemented by additional charges which in part can be, and have been, varied over time so as to allow defence of a given level of domestic market prices even if world prices fluctuate.

In this situation there is, at least for the Visegrad countries, no need to argue that these countries should now begin to establish some form of market price stabilization.<sup>10</sup> This has already happened. Moreover, the level of price support granted in the Visegrad countries is such that it already exceeds the level recommended by some authors, based on what they believe are "hard core" production costs.<sup>11</sup> As can be seen from Table 3.1, intervention prices (or their equivalents, i.e. some form of more or less rigid price guarantee) for wheat in the Visegrad countries, while being below the EU level, are generally around the level of 100 US \$ per ton, except in the case of Hungary where they are in the order of magnitude of 90 US \$ per ton.<sup>12</sup>

Wheat is not the only product where price stabilization already takes place in the Visegrad countries. As summarized in Table 3.2, various major agricultural products are covered by some form of domestic market interventions and trade policies in the Visegrad countries, all of which are intended to stabilize, if not support, domestic market prices and protect domestic producers against foreign competition.<sup>13</sup>

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<sup>10</sup> This is the main argument behind the recommendations of Nallet and van Stolk (1994).

<sup>11</sup> Nallet and van Stolk (1994) suggest that "hard core" costs of cereal production in the CEECs are 75 to 85 US \$ per ton (p. 13), and use a figure of 85 US \$ per ton in their illustrative example of a price support system for cereals in the CEECs. No sources are given for this estimate, nor is reference made to the well known difficulties of estimating production costs.

<sup>12</sup> "Intervention prices" as given in this table are not strictly comparable across countries, for a number of reasons. For example, in Hungary the "guaranteed" price is guaranteed only for a given maximum production per farm (2.4 tons per hectare). Also, while the intervention price in the EU is granted at the wholesale level, "intervention prices" in the Visegrad countries are generally "guaranteed" at the farm gate level.

<sup>13</sup> By necessity, the extremely abbreviated summary of agricultural market and trade policies pursued in the Visegrad countries presented in this table misses many details, and uses expressions which are not always a good description of the actual policy implementation. For example, the term "intervention buying" does not really mean the same thing in the CEECs as it means in the EU.

**Table 3.1: Intervention Prices (or their Equivalents) for Wheat in the Visegrad Countries and the EU**

	Intervention Price in US \$ per ton		
	1992/93	1993/94	1994/95
Czech Republic	104	100	108
Slovak Republic	104	n.a.	n.a.
Hungary	-	84	86
Poland	99	108	107
EU	256	166	158
World Market Price (f.o.b. Hungary)	104	n.a.	n.a.

Sources: OECD (1994a and 1994c); East Europe Agriculture and Food, var. issues; Münch (1994), IMF, var. issues.

The situation is different in Bulgaria and Romania, where prices of many agricultural products are still very low. In these two countries, there are still export restrictions in place for some products, such that domestic market prices are kept below the international market level.

Given this situation, the issue is not whether the Visegrad countries should introduce some form of price stabilization, but rather how they should manage their existing market and trade policies in the future, and whether they should continue to raise the level of support and protection in agriculture as they have done in recent years. To some extent one can understand the political pressures that are being brought to bear on agricultural policy makers in the CEECs, and also the way in which they have responded to these pressures. However, it would be good to have an idea of the extent to which the more recent adjustments which some CEECs have made to their agricultural policies are based on a longer run strategy. Such a strategy should be based on a clear view of the priorities for future economic developments in the countries concerned, and it has to take account of the constraints under which agricultural policies can be pursued.

**Table 3.2: Nature of Domestic Market Interventions and Trade Policies for Selected Agricultural Products in the Visegrad Countries, 1993-94**

Product	Policies	Poland	Hungary	Czech Republic
Wheat	domestic measures	intervention buying at predetermined prices	intervention buying at predetermined prices, limited quantity per ha	intervention buying at predetermined prices
	trade measures	<i>ad valorem</i> tariff, occasionally adjusted, <i>de facto</i> export subsidies	<i>ad valorem</i> tariff, restrictive export licensing, export subsidies <sup>a)</sup>	<i>ad valorem</i> tariff, export subsidies
Coarse grains	domestic measures	intervention buying at predetermined prices (rye)	intervention buying at predetermined prices, limited quantity per ha (corn)	-
	trade measures	<i>ad valorem</i> tariff occasional adjusted, <i>de facto</i> export subsidies	<i>ad valorem</i> tariff, restrictive export licensing, export subsidies <sup>a)</sup>	<i>ad valorem</i> tariff
Oilseeds	domestic measures		intervention buying	-
	trade measures	<i>ad valorem</i> tariff, occasionally adjusted	<i>ad valorem</i> tariff, restrictive export licensing, export subsidies	<i>ad valorem</i> tariff plus specific tariff, occasionally adjusted
Sugar	domestic measures	intervention buying at predetermined prices	intervention buying	intervention buying at predetermined prices
	trade measures	<i>ad valorem</i> tariff, minimum import price, export subsidies	<i>ad valorem</i> tariff, export subsidies	<i>ad valorem</i> tariff, export subsidies
Milk	domestic measures	guaranteed minimum price at farmgate level, intervention buying at predetermined prices of butter and skimmed milk powder	guaranteed minimum prices at farmgate level, intervention buying at predetermined prices of butter and skimmed milk powder	guaranteed minimum price at farmgate level, intervention buying at predetermined prices of butter, whole and skimmed milk powder, some cheeses and casein
	trade measures	<i>ad valorem</i> tariffs for dairy products, import licensing of butter, minimum import price of butter and skimmed milk powder, <i>de facto</i> export subsidies (butter)	<i>ad valorem</i> tariffs for dairy products, restrictive import licensing for dairy products, export subsidies	<i>ad valorem</i> tariffs, for butter plus specific tariff, occasionally adjusted, export subsidies
Beef	domestic measures	-	occasional intervention buying at predetermined prices	intervention buying at predetermined prices
	trade measures	<i>ad valorem</i> tariff	<i>ad valorem</i> tariff, restrictive export licensing, export subsidies	<i>ad valorem</i> tariffs plus specific tariff, occasionally adjusted, export subsidies
Pork	domestic measures	occasionally intervention buying	occasional intervention buying at predetermined prices	occasional intervention buying at predetermined prices
	trade measures	<i>ad valorem</i> tariff, occasionally adjusted	<i>ad valorem</i> tariff, restrictive export licensing, export subsidies	<i>ad valorem</i> tariff, export subsidies

<sup>a)</sup> Export subsidies can be granted, though this has not yet happened

Source: Münch (1994)

An important consideration in this context regards the position which agriculture should be given in the overall economy and society. Policy support for any individual sector requires resources which have to be earned somewhere in the economy. This insight is well founded in economic theory and empirical research, and there is now a large and growing body of evidence, resulting from general equilibrium analysis, which clearly demonstrates these economic linkages across sectors. If one particular sector is granted more than average support, this necessarily imposes an economic burden on other parts of the economy.

There can be a number of reasons why specific policy support to individual sectors may be justified. In particular, if it should be the case that agriculture suffers more during transition than other sectors in the economy, then there may be a reason to argue that support for agriculture is justified. For example, if structural changes during transition are more severe in agriculture than on average in the rest of the economy, then it may be necessary to help agriculture to create a healthier base for future economic success, allowing farmers to compete on an equal footing with other sectors of the economy once the dust of transition has settled. However, it is doubtful whether there is a good empirical base for this argument in the CEECs. As shown above (Chapter 2), agriculture in the CEECs, in spite of all the difficulties it is facing, has suffered less of a decline in output than industry. Against this background one has to consider that any above average support granted to agriculture makes recovery more difficult for the rest of the economy.

Looked at from another perspective one could ask whether agriculture in the CEECs is likely to have a comparative advantage, and whether there is reason to believe that governments need to assist farmers in their efforts to make effective use of that comparative advantage. Some of the views advanced in Chapter 2 above may appear to suggest that agriculture in the CEECs has a potential comparative advantage. In particular, the expectation, expressed above, that there is a good potential for a growing agricultural output in the CEECs could be interpreted as suggesting that agriculture can develop into a particularly successful sector in the CEECs. However, this interpretation is not really warranted. There may well be reason to believe that there is potential for an absolute increase of agricultural output in the CEECs, but this does not necessarily say that agriculture has a comparative advantage over other sectors of the economy. As a matter of fact, at this stage it is extremely difficult to analyze the comparative advantage of individual sectors in the CEECs empirically. As a result of the structural changes going on, productivity is changing in all sectors of the CEEC economies, and it is hard to say by how much they are likely to change in which sectors. Once transition is completed the picture will become much clearer, but until that time any forecast of comparative advantages for individual sectors is largely a matter of speculation.

More fundamentally, though, the question has to be asked what governments can do, if anything at all, in order to assist individual branches of the economy to develop their potential fully. Overall policy support to a given sector is not really the answer, and it may make things worse rather than better. In particular, price support and protection against competition from foreign producers is likely to be counterproductive in this context. Western industrialized countries have learned this lesson the hard way. Price support for agriculture and policies which shield domestic farmers against competition from abroad has helped agriculture in many Western countries to maintain a structure which lacks international competitiveness. The result has been a vicious circle of low competitiveness, consequent requests for more government assistance to farmers, and even less competitiveness maintained in the cosy world of domestic support and market protection. Only recently have governments of western countries begun to recognize the fallacy of their past agricultural policy approaches, and they are now involved in the painful process of retreating gradually from misconceived policies. Agricultural policy reforms which are now being implemented in many western countries provide ample evidence.

The CEECs are still in a position to avoid such policy errors. Levels of support and protection in these countries are still low compared with the policies from which western countries are trying to evolve. More support and protection for farmers in the CEECs may appear to make it easier for them to get over their current economic and financial stress. However, not only would such a policy impose a burden on the rest of the economies of the CEECs. By delaying adjustments which anyhow cannot be avoided in the longer run, such an agricultural policy approach would also reduce the chances of the CEECs creating a competitive agricultural sector. Whatever the future political and economic context may be in which CEEC agriculture has to operate, one of the most important priorities for CEEC agricultural policies should be to gain, retain and improve competitiveness in agriculture, both vis-à-vis farmers in other countries and vis-à-vis other sectors in the domestic economy. The foundations for that competitiveness, or the lack of it, are being laid during the current process of adjusting to the new conditions created in the transition process. Any policy error made at this time is bound to have serious implications for the future.

Another important priority for the CEECs is to develop a competitive food industry. In developed western economies, the food industry is economically much more significant than agriculture, measured in terms of its contribution to GDP and employment. Hence in policy-making the food industry should be given at least as much attention as agriculture, though this has not traditionally been the case in many countries. Moreover, a competitive food industry is one of the major prerequisites for the development of a healthy agricultural sector. After all, most of what farmers produce has to go through the food industry before it reaches the market place. If the food industry in a given country is not internationally competitive, farmers in that country find it difficult to compete with farmers in the rest of the world. On the

other hand, government policies geared to affecting the situation at the farm level unavoidably have implications for the food industry. High price support for farmers makes life more difficult for the food industry. Western countries have therefore often felt forced to complement their agricultural policies with compensating measures for the food industry. The EU's elaborate system of import levies, export subsidies and domestic aids for the food industry, to compensate it for high raw material costs in the EU, is a telling example. However sophisticated such a compensating policy system for the food industry, it is bound to result in distortions in that sector, making enterprises in the food industry either secondary beneficiaries or victims of agricultural policy support. Governments in the CEECs may want to avoid falling in that same trap.

Competitiveness, in both agriculture and agro-industry, is a policy priority with a long-run perspective. However, there are also important concerns of a more immediately pressing nature in CEEC agriculture. Agricultural markets in the CEECs have occasionally exhibited rather wide price fluctuations, both over time and across regions. Some farms are suffering from economic and financial stress as a result of the downturn in real producer prices during transition. As a consequence, real incomes of farmers and farm workers have declined, sometimes substantially. Many agricultural enterprises in the CEECs carry a heavy burden of indebtedness. In some of the CEECs there is high overall unemployment, in both urban and rural regions. In a rapidly changing institutional and economic environment, there is the threat that rural communities may lose their coherence. There are cases where environmental problems have accumulated and where solutions to these problems have to be sought urgently. These are only some of the more pressing immediate concerns which agricultural policies are facing in the CEECs. In a situation like that, policy priorities can not only reflect longer run requirements, but they also have to take account of the need to create political and economic stability, to avoid social hardship and to keep social structures intact.

While it is easy to agree to such priorities, it is much more difficult to design the appropriate policy responses. There are two major trade-offs which need to be considered. First, most policy measures which try to respond to an immediately pressing economic and social problem in one particular sector of the economy and society involve a fair amount of income redistribution among sectors. For example, measures designed to improve social conditions in agriculture in the short run, i.e. not leaving farm income improvements to originate from higher productivity in the farming industry, tend to tackle the perceived social problem in agriculture at the expense of incomes in the rest of society. It is an optical illusion to believe that incomes in one sector can, in the short run, be improved through policies which

do not lower incomes in other sectors.<sup>14</sup> In order to be fully acceptable, such policies have to pass the test of social equity across the whole nation. Second, there is often a very real trade-off between short run improvements and longer run problems created by the policies concerned. For example, attempts at improving economic conditions in agriculture through credit subsidies involve the danger that investments are made whose productivity is less than it could be from other uses of capital in the economy, both in agriculture and in other sectors. As a result, credit subsidies run the very real danger of reducing productivity in the longer run.

These comments are not meant to say that there is nothing which can be done to tackle some of the immediate problems. However, it is necessary to design such policies with a clear view of the overall and the longer run priorities for the CEECs. Typically this means that optimal policies meant to respond to immediately pressing problems should not include measures which interfere heavily with market forces. Moreover, it is advisable to make these policies consistent with the longer run orientation of market and trade policies for agriculture in the CEECs. It is for these reasons that the next few Chapters of this study will concentrate on agricultural market and trade policies in the CEECs, having their longer run aim of acceding to the EU in mind. Policies for the more immediate future will be discussed later (in Chapter 8).

With all these priorities for future agricultural policies in the CEECs in mind, what are some of the major constraints under which these policies must be pursued? To some extent these constraints result from the priorities for other sectors of the CEEC economies. One important consideration in this regard is the burden which food consumers have to bear. Food consumption still makes up for a relatively large share of total consumer expenditure in the CEECs, for the average consumer one quarter in Hungary, around one third in Bulgaria, the Czech Republic and Poland, and as much as 58 per cent in Romania.<sup>15</sup> For low income consumers, the shares are substantially higher. For example, households of pensioners in Poland are spending more than 60 per cent of their incomes on food consumption.<sup>16</sup> With such high shares of consumer expenditure going to food, and with serious social problems among

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<sup>14</sup> For example, import tariffs, which may improve the income situation among producers competing with low priced imports, reduce real incomes of consumers and of producers in other sectors of the economy. In a small economy which cannot influence world market prices it would be wrong to think that tariffs redistribute incomes away from foreign producers towards domestic producers in the protected sector. The political attractiveness of introducing higher tariffs results from the fact that income reductions among users of the products concerned are thinly spread over a large number of individuals and therefore less noticeable, while income improvements for producers of the products concerned are more concentrated on a smaller number of people and therefore more visible.

<sup>15</sup> Jackson and Swinnen (1994), p. 39.

<sup>16</sup> Glwony Urazad Statystyczny (1993).

low-income urban households, there is an obvious constraint to the level of food prices in the CEECs.

Another constraint on agricultural policies results from the need for macro-economic stabilization. Inflation is still a serious problem in some of the CEECs, and policy measures which lead to higher prices in any individual sector tend to conflict with the overall aim of reducing rates of inflation. At the same time, CEEC governments need to keep their public budget deficits under control in order to stabilize macro-economic developments. They have made serious efforts to do so, and de-subsidization in food and agriculture has been an important element of these efforts. On the other hand, more recently there has again been an increase in public expenditure on agricultural policies in some of the CEECs. For example, in Hungary total budgetary outlay on agricultural and food policies in 1988 amounted to six per cent of GDP. By 1992 that expenditure had decreased to merely one per cent of GDP. In 1993, however, it increased again to two per cent of GDP, and planned expenditure for 1994 amounts to two per cent of GDP as well.<sup>17</sup> The more urgent the need is to secure macro-economic stability, the more important it is to limit fiscal exposure resulting from agricultural policies.

Constraints on agricultural policies also result from trade agreements the CEECs have concluded, or may conclude in future. At the most general level there are commitments accepted under the GATT. In particular, signatories of the Uruguay Round Agreement on Agriculture have, in addition to any more general GATT disciplines, accepted specific quantitative commitments regarding tariffs, export subsidies and domestic support. These commitments apply to all six CEECs with the exception of Bulgaria. Bulgaria is still in the process of negotiating accession to the GATT/WTO, and once those negotiations have been concluded successfully it will have to honour commitments of a similar nature. The quantitative implications of the commitments accepted under the Agreement on Agriculture will be discussed in somewhat more detail below in relation to adoption of the CAP by the CEECs (Chapter 5, see also Appendix II). However, it is important to note that potentially the most binding element of the Agreement on Agriculture is the fact that there are strict limitations on the extent to which exports can be subsidized. In particular, export subsidies must not be introduced for products which were not subsidized in the past and are therefore not included in the respective part of the GATT Schedule of the country concerned.

In addition to these multilateral commitments under the GATT, constraints can result from bilateral trade agreements. For the CEECs, the most important among these bilateral trade agreements are the trade-related parts of their Association Agreements (Europe

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<sup>17</sup> World Bank (1994).

Agreements) with the EU. In agriculture, these agreements require the CEECs to maintain preferential access to CEEC markets for EU exports, for a specified list of products, generally for limited quantities. In addition there are trade agreements with the EFTA countries, which will have to be somehow embodied into the Europe Agreements once the four EFTA countries concerned have joined the EU. Amongst themselves, the Visegrad countries have concluded the Central European Free Trade Agreement (CEFTA), although this does not provide for free trade in agriculture. However, some preferential reductions of tariffs for specified agricultural and food products are envisaged under that agreement, and this also acts as some form of a constraint on agricultural trade policies. While commitments to apply preferential tariffs under these bilateral trade arrangements impose less rigid policy limits than the GATT Agreement on Agriculture, they have to be considered carefully in designing future policies. The higher MFN tariffs (i.e. tariffs vis-à-vis non-preferred exporters) are, the more there is the danger that imports coming in under preferential tariffs distort trade and undermine the effectiveness of tariff protection. This is particularly true where preferential tariffs are set in absolute terms, but it is also the case where preferences take the form of given percentage reductions from the applicable MFN tariffs (as is more often the case in the bilateral agreements concluded by the CEECs).

Among the many other constraints on agricultural policies in the CEECs, one more shall be mentioned here. Policies have an effect not only through their direct impact on economic variables. They also generate expectations among people affected by these policies. This has a number of consequences. In particular, it is often rather difficult to retreat from policies once introduced, and even a scaling down of given policy measures can be politically painful. Hence policies introduced under the pressure of the day often become permanent. Rather than creating more freedom for a government which hoped to eliminate current pressures, these policies then reduce the scope for future policy action. Given the many uncertainties regarding future economic and agricultural developments in the CEECs it would be wise to maintain as much policy flexibility as possible. Moreover, through affecting expectations, current policies can also trigger economic developments which are irreversible in the future. For example, entrepreneurs make careful decisions as to where to locate the industries they invest in. Once these decisions have been made they cannot be revised for a long time. If agricultural policies in some CEECs create an economic climate which makes investments in their food industries appear unattractive, for example because of high raw material costs, these investments go to other countries. It is then later very difficult to change the geographic location of these

industries.<sup>18</sup> In other words, today's policies can have impacts which extend far beyond the time horizon for which they were designed.

One important expectation among people in the CEECs concerns accession to the EU. It is no longer in the hands of CEEC governments, nor in those of EU politicians, to change the basic thrust of these expectations. The general public in the CEECs firmly expects accession to take place in the foreseeable future. Indeed, it is hard to overestimate the intensity of this expectation. A large and growing number of day-to-day activities in the CEECs are geared to preparing for this decisive element in future life. To an extent, eventual membership in the EU is seen as the light at the end of the long tunnel of transformation. In CEEC agriculture, the perceived advantages of the CAP are looked at with much anticipation. It will be an important task for CEEC governments, but also for the EU, to make sure that such expectations regarding future agricultural conditions after accession to the EU do not become unrealistic.

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<sup>18</sup> For an excellent discussion of the relationship between policies and location decisions, and of the resulting long run irreversibilities for the geographic pattern of economic activities, see Baldwin (1994), pp. 3-22 ff.

#### **4 Integrating CEEC Agriculture with the EU: Chances and Issues for the CEECs**

Several countries have gone (and the EFTA countries are in the process of going) through the experience of having to integrate their agriculture with that of the European Union when they joined the family of member states. Depending on the structure of their farming industries and the nature of their past policies this was a more or less comfortable experience. However, none of the past and current rounds of EU enlargement was comparable to what will be involved when countries from Central and Eastern Europe join the EU. In particular, never have preparations for accession started in a situation where the state of affairs in agriculture (and the rest of the economy) was as fluid as it currently is in the CEECs. Also, and closely related to this, never have countries acceded to the EU where farmers have so much felt that accession to the CAP may solve so many of their current problems. It appears that in much of Central and Eastern Europe the CAP is seen as a panacea. If only they could begin to benefit from that policy, then their fate would be much less uncertain: this is what many farmers in the CEECs appear to feel. These feelings are one of the driving forces behind the trend to establish "CAP-like" policies in some of the CEECs.

From the perspective of EU farmers, such aspirations among their colleagues in the East may be somewhat surprising. After all, many EU farmers have never been quite happy with the CAP, and after the MacSharry reform they are even less happy with it. However, one can understand why farmers in the CEECs feel differently about the CAP. From their perspective, the level of support granted by the CAP is generous. The CAP offers support prices which, even after completion of the MacSharry reform, are substantially above those in the CEECs for most products. In addition there are compensation payments under the CAP whose level per hectare, in the case of cereals, is of the same order of magnitude as total current per hectare revenue in many CEECs. It cannot come as a surprise that under such conditions many farmers in the CEECs would be happy to accede to the CAP. On the other hand, there are also fears regarding competitiveness. Even though parts of EU agriculture are not competitive at the international level, agriculture is a rather sophisticated business in some sectors of the EU farming industry, and farming enterprises in the CEECs which are still struggling to establish themselves firmly are sceptical about their ability to compete with well financed western farms operating with the latest technology in farming systems, machinery and equipment.

Which of these two seemingly contradictory views is right? How competitive would agriculture in the CEECs have to be before it can join the EU? The answer is far from straightforward. The best that can be said in short is that things differ very much among commodity sectors. To take just one example, consider the situation in the dairy sector. Producer prices for milk in the CEECs are way below those in the EU. In Poland, for example,

they are a third, in Hungary and the Czech Republic they are around 60 % of those in the EU. In the EU there is rather firm price support for milk. Farmers do not necessarily need to be competitive in order to produce milk. If they manage to produce at costs which are below the supported price than they are in the business (though in the EU only as long as they have quota rights). It would appear that milk producers in the CEECs should not find it difficult to produce at costs below the CAP support price. After all they are currently producing at prices substantially below that level. Hence one should think that CEEC dairy farmers could easily stand "competition" with EU dairy farmers. In the end this is probably true. However, the case is less obvious than it may appear. Price support for milk under the CAP does not come at the farm level, but at the level of processed commodities, mainly through intervention buying of butter and skim milk powder. The farm gate price for milk then depends on the efficiency of the dairy factories. To the extent that dairy factories in the CEECs are less efficient than those in the EU, CEEC milk producers would receive lower producer prices than those in the EU. Moreover, a good part of the production cost of milk goes for feed. Feed prices in the CEECs, in particular cereals prices are now below those which may apply once the CEECs have joined the EU. Hence costs of milk production at the farm level may increase as the CEECs adopt the CAP. Taken everything together the benefits of joining the EU for CEEC milk producers may therefore be less than what they appear to be at the first glance.

More generally, the situation depends, among others, on the nature of the CAP market regime for the product concerned. Where price support is relatively firm, as for example in the cases of cereals, sugar and milk, competition among farmers in the (enlarged) EU is limited. Clearly, the level of farm income derived from that price support depends on the efficiency at which farmers produce. However, survival in competition is not so much an issue. For other products, there is essentially no domestic price support. This is, for example, the case in the grain based livestock sector (pork, poultry, eggs). EU producers of these products are protected against competition from third countries through high (essentially prohibitive) import levies. However, within the EU there is essentially unfettered competition. Farmers who are not sufficiently competitive (either through efficient production methods or through low factor prices and opportunity costs) will not be able to continue production. In addition to these factors, competitiveness of the processing and marketing sector is an essential ingredient of agricultural success, as illustrated above in the case of milk.

Keeping all this in mind it is not easy to say in general how competitive an agricultural sector must be before it can successfully join the EU. Different sub-sectors of agriculture will make different experiences when they integrate into the common EU market, and this explains why different producer groups in the CEECs may feel differently about the extent to which the CAP will be a panacea for them. However, it is important to remember that accession to the EU is a simultaneous process for all sectors. One cannot join the EU in the milk sector, but

stay outside for pork. From that perspective it is the potentially least competitive sector which determines the point in time at which accession is possible without major problems. Moreover, it must be remembered that competitiveness is not a purely technology-related phenomenon. It has much to do with factor prices, and in particular with the opportunity cost of labour. Low labour cost, or to put it differently low income expectations, can make up for a lot of technical disadvantage.

While the issue of competitiveness needed to join the EU successfully is somewhat ambiguous in agriculture, it is very clear-cut in the food industry. Apart from measures thought to compensate the EU food industry for high raw material costs under the CAP (which in some cases achieve overcompensation in practice) there is no substantial form of protection and support for that sector in the EU. Indeed, there are indications that the EU food industry is a particularly competitive sector by international comparison. Generally, technologies used represent the state of the art, equipment is modern and well maintained, product quality and diversity match highest international standards, marketing activities are sophisticated, financial conditions are sound. Moreover, competition on the EU market is very intense, and only the most successful companies survive. As a response to the creation of the Single Market, the EU food industry has made any conceivable effort to become even more competitive. At the international level, the Union's food industry has proven to be a highly successful export sector, while food industries from third countries have found it difficult to market successfully in the EU.

Against this background it is clear that the food industry in the CEECs will have to be very strong when open markets are established with the EU. When CEEC agriculture joins the EU, many of its product sectors immediately come under the shield of protection and support provided by the CAP. Yet, there is no form of EU protection from which the food industry in the CEECs can benefit on accession. The icy winds of keen competition will fully hit the CEEC food industry at the time trade with the EU is fully liberalized in a single market between the CEECs and the EU. It is for this reason that improving the competitiveness of the food industry is a prime priority for the CEECs in preparing for accession to the EU.

In agriculture, another important consideration in preparing for accession to the CAP relates to the fact that the future of the CAP itself may be less certain than what is sometimes assumed in the CEECs. As a consequence of the decisions taken in 1992, the CAP is currently undergoing a substantial, though partial reform. This may not be the last major change to be made to the CAP before accession by the first CEECs takes place. The prospect of eastern enlargement itself may trigger further reforms. These issues will be discussed below. In any case, when preparing for accession to the EU and adoption of the CAP, the CEECs need to consider that they are shooting at a moving target. Hence much of the aspiration to participate

in the wonders of the CAP may not be warranted if it is based on the assumption that the CAP remains what it has been so far.

In this context it is important to give thought to the significance of existing EU policies during the process of enlargement. In previous rounds of EU enlargement it has always been maintained that the new member states had to accept the full body of existing legislation and policies in the EU (i.e. the "*acquis communautaire*"). The theory was that the entrants had to adjust to the EU rather than the other way round. Accession negotiations therefore revolved around the speed and method by which the new member states had to adopt existing EU legislation, and not whether the EU was going to adjust some of its policies in the process of enlargement. Practice was never quite as pure as that theory, but essentially the onus of adjustment always rested primarily on the entrants. There is no reason to assume that this principle will be abandoned when it comes to eastern enlargement of the Union. However, it is not inconceivable that a somewhat more flexible approach may be adopted in practice. In particular, it may well be that the EU may consider it wise to change the *acquis communautaire* before actual accession negotiations begin, or to continue to do so unilaterally while those negotiations are being pursued. As argued below, there are good reasons to consider this more flexible approach in the area of agricultural policies in view of future accession by the CEECs. For policy planning in the CEECs this may mean that the *acquis communautaire* should be considered less solid than was the case in past rounds of EU enlargement.

At the same time this may mean that the distinction between being and not yet being a member state of the EU may be somewhat less significant on this occasion. To some extent the EU has already invited the CEECs to become "pre-members", by suggesting that they engage in various sorts of political "dialogue" with the EU, including joint meetings with the EU Council of Ministers and joint summit meetings. If these suggestions are more than a purely political gesture and an opportunity for the CEECs to become acquainted with EU political procedures, they make particular sense if they are used for a debate about mutual adjustments of policies which could make it easier to prepare for accession and enlargement, on both sides.

However, in spite of such a deepened status of "pre-membership" many important distinctions among members and non-members will remain. In the area of agricultural policies these distinctions are extremely significant. As far as economics go, one of the most important distinctions results from the budgetary implications of the CAP. As one of its constituent "pillars" the CAP has always been based on the principle of "financial solidarity". This principle means that all revenue generated by the CAP (such as import levies collected by the customs authorities of the member states) flows to the common budget, and all expenditure made under CAP market regimes (such as export subsidies and intervention prices paid out by member

state authorities) is financed from the common budget. The economic implications of that principle are indeed an integral element of a common agricultural market and trade policy, and it would be difficult to think of a free flow of agricultural products among member states if that principle were not adhered to.<sup>19</sup>At the same time the common financing of CAP market regimes has important and problematic implications for economic incentives in the member states. For any individual member state, the economic value (the shadow price) of one unit of agricultural produce is close to the domestic EU market price, while for the EU on aggregate it is the much lower world price.<sup>20</sup>For existing member states the system of common financing therefore results in distortions of incentives: expanding agricultural production is much more attractive for any individual member state than it is for the Union on aggregate.

For future member states preparing for accession these considerations have extremely important implications. The economic profitability of agricultural production has to be assessed on the basis of current world market prices as long as accession to the Union has not yet taken place. On the first day of full membership, however, the situation changes drastically. The profitability of agricultural production then suddenly depends on the domestic EU price.<sup>21</sup>The economic change which takes place on the day of accession is most obviously seen if one assumes that an entrant country had already aligned its support prices to the CAP before accession. Any surplus which this country produces has to be exported with export subsidies (as long as the CAP price is above the world market price). Before accession to the Union the country concerned has to finance these export subsidies out of its domestic budget. After accession the Union budget suddenly accepts financial responsibility.

One implication of this fundamental change which membership brings about in agricultural policies is that, as long as they are not yet members, potential entrants have to consider their priorities in agricultural market policies in a way which differs very much from the perspective of existing member states. The fact that existing member states may happily accept the market implications of the CAP must not mislead future entrants to believe that the same policies are desirable for themselves. It is a great difference whether one has to finance ones market regimes out of the national budget or whether the Union budget takes care of that

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<sup>19</sup> In this context it is extremely important to make a careful conceptual distinction between common market and trade policies on the one hand and structural and direct income policy measures on the other hand. For example, structural policies have always been pursued in the EU under joint financing between the Union and member states, and this is perfectly feasible. Equally, it is conceivable that decoupled income support is co-financed between the Union and the member states, or financed completely by member states. This issue will be taken up again below.

<sup>20</sup> See Koester (1977).

<sup>21</sup> This assumes that common CAP prices are adopted by the new member state on accession. If there is a transition period during which prices are gradually aligned the relevant shadow price is the transition price.

expenditure. This issue will be discussed again below in relation to alternative options for CEEC agricultural market and trade policies before accession.

The issues raised here become more complicated if one considers the time dimension and dynamic adjustments. Assume a given country reckons that once a member of the Union and financially covered by the CAP it is economically profitable to produce considerably more of a given agricultural product. Should that country begin to boost its production already before membership, such that it is in full speed at the time it becomes a member state? In most cases the answer will probably be in the negative, because it does usually not take too much time to expand agricultural production once producers receive the appropriate incentives. The CAP, however, has some features which may suggest a different answer. In particular, where supply controls are used under the CAP, the level of allowed production has traditionally based on a past reference period. This was the case when quotas for sugar production were issued (and later reallocated), and it was also true when milk quotas were introduced. Most recent examples of that nature were the establishment of base acreage for compensation payments and set-aside requirements, and the allocation of acreage for oilseed production among member states. For agricultural policy makers in the CEECs this traditional practice in the EU means an incentive to expand their production as much as possible before entry, such that they create a good base for receiving production rights, and possibly compensation payments, once membership in the Union is reached. Experience with earlier rounds of EU enlargement, including the current round of EFTA enlargement, sends the same signal to the CEECs and may suggest to them that there is a point in establishing "property rights" to CAP quotas as early as possible.

From this perspective it would make sense, and indeed is urgent, for both the EU and the CEECs, to find early agreement on how the base should be established for any production quotas and other supply controls which may exist under the CAP at the time of accession. In order to avoid wrong incentives it may be appropriate to agree on a method for establishing base numbers which do not depend on future production developments in the CEECs. This does not mean that numbers have to be based on actual past production or resource use. However, it should not be possible to affect the base through future production decisions. Alternatively, and preferably, the EU may reconsider its own approach to supply controls, and change the CAP such that they are no longer necessary.

## **5 Alternative Policy Options for the CEECs: Support Levels and Trade Policies for the Medium Run**

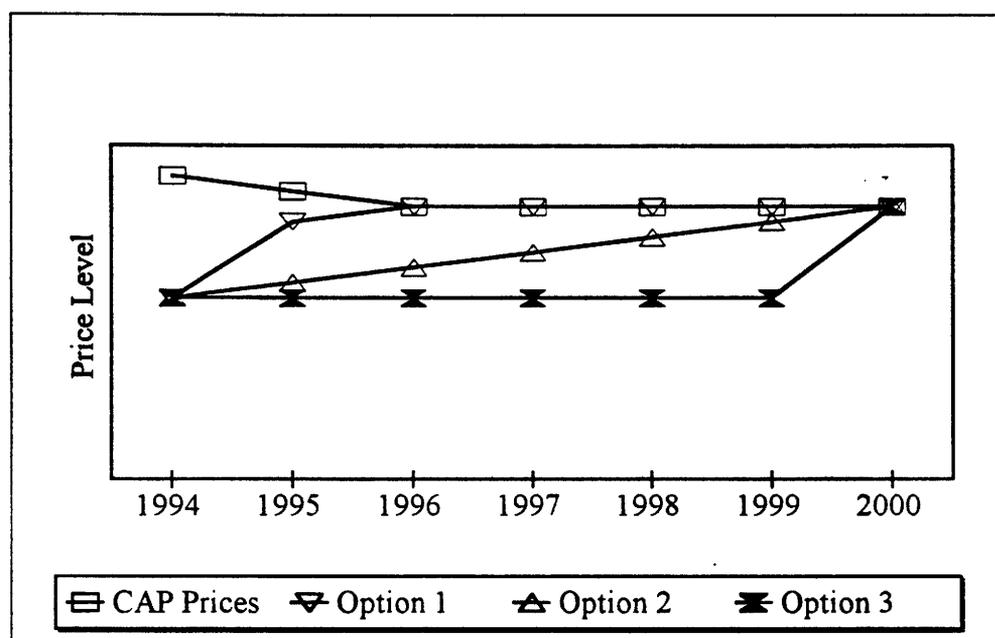
### **5.1 Basic Choices**

There is a wide variety of policy measures which can be brought to bear on the agricultural and food sector. Typically, the agricultural policy mix chosen by any country is a complex combination of many different instruments. However, one basic choice to be made by all countries, with fundamental implications for the whole structure of agricultural policy instruments adopted, relates to the overall level of support and protection granted to domestic farmers. Any decision made in this regard has far reaching implications for the development of agriculture, and it cannot be revised in a short period of time. Hence choice of the level of support and protection in agriculture is a typical example of a fundamental policy decision of a medium to long term nature. To make the appropriate choice in this regard is one of the central issues for agricultural policy design in the CEECs for the years to come. Indeed, the agricultural policy debate in the CEECs in recent years has very much emphasized the importance of this choice. Various domestic pressures, as discussed above, tend to suggest that there should be more protection against competition from other countries, and a higher level of support for domestic agriculture. The most obvious factor pointing in this direction is the low level of profitability and the resulting financial difficulties currently faced by large parts of agriculture in the CEECs. On the other hand, there are several domestic constraints, also mentioned above, which make it difficult to provide more protection to farmers in the CEECs. These contradicting domestic forces create serious problems for agricultural policy makers in the CEECs. It is for this reason that the basic choice of an appropriate level of support and protection is discussed here first, before other agricultural policy measures are considered later (in Chapter 8 below).

For the CEECs, one way of looking at the appropriate level of support and protection in agriculture is to consider how best to align agricultural support and protection to that of the CAP, given the prospect of joining the EU in the foreseeable future. Should the CEECs align their agricultural prices to the CAP as soon as possible? Would it be better to align prices gradually, along a trajectory which reaches CAP prices in a given number of years? Or is it best to postpone adjustment to CAP prices as long as possible? These alternative options will be discussed below, in a manner which necessarily is somewhat schematic. The nature of these options can be illustrated as in Graph 5.1, where option 1 describes a rapid price alignment

with the CAP, option 2 stands for a gradual price alignment, while option 3 represents the strategy of keeping prices at current levels until accession.

**Graph 5.1: Aligning CEEC Prices with the CAP: Alternative Options**



Much of the relevance of how best to align CEEC prices to the CAP depends on the size of the gap which currently exists between agricultural prices in the CEEC and those in the EU. If that gap is small there is no need to be concerned about price alignment, and vice versa. It is difficult to say very much in general because agricultural prices differ significantly among the CEECs, due to the different agricultural price, market and trade policies pursued by these countries. However, in general prices in the Visegrad countries are below the current level of CAP prices. Graph 5.2 provides information on price gaps for the Visegrad countries, for some major agricultural products.<sup>1</sup> 1993 prices in the CEECs are shown relative to 1993 EU prices (which are set equal to 100).<sup>2</sup> Roughly speaking, agricultural prices in the Visegrad countries are around one third below those in the EU.<sup>3</sup> It is also interesting to note that price ratios

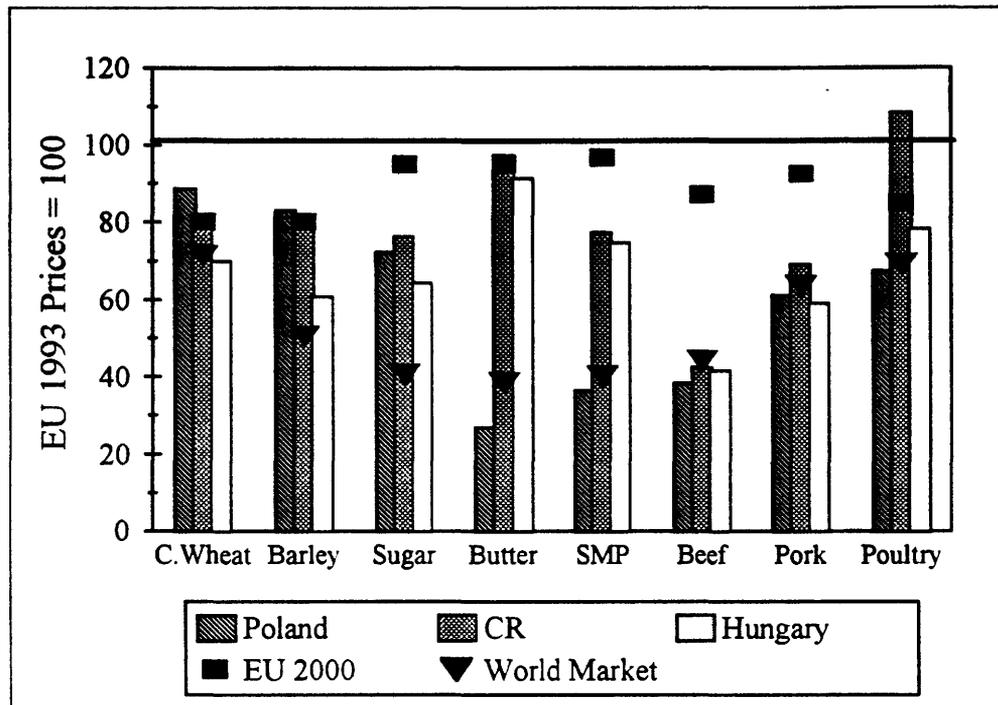
<sup>1</sup> The wheat price in Poland in 1993 is not fully representative of the current price level of wheat in that country, as the 1993 price was heavily affected by the shortfall of the 1992 crop due to drought. In 1994, the wheat price in Poland was 26 per cent below the 1993 price in real terms.

<sup>2</sup> Price comparison is made at the wholesale level as it is that level at which CAP price support is provided. Where wholesale prices were not available for the CEECs, farm gate prices were used, and adjusted by adding a marketing margin, generally adopted from the OECD estimates of PSEs for Hungary and Poland.

<sup>3</sup> The weighted average of domestic wholesale prices for six major products, i.e. wheat, barley, sugar, beef, pork and poultry, in Poland is about 40%, in Hungary about 30% and in the Czech Republic about 20% lower than in the EU.

between individual agricultural products in some of the Visegrad countries differ very much from those prevailing in the EU. Though not included in this graph, prices in Bulgaria and Romania tend to be lower on average than those in the Visegrad countries.

**Graph 5.2: Prices of Major Agricultural Products in the Visegrad Countries, in the EU, and on World Markets**



Sources: National Statistics, OECD, IMF

Past prices in the EU, though, are not a good benchmark for price alignment in the CEECs. After all, CAP reform as decided in 1992 will result in some further price cuts in the EU, with the final tranche of these price cuts to be implemented in 1995. Moreover, even if no further explicit reforms to the CAP were to be decided in the EU, there will be reductions in real CAP prices resulting from some overall inflation in the EU to which CAP prices are not likely to be fully adjusted. As a result, CAP prices in, say, the year 2000 will be lower than 1993 prices. The gap to be closed through price alignment is therefore less than that which existed in 1993. Hence CAP prices which may prevail, without any further CAP reform, in the year 2000 have also been included in Graph 5.2.<sup>4</sup> In most cases, even those possible future CAP prices are well above current prices in the Visegrad countries. It is price alignment to

<sup>4</sup> In forecasting these CAP prices for the year 2000, price reductions already decided under CAP reform have been included, and the assumption has been made that there will be a real decline of agricultural prices in the EU, mainly due to inflation, of 1% per cent per year between 1995 and 2000.

close this gap between current Visegrad prices and future (unreformed) CAP prices which will be discussed in the following.

## **5.2 Option 1: Rapid Price Alignment with the CAP**

One option for the CEECs is to align their agricultural prices very rapidly to CAP prices, say within the coming two years. Many CEEC farmers might be happy to see this occurring as it would help them to overcome their current economic difficulties. However, even among CEEC farmers such a rapid price rise may not be universally welcome. CEEC governments would probably not want, and not be able, to raise all agricultural prices simultaneously through market policies. In particular, prices for some livestock products, above all pork and poultry products, are very difficult to support at a high level without massive state interference and in the absence of large budget appropriations. As a result, prices of basic crops, mainly cereal prices, would be likely to rise faster than prices of livestock products. Livestock producers would then be hit by rising feed costs which would not be matched by simultaneous price increases for livestock products. Hence livestock production, which may in the longer run turn out to have a competitive potential in the CEECs, would have to go through a very difficult period, even more difficult than the recent past which has already seen a particularly pronounced decline of livestock production in the CEECs.

However, there are more reasons which caution against the option of a rapid alignment to CAP prices. Real consumer incomes in the CEECs have declined drastically during transformation, and they are only slowly recovering from that decline. A rapid alignment to CAP prices would push up food prices immediately, and would therefore tend to eliminate most, if not all, of the potential growth in real consumer incomes which can be hoped for in the next few years in the CEECs. This effect would be particularly pronounced as the share of food in total consumer expenditure is still rather high. Consumers, who now begin to see the chances of enjoying the fruits of economic transformation, would be frustrated.

Assuming a rapid transmission of higher farm gate prices to higher food prices implies that the food industry and the marketing chain in the CEECs are not able to absorb some of the increase in raw material prices through a reduction in processing and marketing margins. This assumption is fairly realistic, to say the least. Indeed, higher farm gate prices, resulting from a rapid alignment of CEEC policies to the CAP, would make the difficult situation of the food industry and marketing enterprises in the CEECs even worse. One of the particularly important priorities for agricultural policy in the CEECs, as was argued above, is to strengthen the food industry and the marketing sector. Without a more efficient, competitive and profitable food industry, the CEECs will find it difficult to stem the tide of processed food imports, to expand

their agricultural and food exports, to create better market chances for their farmers, and to compete effectively with the EU's sophisticated food industry after accession. A policy-induced rapid increase of prices for agricultural raw materials, as would result from an attempt to align policies to the CAP too soon, would greatly reduce prospects for a healthy development of the food industry and the marketing sector in the CEECs. A prolonged crisis of that downstream sector would ensue, with potentially damaging longer run consequences for CEEC agriculture.

Another serious problem which would result from a rapid increase in agricultural price support in the CEECs is the high burden which it would place on government budgets. Aligning prices rapidly with the CAP would be possible only through massive government interference with market forces in the CEECs. Intervention buying would have to occur at a much more extensive level than currently is the case. Where produce is exported, export subsidization would have to increase massively. Indeed, there would be a tendency for more surpluses to originate, given the low tolerance of consumers for higher food prices, and some stimulation of higher output in agriculture. All the additional agricultural exports would have to be subsidized, at rising levels of subsidy per unit with a larger gap between domestic and international prices. With only slowly recovering GDP growth in the CEECs, and hence a still rather weak tax base, it would be extremely difficult, if possible at all, to finance such a rapid increase in agricultural policy expenditure. Moreover, there are so many demands on the government budgets in the CEECs during the transformation process, and so many macro-economic constraints to be considered by the governments, that a more than proportional increase in agricultural policy expenditure would be very difficult to defend.

Within agriculture, not only would livestock producers likely be hit hard but a rapid rise in price support would send the wrong signals to CEEC farmers in general. Since this rising farm price support would be "domestically produced" (as opposed to a price adjustment resulting from actual accession to the EU) it would create the illusion among farmers that domestic agricultural policy in the CEECs is capable of doing anything it wants. Rather than working towards becoming more economically independent of government policies, and more competitive on domestic and international markets, farmers would develop a habit of entrusting their fate to the government, and then possibly become equally dependent on the state as they were in the past. The end result of the process triggered by such a policy would be an agricultural sector which lacks efficiency and competitiveness, depending on government support rather than its own strength.

For all these reasons a rapid alignment of CEEC prices with the CAP is not a viable option. Fortunately this is well understood in the CEECs. Even though there is some pressure to raise agricultural price support further, governments of the CEECs appear to accept that the

current level of CAP prices is beyond both the possibilities and the needs of their countries in the immediate future.

### **5.3 Option 2: Gradual Price Alignment with the CAP**

A more tempting policy option for CEEC governments is a gradual alignment of agricultural price support with the CAP. Given the expectation that accession to the EU will take place in the foreseeable future, and the assumption that the CAP will fully apply to the CEECs once they have become members of the Union, a plausible strategy might be to begin price alignment soon, and to plan for it to be completed by the time of expected accession to the Union. Reasonable arguments can be advanced in favour of this option. The whole agricultural sector, including the food industry and consumers, it could be argued, needs to adjust to the conditions which will govern agricultural markets and prices after accession to the EU. Gradually approaching future CAP prices may allow such adjustments to take place smoothly. It takes time to make the investments, and possibly also disinvestments, required to operate efficiently in a CAP environment, and a gradual alignment with CAP prices is one way to deal with the timing problem. The public institutions required to implement the CAP (such as intervention agencies etc.) could get used to their duties, not only in terms of how they need to operate but also in terms of gradually beginning to administer quantities and prices at the levels to be expected once membership in the Union is reached. Arguments like these could make the option of a gradual price alignment appear attractive.

The most straightforward implementation of this option would be to embark soon on a time path for agricultural price support in the CEECs which follows a straight line trajectory between their current price levels and the level of CAP price support expected to prevail at the time accession to the Union may take place. For example, the CEECs could work on the assumption that accession is conceivable in the year 2000; they could forecast CAP prices for that year; they could decide to start price alignment in the year, say, 1996; and they could move their agricultural prices towards those future CAP prices. Each year between 1996 and 2000, one fifth of the gap between their current prices and CAP prices in the year 2000 would be closed. In a way this strategy would resemble transition arrangements as adopted in earlier rounds of EC enlargement, for example in the case of accession by Spain and Portugal. The difference, though, would be that price alignment in the CEECs along such lines would be pursued as their sovereign domestic policies, rather than as an element of accession treaties agreed with the Union. Hence the policies required to implement such a gradual price alignment would have to be implemented, and financed, by the CEECs themselves, and EU policies would not directly be affected during the process of price alignment.

An assessment of this option very much depends on the quantitative implications it would have for agricultural markets, trade, consumers, and government budgets, in each of the CEECs. An analysis of these implications forecasts over a period of several years, with all the uncertainties inherent in agricultural developments to be expected in the CEECs in the years to come. In particular, it is difficult to predict how supply of and demand for agricultural products may change in the medium term in the CEECs, since the dust which was stirred up during the early phases of the transformation process has not yet settled. A number of studies exist which have tried to analyse the implications of adopting the CAP in the CEECs. Among these studies is our own analysis, based on a quantitative model which forecasts market trends in the EU and other countries over the coming years, under alternative assumptions on future agricultural market policies, macro-economic conditions and productivity trends. For the time being, among the CEECs only the Visegrad countries are included in that model. Hence our quantitative model estimates are limited to those countries. Some results of this analysis are presented in Annex I, for a gradual price alignment in the CEECs to reach CAP prices by the year 2000. In that analysis, the assumption has been made that the CAP remains essentially unchanged in the shape it will have once the MacSharry reform is completed. Only some of the more important results are briefly reported here.

Even though CAP prices in real terms will further decline between now and the year 2000, prices for most products in the Visegrad countries would have to rise significantly in order to be aligned to the CAP. As one result of this price increase, and as a consequence of productivity growth to be expected, output of most agricultural products can be expected to rise noticeably. At the same time, price alignment with the CAP would dampen the growth of demand for agricultural products which otherwise would result from the expected improvement of standards of living. The market balance in agriculture would, therefore, tend to change. For a number of agricultural products there would be a tendency for surpluses to build up. With alignment to CAP prices in the year 2000, the Visegrad countries on aggregate are likely to have a surplus of cereals in the order of magnitude of 8 million tons and a sugar surplus of about 1.8 million tons. The exportable surpluses of livestock products in the Visegrad countries may also be significant, around 0.6 million tons of beef, 1 million tons of pork, and 0.4 million tons of butter.

At the first glance a rise in agricultural exports from the CEECs may appear welcome since it adds to foreign exchange earnings. However, agricultural exports stimulated by price support are a rather expensive way of earning foreign exchange. Agricultural prices to be adopted by the CEECs if they were to align to the CAP by the end of this decade would be above world market prices, to varying degrees for the different agricultural products. Domestic market surpluses can therefore be exported only if export subsidies are granted. Export subsidies have already now become a feature of agricultural policies in most CEECs, and they

are beginning to cause a headache for fiscal stabilization. With price alignment to reach CAP prices by the end of this decade, export subsidy expenditure in agriculture would have to grow significantly. Not only would the surpluses to be disposed of grow. The gap between domestic and world market prices would also expand. As a consequence, expenditure on export subsidies would increase progressively.

For the Visegrad countries on aggregate, for the products included in our analysis, annual export subsidies (net of import levies) may reach the order of magnitude of 3.3 billion ECU (in 1993 prices) by the year 2000. In addition to this expenditure there would be expenditure on other elements of market policies, such as intervention buying, storage aids, subsidies for domestic surplus disposal, and administration of market policies.<sup>5</sup> Based on experience in the EU, this additional expenditure could be another 1.4 billion ECU per year. Moreover, there would be expenditure on market policies for other products not taken into account here, such as fruit and vegetables, wine, tobacco and sheep. For these products, as a rough estimate another 4.3 billion ECU of annual expenditure could be required in the Visegrad countries with price alignment to the CAP by the end of this decade. In total, by the year 2000 the Visegrad countries alone may have to incur an annual expenditure in the order of magnitude of 9 billion ECU (in 1993 prices) for agricultural market policies if they were to adopt the strategy of aligning gradually to CAP prices. On top of this expenditure for market policies would come the spending on other policies, such as structural policies, investment aids, and social policies.

At the level of individual Visegrad countries, Poland's expenditure on export subsidies (net of revenue on import levies) for the products included in our analysis might be around 2 billion ECU by the year 2000. Taken together with spending on other elements of market policies, and for products not included in our analysis, total expenditure on agricultural market policies in the year 2000 may be as much as 5.5 billion ECU in Poland. This would be more than 60 times the expenditure on agricultural market policies in Poland in the year 1993.<sup>6</sup> In Hungary, expenditure on agricultural export subsidies (net of import levy revenue) for the products included in our analysis may reach 0.8 billion ECU by 2000. With expenditure on other market policies and other products, a total of around 2.2 billion ECU may result. This

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<sup>5</sup> In the scenario reported here, we have assumed that compensation payments, as granted in the EU for cereals, oilseeds, pulses, cattle and sheep are not yet made in the CEECs. Clearly, if such payments were introduced as an element of aligning with the CAP, expenditure would increase massively. The issue of such compensation payments, and the financial magnitudes involved, will be taken up below.

<sup>6</sup> Expenditure on agricultural market policies in Poland so far comes mainly in the form of government contributions to the activities of the Agency for Agricultural Markets (ARR). In 1993 that contribution was 1907.4 billion Zloty, equivalent to around 80 million ECU.

sum is more than 7 times the level of corresponding expenditure in Hungary in 1993.<sup>7</sup> For the Czech and Slovak Republics taken together, total expenditure on agricultural market policies in the year 2000 under this option is estimated to be somewhat less than in Hungary.

Budgetary expenditure on agricultural market policies at these levels in the CEECs would cause serious fiscal problems and macro-economic difficulties, and would probably be unsustainable. In addition, agricultural prices at the CAP level would impose a significant burden on food consumers. A gradual price increase, as considered under this option, may face somewhat less opposition from consumers than a rapid price rise as implied in the policy option discussed above, and it may be more palatable because it would tend to go in parallel with rising spending power of consumers. However, even with optimistic assumptions on macro-economic growth in the CEECs for the rest of this decade, disposable incomes in most of the CEECs would still be below the current level of incomes in the poorest member states of the EU-12. High food prices would, therefore, be an undesirable feature in the CEECs even at the end of this decade. Moreover, high food prices would divert spending power of consumers from other economic activities which could make a better contribution to overall economic growth which is so much needed in order to bridge the income gap between the CEECs and the EU. In other words, for a number of domestic reasons, even the option of gradually aligning CEEC agricultural prices to the CAP cannot be recommended, and may not even be sustainable.

At the same time, CEEC governments will want to consider the trade implications of their future agricultural policies. In particular, those CEECs which are (or will be) signatories of the GATT, or in future the WTO, must not neglect the commitments they have accepted in agriculture as a result of the Uruguay Round (or the equivalent commitments which they will make during their negotiations on accession to the GATT/WTO). The extent to which these commitments will constrain future policies in the CEECs is again a matter for quantitative analysis. The mere fact that tariffs are bound, that export subsidization must not exceed certain limits and that domestic support has to remain below a given commitment does not in itself say that there is no scope for raising agricultural support and protection. After all, GATT bindings for agriculture are generally based on a past reference period (1986 to 1988 or 1990), and not on current actual policies.<sup>8</sup> Through policy changes which have taken place since the base period, and through the quantitative parameters chosen for establishing base period numbers, countries can have (implicitly) created scope for future increases in support and protection,

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<sup>7</sup> Expenditure on intervention and export subsidies in Hungary was 32.383 billion Forint in 1993, see World Bank (1994), p. 35. This sum is equivalent to 0.29 billion ECU.

<sup>8</sup> This is not necessarily true for countries which accede to the GATT after the Uruguay Round (such as, among the CEECs, Bulgaria). In the following only those countries will be considered which have already participated in the Uruguay Round negotiations.

relative to current policies. In the EU, for example, this is the case for most tariff bindings in agriculture, which would allow for an increase of protection from current levels, rather than forcing protection further down.<sup>9</sup> In the CEECs, so many things have changed so fundamentally since the Uruguay Round base period that a careful analysis of their current situation is required in order to see how binding their agricultural commitments are. Moreover, as neither quantities nor prices in the CEECs during the Uruguay Round base period had the same economic meaning as they have in market economies, the CEECs have in some cases been allowed to specify commitments which are essentially determined synthetically, rather than being mechanically calculated on the basis of reference period numbers. This means that in the absence of a quantitative analysis it is even less clear, *a priori*, how binding their commitments are relative to current policies.

In order to get some impression of the extent to which their GATT commitments will constrain future policies in the Visegrad countries, we have analysed their GATT Schedules, concentrating on major agricultural products. The results of this analysis are presented in Appendix II and only briefly summarized here. A number of rather interesting and important conclusions emerge from this analysis.

First, both the methods adopted for establishing commitments and the quantitative implications of the Schedule commitments differ very significantly among the Visegrad countries. For example, Poland has bound tariffs which are generally based on those bound by the EU, emphasized by the fact that Polish Schedule tariffs are expressed in ECU rather than in Zloty. Hungary and the Czech and Slovak Republics have generally bound *ad valorem* tariffs, at levels often far above tariffs currently applied, but generally below the equivalents of tariffs bound by Poland and the EU. As another example, Poland has bound both domestic support and export subsidy outlay in terms of US dollars, while Hungary and the Czech and Slovak Republics have made their bindings in domestic currencies. As a result of such differences, the extent to which future policies are constrained, and in particular the extent to which these constraints may prevent the CEECs from aligning their agricultural policies with the CAP differs very much from country to country.

Second, in all Visegrad countries, the tariffs bound in the Uruguay Round are higher, often significantly, than needed to defend current levels of price support (with very few exceptions, see Appendix II). However, in most cases the tariffs bound are not high enough to allow for a strategy of gradual price alignment with the CAP by the year 2000. The exception is Poland, with tariff bindings modelled after those of the EU.

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<sup>9</sup> This does not apply to cereals, for which a maximum duty-paid price, determined in relation to the EU intervention price, has been agreed.

Third, domestic support commitments are likely to create a major headache in Hungary and the Czech and Slovak Republics, under any policy scenario. Because these countries have bound domestic support in their national currencies, and because all commitments under the GATT Agreement on Agriculture had to be expressed in nominal terms, the massive inflation which has occurred in these countries since the GATT base period has completely eroded all scope for providing domestic support. As a result the actual 1993 AMS (aggregate measurement of support) in Hungary and the Czech and Slovak Republics has already exceed the bound AMS for 1995 by far.<sup>10</sup> Hence there is no scope for further increase in support for these countries, let alone for a gradual price alignment with the CAP. These countries (and other GATT signatories in a similar situation) are likely to request the GATT Committee on Agriculture to allow them to resort to Article 18:4 of the Agreement on Agriculture, which suggests that "due consideration [shall be given] to the influence of excessive rates of inflation on the ability of any Member to abide by its domestic support commitments". It remains to be seen how the Committee on Agriculture will deal with such cases. However, even if the Committee should allow these countries to exceed their legally bound domestic support commitments because of their past high inflation, it may well be that the Committee will want to maintain the strongly binding power of the commitments, and would not allow countries to utilize past inflation as a justification for future increases in the level of domestic support. Hungary and the Czech and Slovak Republics might then find that their domestic support commitments, even if adjusted for past inflation, are such strong constraints that they exclude the option of gradual price alignment with the CAP by the year 2000. Poland's domestic support binding in US dollars, on the other hand, does not appear to create a problem for current levels of support. However, should Poland wish to align its prices with the CAP, it would exceed its AMS binding significantly.

Fourth, the extent to which export subsidy commitments may turn out to constrain policies differs extremely among individual products and countries. There are a number of products in each of the Visegrad countries where export subsidy commitments under the GATT would probably be violated if prices were gradually aligned with the CAP. There is no consolation from the fact that there is some slack in export subsidy commitments for other products. The GATT commitments on export subsidies come strictly at the product level. "Savings" on one product cannot be transferred to another product. Hence if a given policy strategy tends to violate export subsidy commitments for some products, that strategy is not in its entirety feasible. Moreover, under the GATT Agreement on Agriculture signatories have agreed not to introduce export subsidies for products whose exports were not subsidized in the

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<sup>10</sup> An additional problem for the Czech and Slovak Republics is that their base period AMS does not include any price support element. With administered prices for a number of products now in place, the current AMS for these two countries exceeds the domestic support commitment even more.

base period. This is a strongly binding commitment which would create serious difficulties in the Visegrad countries if they were to raise their prices to the CAP level. Such higher support prices would stimulate surplus production of a number of products where the Visegrad countries have in effect zero export subsidy commitments.

As an overall conclusion from this analysis of the GATT commitments in the Visegrad countries it appears that these commitments are such that they do not in general allow these countries to adopt a strategy of aligning their prices with the CAP before accession. A different matter is the issue of how the GATT would handle an extension of the CAP to the CEECs once they have become members of the EU. The GATT provision relevant to this issue is Article XXIV:6 of the GATT, which essentially will require the EU to negotiate commitments for the enlarged Union with its GATT partners (as this has been the case in earlier rounds of EC enlargement). This is not the place to speculate about the possible outcome of such negotiations. However, it should be pointed out that enlargement of the Union to comprise relatively large countries (in agriculture) which enter with GATT commitments often very much below those of the existing EU cannot automatically be assumed to proceed smoothly in the GATT, without policy adjustments in the existing Union.

In sum, the implications which a strategy of gradually aligning CEEC prices with the CAP would have are such that this strategy appears undesirable, and even not feasible. It would

- place a massive burden on CEEC consumers and taxpayers;
- result in an unacceptable fiscal exposure and the consequent macro-economic problems;
- violate the GATT commitments of the CEECs.

Governments of the CEECs appear to be generally aware of these facts. It is for these reasons that the third option of keeping price support in the CEECs low until accession to the EU merits, and is being given, priority attention.

#### **5.4 Option 3: Low Support Until Accession**

As argued in the previous two Sections, any large increase of support and protection, be it rapid or gradual, is likely to result in serious economic and financial difficulties, and would probably be inconsistent with commitments under the GATT. Indeed, current levels of support and protection in the Visegrad countries have already reached a point where they may imply economic and financial costs which place an undesirable burden on the overall economy (see

above, Chapter 3). For those Visegrad countries which have already reached a relatively high level of support, and for those products where this is the case, it may indeed be appropriate to consider a reduction, rather than a further increase of support and protection. More intensive state interference with market forces through more rigid measures of support, protection and stabilization implies the danger of creating an agricultural sector which considers itself to be, and finally is, dependent on government support, rather than being competitive internationally. In the longer run, such an agricultural sector would have less and less to contribute to overall economic well-being in the CEECs, but would essentially depend on transfers from the rest of the economy. This is exactly what the EU has experienced as a result of the high level of protection and support provided by the CAP (see below, Chapter 6).

There is one more reason why keeping the level of support low until the time of accession to the EU, rather than beginning price alignment with the CAP soon, is the recommended strategy in the CEECs. Price alignment with the CAP requires an assumption on where the CAP will be at the time of accession by the CEECs. In the previous Section the analysis presented was based on the working hypothesis that the CAP will not change in future, except for the changes which are already in the pipeline due to completion of the MacSharry reform. While this hypothesis may be useful for analytical purposes, it is not necessarily realistic. Completion of the MacSharry reform may not suffice to solve most of the major problems which the CAP has created. There are domestic reasons in the European Union why more changes should be made to the CAP. Moreover, as accession by the CEECs to the EU becomes more and more likely, and as the time at which accession may take place gets closer, the need will be felt to reconsider some basic elements of the CAP. The following two Chapters of this study will explain why this is the case.

It is not certain how agricultural policy in the EU will respond to these pressures for further changes to the CAP. However, it may well be that significant adjustments are made to the CAP in the years to come. If this happens, the direction of change will likely be towards lower levels of price support and market protection. Hence at the time of CEEC accession the level of support and protection under the CAP may be closer to where it is now in the CEECs than to what it is currently in the EU. It would be tragic if at that time the CEECs had moved to the current level of CAP support, and would then have to revert to where they came from in the mid-1990's. As the EU experience has amply shown, it is much more difficult, both politically and economically, to reduce a high level of agricultural support than to keep it low level in the first place.

For all these reasons it appears that keeping a low level of support and protection in the CEECs is the preferable strategy among the three options considered above. Also, given the fact that most of the CEECs have already introduced policies to stabilize domestic markets and

to protect domestic producers against excessively low world market prices, there is no reason to suggest now that completely new systems of agricultural market policies should generally be introduced in the CEECs. There are still occasional wide price fluctuations on domestic markets, which are sometimes given as a reason to revise market policies in the CEECs.<sup>11</sup> Price fluctuations are, to some extent, a natural phenomenon on agricultural markets. Some additional stabilization measures may be necessary (see below, Chapter 8). But to eliminate price fluctuations altogether would mean to suppress necessary market signals, without the certainty that governments are better able to determine appropriate prices than the market place. In particular, it is important to emphasize the conceptual and practical distinction between the stabilization of prices on the one hand and price support on the other hand. Price stabilization by definition would at best cut off some particularly pronounced price drops. Price support, on the other hand, intends to raise the level of prices on average, usually by keeping them even above the level they might otherwise have in short periods of fluctuations with momentarily high prices. The EU has made the experience, at high cost, that price stabilization can easily turn into price support, simply because there is a tendency to raise the floor price higher and higher over time. The CEECs should be aware of the danger that this could happen to their own price policies as well.

All this is not meant to say that certain improvements cannot be made to agricultural policies in the CEECs. Some such improvements will be discussed below in Chapter 8. These policy adjustments considered below should also help to make a low price strategy politically feasible in the CEECs. Moreover, there are still cases where domestic market prices of some products are currently kept below the international price level, in particular in Bulgaria and Romania where export restrictions interfere with market price formation. In these cases, revisions should be made so that domestic producers are not disadvantaged relative to international market prices. Where low consumer prices (e.g. for bread) are considered a priority, limited consumer subsidies, or even better social safety net policies, are preferable to artificially low market prices.

The arguments advanced here have been on a fairly general level, and not much distinction has been made between individual CEECs. Is it true that all CEECs should pursue the same policies? As a matter of fact, agricultural market and trade policies already differ significantly among the CEECs, both with respect to the instruments employed and the levels of support and protection granted. Implicitly an advice that support levels should be maintained at their current levels, rather than being raised, would mean that this differentiation among individual countries would continue to prevail. To the extent that past policy decisions in individual countries reflect their different economic and social conditions this policy

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<sup>11</sup> See Nallet and van Stolk (1994), *passim*, for such an argument.

differentiation may have good reasons. On the other hand, not all (implicit) decisions on levels of support and protection in the past may have been made with full insight into all the implications. It could well be argued that some levels of support in some CEECs are already higher than is in their own best interest, and should therefore be lowered. Hence in a way one could suggest that a more uniform policy with low support and protection levels across all CEECs would be better than the current differentiation. One major additional argument against a continued policy diversity is that it makes it difficult to create more liberal agricultural trade among the CEECs. This point will be taken up below in Chapter 8. Again it has, though, to be emphasized that there are other policies which can and should complement the fundamental decision regarding the level of support and protection. Such other policies can and should differ among countries, in accordance with their specific economic and social conditions. Some of these policies will also be discussed in Chapter 8.

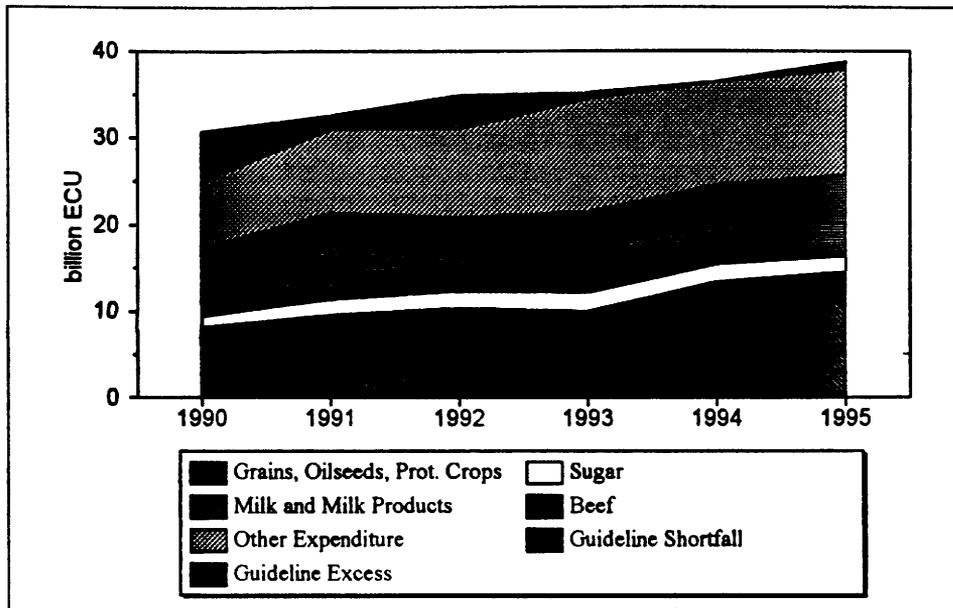
## **6 Policy Options and Constraints for the CAP: Medium Term**

### **6.1 A. Medium Run Outlook for the CAP**

The ease with which the CEECs can be assimilated into the CAP will depend crucially on the development of the CAP over the next six years. This medium term outlook is the subject of this Chapter. The outlook is likely to be conditioned by four different sets of pressures. First, the budget costs of the CAP will continue to be controlled by an overall budget constraint which is unlikely to be relaxed. Second, the constraints imposed on the CAP as a result of the Uruguay Round agreement will put strict limits on price developments under the CAP, and help to shape the instruments used. Third, the accession of some of the EFTA countries, and the progress toward membership of the CEECs will change the market balance for the EU and influence both the budget cost and the political support for the CAP. Fourth, the CAP will continue to be subject to pressures linked to broader rural and societal aims such as environmental, health and distributive objectives. All these factors will in turn be influenced by internal trends in technical progress (such as the increase in cereal yields) and in external factors (such as world market prices). In the face of so many variables, no-one can say with any certainty what the CAP will look like when the CEECs join the EU. One can however indicate which set of policy responses gives the best chance of a satisfactory docking of Central and Western European agricultures.

The EU has experienced a period of five years when budget costs for agriculture have been subject to limits, based on the proportion of total spending. The extra payments needed for CAP reform have strained these limits. Evidence of mounting budget pressures can be seen already. Graph 6.1 shows the growth in budget in the past five years. Even without the influence of new members on the budget (see below) it is likely that current policies will exhaust the budget allocation in the very near future.

The response of the Union to these budget pressures will determine in large part the CAP that the CEECs join. If the response is to reduce prices then this will be consistent with eventual accession of the CEEC: if the reaction of the Union is to tighten supply control and remove productive capacity this will make accession more difficult. Any attempt to shift the burden to consumers will run into problems with the GATT Agreement (see below). One possible way out would be to shift the financial burden back to the individual member-states. If

**Graph 6.1: FEOGA Guarantee Fund Expenditure, 1990-1995**

Sources: Agra Europe, var. issues; USDA (1994).

the states took over any responsibility for price support, this would cause political problems and threaten the unity of the market. It would however be possible, with other balancing budgetary adjustments, to take over some part of the compensation payments, properly disconnected from production incentives, as national obligations. This would not only reduce FEOGA spending but make the budget burden easier for new members to accept.

Even if the limits on budget shares were not to keep the CAP spending within strict limits, there is now for the first time an effective external constraint on the CAP. The Uruguay Round Agreement on Agriculture, if it goes into effect as planned, will have implications for the CAP from 1995 until 2000. As mentioned in the preceding Chapter, the Agreement calls for a conversion of all non-tariff trade barriers (including variable levies) into tariffs, which would then be reduced on a given schedule. Export subsidy expenditure is constrained, and reduced on a given schedule. The volume of exports benefiting from subsidies is also to be reduced, and export subsidies cannot be introduced on other products. Domestic support in those cases where prices are administered is also reduced by schedule. Though the degree of liberalization is not dramatic, there will be additional pressures before the end of the decade to negotiate a continuation to the Agreement in order to liberalize agricultural trade further.

The GATT commitments in agriculture accepted by the EU are unlikely to have a marked impact on EU agriculture in the next two years. Agreement was made possible by the slight decline in some CAP prices (expressed however in terms of a strengthening "green"

ECU) over the years since the Uruguay Round started, and more particularly by the bold Reform decided in 1992. As a result, the constraints on export subsidies and total support can be met without immediate policy change. In the medium term, the constraint on the volume of exports which can be subsidized represents the most binding constraint and is likely to impact on CAP price decisions before the end of the GATT implementation period (i.e. before 2000).

The Agreement also mandates a change to the variable levy system for import protection, replacing it with tariffs. This tariffication is accompanied by a special safeguard mechanism which can be used in cases of import surge or world price collapse. The height of the new bound tariffs are such as to put little pressure on domestic market prices for the next few years. Moreover, for cereals a maximum duty-paid import price has been negotiated as a part of the EU's obligations. This implies a continuation of a modified threshold price system, at least so long as world prices do not drop to very low levels.

It would however be a mistake to think that the impact on the CAP of the GATT agreement is small. Even though it does not mandate many price and policy changes in the immediate future, it effectively constrains future decisions. Specifically, it makes it difficult if not impossible to revert to the policy price levels that obtained before CAP reform. It makes it difficult to increase the level of compensation to farmers under CAP reform, or to relax set-asides, without incurring the risk of challenge under the GATT. It makes it impossible to expand the use of export subsidies beyond the limits agreed in the Schedules. And it obliges the Union to maintain current access for specified agricultural products. In effect it locks in the policy changes of the past few years, and makes any deviation from that path both politically and economically costly.

The enlargement of the EU to include Austria, Finland, Sweden and when ratified Norway, will not have a great influence on the CAP. The new members taken together are net importers of most major farm products, with the exception of milk products. Their accession will not add significantly to the budget, and will not cause any major disruption in agricultural markets. The two influences that can be expected are more subtle. First, the new members will have some influence on the political balance of the Union with respect to agricultural policy. This is likely to show up as strong opposition to price declines, at least if unaccompanied by compensating headage and hectare payments. It will also be manifest in a stronger interest in the environmental impacts of intensive agriculture and in the pressure to recompense farmers for the scenic and recreational value of their land (see below).

In addition, the accession of the EFTA countries will establish precedents for the further enlargements to the East. First, the fact that the Compensation payments under CAP reform were treated as a part of the *acquis communautaire* sets a precedent which other new members may be able to follow. In effect, the Union accepted some part of the financial cost of

providing headage and hectare payments for the EFTA countries. These payments would have been needed in any case to bridge the gap between their generally higher price levels (except in the case of Sweden) and those of the CAP. As the net budget contribution expected from the new members was decided by negotiation, the transfers under the MacSharry payments were not necessarily a (net) burden on the EU budget. Similarly, the cost of the new programmes for Arctic regions are unlikely to be a heavy burden on the budget.

The prospect of the accession of the Central European states is much more threatening to the stability of the CAP, and to its ability to live within financial guidelines. This central issue will be taken up below when discussing alternative policy options for the CAP.

In addition to the market balance and budget cost constraints, other forces will be acting on the CAP in the next six years. These include the pressure to make sure that environmental goals are not violated by commercial agriculture. The addition of new members highly sensitive to environmental issues will strengthen this trend. One would expect more concern over animal welfare, worker health and consumer quality and food safety issues. By contrast, broad goals of "rural development" not tied to these essentially urban concerns are unlikely to make much impact on the agricultural policy.

In addition to environmental and health concerns, issues of income distribution are likely to surface over the next few years, as the gap between those who receive large payments from the CAP and those that don't is increased. This could lead to pressures to limit payments, and to put other constraints on the significant amounts of money that now are paid directly to the farmer. This could in turn lead farmers to want to find some other criteria for payment, such as stewardship of natural resources and provision of amenities.

The combination of these two pressures could take the CAP down a path toward the personalization of policy, and away from the support of commodity prices as a proxy for income maintenance. Some part of the payments would be given for activities undertaken to preserve environmental amenities. But these payments would be *in lieu* of controls on farming practices, and hence conform both with the trend to using market mechanisms to achieve environmental aims and also be consistent with the notion of freedom of the farmer to choose his farming pattern and practice. Coupled with the GATT constraints on price policies, and the encouragement to use other methods to achieve income objectives, one could well see a different mix of policies in rural Europe by the end of the century.

## 6.2 Options for the CAP in the Medium Term

### Option 1: Minimal Changes to the CAP

One reaction to all these events is to try to preserve the policy as it exists, adapting to pressures in an ad hoc way. Such a strategy would avoid taking action to forestall crises. This reactive approach to policy developments has three main problems. First, such a strategy delays the necessary changes in policy which would in any case be in the interest of the Union. These include the promotion of a competitive agricultural industry that can sell goods on world markets without the need for subsidies, the provision of raw materials for a food industry that also is competitive, and the removal of the artificial incentives to keep land in inefficient activities for the sake of benefiting from support payments.

European agriculture at the moment appears to add little or nothing to the GNP of the Union. Net Value Added in the sector as a whole was about 110 billion ECU in 1991 (see Table 6.1). This was 49 percent of the value of final output. For the same year, the OECD calculated that 68 billion ECU had been transferred to the sector through the CAP, a sum also equal to 49 percent of the value of sales for those commodities included.<sup>1</sup> At the same time the OECD reports total transfers including those by national governments at 118 billion ECU, somewhere in between the net and gross value added.<sup>2</sup> In other words, the transfers through policy are the same order of magnitude as the excess of revenue over costs of inputs from other sectors (i.e. value added). If this is the case, then the cost of purchased inputs must be roughly the same as the market value (without policy intervention) of output. Hence, no appreciable value is being added to the inputs purchased from other sectors, and the industry as a whole contributes little or nothing to GDP. It is this total waste of good agricultural resources and the skills of the farm community that constitutes the biggest reason not to continue with current policies.

Second, in addition to internal economic considerations, there are other reasons to change policies before forced to by crisis. A strategy of waiting for further crises to develop will inevitably increase the likelihood of a conflict with GATT obligations. It will also maximize the likely political cost of enlargement and of conforming with GATT obligations. By reacting to problems rather than anticipating them, the policy will be in a semi-permanent

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<sup>1</sup> OECD, *Agricultural Policies, Markets and Trade*, Paris, 1993, p.131.

<sup>2</sup> *Ibid*, p. 160. Total transfers reported include those in the form of social policies. Not all of these transfers turn up in Net Value Added. This should be kept in mind when interpreting the comparison of these figures.

**Table 6.1: Value Added in EC-12 Agriculture in 1991**

	Billion ECU	Percent
Final Agricultural Output	223	100
Gross Value Added (Market Prices)	127	57
Gross Value Added (Factor Cost)	138	62
Net Value Added (Factor Cost)	110	49

Source: OECD (1994d).

state of crisis. Those that support the continuation of the CAP as it stands at present will always be seen to be at odds with those that are arguing for EU enlargement, for good trade relations with other OECD countries and with the developing world, and for a competitive EU agriculture which can support a competitive food industry and contribute to the economy.

Third, the most important disadvantage of the minimal change option in the context of preparing for accession by the CEECs is that it would essentially preclude the extension of the CAP to the new entrants from Central and Eastern Europe. Such an extension would result in a situation which is not sustainable for budgetary and trade reasons. As reported above in Chapter 5, we estimate the annual budget expenditure for market policies in the four Visegrad countries resulting from price alignment with the CAP to be in the order of magnitude of 9 billion ECU in 1993 prices. In the context of our discussion of policy options for the CEECs, this expenditure was considered to be spending out of government budgets in the Visegrad countries. Once these countries have acceded to the EU, this expenditure turns into a burden on the EU budget. In addition to this expenditure for price support and export subsidies the EU would have to finance MacSharry compensation payments to farmers in the CEECs if the CAP remains unchanged. Of course it could be argued that there is no price decrease to be compensated in the CEECs, and hence that there is no need to extend MacSharry payments to them. On the other hand a precedent was set in accession negotiations with the EFTA countries, where no doubt was raised over the right of their farmers to receive compensation payments, out of the Brussels budget, like any farmer in the EU-12. With an unchanged CAP, under which farmers in all existing member countries receive compensation payments out of the Brussels budget, it would be politically rather difficult to explain to the much poorer farmers in the CEECs why they should be excluded from such payments, while at the same

time being expected to compete with farmers from the rest of the Union on an equal footing as far as market prices are concerned.

If MacSharry payments were indeed extended to CEEC farmers, this would amount to an expenditure of around 4.3 billion ECU for Visegrad country farmers alone (see Appendix I). Additional sums would be required for market policies and compensation payments in the other CEECs. Total additional expenditure for extending an unchanged CAP to the six associated countries in Central Europe may well be in the order of magnitude of 20 billion ECU or more (see Appendix I).<sup>3</sup> Expenditure under the FEOGA Guidance section would then increase by more than one third. Such a massive increase would not only be politically difficult to accept. It would also violate the principle of budgetary constraint established by the guideline for the CAP, which links agricultural policy expenditure to GDP in the EU. Accession by the six CEECs would expand GDP of the then EU-16 by around 3 per cent. A simultaneous increase of CAP expenditure by more than one third would not appear to be consistent with that growth in GDP.

Also, as discussed above in Chapter 5, the GATT commitments which the CEECs would bring to the EU do not provide scope for their adoption of the CAP. If aggregated with the EU's GATT commitments, which at the time may hardly suffice to cover an unchanged CAP, they would certainly not be sufficient to allow for the CAP to be extended to the CEECs. It also is unlikely that the EU would find acceptance in GATT negotiations under Article XXIV:6 that it can adjust its Schedule commitments such that they would suffice to cover an unchanged CAP extended to the CEECs.

In other words, the minimal change option for the CAP is not only undesirable from the perspective of the current EU. It would simply be unsustainable if extended to the CEECs.

### **Option 2: Continuation of CAP Reform, Improve Coverage, Adjust Instruments**

An alternative approach is to attempt to continue the reform process started in 1993. This means at least two further stages in the reform process. The first is to complete the reform of sectors other than the cereals and oilseeds complex. Reform of the dairy industry was shelved at the last minute in 1993, in order to get agreement on the cereals and oilseeds sector. At that time, further dairy quota cuts were contemplated, along with price cuts for dairy products. Some price cuts survived, but the dairy sector is still operating with prices far above world market levels. Reform of the dairy sector needs to be restarted. Price reductions could

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<sup>3</sup> Various other studies have tried to estimate the budgetary implications of extending the CAP to the CEECs. A survey of some of these studies is provided in Directorate General II (1994). The maximum estimate, by Anderson and Tyers (1994), arrives at a figure of 40 billion ECU.

be compensated by the issuance of certificates to farmers, as suggested in the original MacSharry reform paper. In addition to the cereal and dairy sectors, other sectors also are in need of policy modification to become more efficient. The sugar sector, long neglected in reform discussions because of its small budget cost, is also among those that operate at price (and cost) levels well above the international competition. The wine sector, along with those for fruits and vegetables could also be improved by inclusion in the reform process.

The second step in this modest completion of CAP reform is to reduce the incentive that currently exists for farmers to continue to farm hectares just in order to get compensation payments. If the farmer cannot make a profit from the production of cereals and oilseeds at the market price, as supported by the threshold price (or maximum duty-paid price under GATT rules, in the case of cereals) and the intervention price, then it is clearly a waste of resources to insist that the land is used in this way. One might wish to suggest a number of criteria for receiving the payments: use of the land in an inefficient way should surely not be one of them.

From the point of view of CEEC enlargement, this option would be slightly less problematic than the minimal change option. However, it would not fundamentally change the agricultural policy environment to which the CEECs would accede, and it would not sufficiently solve the problems which CEEC accession would create for the EU budget and for the GATT commitments of an enlarged EU. The crisis following CEEC enlargement might be less dramatic, but it would be sufficiently severe to get into the way of a smooth process of assimilating the new countries of Central and Eastern Europe.

### **Option 3: Complete Reform Process to Give Competitive Agriculture**

The third strategy is to be proactive, anticipating changes and adapting before a crisis occurs. It involves going considerably further than the present reform in lowering market prices and in paying compensation payments to those that are severely disadvantaged.

In the case of the cereal sector, the next step would be to lower the market price by some significant amount, until close to expected medium-run world market prices levels. The extra compensation payments, as well as compensation payments already made under the MacSharry reform, would be paid in a different way than currently is the case. First, no further use of land would be necessary to receive the payments. They should carry a termination date, say ten years, with a declining payment value, but be fully portable and transferable.<sup>4</sup> Set-asides

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<sup>4</sup> The best way to make fully decoupled payments portable and transferable is for the EU to accept a firm commitment, vis-à-vis each farmer eligible to receive payments, to make these payments on a regular schedule over a given number of years. Farmers should then be allowed to sell their rights to these payments on the capital market, like government bonds. For a full discussion, see Tangermann (1992).

would be discontinued, as being unnecessary if market prices are close to world market levels. Export subsidies would fall with the drop in market price, and so the level of exports need not be constrained by set-asides. Moreover, if farmers are no longer required to farm land in order to receive compensation payments, output would decrease. Farmers would make planting decisions based on the best use of their land rather than on the need to satisfy programme requirements.

In the case of the dairy sector this option could include a multi-year commitment to move support prices towards those on world markets, compensated where necessary by payments not tied to continued milk production. The system of dairy quotas itself, as long as it is still necessary until prices have been sufficiently reduced, needs to be overhauled, to allow the sale of quota rights across member states. Production of without-quota milk should be allowed by producers who wish to compete with overseas producers. Products made from this non-quota milk would not receive an export subsidy. Over time such milk could replace quota milk on the domestic market, as the quantity of quota milk is reduced by the purchase of quotas from farmers. These quotas would not be reissued: the effect would be to give compensation to the farmer for loss of the quota rents inherent in the supported market.

The two central elements of this option would be a reduction of CAP support prices to a level close to world market prices, and a complete decoupling of compensation payments from production and use of resources. Both elements could be implemented in a gradual fashion, without a "reform of the (MacSharry) reform" having to be declared. Price reduction could occur in annual steps, though it would be best to have a predetermined schedule of such price cuts over a number of years. Decoupling of compensation payments could be implemented in an incremental fashion by gradually increasing the percentage of their base acreage which farmers can voluntarily set aside without losing payments. As more and more acreage would be idled voluntarily in this process, the percentage of mandatory set-aside could be simultaneously reduced. Similar schemes could be designed for livestock payments.

Another helpful feature of such a change to the CAP would be a redefinition of the approach to financial solidarity in EU agricultural policy. Once compensation payments are decoupled from production and resource use they will no longer distort production incentives and become pure income transfers. Under the subsidiarity principle, much can be said for pursuing income policies at the level of the member states, as long as they do not distort competition across borders. It would therefore be logical to hand financial responsibility for decoupled payments over to the member states. As this would significantly change the volume and direction of financial and economic transfers among member states, lump sum adjustments would probably need to be made to member states' contributions to the EU budget. However, once initial budget adjustments have been made such that no member state can claim to be

financially disadvantaged, member state governments should be happy to have flexibility in granting income transfers to their farmers in line with their domestically felt needs.<sup>5</sup>

An important advantage of this option would be that the question of whether compensation payments should be made to CEEC farmers is a non-issue. Governments of the CEECs would have to decide for themselves whether it is appropriate to grant income payments. In all likelihood they would not find that advisable. The historical origin of compensation payments in the EU is the reduction of support prices agreed as part of the MacSharry reform in 1992. Accession to the EU would not result in agricultural support price reductions in the CEECs, unless they were to move in the meantime to a level of price support above that prevailing in the EU at the time of accession. If prices do not have to be reduced as a result of joining the CAP there is no reason to offer compensation, and hence CEEC governments are unlikely to see any need for such payments. Indeed, low CAP prices and nationally financed decoupled payments in a pre-accession EU would eliminate the temptation to raise the level of price support in the CEECs before accession just for the reason of being entitled to compensation payments from Brussels. The existence of potentially different levels of compensation payments in different member states of the (enlarged) Union would not cause economic problems, and would not be inconsistent with a Single Market, if these payments properly decoupled as suggested here.

### 6.3 Comparison of Options from the Viewpoint of the Present EU

Casual observation of the political process suggests that the option most likely to be followed is that of relative inaction until provoked by crisis. However the economic costs over the next few years of such a course may well be high. If yield increases for the major crops continue at 1.5 - 2 percent a year, the inaction strategy will prove untenable. Changes in the CAP will be forced by both the GATT Agreement and the budget. The changes will be either of the type outlined in options 2 and 3, in which case the delay will have been costly, or will be of a less desirable nature. Similarly, if world prices are seriously depressed then export subsidy expenditure as allowed under the GATT will be inadequate to remove surpluses off the domestic market.

The most tempting *ad hoc* strategy for the relief of market surpluses is supply control, through greater set-asides or land retirement schemes. In the case of animal products, herd reduction schemes play the same role. The problem comes in the distortion that such schemes

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<sup>5</sup> Major elements of this option for the CAP are similar to those suggested by an Expert Group (1994) in a report for DG II.

imply for the allocation of resources within the farm sector (even if the total resources in the sector have been reduced by supply control). This distortion is also among countries, in that supply control is likely to have differential effects in different member states, and among farms. Total costs will be considerably higher for the same level of output, and hence farm incomes will be less for the same supported level of receipts. Moreover, the further intrusion of bureaucratic controls into the normal farm decisions on what to plant and what stocking density to maintain could cost both political support for the CAP (and for the EU) as well as add to the economic burden of the industry. In short, continuation of the current policy may have appeal but runs the risk of, at the least, costly delay in making needed changes and, at the worst, the promotion of supply control even though it is an undesirable direction for policy to take.

The middle-ground option of a continuation of CAP reform is inherently more costly in political capital, but has certain advantages. First, the reduction in the market price for dairy, sugar and other newly reformed commodities offers to those sectors the advantages that the first stage of reform did to grains and oilseeds. Lower consumer prices and lower prices for the processing industry would in effect remove a tax that currently holds back consumption and reduces competitiveness. Compensation payments would preserve for some time the income streams to producers until they were able to switch to alternative commodities. GATT constraints would be more easily met, and the improved international climate would have beneficial consequences for exporters of other products.

Nevertheless, there is a problem to this strategy. It may not prove enough to avoid problems associated with the challenge of membership of the CEECs. Price levels would still be higher than can in the long run be sustained. It would require a long transition period (see below) to avoid the overstimulation of agricultural output in the new members.

The more positive policy change would not only complete the MacSharry reforms but lay the foundation for a competitive agriculture for a Union of about twenty countries. This would include a truly single market over the area of the current Union, which would also be offered to new members from the start. It would comprise payments to farmers based on their past production of supported commodities, as an *ex-gratia* compensation for expectations misled by government promises. It would allow farmers to make their own planting and livestock raising decisions. It would remove the artificial incentive to maintain high use of chemical inputs, and hence to put in jeopardy the environment.

The benefits of taking CAP reform to its logical limit would be considerable. First, the wastage of resources that currently go to produce goods that have no commercial markets would be reduced. Second, the food industry could develop on a pan-European basis with the lowest raw material costs possible. Third, it would give the EU a position in world trade which

it has not had for years, in the forefront of those seeking to improve world markets. Fourth, and most important, the assimilation of the CEECs would be made both easier for the EU and less costly to the entrants.

## **7 Post-Accession Transitional Arrangements Between the EU and the CEEC**

### **7.1 Transitional Arrangements in Previous Enlargements**

The EU has had considerable experience in assimilating countries with different agricultural policies and price levels into the CAP. The accession of the UK in 1973 posed significant problems of a political and economic nature. On the political side, public opinion labelled the EC as a bastion of high food prices, in contrast to the price levels in the UK which for historic reasons had been governed by the state of world markets. The UK dispensed with the “deficiency payments” which farmers had come to accept as the main instrument of agricultural policy. It was also considered a food policy, in so far as it allowed consumers ready access to supplies at low prices. The reconciliation of this system with the CAP was to have a transition to the higher CAP prices, along with the introduction of import levies and export subsidies. The price gaps over the transition were offset by “accession compensatory amounts”, added to or subtracted from the traded price.

On reflection, a golden opportunity was lost at that time to make a radical adjustment to the price level in the EC to which the UK farmers and consumers were adjusting. Had compensation payments been given to the farmers in the Six, the troubles of the CAP in later years would not have been so great. It may have been difficult to do, however, in the climate of the time. An extraordinary rise in world prices in the mid-1970's altered conceptions about the long run state of world markets. As a result, prices rose less fast in the UK than they would have done outside the EC, as they were effectively subsidized by other member states. CAP prices were notched up in lagged response, and were left high and dry by the receding world market prices. These high prices led directly to the budget and trade problems of the next decade.

Transition arrangements had to be negotiated in the second round of enlargements, as well. Greece was given up to seven years to prepare its own markets for competition with EC produce. Portugal was granted an even longer period when it joined the EC, with a five year initial phase to allow Portuguese authorities to modify the marketing systems to allow implementation of CAP regulations, followed by a further five years to adopt EC price levels. Portugal had prices in many cases higher than the EC, implying some adjustment problem for farmers. A long transition was presumably desirable to allow time for this adjustment. Spain, by contrast was ready to compete immediately, but was deemed to be a threat to the EC market in such areas as wine, olive oil and fruits and vegetables. As a consequence, Spain also

had a transition period, though shorter than that for Portugal, which in effect allowed the EC to modify its policies in the area of Mediterranean crops.

The transition arrangements for the EFTA countries were different again. The EFTA countries had a history of price supports higher than in the EC. They also had a history of closed markets, and had resisted attempts to open up agriculture among themselves as a part of EFTA. Agriculture was kept out of the EC-EFTA bilaterals which were negotiated after the UK joined the EC. Agricultural goods were also kept out of the EEA, the Treaty which in effect gave EFTA countries economic though not political membership of the Community. When the EFTA countries came to apply for membership, the anomaly of agriculture had to be tackled. The normal assumption would therefore have been a long transition to allow farmers in these countries to adjust over time to the considerably lower farm prices. The exception to this would have been Sweden, where the farm support prices had been reduced (with the payment of some compensation to farmers) in advance of membership application as a part of economic restructuring. But the EFTA countries were applying to join the EU (i.e. post-Maastricht) and hence had to adhere to the principle and to the practicalities of a borderless European Union. Accession compensatory amounts had been traditionally granted or collected at the border. In the spirit of CAP reform, of the GATT talks, and of their own attempts to get away from high market prices, the new members settled for instantaneous adoption of policies and policy prices, with an overlay of compensation payments based on hectareage and headage and financed from both EU and national funds.

## **7.2 Options for the Transition Period**

### **Option 1: Exclusion of Agriculture from Single EU Market**

Transition arrangements for the CEECs could follow one of four models. First, one could imagine an agreement for membership which so circumscribed agricultural trade flows that it constituted a de facto exclusion of the sector from the internal market between the existing EU and the new members. The analogy is with the treatment of agriculture within the EEA. This virtual exclusion could take the form of strict quantitative restrictions on imports from the CEEC, or semi-permanent taxes on imports from (and subsidies on imports to) the CEEC. The implication would be that the price levels need not converge, and the policies need not be harmonized. The internal agricultural market in the EU would be protected from competition from the CEEC. Such a situation is more likely to obtain if the CAP has not been reformed further (Option 1 for the EU, above) and if the CEECs have not made a move to EU levels (Option 3 for the CEEC). Under such circumstances, the price gap could be wide. The temptation to exclude agriculture from the process would be considerable.

This would have a number of serious economic and political implications. It would perpetuate the current imperfect market access of CEECs into the EU. As a result, the CEECs would be denied benefits that other members enjoyed in the internal market. Politically, this would constitute "second-class citizenship" for the CEECs. From the point of view of European integration, it would imply a breach in the principle that Single Market legislation applies to all members. It would in effect represent a move to "Europe à la Carte". Other countries may be tempted to have their own separate agricultural markets and policies. Lastly, it would postpone the removal of border posts between the current EU and the CEECs, and hence represent a departure from the free internal market. All this would be just for the sake of avoiding inevitable decisions in agricultural markets.

### **Option 2: Long Transition for Prices in the CEECs**

A second transition model would try to make the transition period as long as possible, as a way of avoiding the political problems of a permanent exclusion of agriculture from the free circulation of goods within the Union. One could imagine a long transition period, say fifteen years. This again denies the new members immediate market access, and also gives them the option of keeping prices low in the meantime. Moreover, it does not obviate the need for border posts. A long transition period would inevitably postpone adjustments in CEEC agriculture. The problem with postponing adjustment is that necessary changes are delayed and the costs of being out of adjustment are borne for a longer period. There is a cost to keeping two different price levels for agricultural goods in the EU (or more, if the CEECs have not harmonized their own prices). This cost is a misallocation of resources within the agricultural sector of the enlarged EU, leading to higher production costs and ultimately to lower farm incomes. But there will be benefits to a delayed adjustment if the end-point is itself unsatisfactory. Adjustment to farm prices which are too high has its own costs. Too many resources are kept in agriculture, to the detriment of other sectors and the economy as a whole. Delay in imposing these costs on the economy need not be a bad strategy.

The economic cost of this strategy may well revolve around the budgetary arrangements. If the CEECs are relieved of paying agricultural levies to the EU, and are denied access to export subsidy funds, then the appropriate price level for agricultural products in the CEECs will be close to the expected level on world markets. Higher price levels impose taxes on consumers and necessitate export subsidies. If however the EC does collect revenue, over the long transition period, from the (lower) level of tariffs applied in the CEECs; if the CEECs receive export subsidies from the EU for their third-country exports; and if there is no artificial ceiling on budget transfers from and to the new members, then this makes the world market price in effect irrelevant. In that case the economic benefits will depend crucially on the market balance for agricultural products. For export products a rapid shift to higher EU prices will be

advantageous. For imports it will impose an economic cost. On balance it would seem that a long transition is likely to be against the interests of the CEECs if they have a predominant export interest in agriculture and if they are immediately drawn into the budget process.

In any case the major distinction between excluding the CEECs from the CAP altogether and a long transition period is mainly of a political and optical nature. In terms of administrative arrangements the two options are very similar at least during the initial phase. Border posts would have to be maintained just for agricultural reasons under the long transition option, and the Single Market would not apply to agriculture. In spite of these drawbacks, if the CAP is not changed before accession it would be difficult to extend it immediately to the CEECs after their accession, for all the reasons discussed above. Hence the issues of CAP reform and design of the transition regime for the CEECs are closely interwoven.

### **Option 3: "Single Market" without Competition**

A third option for transition allows for the impression of a common market without the reality. If the CAP is not reformed before Eastern enlargement, if the appearance of a Single Market without border posts is considered an imperative, and if the EU budget does not suffice to finance the market surpluses which application of the CAP would then tend to generate in the CEECs, then this third option can be implemented. Production of all major agricultural products in the CEECs can then be made subject to quotas, like sugar and dairy quotas currently used in the EU. With a rigid quota system, surpluses can be avoided in the CEECs even though their farmers are paid the same high prices as farmers in the EU. It is clear that this option would only look like a single market, as none of the effective competition which characterizes a truly single market would be allowed to occur. This option would only be a plausible choice if the EU were to avoid any further proper reform of the CAP and move towards more and more supply control instead.

On the other hand, if market forces are allowed to play an increasing role in EU agriculture it would be both counter-productive and unfair to suggest that the CEECs need to subject their agricultural sectors to rigid supply controls. It would also be a particular irony to suggest that countries which have recently escaped from central planning, and are about to make the final move towards the world of market economies by acceding to the EU, should move all the way back to state controls in agriculture at the very time of joining the EU.

### **Option 4: Rapid Transition to Common Prices**

A fourth option allows for prices to be harmonized rapidly. The desirability of that option is closely tied to that of the medium term development of the CAP, and to the strategy

of the CEECs prior to accession. Put simply, if the CAP is not reformed then much of the urgency to move to full market integration in agriculture is lost. A quick transition would then not be beneficial either to new members or to the existing EU. However, if the CAP were to be further reformed in the period before entry, then a rapid transition period would be both possible and desirable. Equally, a rapid transition to low common prices under a reformed CAP would be feasible for the CEECs only if they were to keep their support prices and level of protection low until accession. If the CEECs were to raise their level of support and protection in the next few years while the CAP is reformed, then the CEECs need time to adjust to what after their accession would be a low level of CAP prices relative to the prices the CEECs have reached in the meantime. An extended transition period would then also be needed.

As argued above, the strategy of keeping price support low is rational for the CEECs in any case. If, by the time of accession, the CAP has undergone further but still incomplete reform, the strategy by the CEECs of not moving soon to current CAP prices will have proved sensible. They would escape the cost of adopting a price level too high to be maintained. The new members would risk building the expectations of farmers and incurring obligations for compensation if prices had to come down. The strategy of maintaining price levels below those of the Union until membership is imminent implies a cautious policy of preparing CEEC agricultural sectors for membership, without overstimulation of those sectors which only CAP membership is likely to make profitable.

In the event that the CAP should undergo a complete reform as suggested above, the best strategy for the CEECs will also have been to have kept prices low. This eliminates any false expectations of highly protected markets. It avoids the pre-accession costs of increased price support. And it reduces tensions arising from GATT obligations which might otherwise constrain policy in the medium term. As important, it minimizes the potential threat as seen by the EU, of the disruption of markets following accession.

Under a reformed CAP, and only under that policy, the issue of how to deal with agricultural transition after CEEC accession is easily resolved. If CAP prices are low by the time of enlargement, and if the CEECs are wise enough to keep their prices low until that time, then there is no need for a transition period, and a complete Single Market, including agriculture, can be established immediately following accession. There is no problem of "second-class citizenship" and no need to design complicated transition arrangements for agricultural markets.

### 7.3 Trade and Budgetary Arrangements for the Transition

Intra-EU flows after enlargement would be governed by the choice of transition period. If price levels are still different at accession, border tax adjustments such as have been used in the past would seem to be needed. If the decision has been made to keep quantitative controls on CEEC imports, more extensive monitoring will be needed. This raises the question as to whether there will be commercial borders between the EU and the new members. If the only reason to have such borders is to regulate agricultural markets, there will be considerable pressure to speed up the process of policy and price harmonization. Given the tendency of border controls, in particular those of a quantitative nature, to be used as hidden form of protectionism, there is much to be said for removing such borders as a priority within the enlarged Union. This suggests that any price level differences at the time of accession should be compensated by means of payments directly to farmers (if the price level is higher in the acceding country) so as not to require interference with cross-border commerce. The other aspect of this is that CEEC farmers would benefit immediately from higher prices in the Union.

Trade flows from outside the EU would under such arrangements be immediately subject to the same tariffs as charged on imports into other member states. CEEC goods would be eligible for the same export subsidies as other members. The EU might under these circumstances consider negotiating an increase in the allowed expenditure on export subsidies under the GATT schedule, and the allowable quantities that can benefit from a subsidy. But as the CEECs did not have significant export subsidies in the base period, other countries may take the view that enlargement of the EU is not a reason to create more problems for other exporters. In this case the EU may have to absorb the extra exportable surpluses on the domestic market.

The budget arrangements for new members will no doubt be a matter for negotiation and compromise. The new members will be expected to contribute to the budget the tariff revenue on imports and to be reimbursed for intervention and export subsidy costs. They should be eligible for full participation in EU structural programmes. How much additional funding will be forthcoming is a political decision. But the significance of the method in which the transfers are made, mentioned above, should be emphasized. If there is an effective agreement on the net transfer to the new members, then at the margin they will pay in effect for their own export subsidies and keep their own tariff receipts. They will therefore need to calculate benefits and costs of price policies at world market prices, as representing the marginal cost of imports and the marginal value of exports. If there is no effective limit on the net financial contribution or disbursement then the marginal cost of imports and value of exports are the internal policy prices. Under such circumstances, the acceding countries (as with existing members) have no

incentive to keep production in check, as the Union membership as a whole underwrites the disposal of surpluses and taxes any imports which might otherwise be available at world prices. The solution to this dilemma is to reduce the gap between the world price and the internal CAP price to minimize both budget transfers and misleading production signals.

## **8 CEEC Policy Action for the Immediate Future**

When options for agricultural market and trade policies in the CEECs were discussed above (section 5), the conclusion was drawn that it is in the best interest of the CEECs if their level of support and protection is as low as politically feasible until they join the EU. This may sound like a contradiction in terms because it is exactly a low level of support and protection which may not be politically feasible. A number of factors may argue for more rather than less support and protection in CEEC agriculture. In particular, agricultural producer prices still tend to fluctuate widely on CEEC markets; farms are under economic and financial stress; farm incomes have fallen significantly in real terms, and there may be serious income problems in parts of CEEC agriculture; agriculture is hoped to act as a buffer against higher overall unemployment, and any additional shedding of labour which may result if the economic climate in agriculture does not improve is undesirable; imports of agricultural and food products have tended to rise and to cause problems for domestic producers, and with the simultaneous decline in agricultural exports the balance of trade has deteriorated. In a situation like that, is there any alternative to raising levels of support and protection? Indeed, there are alternative policies which can be brought to bear on such problems, and they create less problems in the longer run than protective market and trade policies in agriculture which mainly rely on price guarantees, export subsidies and import tariffs.

### **8.1 Market Stability**

As far as market stability is concerned it is crucial to keep in mind a number of fundamental facts. First, some degree of price fluctuations over time is natural for agricultural markets, and it is very costly for the overall economy if governments try to create completely stable markets in agriculture. Second, one should clearly acknowledge the distinction between price stabilization and price support. Governments which strive to improve market stability usually end up supporting prices at a level higher than the average of the market prices which would have prevailed in the absence of their policies, and this can become very costly, too. Third, well functioning markets have a built-in tendency to reduce price fluctuations through private activities, and the optimal policy for a government is to create the conditions under which such private activities can operate satisfactorily, rather than substituting public policies for these private activities.

Two major types of private activities which help to reduce price fluctuations over time, and to live with any remaining price instability, are storage and futures markets. It appears that

both types of activities do not yet work very well in the CEECs, and that CEEC governments could do a lot to improve their functioning. For stock-keeping to work satisfactorily one important prerequisite is to have good price information systems and market transparency. Indeed, it is extremely important for the CEECs to create and improve the institutions and the infrastructure required to monitor market trends and price developments and to publicize that information. Market participants who do not have reliable price information cannot act rationally, and cannot respond satisfactorily to price changes. Moreover, it is important to consider that market conditions can vary considerably across regions. There can be a shortage in one region and a glut in another region at the same time. Market stability can be very much enhanced if markets can arbitrage across regions. For this to be possible, price information again is an extremely important ingredient, but transport facilities and marketing infrastructure are necessary as well. Also, it is particularly useful if markets can balance across large regions, including regions in other countries. Hence international trading arrangements which allow this to happen make an important contribution to market stability. More open borders for agricultural trade among the CEECs would, therefore, also reduce the potential for price fluctuations. This issue will be taken up later in this section.

Other prerequisites for successful stock-keeping activities, and hence for a full utilization of the potential for private contributions to market stability, are the physical availability of storage capacity and access to credit. CEEC governments may consider to make it easier for private farms and traders to use storage capacities in previously (or still currently) publicly owned market agencies. For example, storage facilities in the big grain procurement agencies could be rented to private agents. Access to credit could be improved by creating and improving the institutional and legal conditions for using commodity stocks as collateral. Also, if credit subsidies are given at all, in spite of the economic drawbacks of these subsidies, it is probably better to concentrate them on credit for storage, rather than for investments in machinery and buildings which in the longer run may turn out not to be productive.

Futures markets have been used very successfully in countries where government interference with market forces did not eliminate the scope for price movements. Commodity exchanges where futures trading can take place require a number of institutional and legal provisions and also the necessary infrastructure. They also require a given minimum size of the market in order to operate successfully. CEEC governments may wish to study the possibilities of establishing the conditions for successful commodity exchanges and futures markets very carefully, with a view to using this instrument more extensively in the future. Again, cooperation across several countries in Central Europe may be useful because it could help to create the market size required for a successful operation of such institutions. As a temporary alternative, but also as a step in the direction of creating well functioning futures markets, government agencies could be allowed to engage in futures contracts, as long as they behave

like private traders, i.e. with a tight budget and without the government covering any losses in these activities. Activities of this sort are less distortionary than government intervention buying.

In addition to price instability, yield fluctuations can contribute to instability of farm revenues. However, one must remember that on aggregate in a given market, yield fluctuations and price fluctuations have a tendency partially to cancel out. This is because in years with low yields and hence low supplies, prices tend to be higher and *vice versa*. It has therefore often been observed that farm revenues have been more stable where prices were not stabilized by the government, even though prices by themselves may have fluctuated widely. In any case, for the individual farmer it is not necessarily the case that a low yield on his farm coincides with a high price on the market, and hence for the individual farmer yield risk can come on top of the price risk. Yield risk cannot be compensated through government market policies. However, the government can help to establish crop insurance schemes which farmers can then use to reduce yield risk. In Central Europe, where droughts can be a serious problem, as recent years have shown, crop insurance schemes may be able to help farmers reducing liquidity risks. However, in setting up such schemes, governments should be careful to design them such that they do not involve a large burden on the public budget. In other words, insurance premia and payments should be actuarially sound.

## 8.2 Farm Incomes and Unemployment

As a response to economic and financial stress in agriculture, measures which help farmers to market their products more successfully and to have easier access to credit are superior to price support. Again, improving market infrastructure and market transparency can do much. Measures in this category include the creation and improvement of wholesale markets; price recording and market information through the media; setting of product standards and quality criteria; support for export promotion agencies, and others. An extremely important aim is to improve competition in the marketing and processing sector, because monopsonistic structures in that sector not only reduce efficiency in the sector itself, they also contribute to depressed farm gate prices and low farm incomes.

In the area of credit for agriculture, much remains to be done in the CEECs. As a fundamental prerequisite for better access to credit, land registration and the elimination of any remaining uncertainties about property rights need to be speeded up. Jointly with measures required to improve the functioning of land markets, for both buying and renting land, policies of this nature help farmers to be able to offer collateral when applying for credit. At the same time, establishment of a well functioning institutional and physical infrastructure for banks in

rural regions will help farmers to have access to credit and banking. Lack of liquidity is one of the major problems in CEEC agriculture, and determined effort are required and possible to overcome this problem.

Low farm incomes in parts of CEEC agriculture will not altogether disappear through such measures, nor through any other measures. However, the problem of low farm incomes needs to be seen in a wider perspective. Generally, low incomes in agriculture reflect low opportunity costs of agricultural labor, i.e. a lack of alternative employment and earning opportunities. There are no agricultural policies which can solve that problem at its roots. Support measures in agriculture, such as price support and protection, may appear to promise relief. But they can at best postpone some of the problem, and often they do not even achieve that. Moreover, low incomes are generally not limited to agriculture, they are found in other parts of society as well. The longer run solution to the problem of low incomes is improvement of efficiency in the overall economy, and the best way to achieve that is to stimulate private economic activities, by creating the appropriate economic and political climate, well functioning institutions and a good infrastructure. For solving the problem of low incomes in agriculture, which generally is equivalent to low incomes in rural regions, regional policies are required which create incentives for profitable investments and production activities in rural regions in general, not only in agriculture.

While such policies contribute to overcoming the low income problem in the longer run, measures are also required in the short run. Such measures fall in the category of social safety net policies. Measures such as old age pension schemes, illness insurance, insurance against accidents, unemployment benefits, tax and income policies for families with children contribute to improving social security. Apart from some institutional peculiarities of agriculture (such as a possible lack of contributions to social security schemes among self-employed farmers or members of cooperatives) there are not generally any reasons why agriculture should have a special status in these social policies. More generally, low incomes are a problem of a general nature, and that problem should be tackled through general measures, rather than measures of a specific agricultural nature. Hence, even if that problem should be particularly pronounced among farmers, it is better to seek relief through measures which are generally available to all members of society. In particular, it would be wrong to respond to any farm income problem through measures such as agricultural market and trade policies. Not only are the benefits resulting from such measures not targeted to those people in agriculture which suffer most from low incomes, but any sector-specific policies involve the danger that the low income problem in that sector is perpetuated because people remain in the sector where they receive public support.

Similar considerations hold for the unemployment problem. Unemployment is a general problem of the overall economy, and it can only be overcome through policies which strengthen competitiveness of the overall economy and improve the functioning of the labour market. Public policies which distort markets may provide the illusion that they reduce unemployment by maintaining jobs in sectors which would shed labour in absence of such government policies. However, essentially these jobs are financed through income redistribution from other sectors of the economy, rather than earning their own incomes through activities which are productive for the overall economy. As a result of such government interference with market forces the economy on aggregate becomes less productive and less competitive, and in the end loses jobs rather than creating them. Expressed in a different way, attempts at keeping workers in agriculture even though the market does not offer remunerative jobs for all of them essentially means to disguise unemployment, rather than reducing it. From a social point of view, such disguised unemployment may appear less harmful than open unemployment. However, this short run relief has to be weighed against the longer run implication that a lower number of remunerative jobs is being made available in the overall economy. There is no way around acknowledging that the most appropriate way to tackle the unemployment problem is to make the economy more competitive, and that the social problem resulting from unemployment is best solved through unemployment benefit schemes.

Both low incomes in agriculture and the shedding of labour from the farming industry are politically pressing problems in the CEECs. However, factual knowledge about the nature and magnitude of these problems is rather limited. Equally, factual information on ownership patterns in agriculture, on farm structures, on financial conditions and profitability etc. is not easily available. Hence policies sometimes respond to perceived problems which may or may not be so real, and the extent to which policies pursued contribute to alleviating the perceived problems is difficult to measure. It is therefore a great challenge for CEEC governments to improve their monitoring systems in agriculture, with a particular view to collecting reliable information on social conditions in agriculture, on farming structures and on economic and financial well-being on different types of farms.

### **8.3 Agricultural Trade**

The worsening of the agricultural balance of trade can technically be halted through higher import tariffs and export subsidies for agricultural products. However, such protective measures are a rather expensive and inefficient way of improving the trade balance. One dollar of foreign exchange earned or saved through these measures costs more than one dollar's worth of domestic resources. The more promising approach is again to improve

competitiveness. In particular, as the domestic food industry becomes more efficient, competitive and quality-oriented it will be able to supply some of the more highly processed foods which have accounted for a good share of the increase in agricultural and food imports into the CEECs in recent years. Equally, with a more competitive food industry and more intensive export promotion, agricultural and food exports from the CEECs can recover. As structural and financial conditions in CEEC agriculture are improved and the decline in agricultural output is halted, chances are good that the agricultural trade balance will improve in the CEECs even in the absence of higher import tariffs and export subsidies.

Another area for immediate policy action in CEEC agriculture is to improve the conditions for trade among the CEECs. Agricultural trading arrangements under the CEFTA are far from creating free trade in agriculture between the Visegrad countries, and agricultural trade among the Visegrad countries and Bulgaria and Romania remains even more restricted through tariff barriers. As in many other "free" trade arrangements in other parts of the world, agricultural trade is treated in a far less liberal fashion than trade in other goods. The major reason is that government policies in agriculture tend to interfere more with market forces than is the case in other sectors of the economy. As a corollary, more open trading regimes in agriculture among the partners of a free trade arrangement would threaten the viability of the national market and trade policies in agriculture. Hence a significant number of trade restrictions in agriculture are usually maintained in order to allow the national policy regimes to go unchanged. Looked at from the opposite angle, the more similar the agricultural market and trade regimes can be designed across a group of countries engaging in a free trade arrangement, the easier it is to include agriculture fully in the free trade zone.<sup>1</sup>

Agricultural market and trade policies in the CEECs are far from being homogenous. The nature of measures employed differs from country to country, but more importantly levels of domestic price support and import protection are also not equal. On the other hand, at least among the Visegrad countries the differences are less pronounced than, for example, they were among the six founding member countries of the European Economic Community when they began to devise a Common Agricultural Policy in the early 1960's. In this situation it should be seriously considered whether, first, the Visegrad countries, and later possibly also the other countries having Association Agreements with the European Union, could not harmonize their agricultural market and trade policies amongst each other to the extent that fully free trade in agriculture within this group of countries could be achieved. Indeed, one could eventually go a

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<sup>1</sup> For a full discussion of the treatment of agriculture in free trade areas, and the implications for domestic policy, see Josling (1993).

step further and consider the introduction of a customs union in agriculture, if not a common agricultural policy among the CEECs.<sup>2</sup>

A move to free trade in agriculture among some or all of the CEECs should not create major difficulties, but it should be designed with care. Free trade requires primarily the absence of border policies among the countries involved, in particular elimination of tariffs, export subsidies and quantitative restrictions in trade among the members of the free trade area. As demonstrated by existing free trade arrangements including agriculture, for example the North American Free Trade Agreement (NAFTA), free trade does not require a complete harmonization of all agricultural policies across all members of the free trade area, though some degree of harmonization will be necessary for some types of policy measures.<sup>3</sup> In particular, domestic policies which directly affect market prices must not diverge too much among the countries involved. For example, guaranteed prices (implemented through some form of intervention buying) must not differ by more than transport cost because arbitrage would otherwise undermine the functioning of price guarantees. Also, in order to make good economic sense, and to be politically palatable to producers in all countries involved, the playing field should be as level as possible among the partners of a free trade arrangement. Hence trade distorting domestic subsidies should not differ too much among the participating countries. The distinction made in the Uruguay Round Agreement on Agriculture between less distorting forms of domestic support ("green box") and other policies provides useful guidance in this regard. The establishment of free trade, and the parallel harmonization of those policies which should not differ too much among the partner countries, does not have to happen overnight. It can be achieved gradually over a given time horizon. Also, the number of countries participating can increase over time. Again, procedures adopted in similar cases, such as NAFTA, can serve as an example. In particular, the Visegrad countries could begin to establish free trade in agriculture among themselves, and other CEECs could be invited to join the club later.

Free trade in agriculture among some or all of the CEECs would have a number of important advantages. First, a common agricultural market among the CEECs would have a relatively large size, with all sorts of attractive consequences. As mentioned above, price fluctuations on that large unified market would tend to be smaller than on smaller national markets. Market institutions such as commodity exchanges and futures markets could be more easily established. Trading companies could deal with larger quantities, and realize better

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<sup>2</sup> Free trade in agriculture among the CEECs associated with the EU would establish a specific agricultural variant of the Association of Association Agreements (AAA) suggested by Baldwin (1994).

<sup>3</sup> For a discussion of the varying need for policy harmonization for different categories of policy measures, see Josling (1993).

prices. Regional specialization could take place, with a better utilization of comparative advantages and the consequent improvement of productivities. Enterprises in the food industry could more easily sell to all national CEEC markets, and would therefore find it easier to establish a smaller number of factories which can better use economies of size. Second, CEEC governments would gain experience in dealing with a larger common market for agricultural and food products. This would help them to prepare for membership in the EU and participation in decision making under the CAP. Third, with a more harmonized agricultural policy across the CEECs, it would be easier for the CEECs to adopt a common position on agricultural trade matters vis-à-vis the EU, and the Union could deal with a more homogeneous group of negotiating partners, rather than with individual countries with divergent views.

The EU, on the other hand, could support the creation of a common market for agricultural and food products among the CEECs in various ways. Not only could it offer institutional advice and assistance, but it could, in agreement with the CEECs, modify the agricultural trade provisions under the Europe Agreements such that all existing preferential quotas are no longer specific to country of origin but can jointly be utilized by all CEECs. On aggregate this should make it easier for the CEECs to make full use of the quotas, many of which have not been fully used so far.

## **9 EU Policy Action for the Immediate Future**

### **9.1 Restructuring Agriculture in the CEECs**

In order to facilitate the restructuring and transition process in the CEECs, the European Union could and should increase its assistance to the CEECs substantially, mainly through PHARE. Measures in this category relate to those CEEC policies which were discussed above in Chapter 8. The EU should provide technical and financial assistance in four main areas.

First, the EU should help to develop and improve the agricultural institutions and infrastructure in the CEECs. In particular, the EU should assist improvements in the marketing sector, thereby helping to reduce the pressure for more agricultural policy support and protection. For example, institutions that monitor and report volumes and prices of agricultural commodities in order to create market transparency have to be improved; market infrastructure needs strengthening, e.g. in the area of wholesale markets, commodity exchanges and futures trading; standards governing food quality and hygiene requirements need to be re-examined; marketing agencies need to be established and strengthened; export promotion can be enhanced. Moreover, the EU should help restructuring and privatization in agriculture through a number of measures. In particular, agricultural extension services have to be tailored to the new economic environment; rural credit needs fundamental strengthening; land registration can be speeded up significantly. The EU and its members states have considerable expertise and experience in organizing and operating these institutions within the CAP and in national policies, and this experience could readily be made available to the CEECs, jointly with the financial means required to establish and strengthen the institutions and the infrastructure required.

Second, the EU could help to absorb some of the adverse employment effects of agricultural restructuring by supporting training programs for displaced agricultural workers. This may involve the establishment of decentralized education centres and the preparation of vocational teachers for their new tasks. Regional and Social Fund expenditure, together with the expertise built up over the years of operating such schemes in the EU would be useful to the prospective members. At the same time the EU should step up efforts to establish monitoring systems which provide better insights into the economic and social situation on farms and in rural regions of the CEECs. Experience accumulated in EUROSTAT can be extremely useful in this area.

Third, the EU could actively contribute to the transformation process by providing credit lines and investment funds for new or reformed enterprises in the CEECs. In the agricultural and food sector, this financial assistance should be mainly directed towards agro-business and food processing companies, as these companies presently face severe shortages of capital. As stated above, the success of such enterprises will be a major determinant of the ease with which the CEECs adapt to the single agricultural market as they join the EU.

Fourth, as a matter of technical assistance, the EU should step up efforts to help the CEECs to establish the institutional and legal conditions necessary to implement the CAP once they have joined the CAP. The Europe Agreements have provisions regarding the "approximation of laws", and these provisions need to be implemented. Even though it would not be desirable for the CEECs to adopt the CAP fully before they join the CAP (see above, Chapter 5), there is no reason why they should not begin to create much of the legal and institutional framework which is needed to do so at some stage in the future. There is a very large body of legislation under the CAP and there are very specific institutions involved in implementing the CAP, and it takes time and efforts to establish all this. The EU has ample experience in this area, and it can also make available the necessary manpower to assist the CEECs in approximating their legislation and institutions to the conditions needed to harmonize their policies with those of the EU as the time of accession approaches.

## 9.2 Policy Towards CEEC Agricultural Trade

Financial support and technical advice from the EU can help the CEECs in their internal transformation process. But more importantly, the EU could contribute most by providing an economic environment in which these countries can develop a functioning market economy. This would ideally involve the offer of free exchange of goods and services on open markets, in particular free trade with the EU. Given the close neighbourhood with the EU and the political and economic attractiveness of being more intensively integrated with EU markets, expanding trade relationships with the EU are one of the central ingredients of the process of strengthening CEEC economies. It has rightly been observed that the EU is "the trade anchor of the transformation process in Central and Eastern Europe".<sup>4</sup> Unfortunately, some of the sectors in the CEECs that are most capable of exporting and earning much needed foreign exchange are also the ones that are the most "sensitive" and therefore regulated within the EU. The internal political resistance to liberalizing these sectors in the EU stands in direct conflict to the foreign policy and security goals of stabilizing the emerging market economies in Central

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<sup>4</sup> Inotai (1994), p. 139.

and Eastern Europe. Agriculture is a prime example of a sector where the CEECs seek and need better access to the EU market, but where the EU finds it politically difficult to be more liberal.

In order to adhere to the broader political objective of stabilizing the CEECs and integrating them into the West, the EU has to give the CEECs the chance to participate in the benefits of international trade. At a sectoral level, this is the more important the more pronounced the economic difficulties and the consequent political instabilities are in the CEECs. Agriculture is one such sector. For stabilizing the domestic political situation in the CEECs it would be most useful if their agricultural exports were granted better access to EU markets. Some of the political heat in CEEC agriculture, which has become apparent in recent election results in more than one country in Central and Eastern Europe could be cooled down if a better market can be created for CEEC farm products. In principle these relationships between trade and political as well as economic stability have been acknowledged early in the EU. In its Association Agreements with the CEECs, the EU has made an important step towards opening its markets up for exports by the CEECs, and these trade arrangements have been clearly embedded in a political process. However, in agriculture market access for the CEECs still remains narrowly restricted. As is obvious from the political background to the negotiations of the Association Agreements in the EU, there was strong resistance from farmers' groups and from some member states against more generous preferences for the CEECs in agriculture. Strong fears were and are expressed in the EU as to the extent to which larger imports from the CEECs would threaten to depress prices on EU agricultural markets, or result in higher FEOGA expenditure. A cool look at the quantities involved suggests clearly that these fears are largely exaggerated. For nearly all agricultural products now included in the Europe Agreements, the quantities allowed in under preferential quotas are so small that they are likely to depress prices on EU markets of the products concerned by less than one per cent.<sup>5</sup> On aggregate, if all current preferential quotas under the Europe Agreements were fully utilized by the CEECs, the price impact on EU markets would be such that EU agriculture would lose no more than 0.3 per cent of its revenue.<sup>6</sup> With such minute orders of magnitude in mind it is difficult to argue that any further opening up of EU agricultural markets for exports from the CEECs would seriously threaten market stability and farm incomes in the EU. The gains in political and economic stability in the CEECs are light-years beyond the economic impacts in the EU. Hence the EU should make a determined effort to open its agricultural markets up more extensively for exports from the CEECs.

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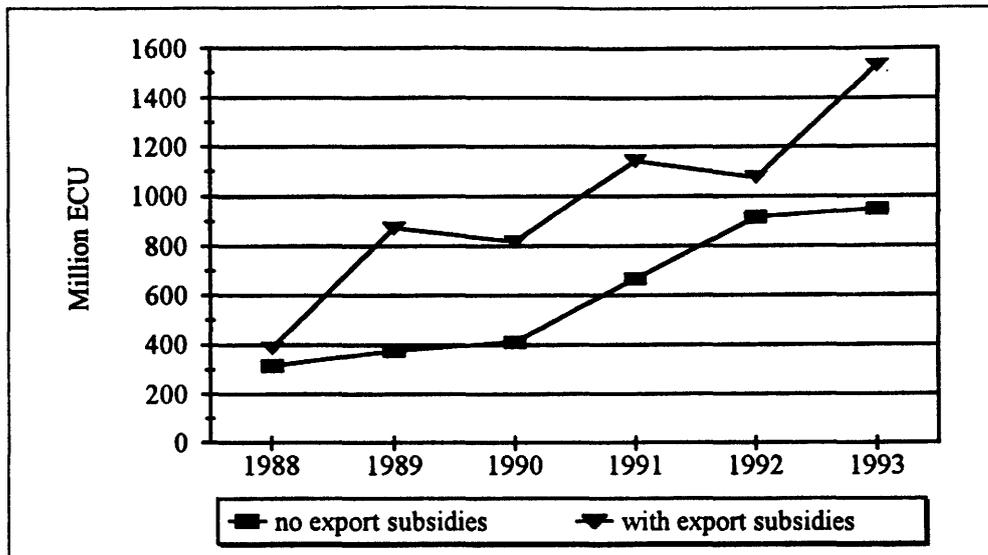
<sup>5</sup> Overberg (1994), pp. 10-12. The only major exception is goose meat.

<sup>6</sup> *Ibid.*, p. 11.

Another issue which is hotly debated in the CEECs is the subsidization of EU agricultural exports. It is often argued in the CEECs that EU subsidized exports contribute to depressed prices on CEEC markets for agricultural products, thereby adding to the economic and financial stress from which CEEC farmers suffer. Moreover, the worsening trade balance in agriculture between the CEECs and the EU is often attributed, among others, to the high subsidies which the EU grants on its agricultural exports. In this context, one of the reasons CEEC governments have given for their tariff increases in agriculture is export subsidization by the EU against which CEEC governments feel they have to protect their domestic producers. As a remedy it has sometimes been suggested that the EU should no longer subsidize agricultural exports to the CEECs.

In discussing this issue it is useful to take a look at recent developments in EU exports of agricultural and food products to the CEECs and to distinguish between different types of products. Very often, when statements are made on "agricultural trade" between the EU and the CEECs, the statistics cited report aggregate trade figures for all agricultural and food products, including all sorts of products which have little to do with the CAP. The commodity composition of EU agricultural and food exports to the CEECs (six countries) is analysed in Appendix III. In particular, commodities are grouped according to the extent to which EU exports are subsidized. After all, even though export subsidization is generally said to be a universal phenomenon of the CAP there are many agricultural and food products where exports from the EU are either not subsidized at all or where export subsidies are so small that they probably have a minor impact on volumes traded. Examples are fish, flowers, manioc, coffee and (since the MacSharry reform) oilseeds and their products. In order to gain a first impression, all products where EU export subsidies are zero or insignificant have been grouped together (as products with "no export subsidies") and distinguished from all remaining agricultural and food products (products "with export subsidies"). The results, shown in Graph 9.1, indicate that subsidized exports from the EU to the CEECs are larger than exports without subsidies, but not very much so. Moreover, until 1992 the increase in exports without subsidies was nearly the same as the growth of subsidized exports (though the latter was more variable from year to year). The large increase of subsidized exports in 1993 is mainly due to higher EU exports of cereals to the CEECs, reflecting the low cereals crop in the CEECs due to drought in that year.

**Graph 9.1: EU Exports of Agricultural and Food Products to the CEECs by Product Category: With and Without Export Subsidies**

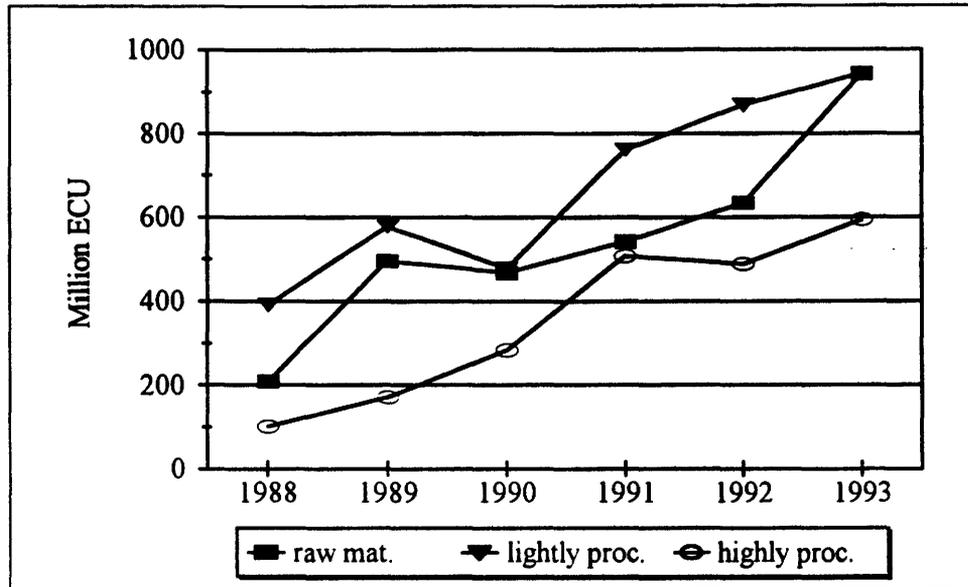


Source: EUROSTAT

Another interesting distinction is the degree of processing which agricultural and food products have undergone when they are exported to from the EU to the CEECs. Three categories of products have been defined in this regard, i.e. raw materials (e.g. live animals, cereals, cocoa beans), lightly processed products (e.g. meat, butter, flour, cocoa powder), and highly processed products (e.g. confectionery, pasta, ice cream, chocolate). As shown in Graph 9.2, processed foods (aggregate of lightly and highly processed) have a larger share in EU exports to the CEECs than agricultural raw materials. During the early stages of the transition process, EU exports of highly processed foods have been particularly dynamic, reflecting the strong demand for high quality foods (and, as a matter of fashion, probably also western products) on CEEC markets. Lightly processed foods have continued to have the highest share in EU agricultural and food exports to the CEECs. Again the strong increase of raw material exports in 1993 mirrors mainly expansion of cereals exports in that drought year in the CEECs.

Shares which different types of products have had in total growth of EU agricultural and food exports to the CEECs (EU exports in 1993 compared to EU exports in 1988-90) can also be analysed at a more disaggregate level of product groups (two digit CN groups). As is clear from Table 9.1, most of the nine product groups which among them account for nearly three quarters of the recent growth of EU exports to the CEECs have relatively little to do with the CAP. Product groups with highest shares in EU export growth include food preparations, tropical products such as citrus, bananas (included in edible fruit and nuts) and cocoa, tobacco, and beverages and spirits. The major CAP-related product category with a large share in total growth of EU agricultural and food exports to the CEECs is cereals.

**Graph 9.2: EU Exports of Agricultural and Food Products to the CEECs by Product Category: Different Degrees of Processing**



Source: EUROSTAT

**Table 9.1: Share of Individual Product Groups in Total Growth of EU Agricultural and Food Exports to the CEECs Between 1988-90 and 1993**

Product group	Share in growth of EU exports to the CEECs, 1988-90 to 1993
Miscellaneous edible preparations.	12.1%
Edible fruit and nuts	11.5%
Cereals	10.2%
Residues from the food industry.	7.9%
Tobacco	6.7%
Edible vegetables	6.2%
Cocoa and preparations	5.9%
Animal or vegetable fats	5.6%
Beverages. spirits	4.8%
All other agricultural and food products	29.1%

Source: Appendix III.

With this quantitative information in mind it is less clear that EU export subsidies have been the main driving force behind the growth in EU agricultural and food exports to the CEECs. This is not to say that EU export subsidies are not a potential threat to the stability of agricultural markets in the CEECs, and that they cannot cause significant difficulties on individual product markets where conditions are anyhow fragile in the CEECs (for example, dairy products). However, it is not really clear whether a promise by the EU no longer to subsidize exports to the CEECs would be the most appropriate response.<sup>7</sup> As long as the CEECs would still import corresponding quantities, because there is import demand on their markets, such an elimination of EU export subsidies would simply mean that the CEECs would import from other sources, possibly paying higher import prices. Any resulting deterioration in their terms of trade would amount to a corresponding loss to the overall economies of the CEECs. A more appropriate option for the CEECs is to continue to collect duties on imports from the EU which receive export subsidies by the EU. In terms of international income distribution, EU export subsidies then amount to an income transfer from the EU to the CEECs. As far as detrimental impacts on CEEC farmers are concerned, CEEC import duties can compensate for the effect of EU export subsidies. Viewed from this perspective the EU should adopt a more understanding attitude towards attempts by the CEECs to guard against subsidized EU agricultural exports. This is not to say that all import tariffs in the CEECs are in their own economic interest. However, as long as the EU continues in general to export agricultural products with export subsidies it would not appear to make economic sense to exclude the CEECs from these subsidies.

A different issue is EU export subsidization to third countries where EU exports compete with exports from the CEECs, for example exports to the former Soviet Union. In these third country markets, EU export subsidies generate direct economic losses to the CEECs. Any reduction of subsidized EU exports to these markets would directly help the CEECs, both in an overall economic sense and in the sense of making it easier for CEEC farmers to find markets for their products. Hence a commitment by the EU to reduce, if not eliminate, subsidized exports of products directly competing with CEEC exports to such markets should be seriously considered.

Another form of assistance the EU could give the CEECs in the trade area would also relate to markets in the former CMEA countries. CEEC agricultural exports to these markets have recently shown some increase again, and they are now increasingly effected in money

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<sup>7</sup> Another policy variant would be an arrangement whereby the EU reduces its export subsidies, in parallel with an equivalent reduction of CEEC import tariffs. This variant has been suggested by Nallet and van Stolk (1994), who have suggested that the EU should not subsidize below a price level equivalent to "hard core" production costs in the CEECs, while the CEECs should not impose duties on such less subsidized exports by the EU.

terms and hard currencies, rather than as barter trade like in the early stages of transition. However, given the serious foreign exchange shortages in particular among the countries of the former Soviet Union, export credits are an important ingredient in this trade. With capital shortage in the CEECs, the availability of export credits is a seriously limiting factor constraining the growth of their agricultural exports to these countries, and exports from the EU and from other western countries are often more successful because they are underpinned by export credits which these western countries can offer. In this situation the EU should consider to open up generous credit lines and/or to offer credit guarantees for CEEC agricultural exports to the countries of the former Soviet Union. The overall economic costs to the EU of this specific form of assistance to the CEECs would not be very large, but the help it would constitute for CEEC farmers and the overall economies of the CEECs could be substantial.

As a last comment on measures in the trade area, it should be clearly seen that anything that helps the CEECs to strengthen their export performance is not only of great and direct economic use in the CEECs. Improvements in the trade area also have the advantage that they are the least distortionary measures one can think of, that they help the CEECs to generate income out of their own resources and to become more economically self-reliant, and that they help to stem the tide of protectionist pressures in the CEECs. In that sense the EU would be well advised if it were to make the fullest use of any opportunity to strengthen the export performance of the CEECs.

### **9.3 Better Implementation of the Association Agreements**

The "Europe Agreements" between the EC and the CEECs provide a framework for the liberalization of agricultural trade in Europe. The Agreements call for the establishment of free trade area over a maximum period of ten years. But special arrangements limit the degree of EU agricultural market access for the CEECs. For most agricultural products the import duties and levies were reduced, but this reduction applies only to limited quantities of exports. The base periods for the determination of the reduced levy quotas were generally chosen to be periods of low EC-CEEC trade. So even substantial increases in percentage terms of these quotas over time do not correspond to the true export potential in the CEECs. Furthermore, increased exports of the products which are most severely restricted in terms of EU market access (beef, dairy, cereals, sugar) would most greatly benefit the CEEC. A revision of the "Europe Agreements" in accordance with the original free trade spirit of these agreements might, therefore, be the most promising form of assistance for the ongoing economic reforms in Central and Eastern Europe.

At the same time, implementation of the preferential trade arrangements under the Europe Agreements could be changed such that a larger share of the economic benefits is likely to flow to the CEECs, rather than to trading companies in the EU. In particular, where licenses are issued under preferential quotas, the current practice of allocating these licenses by EU authorities to companies registered in the EU nearly certainly means that most, if not all of the benefits resulting from levy and duty reductions flow to EU traders. Moreover, implementation of the licensing procedures results in uncertainties which get in the way of a full utilization of preferential quotas by the CEECs. Empirical research has shown that this is indeed the case.<sup>8</sup>

In addition, problems also exist where quota restrictions are not implemented through the issuing of licences, but on a first-come-first serve basis, for example in the case for fruit and vegetables. Because the EU does not publish information on the extent to which existing quotas are already utilized at any particular point in time, EU importers and CEEC exporters do not know whether the preferential duty will apply for any particular transaction or whether the full MFN duty has to be paid on importation into the EU. Indeed, at the time of importation into the EU the trader has to pay the full MFN duty, and he receives a rebate equivalent to the preference somewhat later if it turns out that the preferential quota was not yet fully used. As a consequence, price negotiations between EU importers and CEEC exporters are based on the worst-case assumption that the full MFN duty has to be paid. The CEEC exporter then essentially gets the price he would also have received if no preferences existed at all. If it then later turns out that the quota was not yet fully used and that therefore the importer gets a rebate, this is a windfall profit to the EU importer, of which the CEEC exporter gets nothing.

It should certainly not be the aim of trade preferences for the CEECs that EU importers receive benefits. Preferences are thought to benefit the exporting countries. As a matter of fact, the price advantage resulting from preferential tariff reductions is the potentially most useful economic benefit to the CEECs, generally more useful than small additional quantities which can be shipped to the EU. The reason is that a price advantage resulting from preferential tariffs is essentially a pure economic transfer to the exporting country, while shipment of additional quantities requires either more output in the exporting CEEC, and hence investment of more resources into the production of the commodities concerned, or--more usually--reduction of exports to other destinations and hence a loss of foreign exchange revenue from exports to other countries.<sup>9</sup> The EU should therefore make a determined effort to improve the implementation of agricultural preferences under the Europe Agreements. One way of doing this would be to hand the allocation of preferential quotas over to the exporting countries. In

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<sup>8</sup> See Overberg (1994).

<sup>9</sup> See Tangermann (1993a).

the EU it should be seen that this amendment to the implementation of the Europe Agreements can improve the benefits which the CEECs receive, without harming the interest of EU farmers.

## 10 Conclusion

Agricultural policies throughout much of the world are undergoing change. This change typically involves a decrease in market support prices compensated by payments tied to something other than output. The advantages are that support can be tailored to farm families in need, that costly and trade-disruptive surpluses are reduced, and that environmental and other objectives can be made consistent with the freedom of the farmer to make farming decisions. The EU has made a start in the same direction, as did the EFTA countries before EU membership became the dominant force behind their policy. The CEECs did not have the luxury of a leisurely debate on farm policy changes. Their policies changed swiftly with the change in regime. Nevertheless these countries are looking for the same outcome, a viable policy which allows for the productive use of farm resources and farmers' skills. It is likely that the end-point of EU CAP reform and the search for a long-term agricultural strategy in the CEECs would eventually have been similar even in the absence of EU accession: with membership expected by the turn of the century, the two processes are intimately joined.

The report looked at the present state of CEEC agriculture and found reason for optimism that output will recover and that the CEECs will be able to export agricultural products in competition with other countries. This should be a cause for relief in the current EU, as it implies less need for long-term transfers of funds to support markets and farmers in these countries. However it will also be viewed as a potential threat, both in budgetary terms and for market balance. If the CAP is in its present partially-reformed state, the additional output from the CEECs will break both the budget constraints and GATT obligations, throwing the EU into crisis.

The conclusion of the report is that there are some options which would be expensive and unwise. For the current EU to put on hold reform until forced by budget or trade considerations, and then to make minimal changes would lead to continued crises in the CAP. For the CEECs to yield to farmer pressures and to move in advance of membership to these high CAP price levels would represent a costly misuse of resources in the CEECs and generate a quantity of potential exports that would clash with the Uruguay Round Agreement on Agriculture and threaten the stability of EU markets.

There are also options which would appear to offer the benefits of change with the comfort of stability. The CEECs could start on a transition to the higher prices of the EU, aiming to arrive at those levels by the time of membership. The EU could pursue a policy of continuing to reform the CAP by including other commodities, but with only minor improvements in the workings of the CAP. This comfortable alternative also has drawbacks.

The EU will eventually have to complete its reform or move to more severe quantitative restrictions to control surpluses. CEEC farmers will be encouraged to produce to price levels which are not in the longer term viable. Meanwhile, CEEC governments will be bearing the financial and economic cost of CAP-like policies and prices in advance of membership.

The report strongly favours options which would be more in line with the desirable trend in agricultural policies in the past few years. This would involve completing CAP reform, by extending compensated price cuts to other sectors, by delinking compensation payments from current land use, by allowing farmers to make output decisions unhampered by quota restrictions, and by developing an expanding agricultural sector that competes on world markets without subsidies. This option would also see the CEECs as keeping farm prices down, at least until the moment of entry, to avoid the substantial financial and economic cost of support. Attention instead should be given to the improvement of infrastructure and marketing services in the CEECs, and to the targeting of assistance in ways which build capacity and increase productivity.

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## Appendix I

### **An Estimate of the Quantitative Implications of Aligning Prices with the CAP in the Visegrad Countries<sup>1</sup>**

The estimate presented here is based on a quantitative model of supply and demand for various agricultural commodities in Central Europe and the EU. The model is part of a larger model which is currently being constructed with the aim of looking into agricultural trade between the United States and the European Union, including the implications of EU enlargement to include both EFTA countries and Central Europe. This European Simulation Model (ESIM) is being developed in the Economic Research Service (ERS) of the United States Department of Agriculture (USDA)<sup>2</sup>, with cooperation from outside academics.<sup>3</sup>

The model includes some 20 agricultural products and some of their first stage processed derivatives. It has a relatively rich structure regarding cross-commodity linkages, including acreage allocation among crops and price responsive composition of livestock feed. The elasticity matrices used are synthetic, but exhibit the desirable theoretical properties (in particular homogeneity and symmetry). In constructing the model, emphasis was placed on being able to capture, in considerable detail, the effects of the various instruments used in market and trade policy, including CAP reform measures such as set-aside and compensation payments. The model can generate a time series of annual supply and demand developments in all countries included, resulting from a predetermined scenario of policies over that period. The base period used for calibration is 1989 to 1991.

The model structure is still under development, and the results reported here are preliminary. For the purpose of analysing the potential implications of accession of the Visegrad countries to the EU, a simplified version of the model was used including only the EU and the three original Visegrad countries, i.e. Czechoslovakia<sup>4</sup>, Hungary and Poland, with exogenous world market prices. More information on the model structure, on data sources, and on parameters used will be made available in a paper which is in preparation.

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<sup>1</sup> We wish to thank Wolfgang Münch for collecting data, doing the calculations and helping with the analysis.

<sup>2</sup> Contributors in ERS include Mildred Haley, Michael Herlihy, Martin Johnson, David Kelch, Peter Liapis, Bob Koopman, Steve Magiera, and Ralph Seeley.

<sup>3</sup> Tim Josling and Stefan Tangermann.

<sup>4</sup> For lack of sufficiently detailed data, the Czech and Slovak Republics are still treated as one country in the model.

The scenario investigated here is option 2, described and discussed above in Section 5.3, i.e. gradual price alignment with the CAP, to reach expected (unreformed post-MacSharry) CAP prices by the year 2000. The run begins in the model's base period, i.e. with quantities for the average of 1989 to 1991, and Visegrad country prices for 1991. For the year 1993, actual quantities and prices reported for the Visegrad countries are inserted in the model. For 1994 and 1995 it is assumed that the Visegrad countries do not change their policy prices in real terms, but adopt the institutional price structure of the EU (i.e. intervention and threshold prices where they apply). From 1996 onwards, the Visegrad countries are assumed to align their policy prices gradually with post-CAP reform prices, to match EU prices in the year 2000.<sup>5</sup> From 2000 onwards, market prices in Central Europe are set equal to market prices in the EU. In order to gain a better insight into potential market developments, it is assumed for the time being that there are neither quotas nor set-aside requirements nor compensation payments in the Visegrad countries.

Productivity of agriculture in the Visegrad countries is assumed to develop such that the farming industry recovers from most of the decline in output levels between 1989-91 and 1993 within a five year period. As far as macro-economic trends in the Visegrad countries are concerned, it is assumed that purchasing power of consumers (in real terms) grows by 3% per year over the next five years, and by 2% per year thereafter. Real exchange rates of the Visegrad countries' currencies are assumed to stay constant over the forecasting period.<sup>6</sup> Population growth is extrapolated at current rates.

The price trends in real terms in the Visegrad countries resulting from these assumptions are shown in Graphs AI.1 to AI.7. A first interesting aspect to note is that price alignment with the CAP will not result in major price increases for grains (in the graphs shown for the case of wheat and barley), except for some increase in Hungary. This may appear to contradict the impression that grain prices in the Visegrad countries are below those in the EU. However, as a result of CAP reform EU grain prices will have dropped significantly by the time the Visegrad countries align their prices with the CAP. On the other hand, sugar prices would have to increase significantly, by around 50%. It should be noted that in the absence of a reform of the EU sugar market regime no fundamental reduction in the EU sugar price has been assumed in this scenario.

Large price increases would have to occur for dairy products, where prices on average in Hungary would have to increase by one third, in the Czech and Slovak Republics by 45%, and in Poland by as much as 130%. Even more pronounced would be the price rise for beef, with more than a doubling in Hungary, the Czech and Slovak Republics and in Poland. For pork and poultry, the picture is more diverse. Given that prices for these products are less controlled in

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<sup>5</sup> EU policy prices in the model follow the path determined by the CAP reform decisions of 1992, as amended since then. After CAP reform is completed in 1995/96, prices in the EU are assumed to decline by 1% per year in real terms.

<sup>6</sup> The real exchange rate of the ECU is kept constant throughout. Since all prices in the model are in real terms, no assumption on rates of inflation is necessary.

the EU than prices for other products, market forces have a greater influence. With complete price alignment assumed to occur in the year 2000, there can be price jumps in that year on Visegrad countries' markets for these products. However, no large overall price increase is projected for grain based livestock products, though pork prices may increase somewhat.

Output trends predicted on the basis of these assumptions are presented in Graphs AI.8 and AI.9.<sup>7</sup> For crops, a continuous upward trend in production is expected after 1993, in the first few years as a result of recovering from the drop in productivity during the early stages of the transition process, and later fuelled by price adjustment towards the EU level. No major change is forecasted in the proportions among individual types of cereals. In percentage terms, the increase in sugar production is highest. Differences among output trends are more pronounced in the livestock sector. There is a relatively large increase in milk output and, in percentage terms even higher, in beef and veal production. Pork production may increase noticeably, while output of poultry products may not change very much.

With limited expansion of domestic consumption, this growth of agricultural production in the Visegrad countries is likely to result in a significant (and of course proportionally much larger) increase of net exports from the Visegrad countries (Graphs AI.10 and AI.11). While the Visegrad countries on aggregate were a slight net importer of all cereals taken together in 1993, the exportable surplus of grain in the Visegrad countries may be around 8 million tons by the year 2000. At the same time there may be a sugar surplus of 1.8 million tons. In the livestock sector, there is a potential for significant net exports of beef and pork meat, around 0.6 to 1 million tons respectively. Equally, there is the possibility of relatively large net exports of dairy products, with the butter surplus alone running at 0.4 million tons.

With net exports of such magnitudes originating from the Visegrad countries, significant budget expenditure would be required to dispose of these surpluses. In the year 2000, expenditure for the major products included (which do not at all exhaust the list of CAP products) would run at more than 3.3 billion ECU (Graph AI.14).<sup>8</sup> Major expenditure items are grains, sugar, dairy products and beef.

As long as the Visegrad countries have not yet become members of the EU, this expenditure has to be financed out of their own domestic budgets. However, as soon as accession takes place and the CAP is extended to the Visegrad countries, this expenditure would have to come out of the Union budget. Large as this expenditure estimate may appear, it

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<sup>7</sup> In order to save space, the following graphs provide aggregates for the Visegrad countries, though results are calculated by country.

<sup>8</sup> Expenditure included in this calculation is only export subsidies (net of import levy receipts). Expenditure on intervention buying etc. comes on top of these budget figures. Expenditure on structural policies is not at all included.

should be noted that it is below estimates presented in some other studies on the implications of Visegrad accession for the CAP budget.<sup>9</sup>

It should be noted that in this forecast the assumption is made that no compensation payments are made in the Visegrad countries and that no set-aside is required. This assumption would probably not hold for the case in which the Visegrad countries join the CAP. If they were then required to set aside land at the current EU rate, this might reduce the cereals surplus of the Visegrad countries by around 40 per cent. Budget savings resulting from that surplus reduction may be no more than 40 million ECU. On the other hand, if compensation payments are introduced at the same time, and if they are paid at the current EU rate per base period ton of yield, total expenditure for cereal compensation including set-aside in the Visegrad countries would run at around 3.0 billion ECU. Moreover, extension of oilseed compensation payments to farmers in the Visegrad countries would add another 1.1 billion ECU, and headage payments for cattle would add another 170 million ECU. On aggregate, including the Visegrad countries in the CAP regime of compensation payments and set-aside would add another 4.3 billion ECU to the 3.3 billion ECU in export subsidy expenditure mentioned above.

Moreover, in estimating the budget implications of extending the CAP to the Visegrad countries, other market regime expenditure has to be considered. Since that expenditure is not, at the time being, included in the model used here, only rough estimates can be offered, based on expenditure proportions in the EU under the CAP. For the products included in the model used here, expenditure of around 1.4 billion ECU on intervention buying and other CAP market regime measures might come on top of expenditure on export subsidies and compensation payments. Also, the list of products included in the model does not exhaust the full set products covered by CAP market regimes. Considering the remaining CAP products might add another 4.3 billion ECU. Taken all this together, extension of the (unreformed) CAP to the four Visegrad countries might result in additional FEOGA expenditure of around 13.3 billion ECU.

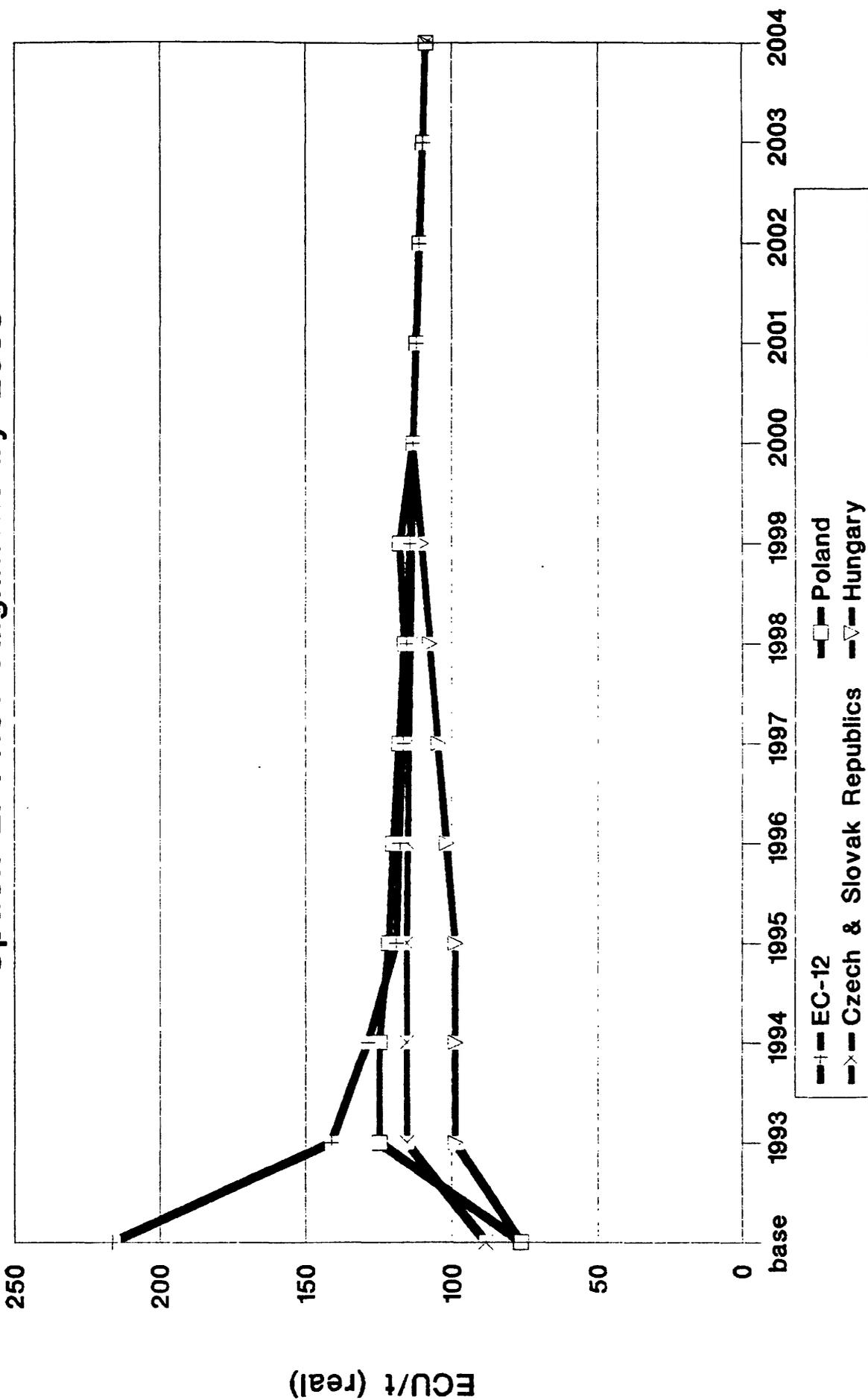
Finally, a very rough estimate can be offered of expenditure which may be necessary in Bulgaria and Romania if these two countries were to be covered by the CAP as well. This estimate is based on the volume of agricultural production in these two countries, relative to production volume in the Visegrad countries. Based on this estimate, CAP expenditure in Bulgaria and Romania may be of the order of magnitude of 6 billion ECU. Hence, on aggregate inclusion of all six CEECs in an unreformed CAP might add as much as nearly 20 billion ECU to expenditure under the guarantee section of FEOGA. Expenditure on structural policies (i.e. from the guidance section of FEOGA) would come on top of that sum.

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<sup>9</sup> See Directorate General II (1994).

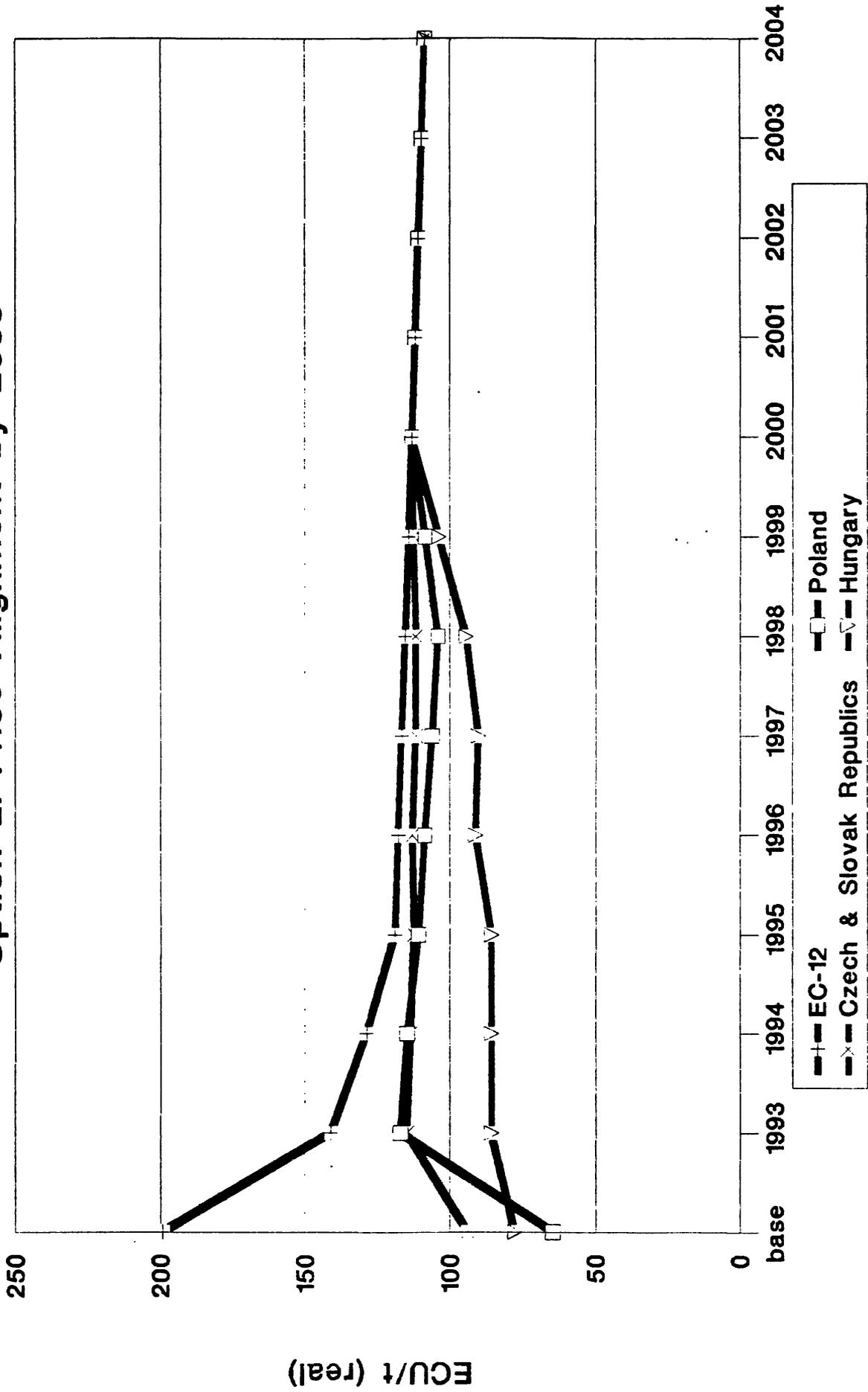
# Graph A1.1: Wheat Domestic Prices

Option 2: Price Alignment by 2000



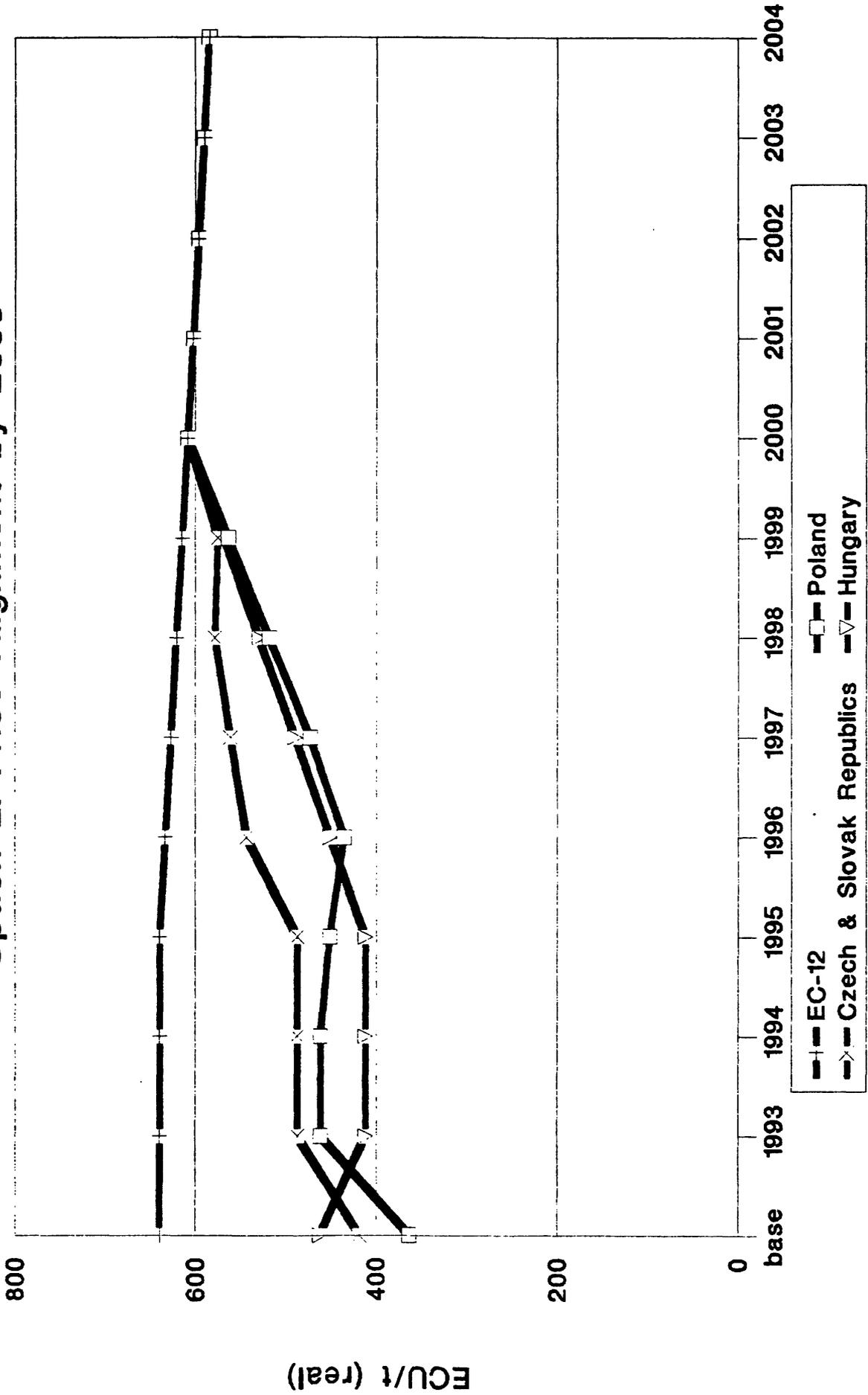
# Graph A1.2: Barley Domestic Prices

Option 2: Price Alignment by 2000



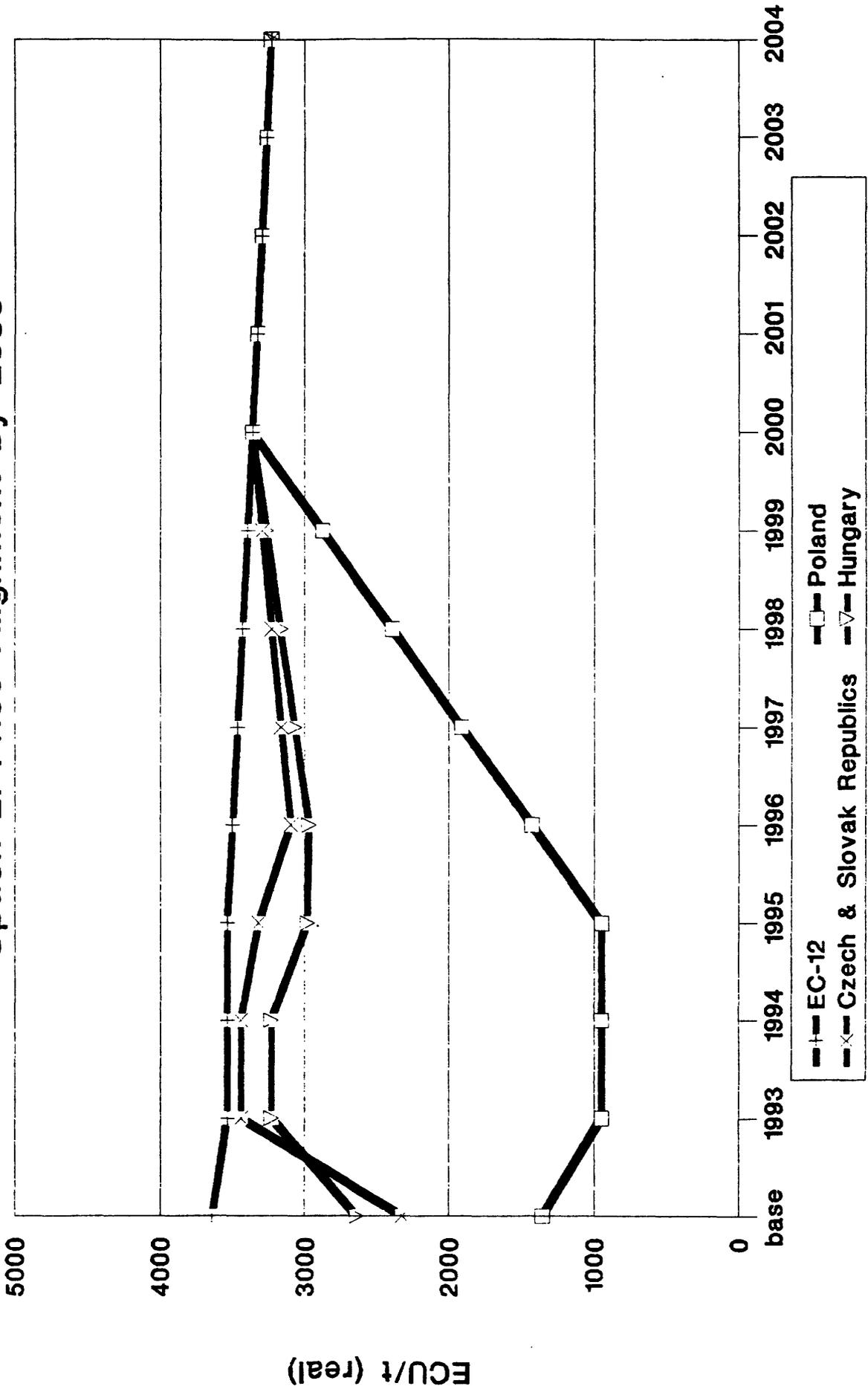
# Graph A1.3: Sugar Domestic Prices

Option 2: Price Alignment by 2000



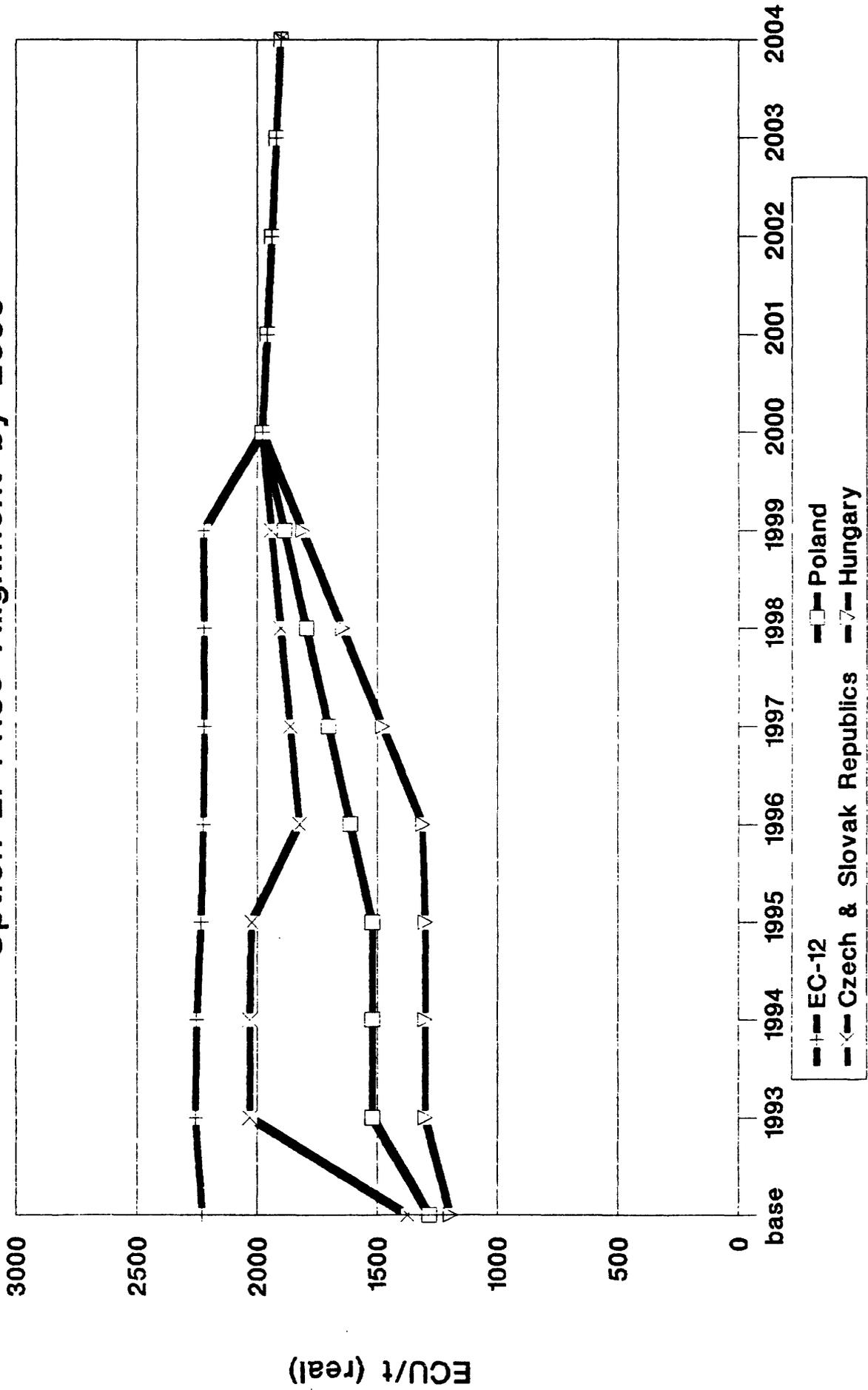
# Graph A1.4: Butter Domestic Prices

Option 2: Price Alignment by 2000



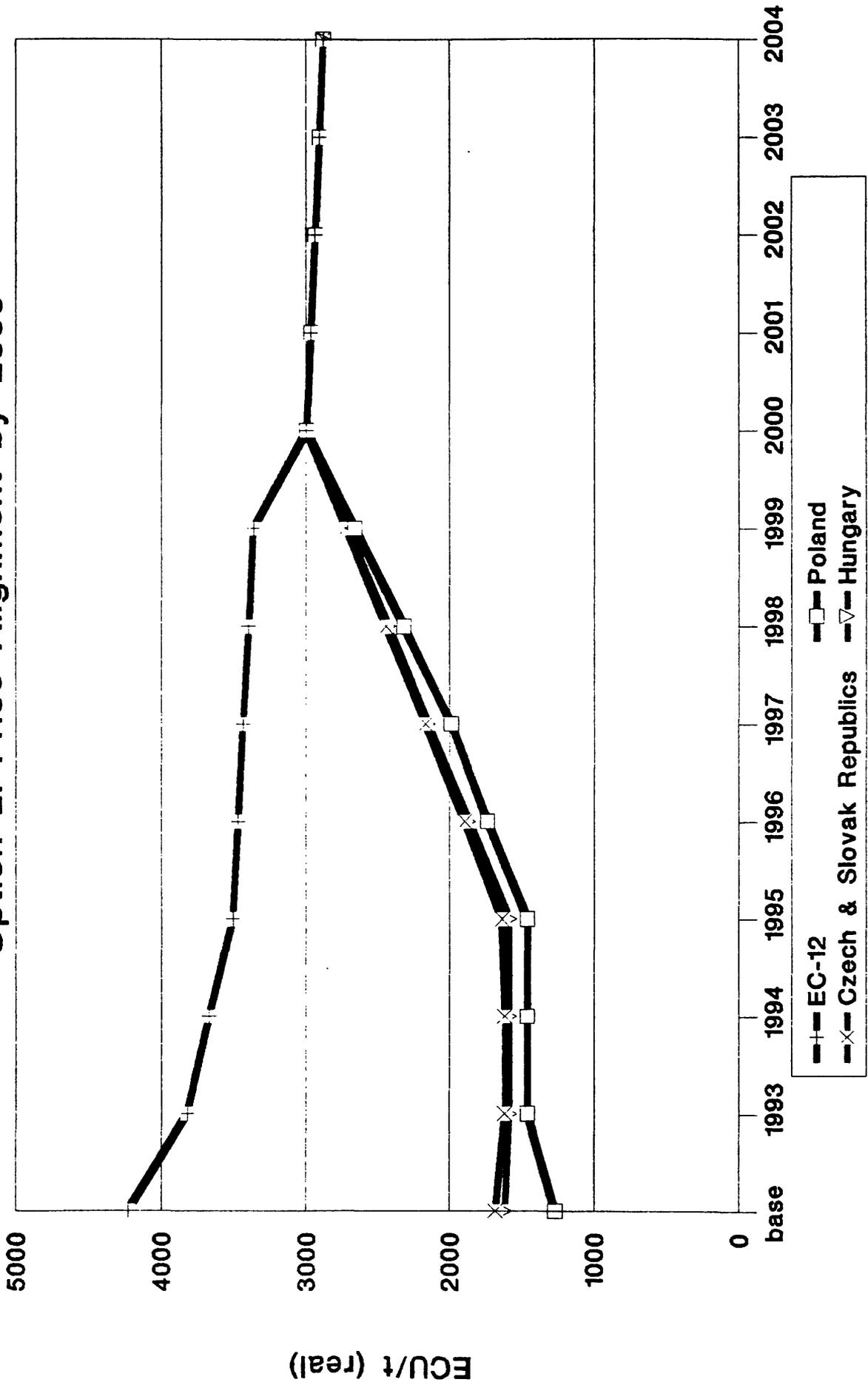
# Graph A1.5: Skim Powder Domestic Prices

Option 2: Price Alignment by 2000



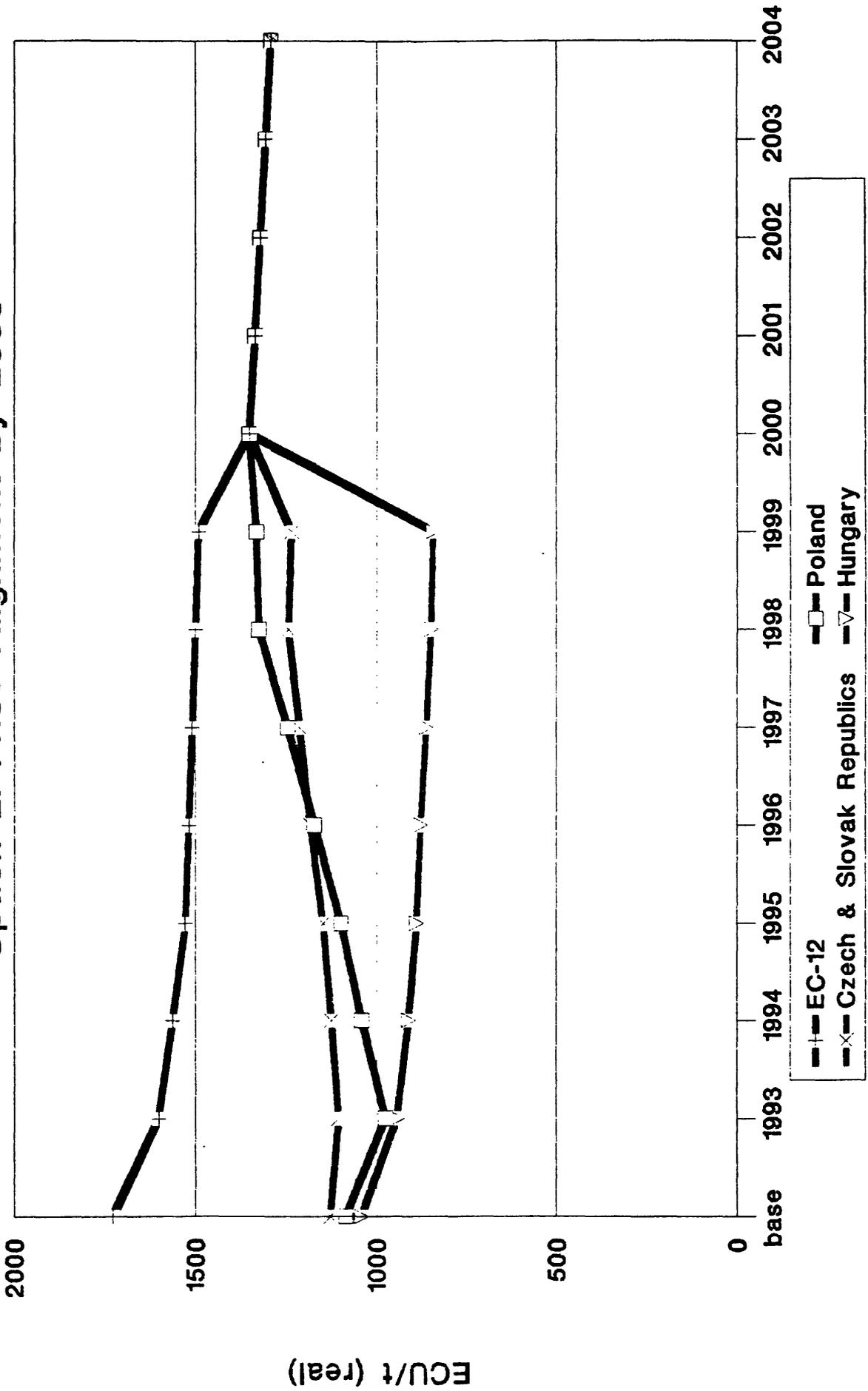
# Graph A1.6: Beef Domestic Prices

Option 2: Price Alignment by 2000



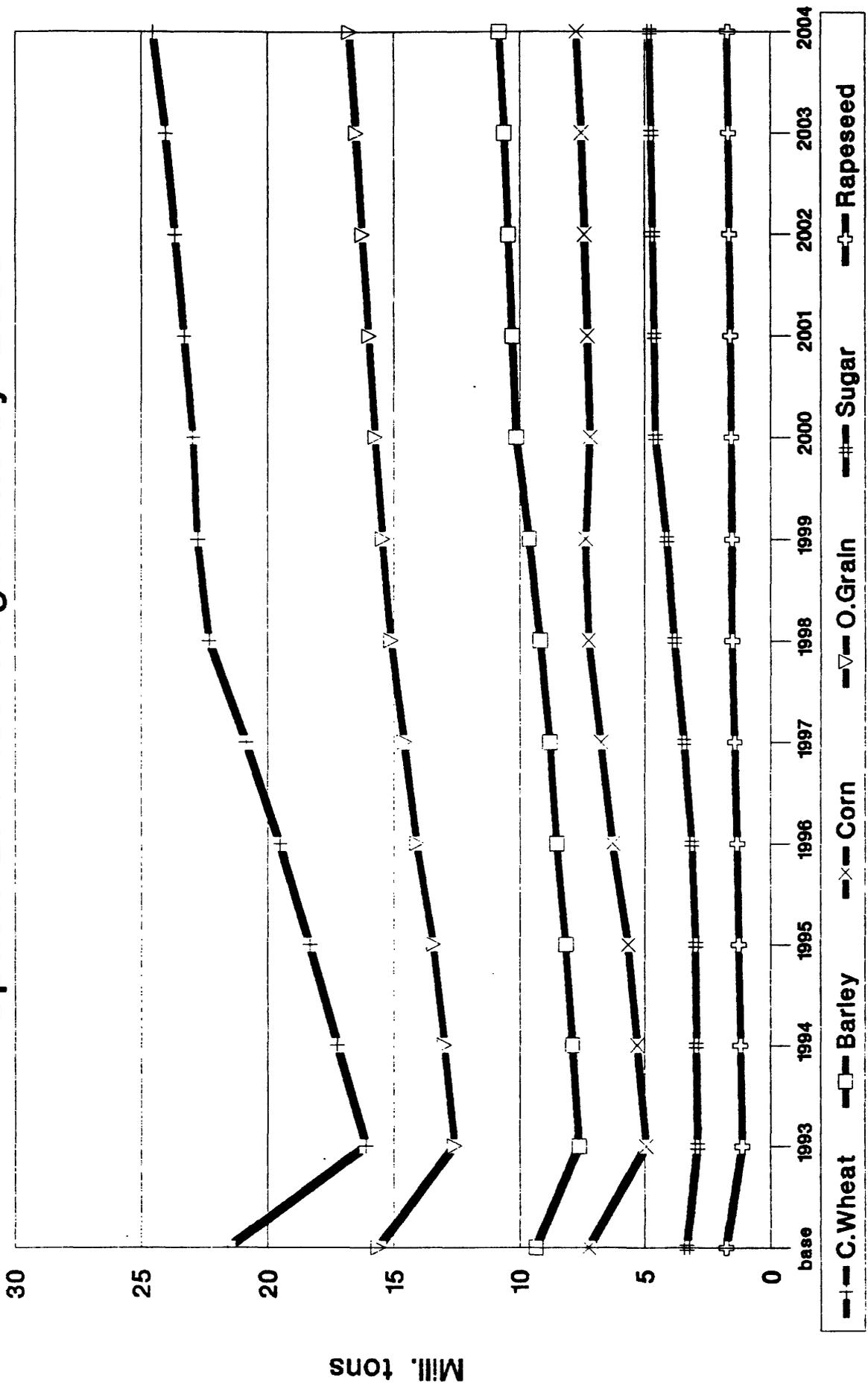
# Graph A1.7: Pork Domestic Prices

## Option 2: Price Alignment by 2000

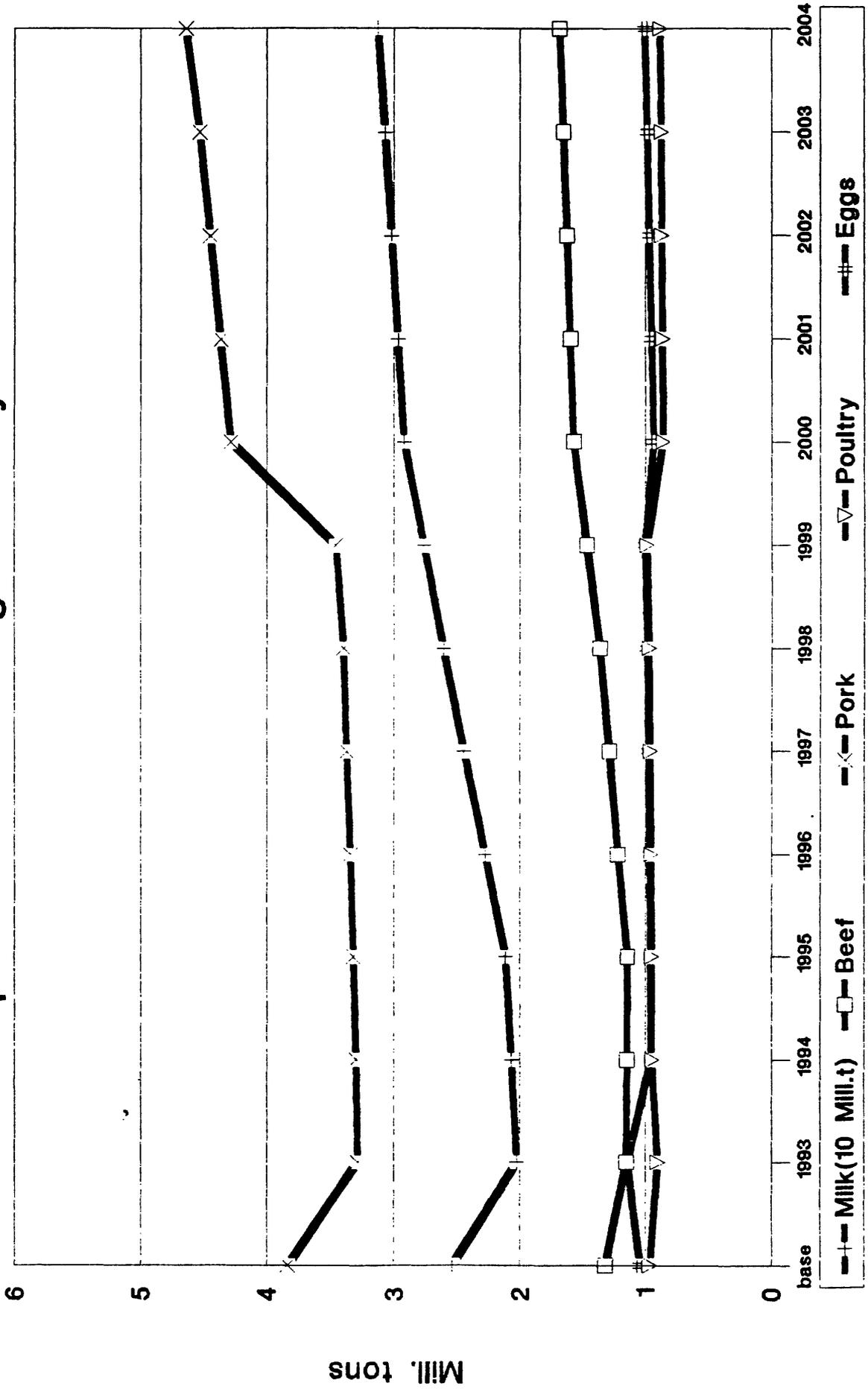


# Graph A1.8: Crop Production Visegrad Total

## Option 2: Price Alignment by 2000



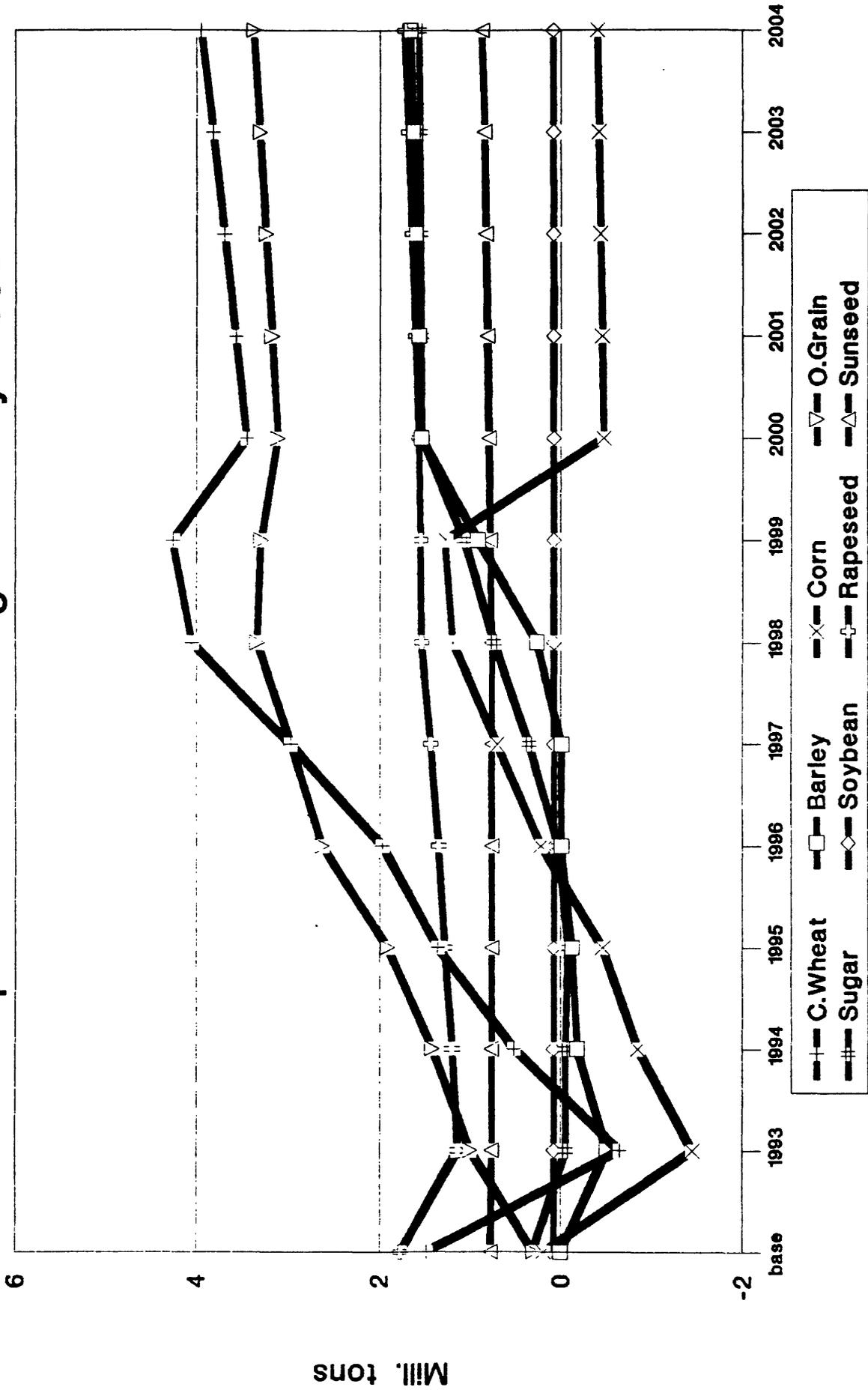
**Graph A1.9: Animal Production  
Visegrad Total  
Option 2: Price Alignment by 2000**



# Graph A1.10: Net Exports Crops

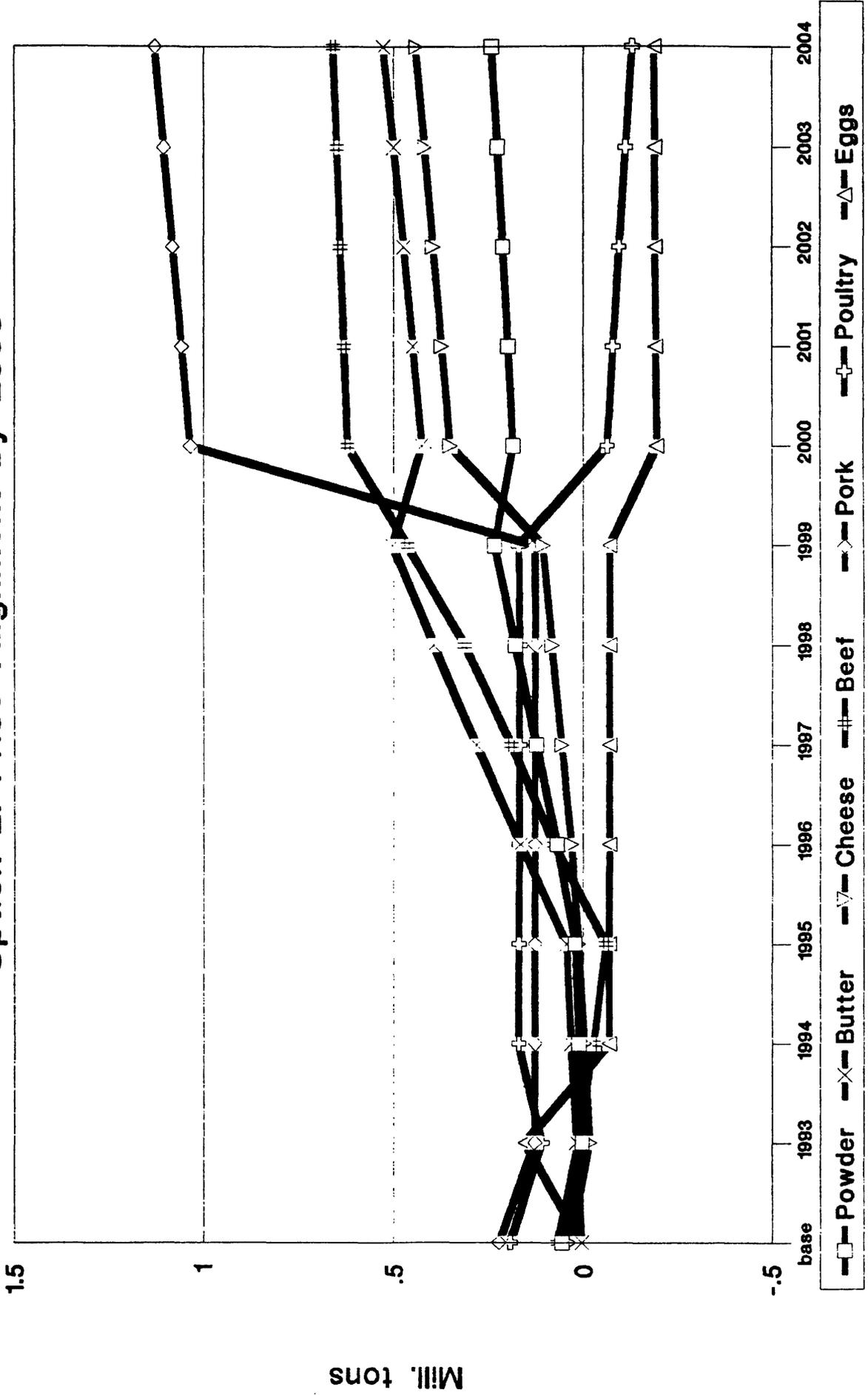
## Visegrad Total

Option 2: Price Alignment by 2000



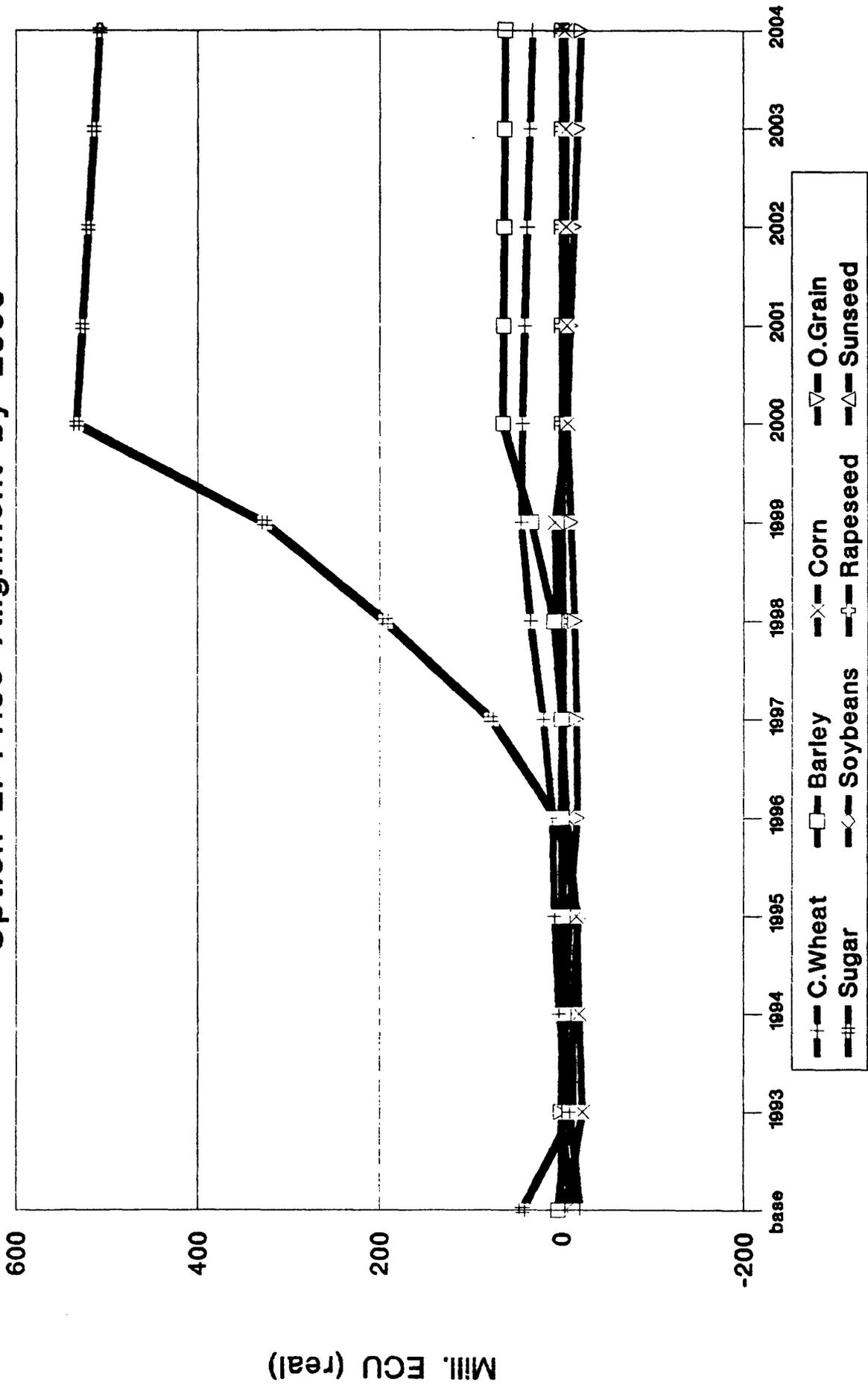
# Graph AI.11: Net Exports Animal Products Visegrad Total

Option 2: Price Alignment by 2000



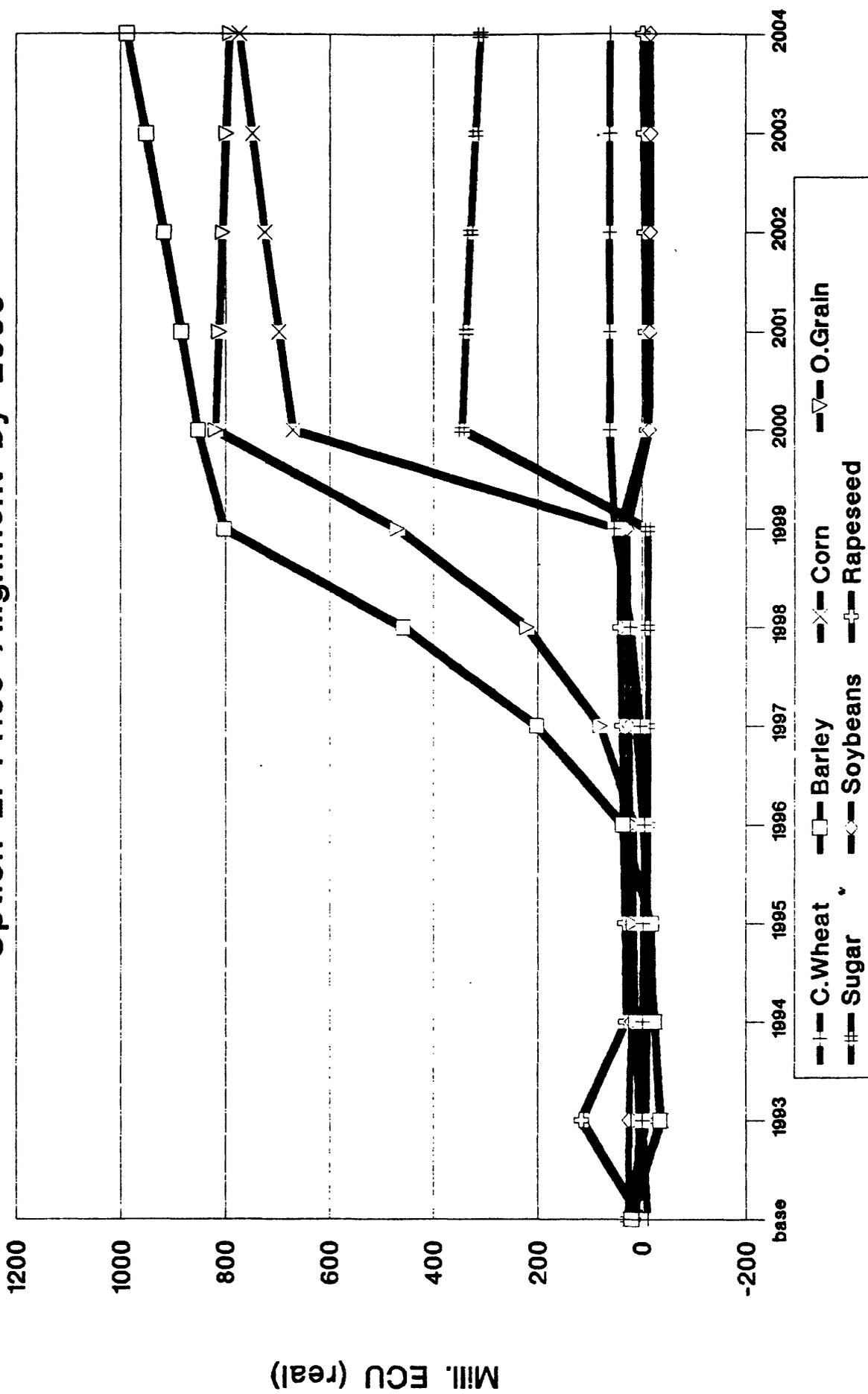
# Graph AI.12: Budget Expenditure Crop Prod. Visegrad Total

Option 2: Price Alignment by 2000



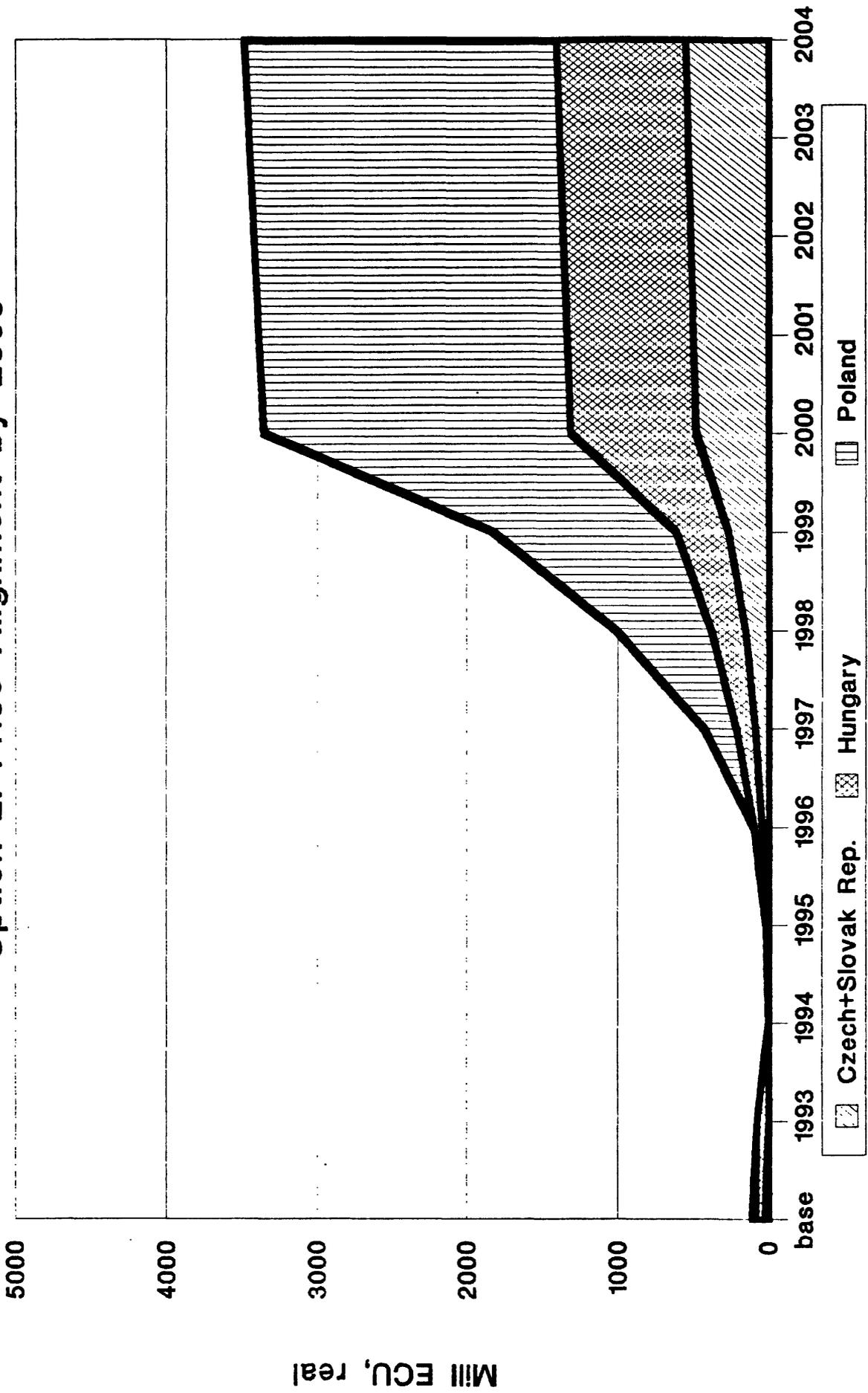
# Graph AI.13: Budget Expenditure Animal Prod. Visegrad Total

Option 2: Price Alignment by 2000

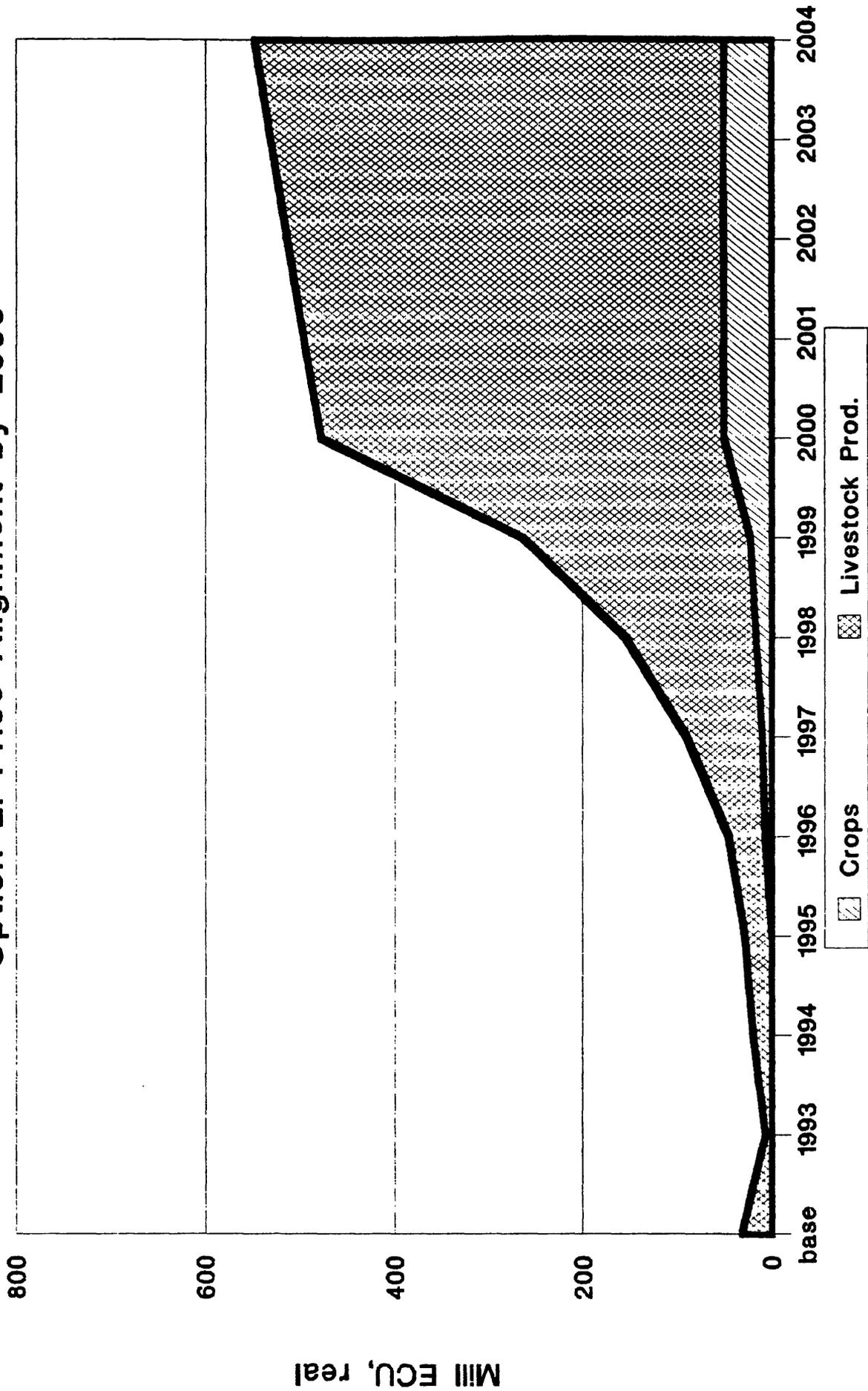


# Graph AI.14: Budget Expenditure Visegrad Total

Option 2: Price Alignment by 2000

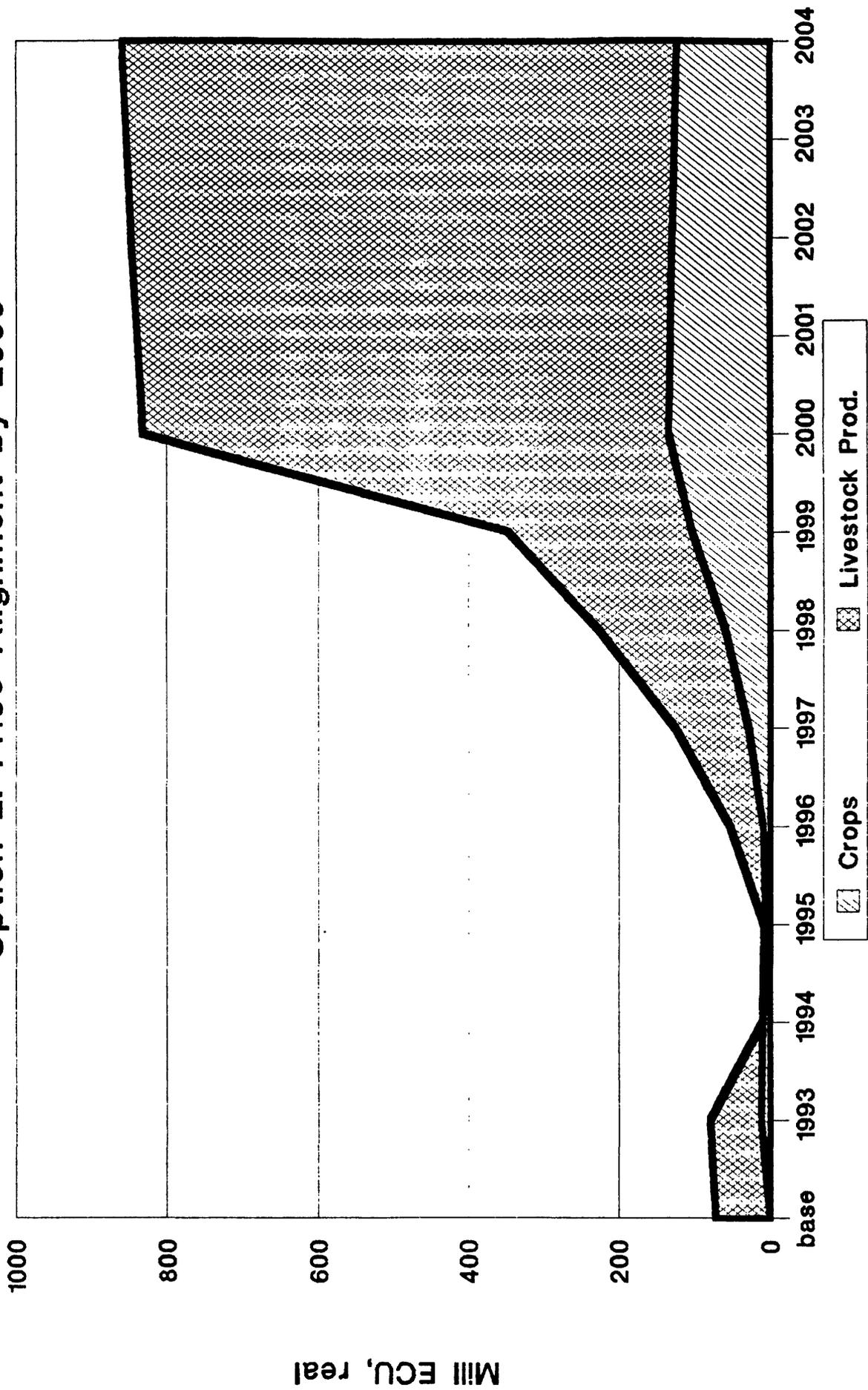


**Graph A1.15: Budget Expenditure  
Czech+Slovak Republics  
Option 2: Price Alignment by 2000**



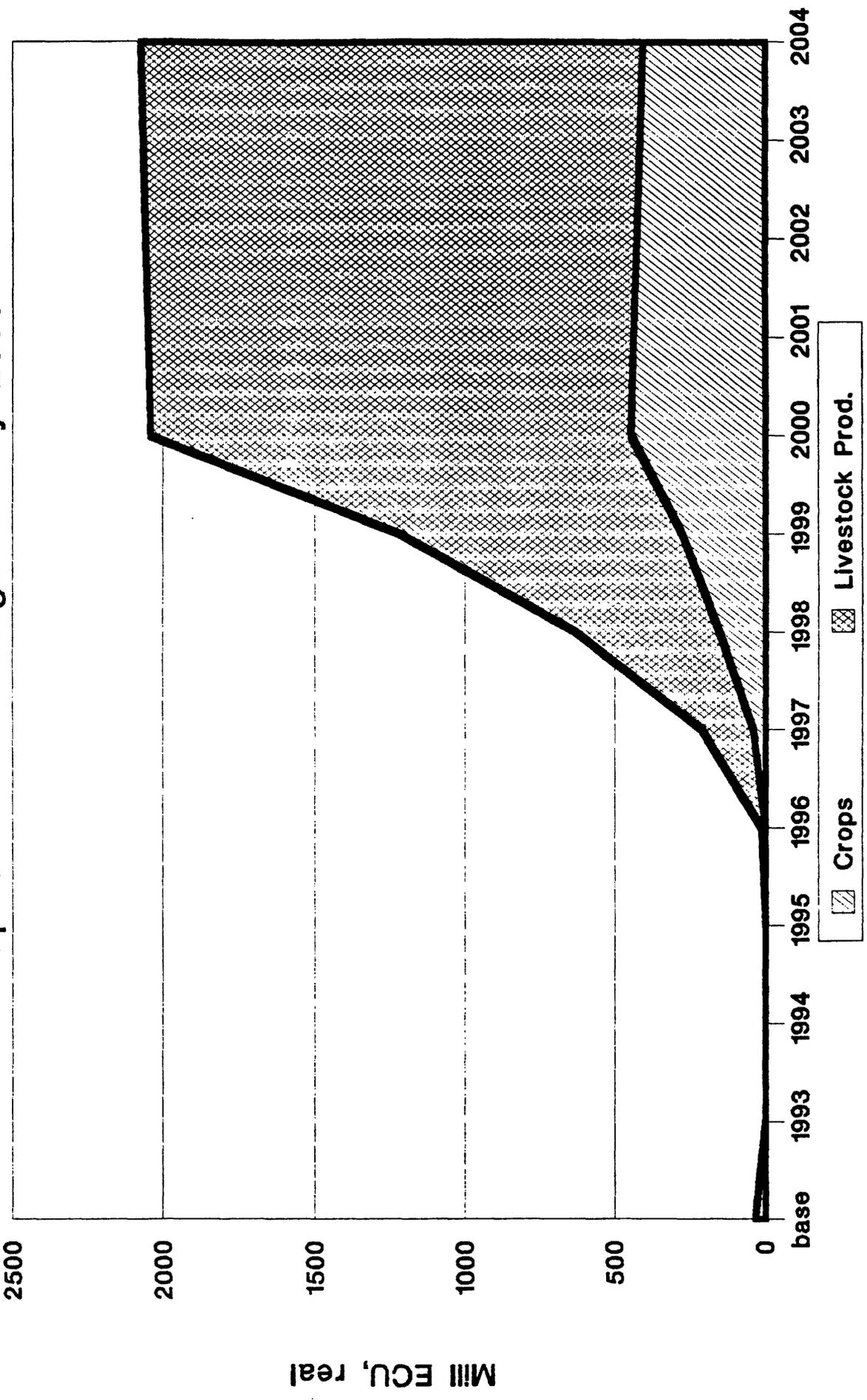
# Graph A1.16: Budget Expenditure Hungary

Option 2: Price Alignment by 2000

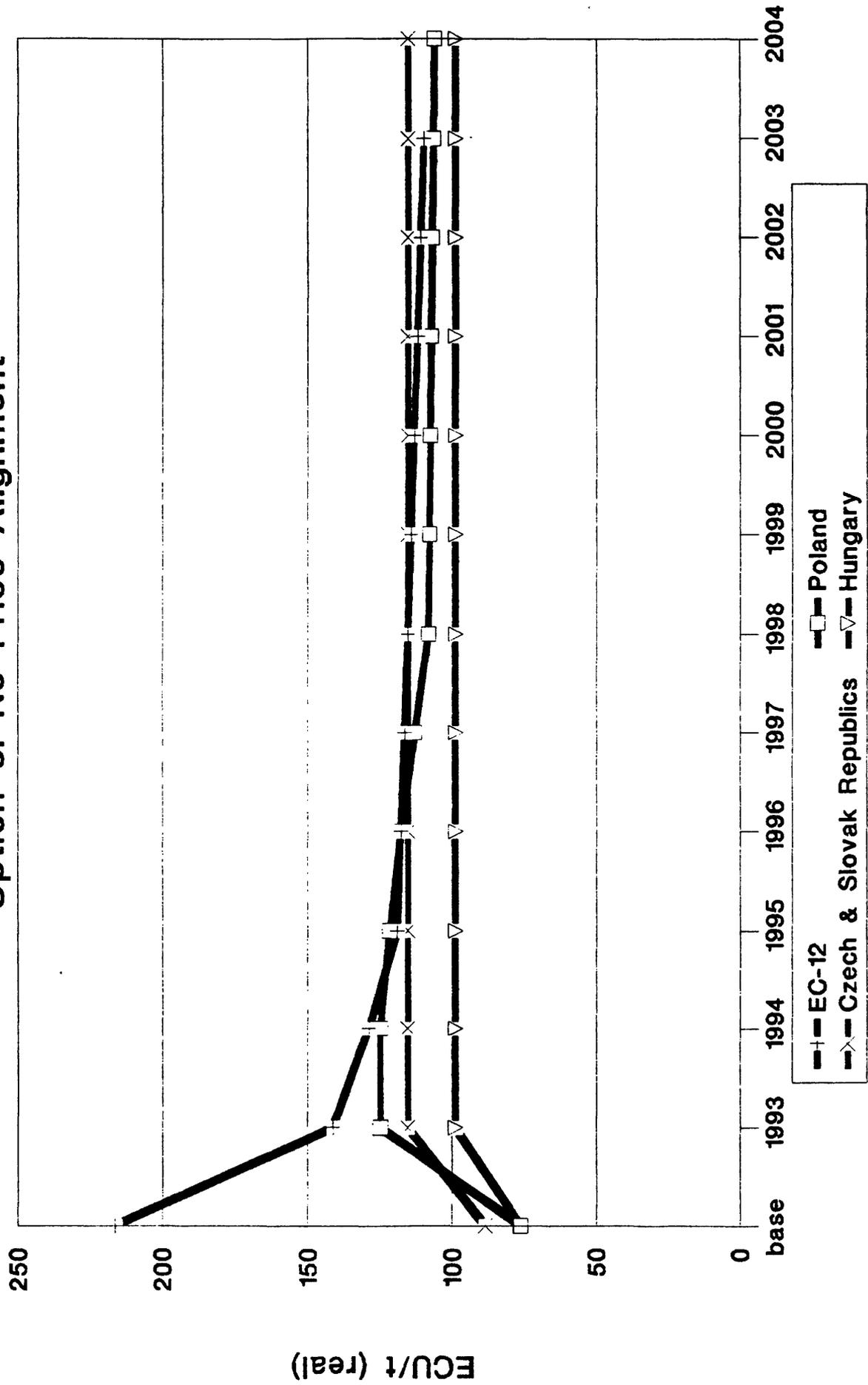


# Graph AI.17: Budget Expenditure Poland

## Option 2: Price Alignment by 2000

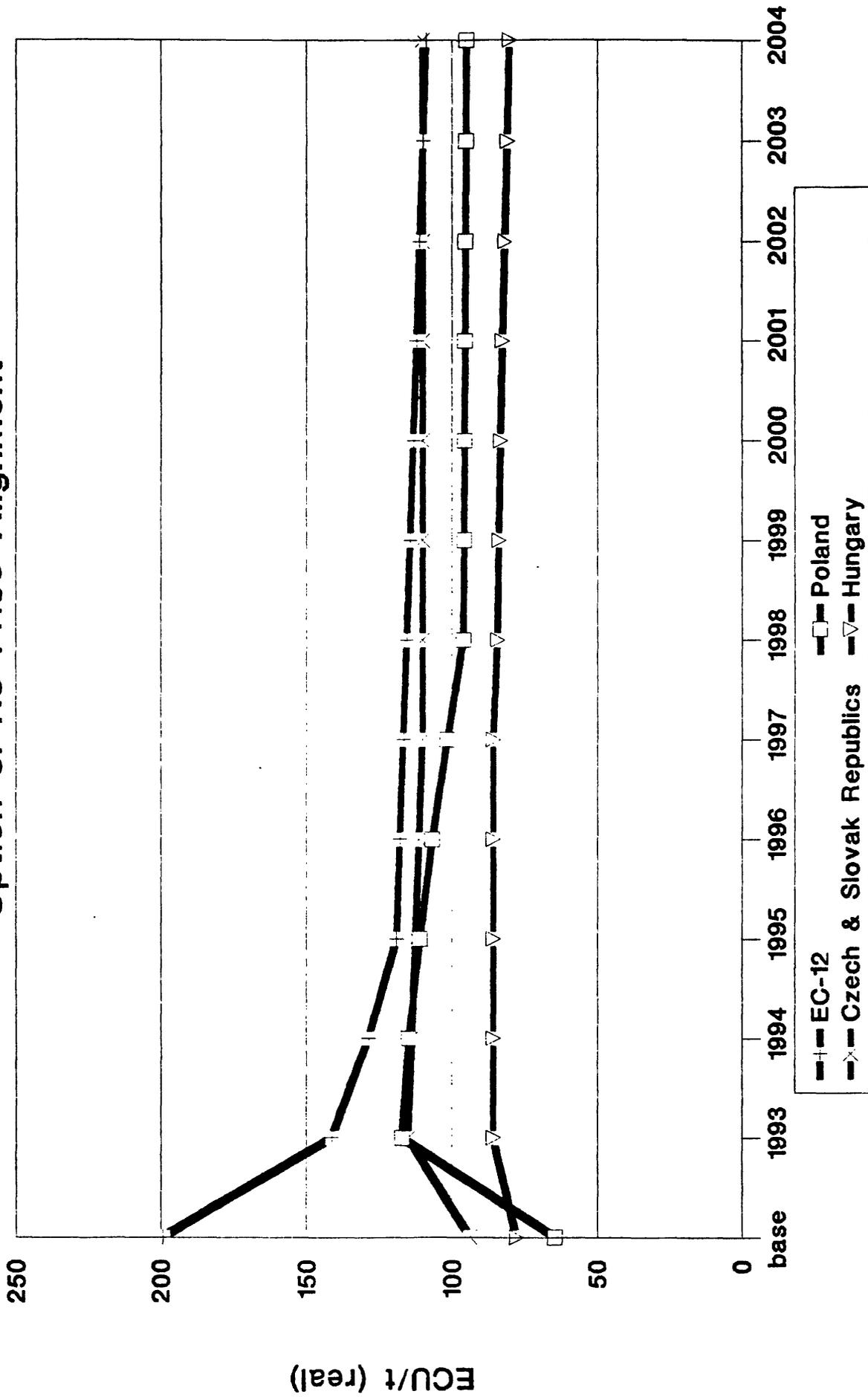


**Graph A1.18: Wheat Domestic Prices**  
**Option 3: No Price Alignment**



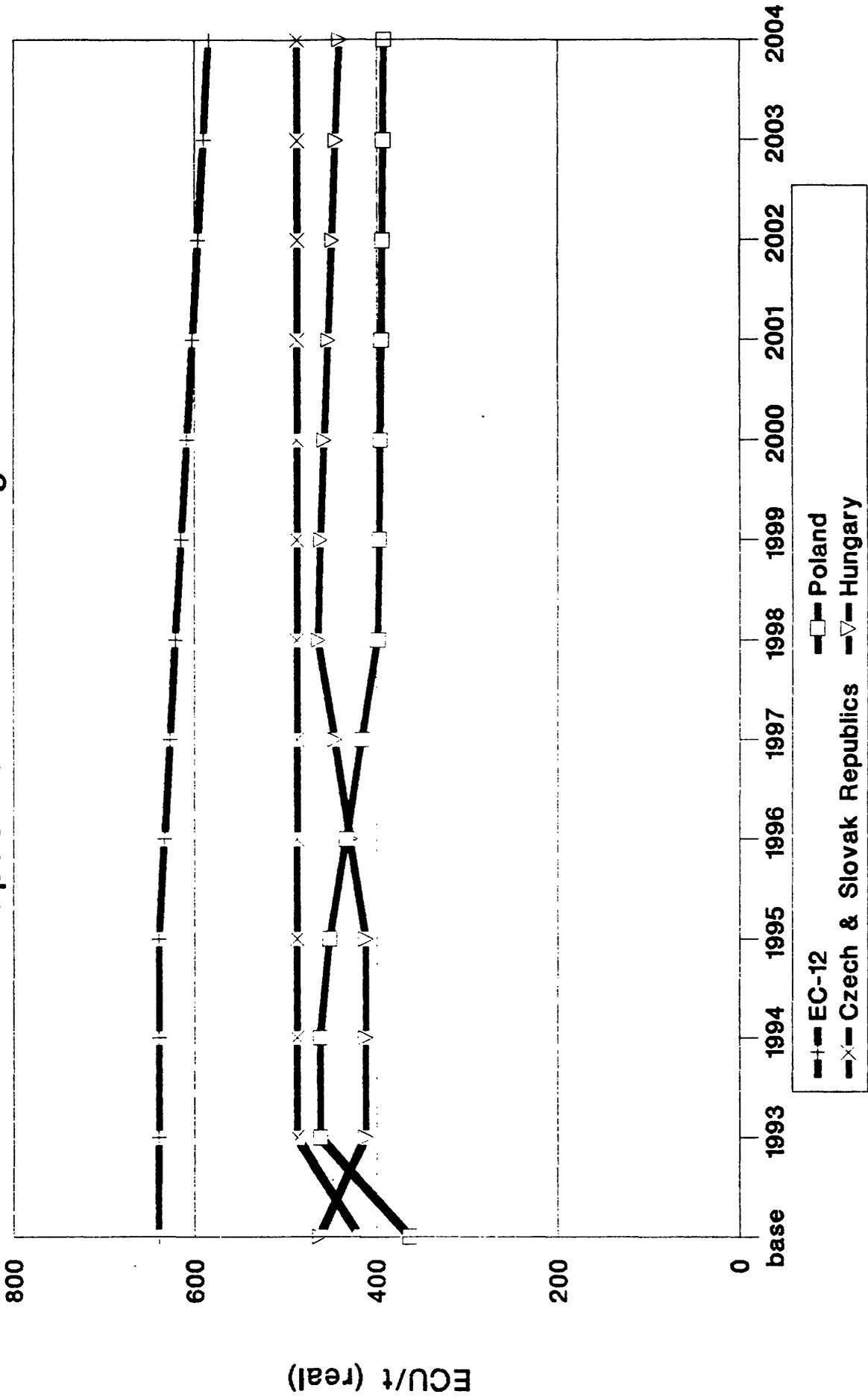
# Graph A1.19: Barley Domestic Prices

Option 3: No Price Alignment



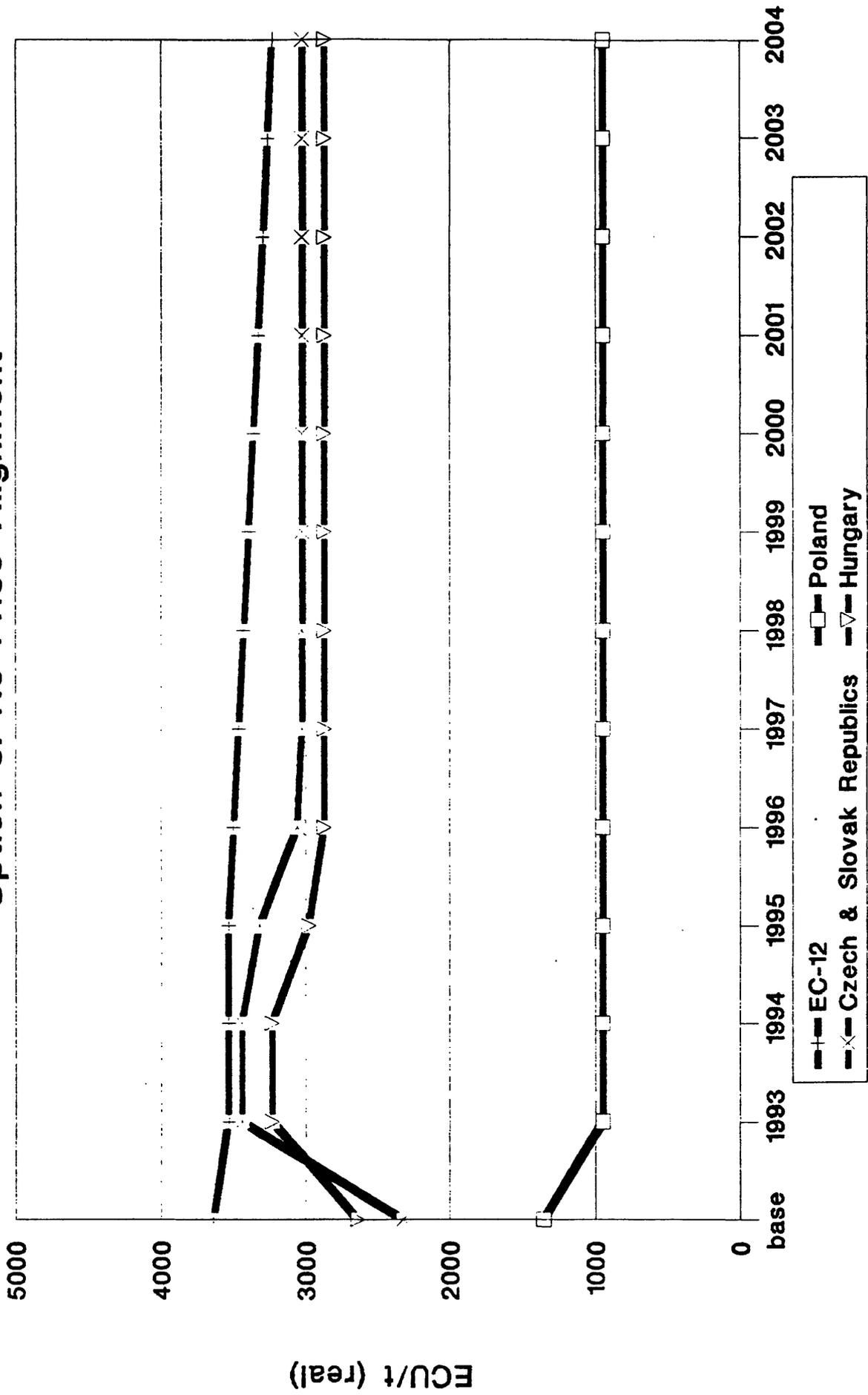
# Graph A1.20: Sugar Domestic Prices

Option 3: No Price Alignment



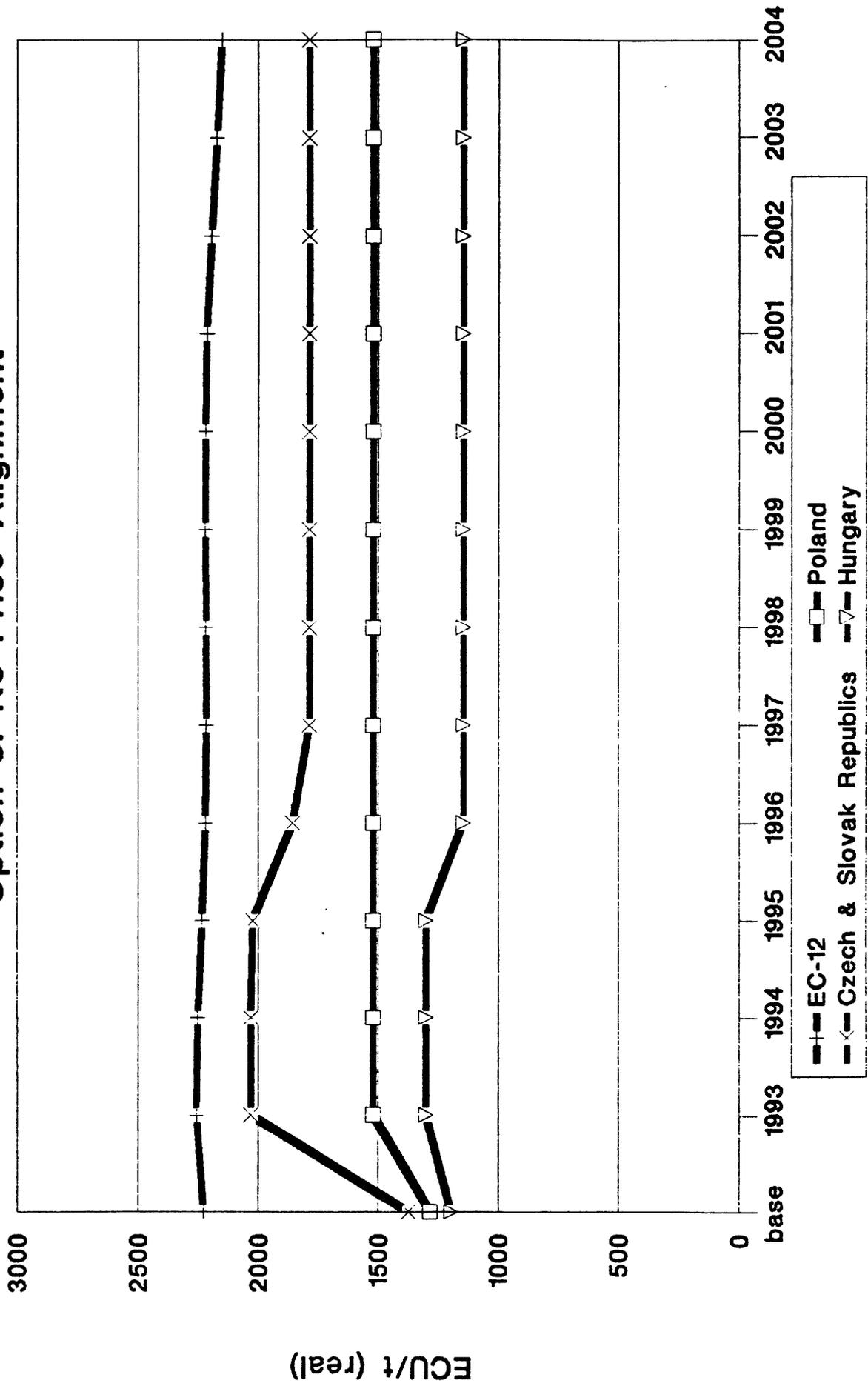
# Graph A1.21: Butter Domestic Prices

Option 3: No Price Alignment



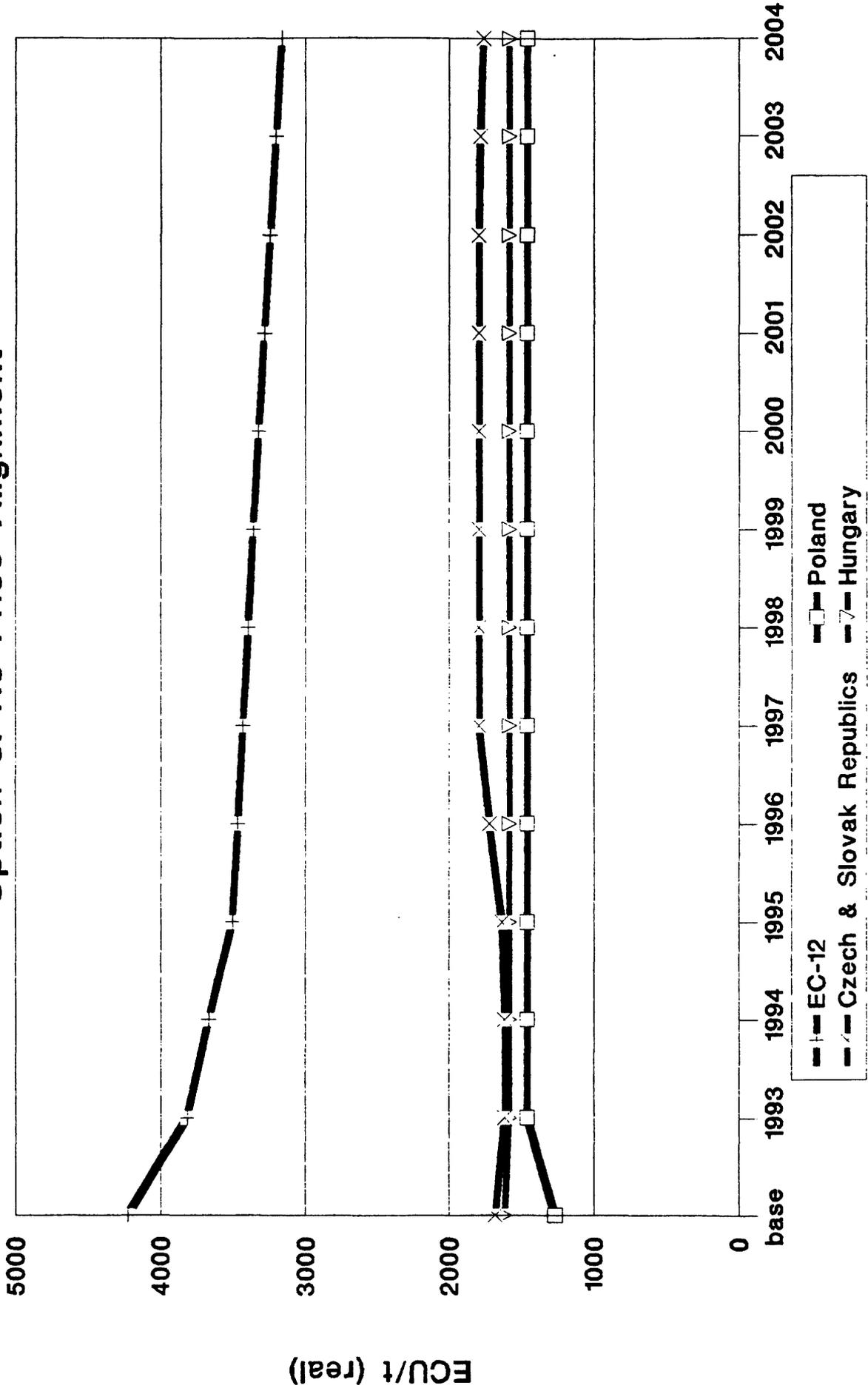
# Graph A1.22: Skim Powder Domestic Prices

Option 3: No Price Alignment



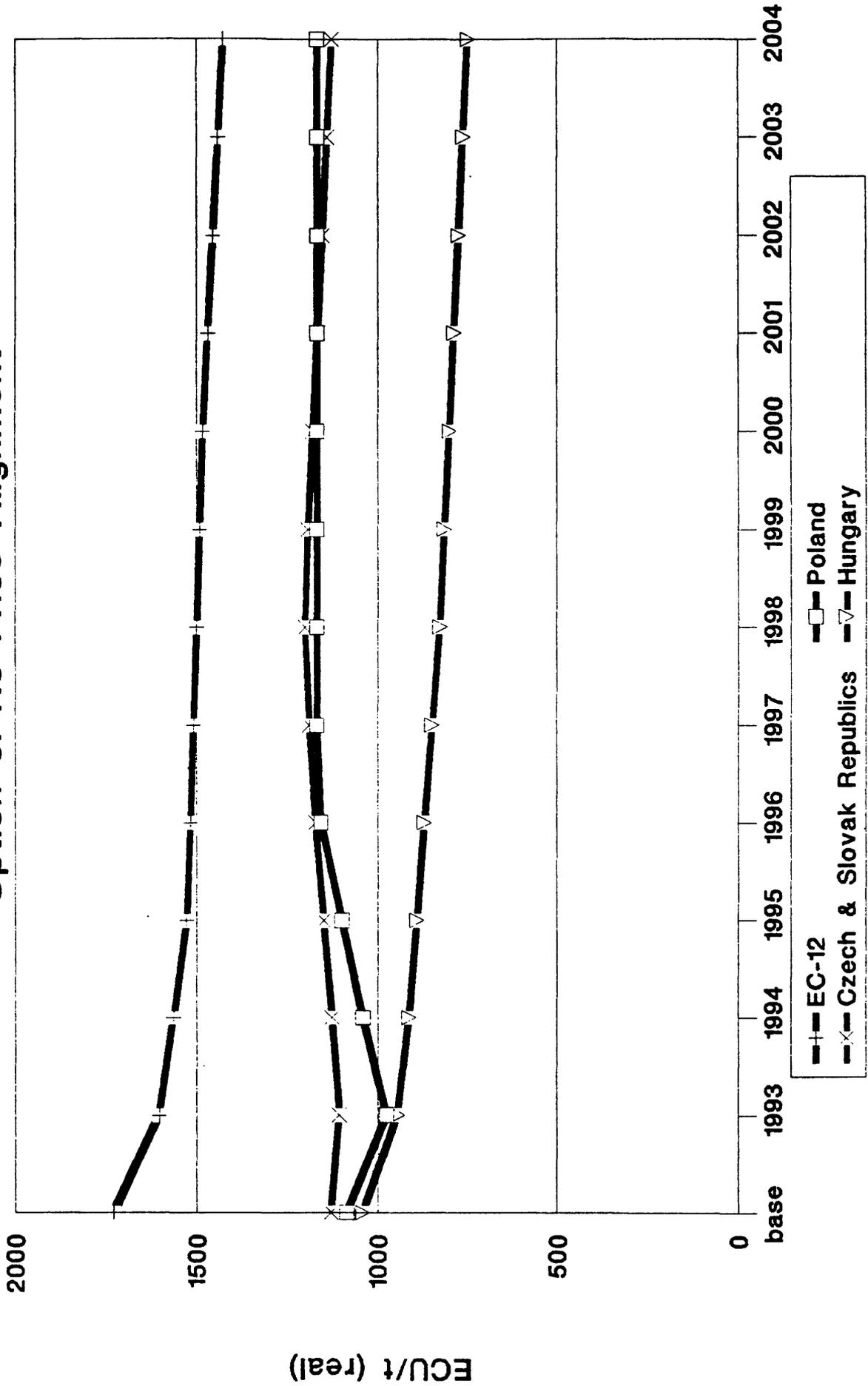
# Graph A1.23: Beef Domestic Prices

Option 3: No Price Alignment

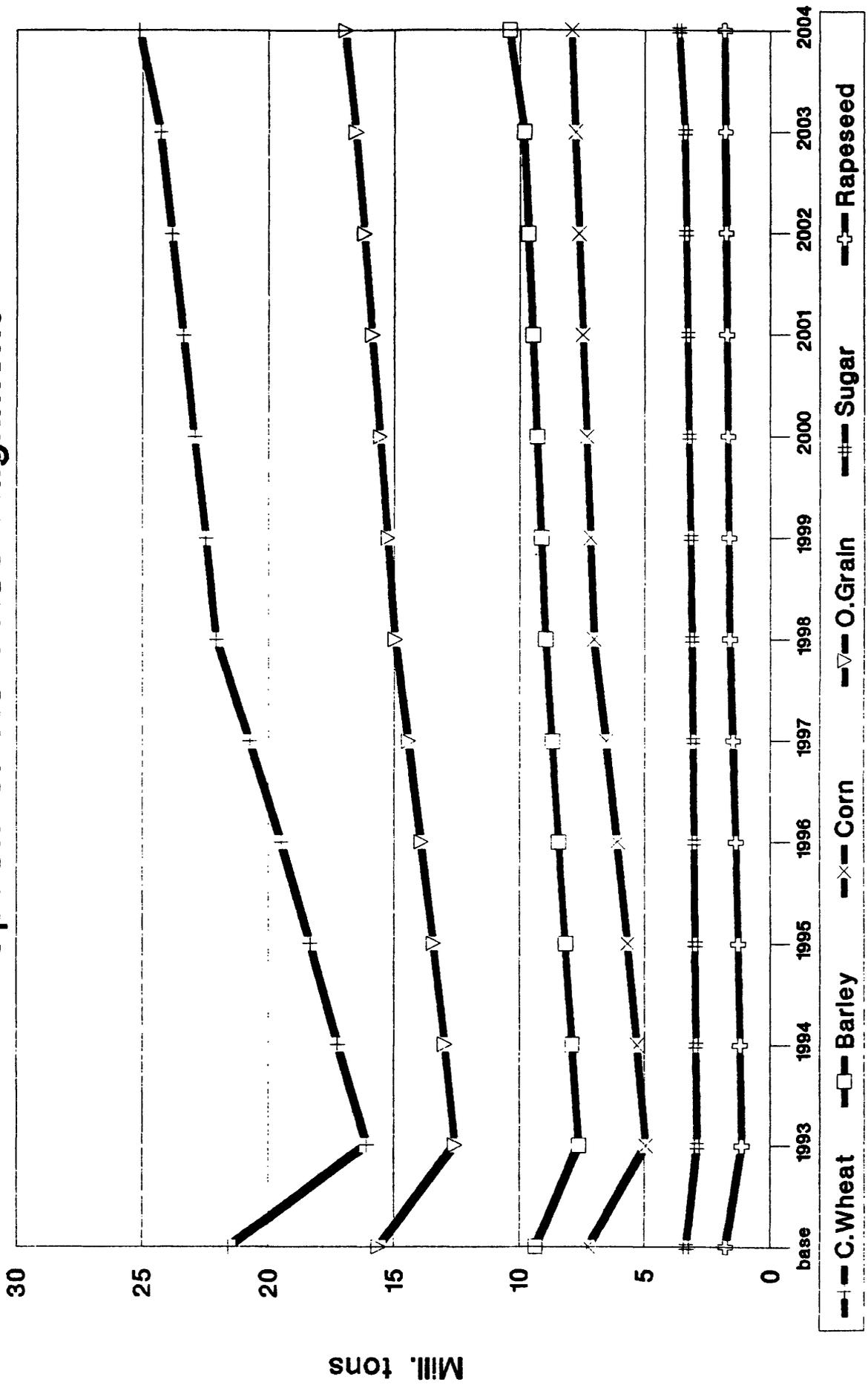


# Graph A1.24: Pork Domestic Prices

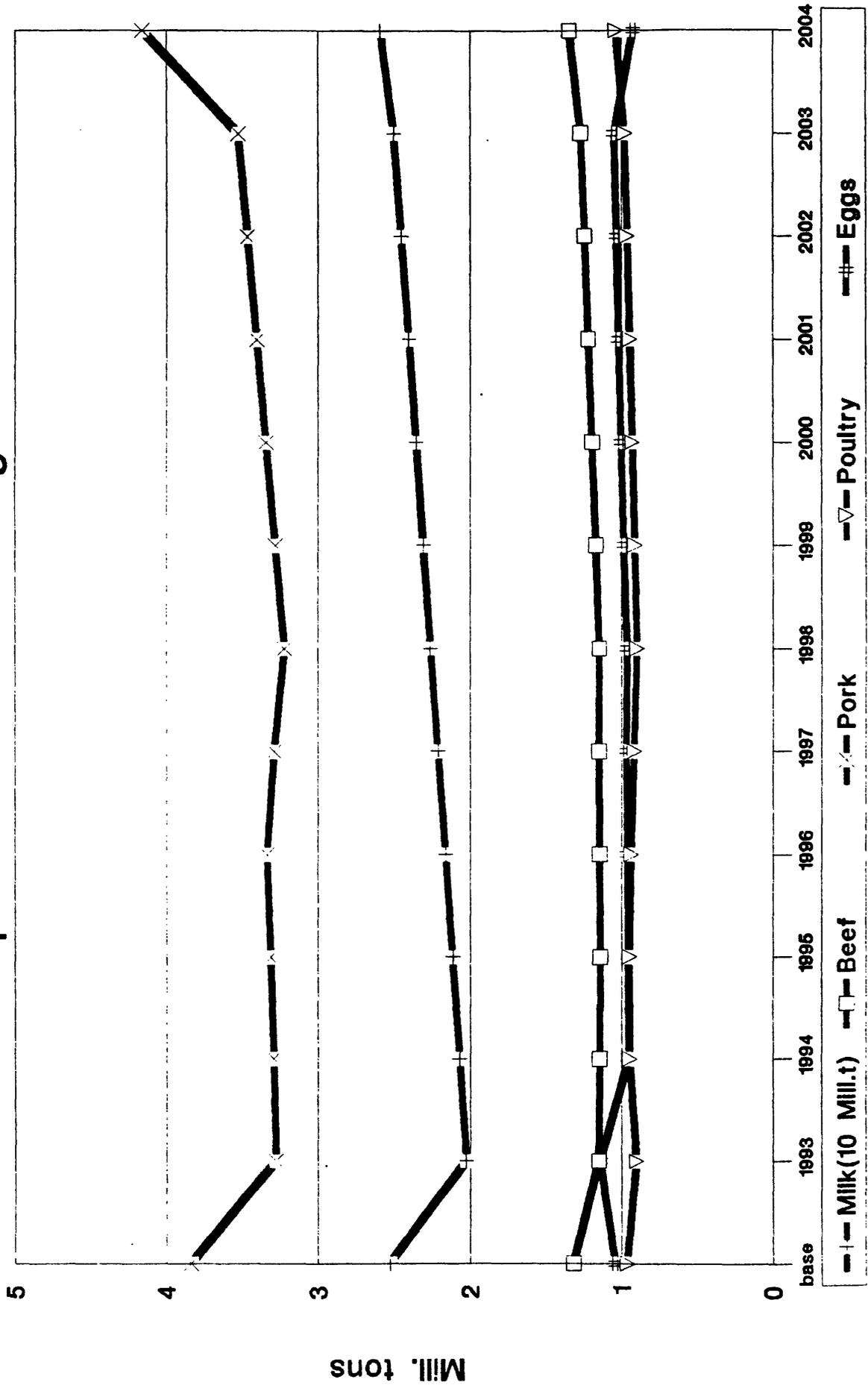
Option 3: No Price Alignment



# Graph A1.25: Crop Production Visegrad Total Option 3: No Price Alignment

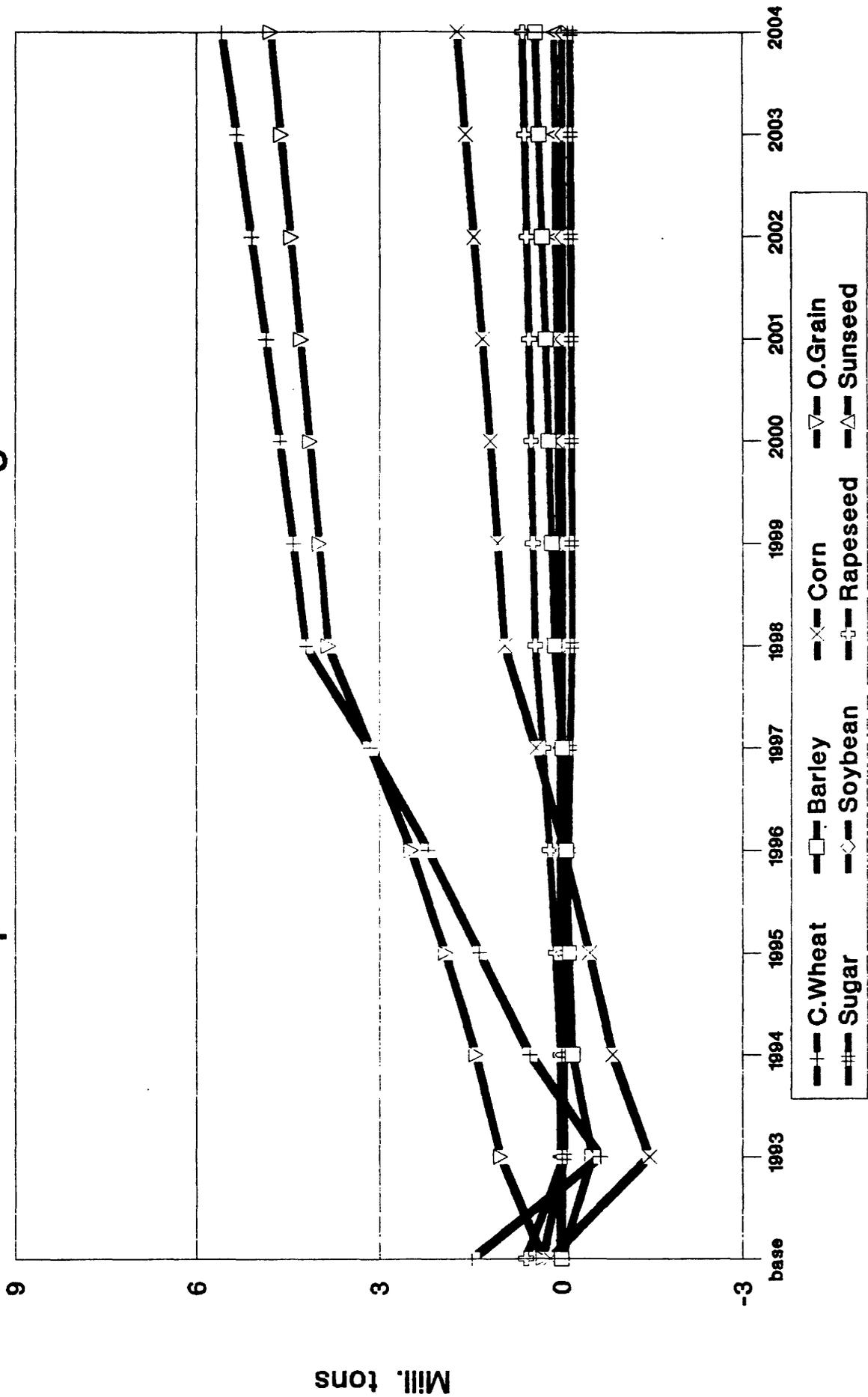


# Graph A1.26: Animal Production Visegrad Total Option 3: No Price Alignment



# Graph A1.27: Net Exports Crops Visegrad Total

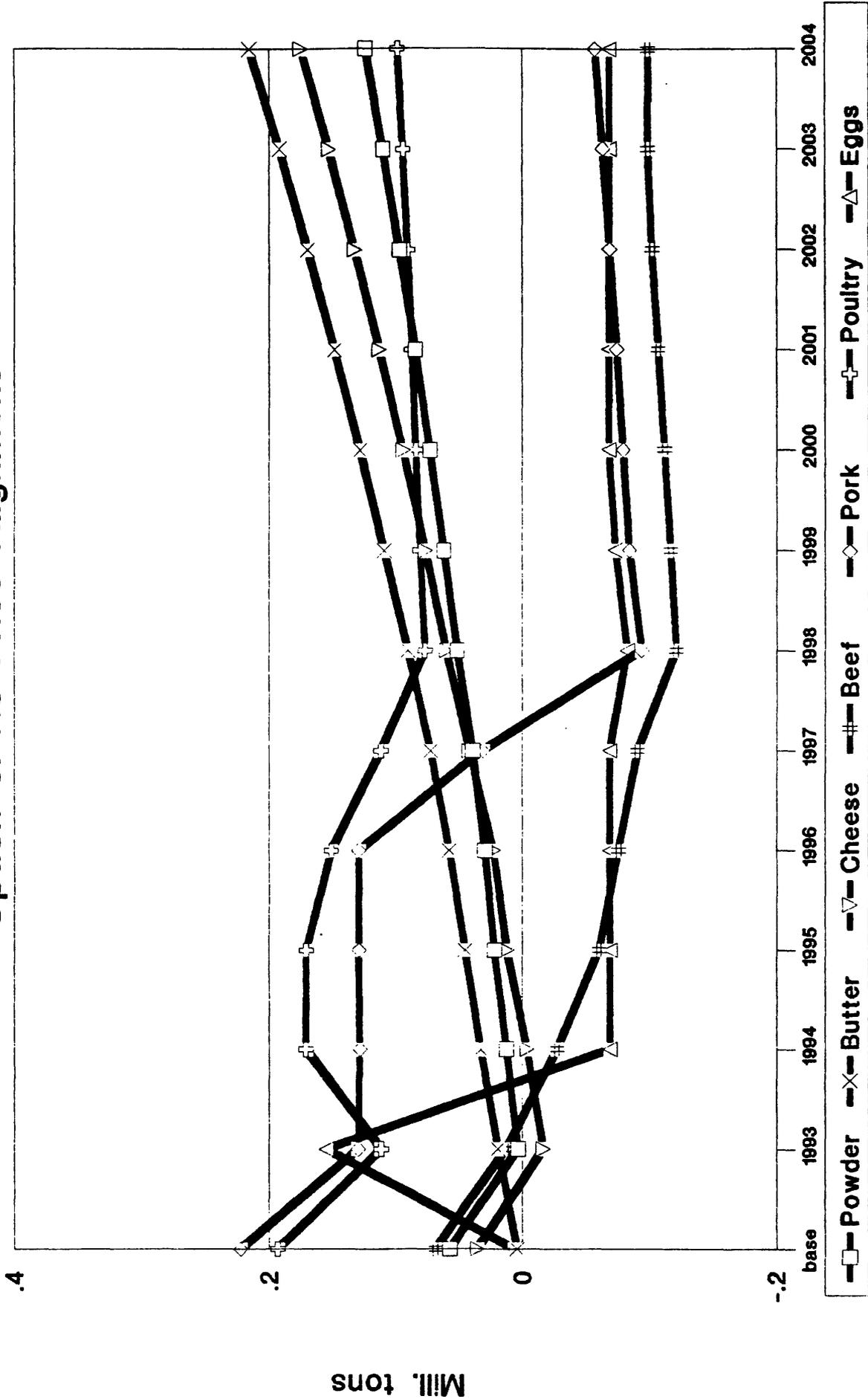
Option 3: No Price Alignment



# Graph A1.28: Net Exports Animal Products

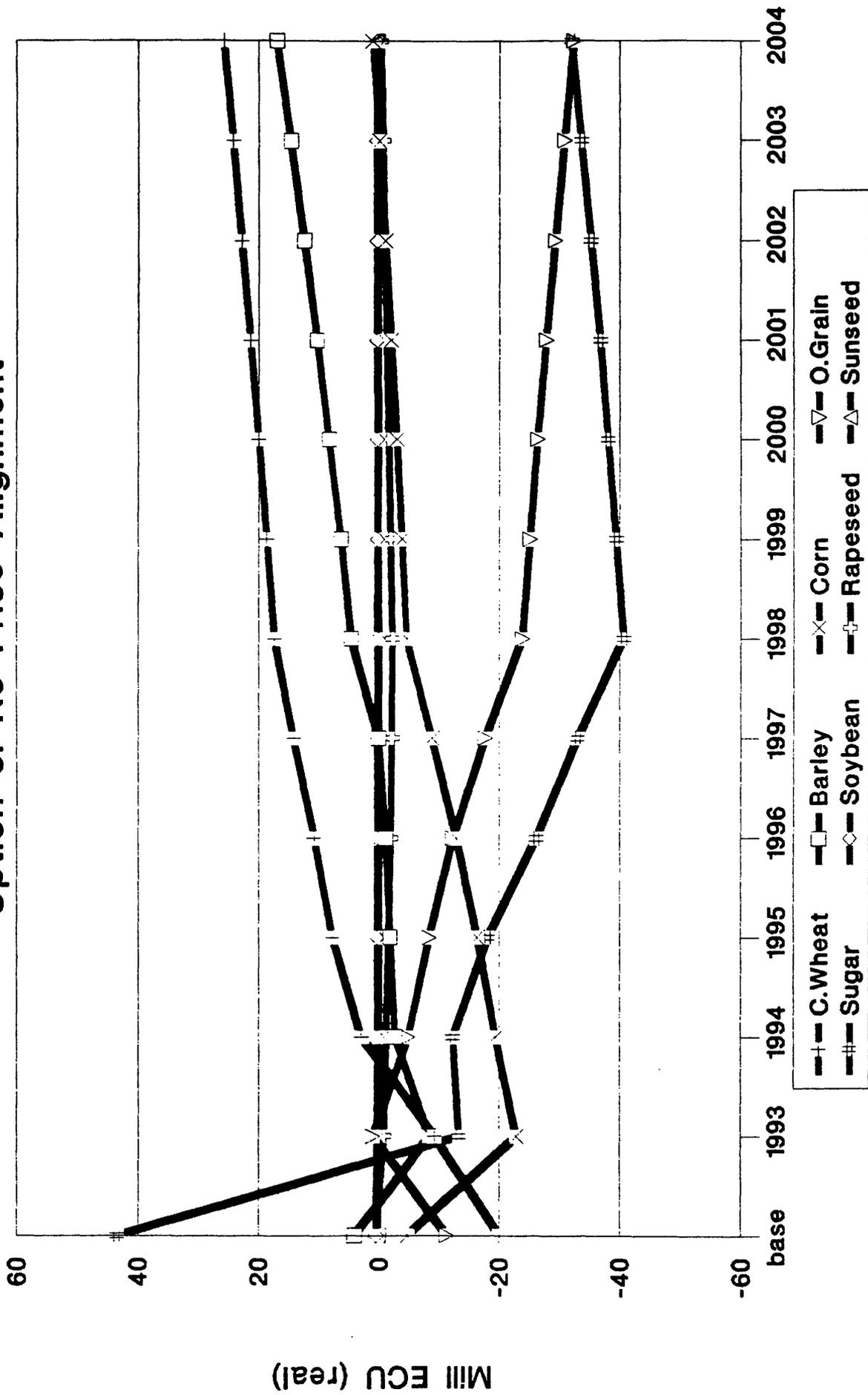
## Visegrad Total

Option 3: No Price Alignment



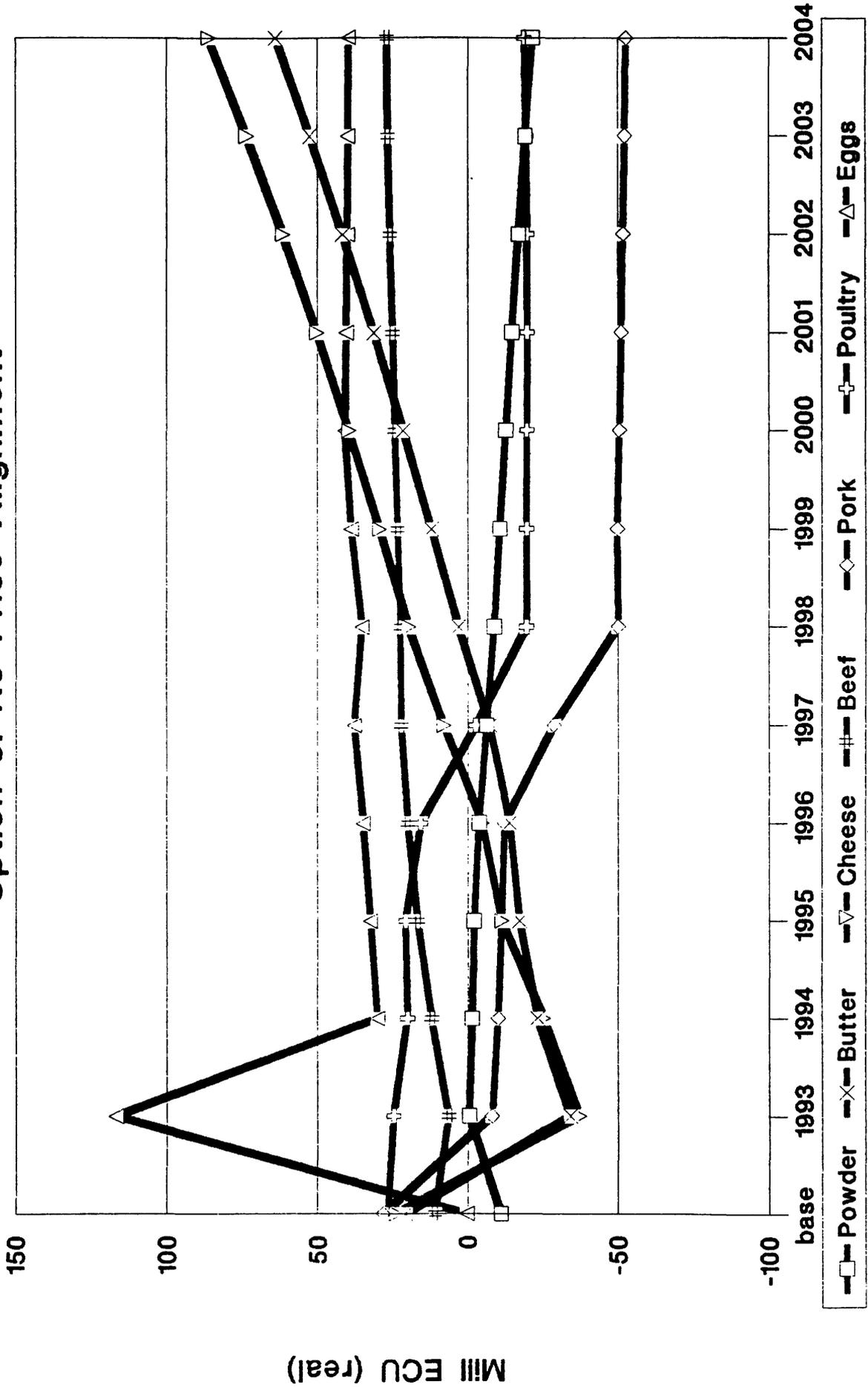
# Graph A1.29: Budget Expenditure Crop Prod. Visegrad Total

Option 3: No Price Alignment



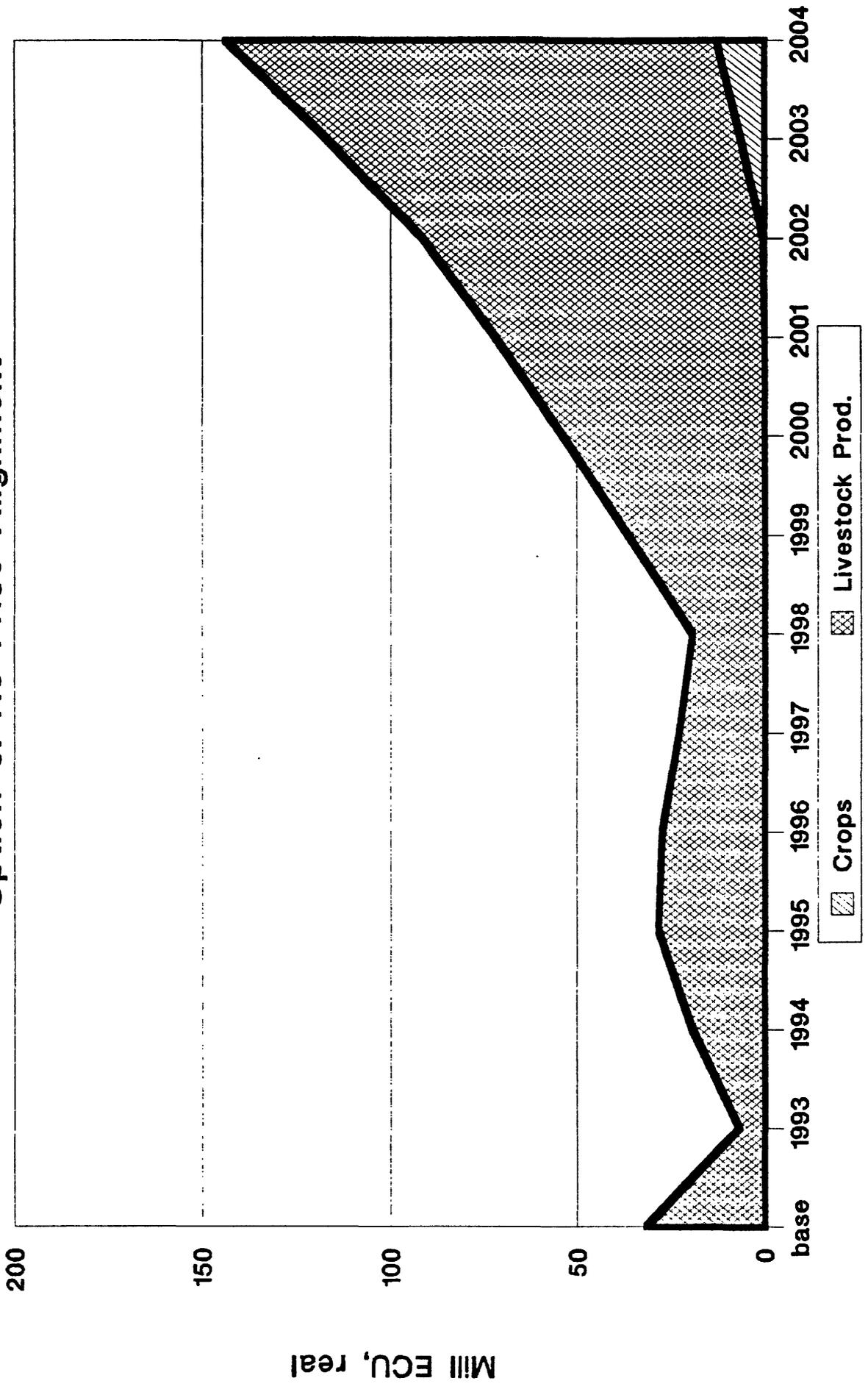
# Graph A1.30: Budget Expenditure Animal Prod. Visegrad Total

Option 3: No Price Alignment



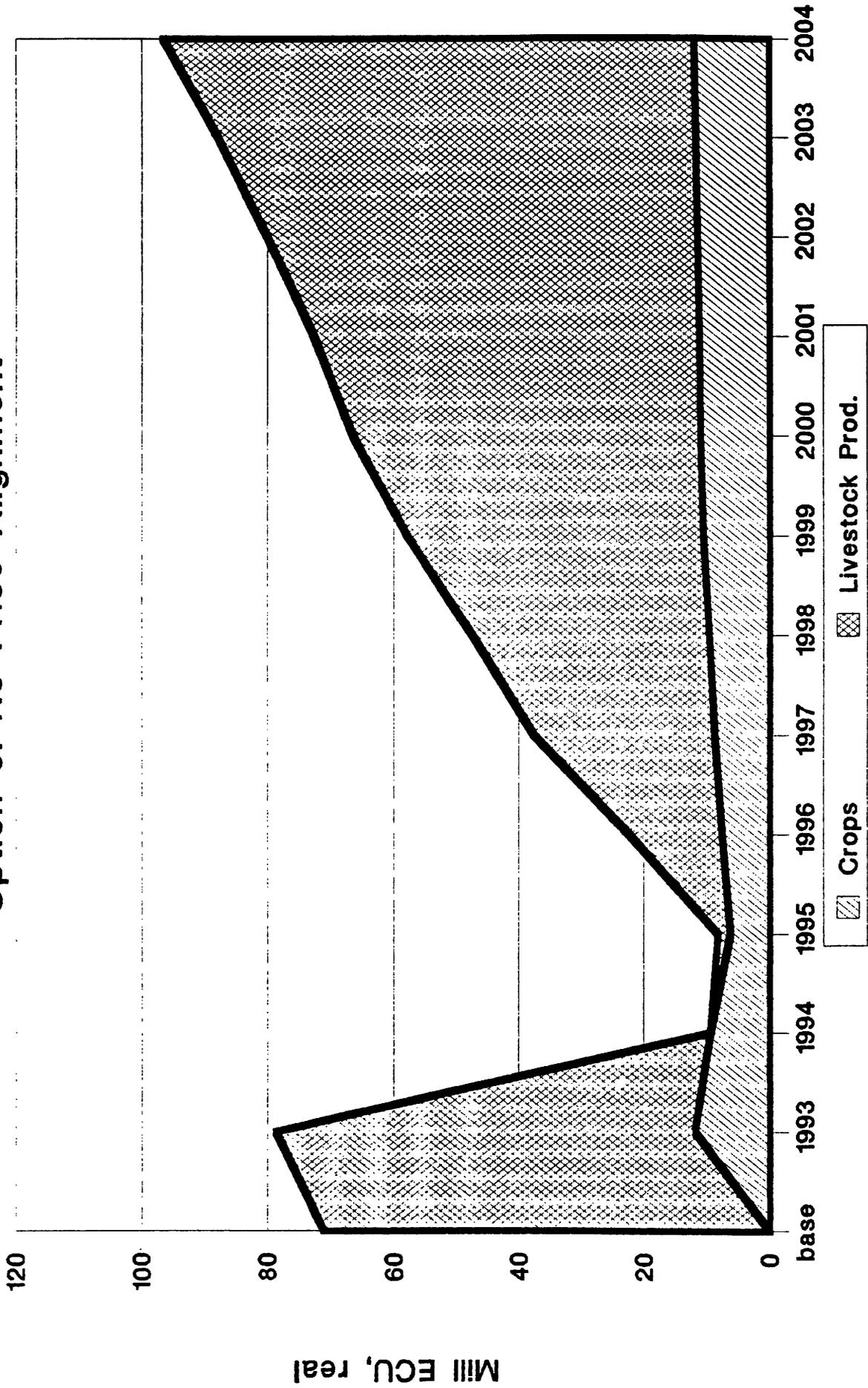
# Graph A1.31: Budget Expenditure Czech+Slovak Republics

Option 3: No Price Alignment



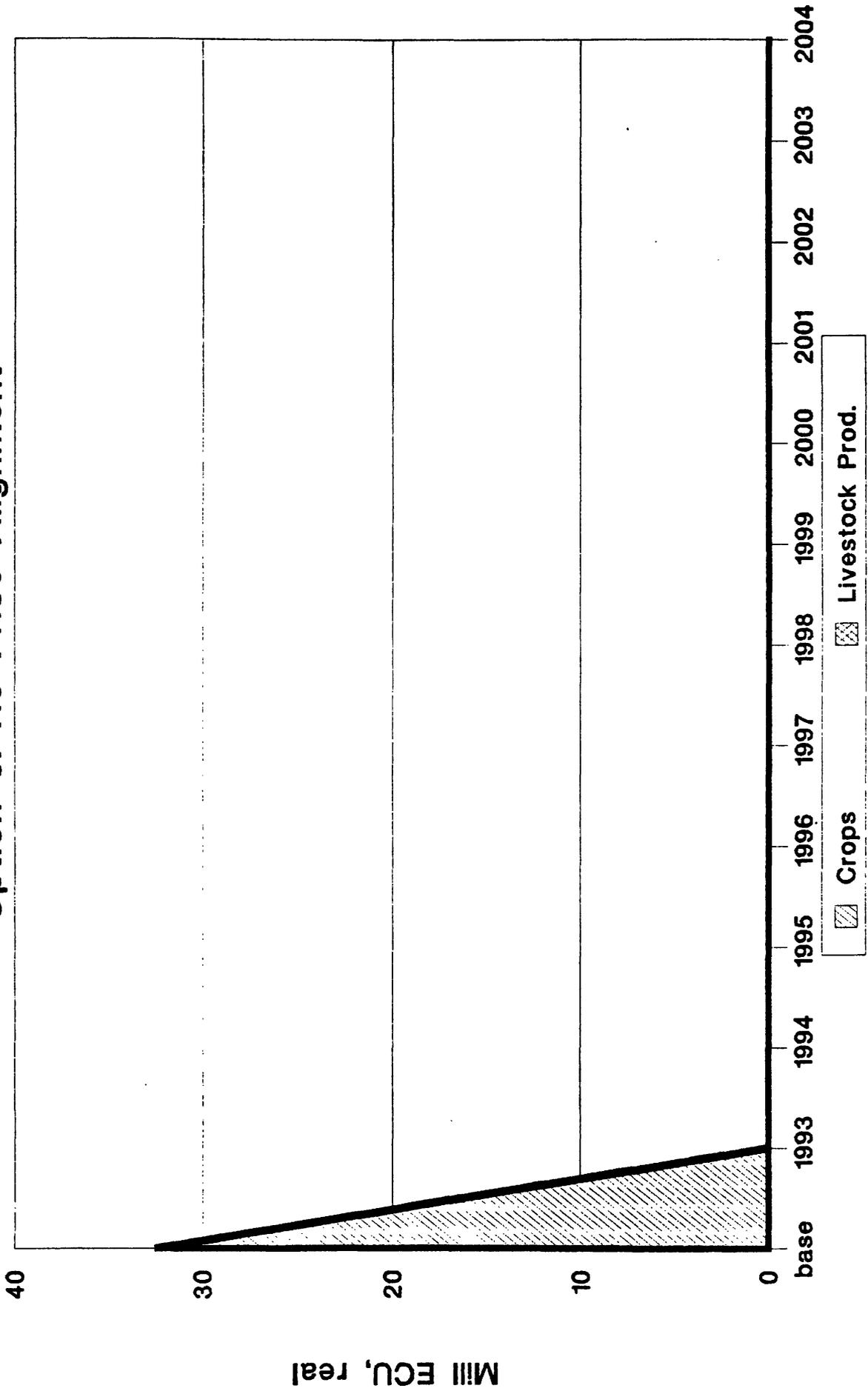
# Graph A1.32: Budget Expenditure Hungary

Option 3: No Price Alignment



# Graph AI.33: Budget Expenditure Poland

Option 3: No Price Alignment



## Appendix II

### The GATT Commitments in Agriculture of the Visegrad Countries<sup>1</sup>

In this assessment of the agricultural parts of the Uruguay Round Schedules of the Visegrad countries, the analysis is limited to around ten major commodities (see tables). The three major components of the Schedules have been analysed, i.e. market access (in particular tariff bindings), domestic support commitments, and commitments regarding export subsidies.

In addition to information about Schedule commitments and current policies, the analysis includes the implications of two alternative scenarios for future policies in the Visegrad countries. Scenario 1 is constructed such that the Visegrad countries align their prices with post MacSharry reform prices in the EU, beginning that price alignment in the year 1996 and completing it in the year 2000. Policies under scenario 1 are therefore identical to those described and discussed above as option 2 in section 5.3. Scenario 2 assumes that current (i.e. generally 1993) policy prices in the Visegrad countries are kept unchanged in real terms (i.e. policy prices are adjusted only for inflation).

Results for quantities and prices under these two scenarios have been generated with a model of agricultural markets in the Visegrad countries and the EU which is currently being constructed, in cooperation with the Economic Research Service of the USDA. More information on that model is provided in Appendix I. The results presented in Appendix I are used here for analysing the GATT implications of scenario 1. In the model used, the Czech and Slovak Republics are still treated as one aggregate, mainly because it is still statistically difficult to disaggregate quantities and prices for the two now separate countries. Hence results of scenario analyses are presented here for the synthetic aggregate of the Czech and Slovak Republics, where GATT commitments for these two countries have been aggregated where possible (i.e. in the cases of domestic support and export subsidies).

#### 1 Tariff Bindings

In Table 1 and Graphs 1 and 2, tariff bindings are reported. Tariff bindings of the EU are included for comparison. All tariffs have been expressed as percentage *ad valorem* equivalents,

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<sup>1</sup> We wish to thank Wolfgang Münch and Henning Twesten for collecting data, doing the calculations and helping with the analysis.

relative to 1993 world market prices.<sup>2</sup> As can be clearly seen in Graphs 1 and 2, tariff bindings differ significantly among the Visegrad countries. Hungary and the Czech and Slovak Republics (the two latter countries generally having the same tariff bindings) have generally bound tariffs at a level significantly below that of the EU, except for oilseeds where the EU has maintained its zero tariff bindings. For poultry, tariffs bound in Hungary and the Czech and Slovak Republics are slightly above the *ad valorem* equivalent of the EU binding. Poland's tariff bindings have generally been designed to be similar to those of the EU, and where specific tariffs are bound in Poland they are expressed in ECU. As a result, Poland's tariff equivalents are of the same magnitude as those of the EU, though in some cases they differ due to the specific combination of *ad valorem* and minimum or maximum specific tariffs which Poland has chosen.<sup>3</sup>

In addition to Uruguay Round tariff bindings, Table 1 also reports current policies (most recent data available to us, i.e. either 1993 or 1994). Both tariffs currently applied at the border (where applicable including import taxes and, in the case of Poland, recently introduced "countervailing duties ") and the tariff equivalents of the gap between current actual domestic market prices and world market prices are reported. In many cases, tariffs currently applied in the Visegrad countries are significantly below tariffs bound in the Uruguay Round. Moreover, the tariff equivalents implicit in current market prices are in most cases below the tariffs actually applied to imports (suggesting that domestic market prices are below import parity prices and that there is a certain amount of redundancy in current tariffs).<sup>4</sup>

Table 2 and Graphs 3 to 5 report results of our scenario analysis regarding tariff equivalents. The tariffs shown are the implicit tariff equivalents which would be needed to defend domestic prices, should price policies be pursued under the two alternative scenarios as described above.<sup>5</sup> Results of these scenario analyses suggest that price alignment with the EU by 2000 (Scenario 1) would not generally be consistent with tariff bindings in the Czech and Slovak Republics as well as in Hungary, the tariffs required to implement such price alignment in most cases being significantly above bound tariffs. Even maintaining current real prices (Scenario 2) would in some cases tend to violate tariff bindings in these countries. In Poland,

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<sup>2</sup> Hungary and the Czech and Slovak Republics have generally bound *ad valorem* tariffs. For the products included in this analysis, the EU has generally bound specific duties (in the case of beef combined with an *ad valorem* tariff). Poland has bound combinations of *ad valorem* and specific tariffs, often such that the specific tariff is used as an upper or lower limit of the *ad valorem* tariff.

<sup>3</sup> In addition to its tariff bindings for cereals, the EU has committed itself not to apply tariffs above a level which would make duty-paid import prices exceed 155% of the EU intervention price. The implication of this clause in the EU Schedule has been incorporated in our analysis.

<sup>4</sup> However, there are also a few cases where current tariff equivalents calculated here are above current tariffs. This can have either of two reasons. First, world market and/or domestic market prices used in this analysis do not correctly describe the market situation. Second, in addition to tariffs there is protection of the domestic market through non-tariff barriers.

<sup>5</sup> These tariff equivalents have been calculated from the gap between domestic prices under the scenarios and world market prices. In practice somewhat higher tariffs would be needed to defend the scenario policies, because the tariff equivalents shown here are only just sufficient to make the landed price of imports equal to the domestic market price.

on the other hand, price alignment with the EU would not be hampered by tariffs bound in the GATT. Given that Poland has bound its tariffs essentially at the same level as the EU this cannot come as a surprise. It is only in the case of butter that Poland's tariff binding would not quite suffice to cover price alignment with the EU.

### **Domestic Support**

Under the Uruguay Round Agreement on Agriculture, the domestic support commitments (expressed in AMS) cover the aggregate of the whole agricultural sector. Because it was impossible to include all agricultural commodities in the analysis, this part of the assessment is also limited to the major commodities included in the other parts of the analysis (see tables on tariffs and export subsidies). The assumption made is that the AMS commitments accepted by the Visegrad countries apply to the aggregate of the ten or so products included in the analysis. Moreover, the analysis has been confined to the market support element of the AMS (i.e. excluding direct payments and other forms of support). Hence, from the base AMS of each country, as reported in the supporting tables attached to the Schedules, that part has been extracted which applies to market price support for the ten products included in this analysis. This sub-sector AMS has then been treated like the overall AMS is treated under the Agreement, i.e. it has been assumed that it has to be reduced by the rate of reduction of the overall AMS (i.e. by 20% between 1995 and 2000).

The bound AMS for the year 2000, as well as the AMS calculated in this analysis for 1993 (using actual 1993 quantities and domestic prices) is reported in Table 3.<sup>6</sup> In that table, all numbers are relative to the bound sub-sector AMS for 1995, which is set equal to 100. Differences among countries are striking. Poland's AMS in 1993 appears to have been very close to what its bound AMS for 1995 is. Hungary has exceeded its bound 1995 AMS already in 1993 by far. This is largely due to the fact that Hungary has bound domestic support in national currency, while Poland has bound domestic support (and export subsidy outlay) in US \$. As a result of significant inflation since the base period, AMS has grown dramatically in Hungary. In Poland, on the other hand, 1993 prices in US \$ equivalent were on aggregate not very far from base period prices in US \$ equivalent.

How the GATT will react to cases like those of Hungary remains to be seen. There is no doubt that rules for calculating current AMS, as laid down in the Uruguay Round Agreement on Agriculture, do not allow for a discount for inflation. Everything has to be calculated in nominal terms. On the other hand, Article 18:4 of the Agreement suggests that in the review of

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<sup>6</sup> The AMS calculated for any year after the base period is very sensitive to assumptions made regarding which products are covered by administered prices (since the domestic/world price gap is included in the AMS only if there is an administered price for the product concerned). In our analysis we have taken the following products as having administered prices: Czech and Slovak Republics--wheat, sugar, butter, skim powder, cheese, beef, pork; Hungary--wheat, corn, butter, skim powder, beef, pork; Poland--wheat, rye, sugar, milk, pork; EU--cereals, sugar, butter, skim powder, cheese, beef.

commitment implementation, under the auspices of the Committee on Agriculture, "due consideration [shall be given] to the influence of excessive rates of inflation on the ability of any Member to abide by its domestic support commitments". It will be interesting to see how the Committee on Agriculture will interpret this rather vague clause. In any case, it appears unlikely that an automatic discount for inflation will be granted.

Domestic support commitments in the Czech and Slovak Republics pose another interesting problem. In the Schedules of both countries available to us there is no market price support element in the base period AMS. The base AMS for both countries contains only direct payments and other forms of support. It is not clear why this is the case. Possibly the assumption was made, when the Schedules were originally drafted, that there were no administered prices in Czechoslovakia during the base period (though this does not appear to be a very convincing assumption). On the other hand, there are certainly administered prices for a number of products now, in both countries. Because there is no element of market price support in the Schedules, there are also no supporting tables attached to the Schedules which would contain base period external reference prices (as is the case for other countries wherever there was market price support in the base period). Because of that lack of "agreed" external reference prices in the Schedules it is not clear how the current AMS resulting from market price support will be calculated in future. Presumably the countries concerned will have to provide statistical evidence, to the Committee on Agriculture, on what their external reference prices have been in the base period, and current market price support will be calculated on the basis of those reference prices. Because of the uncertainties on how such cases will be treated in the GATT, an AMS has not been calculated here for the Czech and Slovak Republics. However, like Hungary the Czech and Slovak Republics have bound domestic support in domestic currency. Hence they are likely to have a similar problem with inflation as Hungary. Moreover, if future market price support is included in the AMS calculation though base period market price support was implicitly zero, there is an additional element of excess support. The Czech and Slovak Republics are, therefore, also likely to exceed their domestic support commitment very much.

Table 4 and Graph 6 show the results of our scenario analysis. All numbers in that analysis are expressed relative to the bound sub-sector AMS for the respective year (i.e. 1995 or 2000), which is set equal to 100. With some further inflation assumed for Hungary (5% annual rate), Hungary has no chance whatsoever to honour its AMS commitment under either scenario. The situation is likely to be the same for the Czech and Slovak Republics. Poland, on the other hand, having avoided inflationary pressure on its AMS commitment by binding it in US \$<sup>7</sup>, can keep its current support close to its commitment, though only if it does not raise real support prices (i.e. under Scenario 2). On the other hand, if Poland were to align its prices with the CAP (Scenario 1), it would exceed its AMS commitment by 250 per cent in the year 2000.

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<sup>7</sup> In addition, Poland has engineered its AMS base in a rather interesting way, applying base period (1986-88) AMS percentages by commodity group to 1992 values of production to calculate the overall base AMS.

## Export Subsidies

Schedule commitments regarding export subsidies, both quantities and outlay, are reported in Table 5. It should be noted that commitments regarding export subsidies do not always come for the same types of product groups in all countries (contrary to what the GATT Modalities document suggested). Thus, for example, rather than having separate commitments for beef meat and pork meat, Poland has one commitment regarding processed meat and one commitment regarding unprocessed meat (each of them covering both pork and beef meat). In the analysis presented here, an attempt has been made to define product groups appropriately. However, results need to be interpreted with care.

Results of the scenario analysis are reported in Table 6 and Graphs 7 to 12. The extent to which export subsidy commitments constrain future policies in the countries covered differs among products. In a number of cases the Visegrad countries have non-zero quantities and outlays bound in their Schedules (presumably because they exported with subsidies in the base period) though they may not be net exporters of the products concerned in the future, depending on future policies. In other cases there are (implicit) zero bindings in the Schedules (simply because there are no entries for the products concerned), but there is a good probability that the countries may find they have a surplus of these products, and would need to subsidize exportation because domestic prices are above world prices. Equally, there are cases where the Schedules would allow for only relatively small amounts of subsidized exports, though there is a probability that actual export availability may be significantly larger.

Of course this latter case tends to happen more frequently under Scenario 1 (price alignment with the EU by 2000). Cases where subsidized exports under Scenario 1 (and sometimes even under Scenario 2) may not fit into Schedule commitments are wheat, coarse grains, sugar, beef and pork in the Czech and Slovak Republics<sup>8</sup>; and all products except oilseeds in both Hungary and Poland.<sup>9</sup> It generally is the case that both quantity and outlay commitments are exceeded at the same time.

## Conclusions

Based on this analysis it appears that the extent to which their Uruguay Round commitments bind future agricultural price and trade policies in the Visegrad countries differs very much among countries. In Poland, tariff bindings would not constrain price alignment

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<sup>8</sup> Under Scenario 2, the Czech and Slovak Republics tend to export more poultry than under scenario 1. This is because the poultry/cereals price ratio is less favourable in the EU (Scenario 1) than currently and projected for 2000 under Scenario 2 in the Czech and Slovak Republics.

<sup>9</sup> In order to gain a better impression of the "pure" effects of price alignment with the EU it has been assumed in the Scenarios analysed here that no supply quotas are imposed on sugar and milk in the Visegrad countries. As a result, alignment with the rather high EU prices for sugar and milk leads to potentially large surpluses of sugar and dairy products in the Visegrad countries.

with the EU. However, Poland would violate its commitments regarding domestic support and export subsidies if it were to align its prices with the EU before becoming a member of the Union. For the Czech and Slovak Republics, tariff bindings are more restrictive than in Poland and would indeed prevent prices from being aligned with the EU. Moreover, for some products export subsidy commitments might also get into the way of aligning prices with the EU. Hungary's tariff bindings would also prevent price alignment with the EU from happening smoothly for some products. Moreover, Hungary is likely to run into difficulties with export subsidy commitments for nearly all products covered in this analysis should it aim to align its prices with those of the EU.

In Hungary and the Czech and Slovak Republics, it is essentially impossible to honour the domestic support commitments in any case, because inflation has eroded their commitments nearly completely. Whether the "excessive inflation" clause in Article 18:4 of the Agreement on Agriculture may be a way out remains to be seen when the GATT Committee on Agriculture begins its work and is confronted with such cases. In the Czech and Slovak Republics there is also the issue of which external reference prices to use in calculating current market price support.

Table 1: GATT Schedules - Tariff Bindings

	Current policies (1993-94)		GATT tariff binding		Current policies (1993-94)		GATT tariff binding	
	Tariff applied %	Tariff equivalent %	1995 %	2000 %	Tariff applied %	Tariff equivalent %	1995 %	2000 %
	Wheat							
EU	n.a.	40,2	83,3	83,3	n.a.	127,4	194,9	124,7
Hungary	50,0	-2,0	50,0	32,0	15,0	-5,6	112,0	71,7
Czech Rep.	30,0	14,7	25,0	21,2	30,0	-3,7	41,7	34,0
Slovak Rep.	30,0	n.a.	25,0	21,2	30,0	n.a.	41,7	34,0
Poland	27,2	23,9	120,6	77,2	37,8	-13,0	278,6	178,1
	Barley							
EU	n.a.	97,9	158,8	158,8	n.a.	57,4	87,5	56,0
Hungary	41,0	20,3	41,0	32,0	15,0	-7,2	61,0	51,9
Czech Rep.	40,0	61,3	25,0	21,2	30,0	8,6	45,8	38,5
Slovak Rep.	40,0	n.a.	25,0	21,2	30,0	n.a.	45,8	38,5
Poland	27,2	64,2	147,8	94,8	48,9	-4,2	118,5	75,9
	Rapeseed							
EU	n.a.	0,0	0,0	0,0	n.a.	44,8	43,2	27,6
Hungary	0,0	0,0	0,0	0,0	61,0	13,2	61,0	39,0
Czech Rep.	20,0	0,0	72,7	60,0	18,0	56,8	54,1	43,0
Slovak Rep.	20,0	n.a.	72,7	60,0	18,0	n.a.	54,1	43,0
Poland	37,8	0,0	100,0	64,0	89,0	-2,6	120,0	76,0
	Sunflower seeds							
EU	n.a.	0,0	0,0	0,0	n.a.	159,8	205,7	131,7
Hungary	0,0	0,0	0,0	0,0	60,0	137,5	159,0	101,8
Czech Rep.	10,0	0,0	48,4	40,0	32,0	153,1	81,5	68,0
Slovak Rep.	10,0	n.a.	48,5	40,0	32,0	n.a.	81,5	68,0
Poland	37,8	0,0	15,0	9,0	48,4	-30,3	160,0	102,0
	White sugar							
EU	n.a.	n.a.	214,6	171,6	n.a.	36,9	108,2	86,5
Hungary	80,0	58,6	80,0	68,0	20,0	-21,2	80,0	51,2
Czech Rep.	70,0	87,9	70,0	59,5	30,0	23,2	49,6	37,0
Slovak Rep.	70,0	n.a.	70,0	59,5	30,0	n.a.	49,6	37,0
Poland	48,4	77,9	208,4	169,1	76,0	-7,8	208,1	133,1
	Skimmed milk powder							
EU	n.a.	n.a.	20,0	20,0	n.a.	20,0	108,2	86,5
Hungary	80,0	58,6	80,0	68,0	20,0	-21,2	80,0	51,2
Czech Rep.	70,0	87,9	70,0	59,5	30,0	23,2	49,6	37,0
Slovak Rep.	70,0	n.a.	70,0	59,5	30,0	n.a.	49,6	37,0
Poland	48,4	77,9	208,4	169,1	76,0	-7,8	208,1	133,1

Table 2: Scenario Analysis - Tariff Bindings

	GATT tariff binding ad valorem equivalent		Scenario tariffs, 2000 ad valorem equivalent	
	1995 %	2000 %	Scenario 1 %	Scenario 2 %
<b>Hungary</b>				
Wheat	50,0	32,0	12,4	-2,0
Barley	41,0	32,0	58,8	16,9
Rapeseed	0,0	0,0	0,0	0,0
Sunseed	0,0	0,0	0,0	0,0
Sugar	80,0	68,0	134,5	76,2
Beef	112,0	71,7	78,6	-5,6
Pork	61,0	51,9	32,7	-21,4
Poultry	61,0	39,0	21,9	5,4
Butter	159,0	101,8	147,1	111,4
Skim powder	80,0	51,2	20,0	-30,6
<b>Czech + Slovak Republics</b>				
Wheat	25,0	21,2	12,4	14,7
Barley	25,0	21,2	58,8	54,4
Rapeseed	72,7	60,0	0,0	0,0
Sunseed	48,4	40,0	0,0	0,0
Sugar	70,0	59,5	134,5	87,9
Beef	41,7	34,0	78,6	7,0
Pork	45,8	38,5	32,7	15,8
Poultry	54,1	43,0	21,9	79,8
Butter	81,5	68,0	147,1	122,7
Skim powder	49,6	37,0	20,0	8,4
<b>Poland</b>				
Wheat	120,6	77,2	12,4	6,8
Barley	147,8	94,8	58,8	34,2
Rapeseed	100,0	64,0	0,0	0,0
Sunseed	15,0	9,0	0,0	0,0
Sugar	208,4	169,1	134,5	52,4
Beef	278,6	178,1	78,6	-13,0
Pork	118,5	75,9	32,7	14,7
Poultry	120,0	76,0	21,9	22,1
Butter	160,0	102,0	147,1	-30,3
Skim powder	208,1	133,1	20,0	-7,8

**Table 3: GATT Schedules- Domestic Support Commitments, Selected Products  
1995 Bound AMS = 100**

	<b>Actual AMS 1993</b>	<b>Bound AMS 1995</b>	<b>Bound AMS 2000</b>
<b>EU</b>	<b>74,37</b>	<b>100,00</b>	<b>80,00</b>
<b>Hungary</b>	<b>746,43</b>	<b>100,00</b>	<b>80,00</b>
<b>Poland</b>	<b>110,98</b>	<b>100,00</b>	<b>80,00</b>
<b>Czech+Slovak Rep</b>	<b>***</b>	<b>***</b>	<b>***</b>
<b>Czech Rep.</b>		<b>100,00</b>	<b>80,00</b>
<b>Slovak Rep.</b>		<b>100,00</b>	<b>80,00</b>

\*\*\*: Zero market price support bound in GATT-Schedule

**Table 4: Scenario Analysis - Domestic Support Commitments, Selected Products**  
**Bound AMS of the respective year = 100**

	Actual AMS	Scenario AMS		2000	
	1993 1995 bound=10	1995 Scenario 1	1995 Scenario 2	Scenario 1	Scenario 2
EU	74,37	68,67	68,67	90,25	101,77
Hungary	746,43	905,62	905,62	4.276,84	1.920,46
Czech+Slovak Rep	***	***	***	***	***
Poland	110,98	112,01	112,01	362,27	113,64

\*\*\*: Zero market price support bound in GATT-Schedule

Table 5: GATT Schedules - Export Subsidies

	Quantity of Subsidized Exports, Mill t						Outlay on Export Subsidies						
	base	1993 actual	1995 bound	2000 bound	change base>200	change 1993>2000	Currency	base	1993 actual	1995 bound	2000 bound	change base>200	change 1993>2000
<b>Wheat</b>													
EU	17,01	10,12	19,12	13,44	-21,00%	32,74%	Bll. ECU	1,78	0,44	2,07	1,14	-36,00%	157,30%
Hungary	1,44	0,00	1,39	1,14	-20,98%	0,00%	Bll. HUF	2,05	0,00	1,83	1,32	-35,99%	0,00%
Czech+Slovak Rep.	0,22	0,07	0,21	0,17	-21,00%	151,29%	Bll. Kcs	0,23	0,03	0,22	0,15	-36,00%	331,49%
Poland	0,00	0,00	0,00	0,00	0,00%	0,00%	Bll. US\$	0,00	0,00	0,00	0,00	0,00%	0,00%
Slovak Rep.	0,14	0,00	0,13	0,11	-21,00%	0,00%	Bll. Kcs	0,29	0,00	0,28	0,19	-36,00%	0,00%
<b>Coarse Grains</b>													
EU	12,62	0,00	12,18	9,97	-21,00%	0,00%	Bll. ECU	1,38	0,00	1,30	0,88	-36,00%	0,00%
Hungary (3)	1,45	0,00	1,24	0,16	-88,99%	0,00%	Bll. HUF	0,23	0,00	0,22	0,15	-36,88%	0,00%
Czech+Slovak Rep.	0,00	0,21	0,00	0,00	0,00%	-100,00%	Bll. Kcs	0,00	0,30	0,00	0,00	0,00%	-100,00%
Poland	0,00	0,00	0,00	0,00	0,00%	0,00%	Bll. US\$	0,00	0,00	0,00	0,00	0,00%	0,00%
Slovak Rep.	0,00	0,00	0,00	0,00	0,00%	0,00%	Bll. Kcs	0,00	0,00	0,00	0,00	0,00%	0,00%
<b>Rapeseed</b>													
EU	0,10	0,00	0,10	0,08	-21,02%	0,00%	Bll. ECU	0,03	0,00	0,03	0,02	-36,02%	0,00%
Hungary	0,00	0,00	0,00	0,00	0,00%	0,00%	Bll. HUF	0,00	0,00	0,00	0,00	0,00%	0,00%
Czech+Slovak Rep.	0,00	0,02	0,00	0,00	0,00%	-100,00%	Bll. Kcs	0,00	0,03	0,00	0,00	0,00%	-100,00%
Poland	0,43	0,00	0,42	0,34	-21,00%	0,00%	Bll. US\$	0,02	0,00	0,02	0,01	-45,11%	0,00%
Slovak Rep.	0,00	0,00	0,00	0,00	0,00%	0,00%	Bll. Kcs	0,00	0,00	0,00	0,00	0,00%	0,00%
<b>Sunflower Seeds</b>													
EU	0,00	0,00	0,00	0,00	0,00%	0,00%	Bll. ECU	0,00	0,00	0,00	0,00	0,00%	0,00%
Hungary	0,09	0,02	0,09	0,07	-21,11%	211,45%	Bll. HUF	0,34	0,01	0,32	0,22	-36,01%	3051,93%
Czech+Slovak Rep.	0,00	0,00	0,00	0,00	0,00%	0,00%	Bll. Kcs	0,00	0,00	0,00	0,00	0,00%	0,00%
Poland	0,00	0,00	0,00	0,00	0,00%	0,00%	Bll. US\$	0,00	0,00	0,00	0,00	0,00%	0,00%
Slovak Rep.	0,00	0,00	0,00	0,00	0,00%	0,00%	Bll. Kcs	0,00	0,00	0,00	0,00	0,00%	0,00%
<b>White Sugar</b>													
EU	1,82	0,00	1,56	1,28	-21,00%	0,00%	Bll. ECU	0,78	0,00	0,73	0,50	-35,99%	0,00%
Hungary (3)	0,17	0,08	0,14	0,03	-80,72%	-46,67%	Bll. HUF	0,23	1,01	0,22	0,15	-36,19%	-85,24%
Czech+Slovak Rep.	0,01	0,00	0,01	0,01	-21,00%	0,00%	Bll. Kcs	0,10	0,00	0,10	0,06	-36,00%	0,00%
Poland	0,13	0,00	0,13	0,10	-20,97%	0,00%	Bll. US\$	0,05	0,00	0,05	0,03	-36,00%	0,00%
Slovak Rep.	0,01	0,00	0,00	0,00	-21,00%	0,00%	Bll. Kcs	0,08	0,00	0,08	0,05	-36,00%	0,00%
<b>Beef</b>													
EU	1,03	0,25	1,12	0,82	-21,00%	224,79%	Bll. ECU	1,97	0,58	1,90	1,26	-36,00%	116,18%
Hungary	0,04	0,00	0,04	0,03	-22,22%	0,00%	Bll. HUF	1,57	0,00	1,47	1,00	-35,97%	0,00%
Czech+Slovak Rep.	0,10	0,00	0,10	0,08	-20,97%	0,00%	Bll. Kcs	0,48	0,00	0,48	0,31	-36,00%	0,00%
Poland (1)	0,10	0,00	0,10	0,08	-21,11%	0,00%	Bll. US\$	0,19	0,00	0,18	0,12	-35,98%	0,00%
Slovak Rep.	0,04	0,00	0,03	0,03	-21,00%	0,00%	Bll. Kcs	0,29	0,00	0,28	0,18	-36,00%	0,00%
<b>Pork</b>													
EU	0,51	0,51	0,49	0,40	-21,00%	-21,76%	Bll. ECU	0,18	0,32	0,17	0,12	-35,99%	-63,85%
Hungary	0,12	0,00	0,11	0,09	-20,87%	0,00%	Bll. HUF	4,74	0,00	4,45	3,03	-36,00%	0,00%
Czech+Slovak Rep.	0,02	0,00	0,02	0,01	-21,06%	259,33%	Bll. Kcs	0,11	0,01	0,11	0,07	-35,92%	496,22%
Poland													
Slovak Rep.	0,01	0,00	0,01	0,00	-21,00%	0,00%	Bll. Kcs	0,05	0,00	0,05	0,03	-36,00%	0,00%
<b>Poultry</b>													
EU	0,37	0,31	0,44	0,29	-20,99%	-7,45%	Bll. ECU	0,14	0,15	0,14	0,09	-36,03%	-40,39%
Hungary	0,14	0,15	0,14	0,11	-21,28%	-27,13%	Bll. HUF	5,49	2,25	5,16	3,51	-36,00%	56,05%
Czech+Slovak Rep.	0,04	0,01	0,04	0,03	-20,89%	512,37%	Bll. Kcs	0,37	0,11	0,34	0,23	-36,00%	122,05%
Poland	0,02	0,00	0,02	0,01	-20,73%	0,00%	Bll. US\$	0,02	0,00	0,01	0,01	-36,00%	0,00%
Slovak Rep.	0,01	0,00	0,01	0,01	-21,00%	0,00%	Bll. Kcs	0,18	0,00	0,17	0,11	-36,00%	0,00%
<b>Butter and Butteroil</b>													
EU	0,46	0,67	0,45	0,37	-21,00%	-44,98%	Bll. ECU	1,33	1,57	1,25	0,85	-36,00%	-45,85%
Hungary	0,00	0,00	0,00	0,00	0,00%	0,00%	Bll. HUF	0,00	0,00	0,00	0,00	0,00%	0,00%
Czech+Slovak Rep.(2)	0,09	0,00	0,09	0,07	-21,01%	0,00%	Bll. Kcs	0,00	0,00	0,00	0,00	0,00%	0,00%
Poland	0,00	0,00	0,00	0,00	0,00%	0,00%	Bll. US\$	0,00	0,00	0,00	0,00	0,00%	0,00%
Slovak Rep.	0,01	0,00	0,01	0,01	-21,00%	0,00%	Bll. Kcs	0,38	0,00	0,36	0,24	-36,00%	0,00%
<b>Skimmed Milk Powder</b>													
EU	0,31	0,00	0,30	0,24	-21,01%	0,00%	Bll. ECU	0,37	0,00	0,35	0,24	-35,99%	0,00%
Hungary	0,00	0,00	0,00	0,00	0,00%	0,00%	Bll. HUF	0,00	0,00	0,00	0,00	0,00%	0,00%
Czech+Slovak Rep.	0,10	0,00	0,10	0,08	-21,01%	0,00%	Bll. Kcs	1,95	0,00	1,83	1,25	-36,00%	0,00%
Poland	0,05	0,00	0,05	0,04	-20,94%	0,00%	Bll. US\$	0,01	0,00	0,01	0,01	-35,83%	0,00%
Slovak Rep.	0,02	0,00	0,02	0,02	-21,00%	0,00%	Bll. Kcs	0,42	0,00	0,41	0,27	-36,00%	0,00%
<b>Cheese</b>													
EU	0,39	0,13	0,41	0,31	-21,00%	135,71%	Bll. ECU	0,44	0,32	0,51	0,28	-36,00%	-11,94%
Hungary	0,00	0,00	0,00	0,00	-21,00%	0,00%	Bll. HUF	0,05	0,00	0,05	0,03	-35,88%	0,00%
Czech+Slovak Rep.	0,00	0,00	0,00	0,00	0,00%	0,00%	Bll. Kcs	0,00	0,00	0,00	0,00	0,00%	0,00%
Poland	0,00	0,00	0,00	0,00	0,00%	0,00%	Bll. US\$	0,00	0,00	0,00	0,00	0,00%	0,00%
Slovak Rep.	0,00	0,00	0,00	0,00	0,00%	0,00%	Bll. Kcs	0,00	0,00	0,00	0,00	0,00%	0,00%

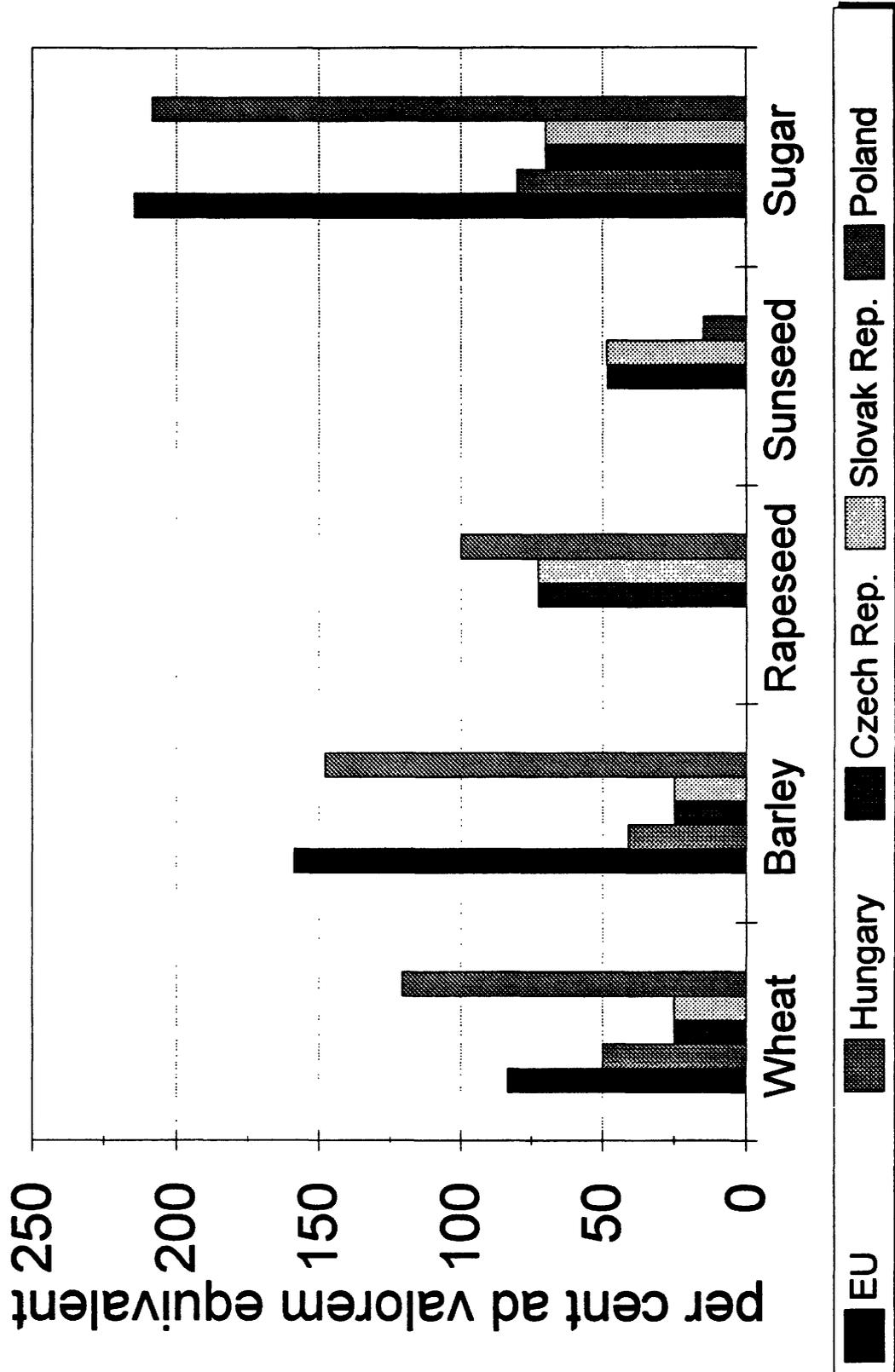
(1) Beef and Pork  
(2) Butter and Dairy Products  
(3) Front Loading (Base: 1991-92)

Table 6: Scenario Analysis - Export Subsidies

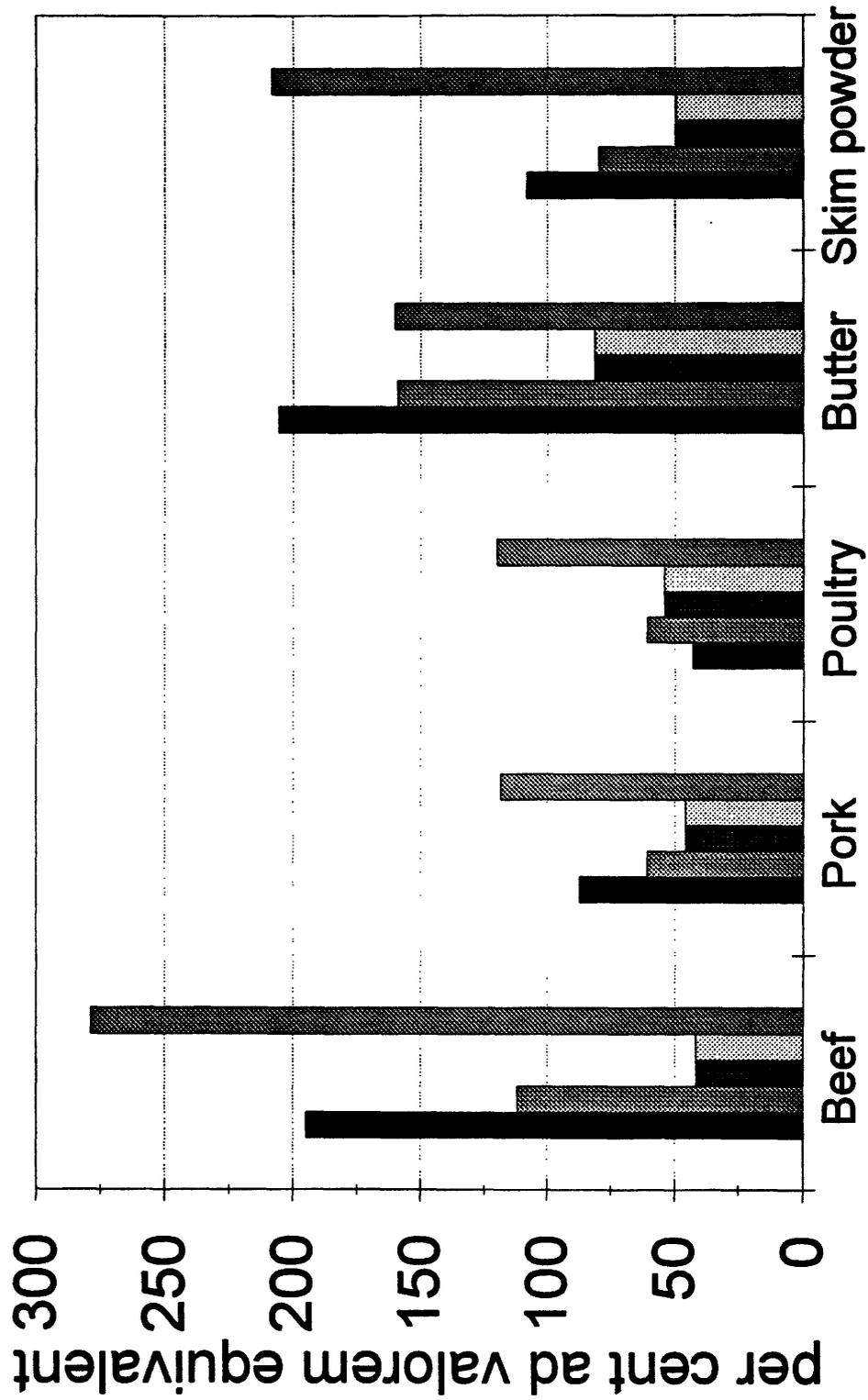
	Quantity of Subsidized Exports commitment = 100				Outlay on Export Subsidies commitment = 100				
	1995 Scen 1		2000 Scen 2		1995 Scen 1		2000 Scen 2		
	1995 Scen 1	2000 Scen 2	1995 Scen 1	2000 Scen 2	1995 Scen 1	2000 Scen 2	1995 Scen 1	2000 Scen 2	
Hungary									
Wheat	0	0	268	0	0	0	0	859	0
Coarse Grains	14	14	327	1.070	62	62	62	1.449	1.914
Rapeseed	0	0	0	0	0	0	0	0	0
Sunflower Seeds	0	0	0	0	0	0	0	0	0
White Sugar	0	0	642	4	0	0	0	14.160	47
Beef	0	0	397	0	0	0	0	4.300	0
Pork	0	0	756	0	0	0	0	2.225	0
Poultry	117	117	190	149	44	44	44	390	76
Butter	***	***	***	***	***	***	***	***	***
SMP	0	0	***	0	0	0	0	***	0
Cheese	0	0	6.575	2.319	0	0	0	188.578	32.247
Czech + Slovak Republics									
Wheat	291	291	824	1.119	80	80	80	478	768
Coarse Grains	0	0	***	***	0	0	0	***	***
Rapeseed	0	0	0	0	0	0	0	0	0
Sunflower Seeds	0	0	0	0	0	0	0	0	0
White Sugar	0	0	1.072	0	0	0	0	2.555	0
Beef	0	0	262	2	0	0	0	4.862	3
Pork	135	135	1.677	260	92	92	92	7.085	530
Poultry+Eggs	21	21	36	0	54	54	54	176	0
Butter+Cheese	3	3	106	57	11	11	11	833	315
SMP	0	0	7	10	0	0	0	11	7
Poland									
Wheat	***	***	0	***	***	***	***	0	***
Coarse Grains	***	***	***	***	***	***	***	***	***
Rapeseed	0	0	0	0	0	0	0	0	0
Sunflower Seeds	0	0	0	0	0	0	0	0	0
White Sugar	41	41	1.259	82	25	25	25	1.894	48
Beef+Pork	48	48	694	0	2	2	2	581	0
Poultry	215	215	0	0	55	55	55	0	0
Butter	0	0	***	0	0	0	0	***	0
SMP	0	0	382	0	0	0	0	1.102	0
Cheese	0	0	***	0	0	0	0	***	0

\*\*\*: Zero subsidized exports bound in GATT-Schedule, but subsidized exports under scenario

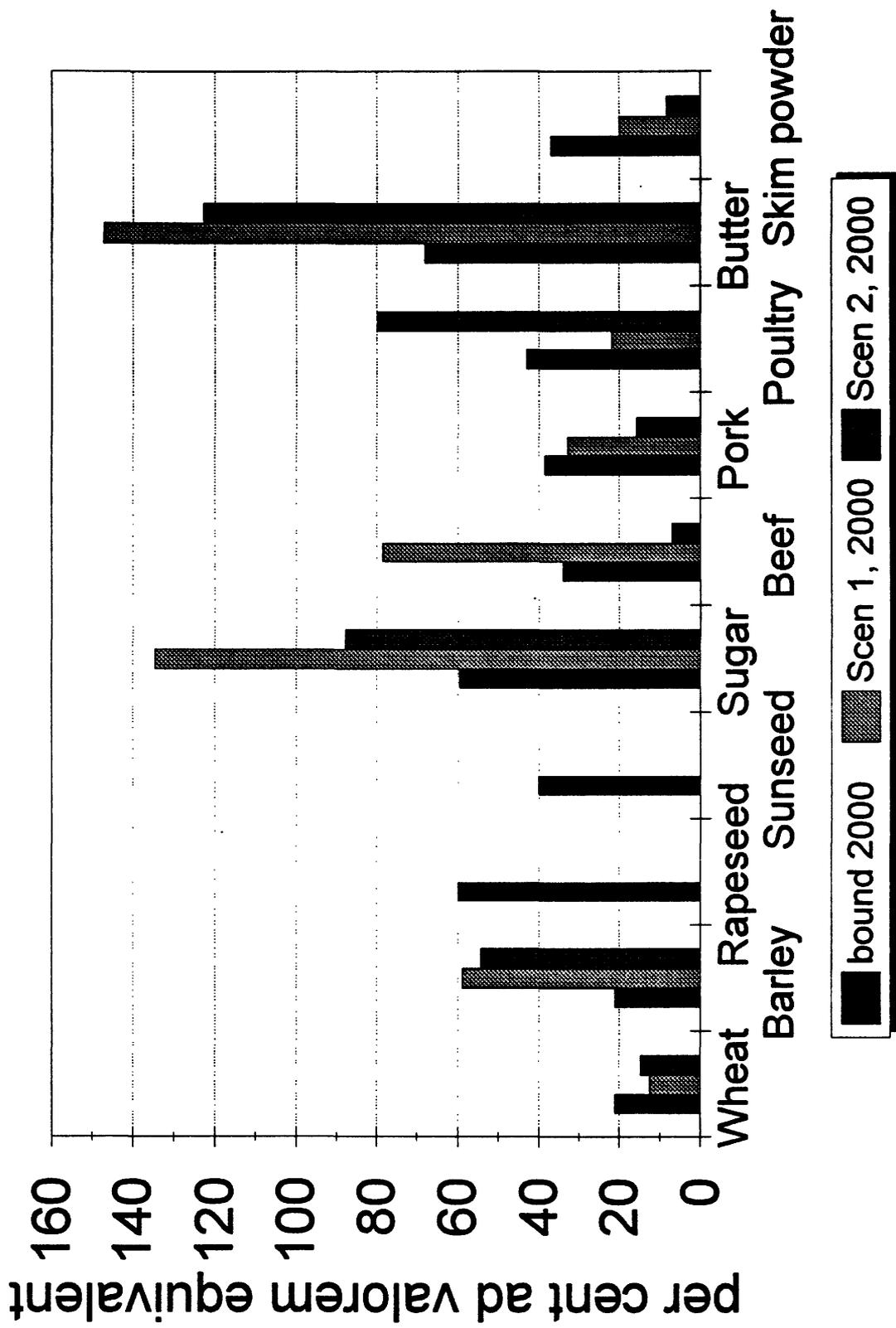
**Graph 1: GATT Schedules  
Tariff Bindings 1995: Crops**



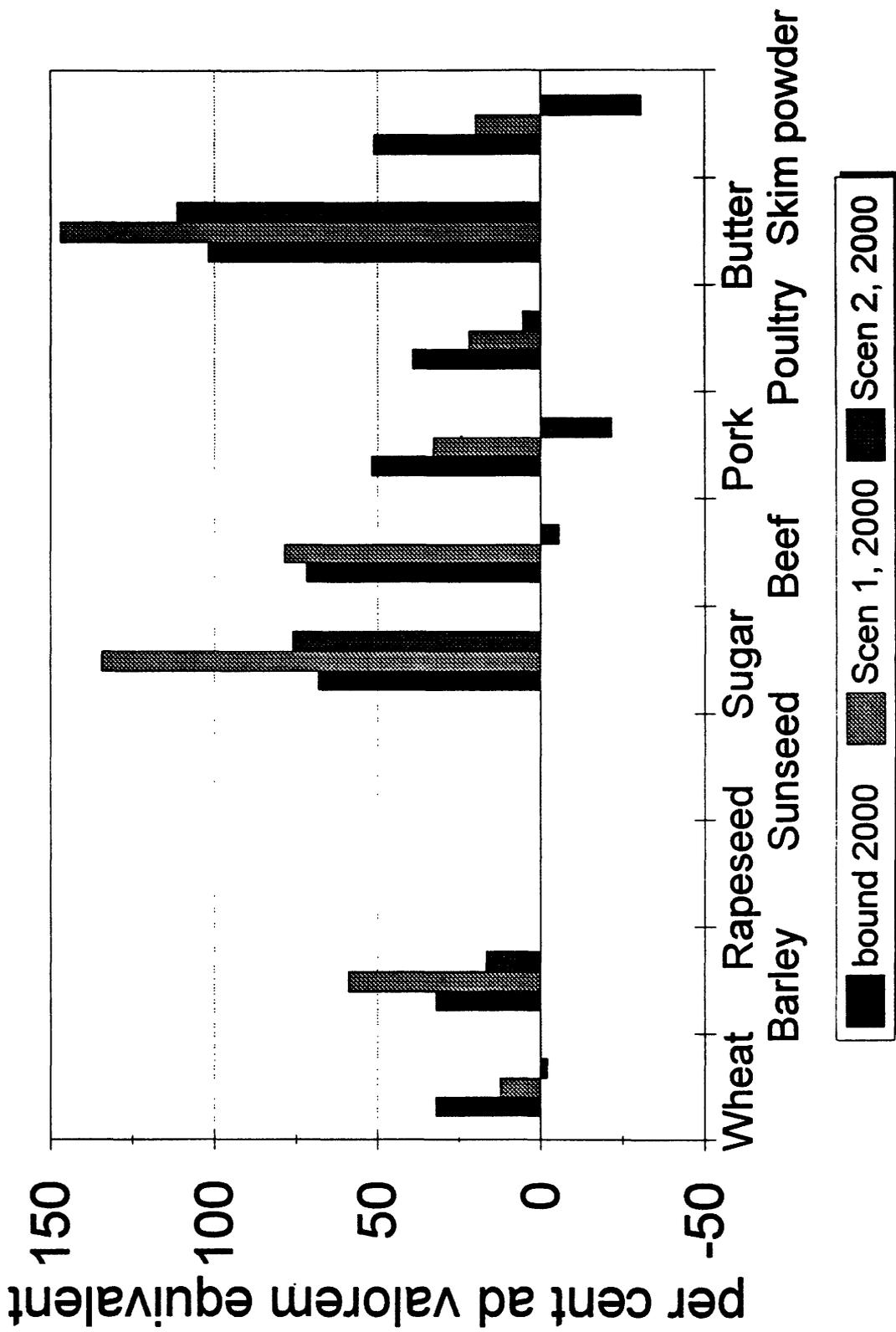
**Graph 2: GATT Schedules  
Tariff Bindings 1995: Livestock Prod.**



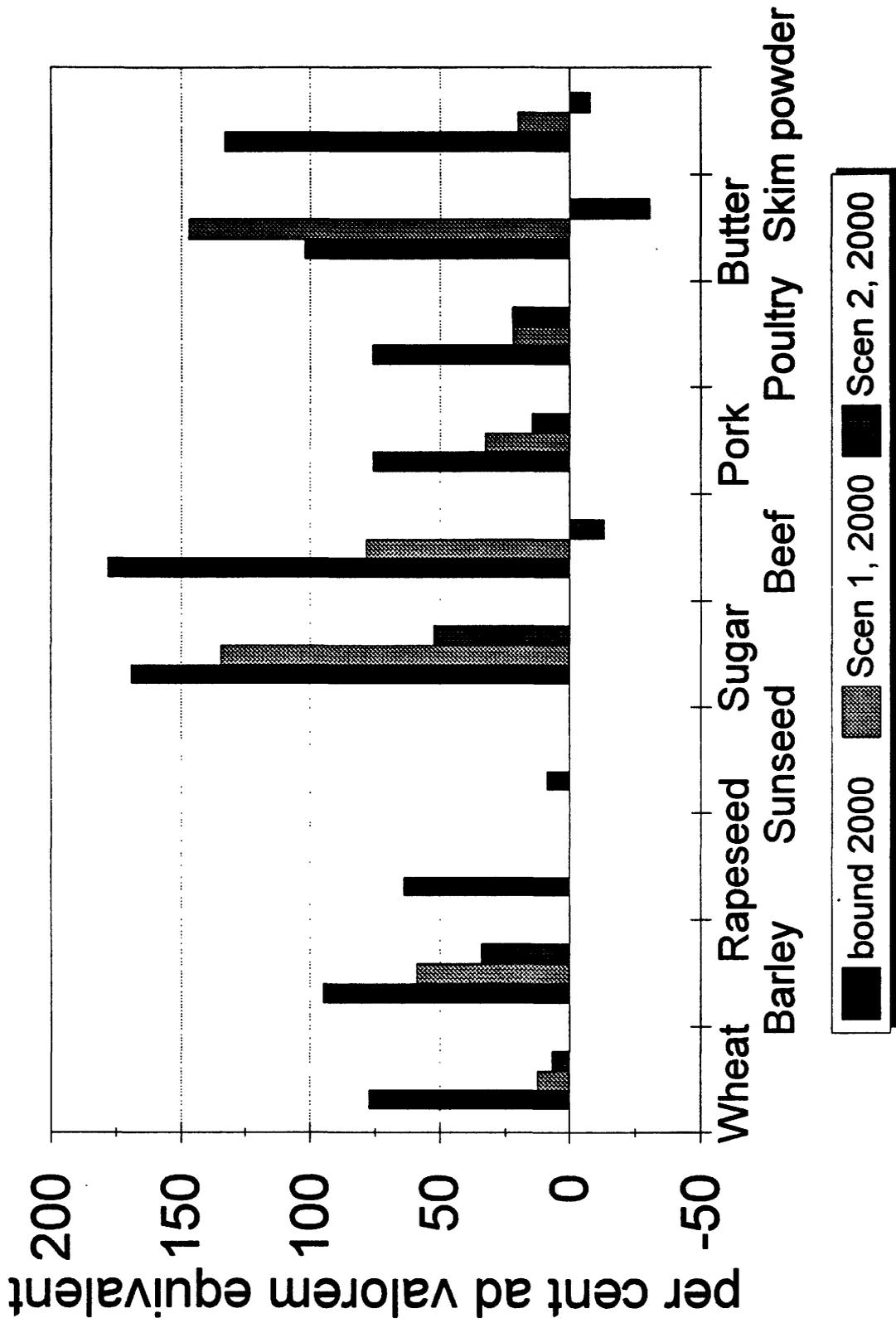
**Graph 3: Scenario: Czech+Slovak Rep.  
Tariff Bindings, Year 2000**



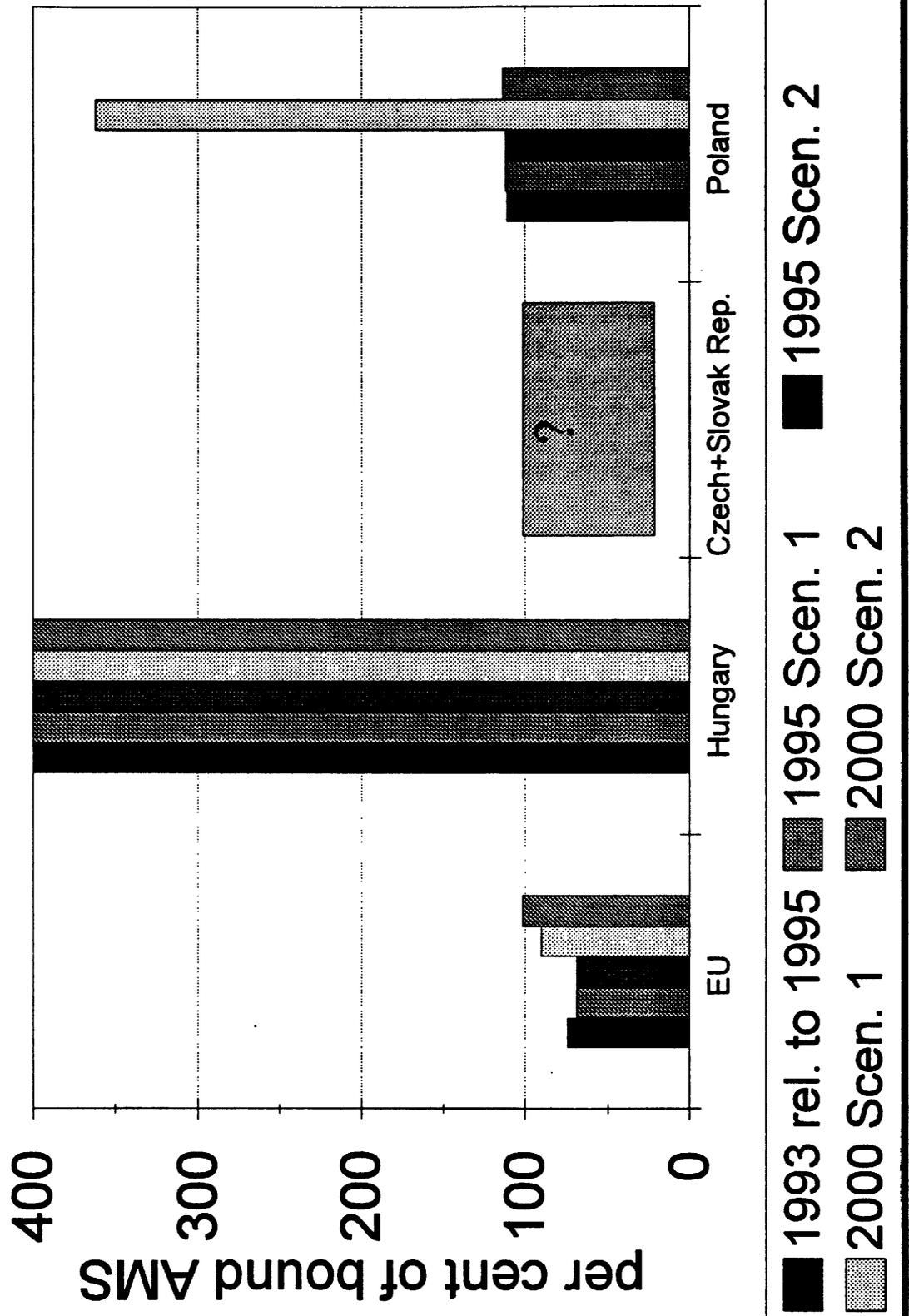
**Graph 4: Scenario: Hungary  
Tariff Bindings, Year 2000**



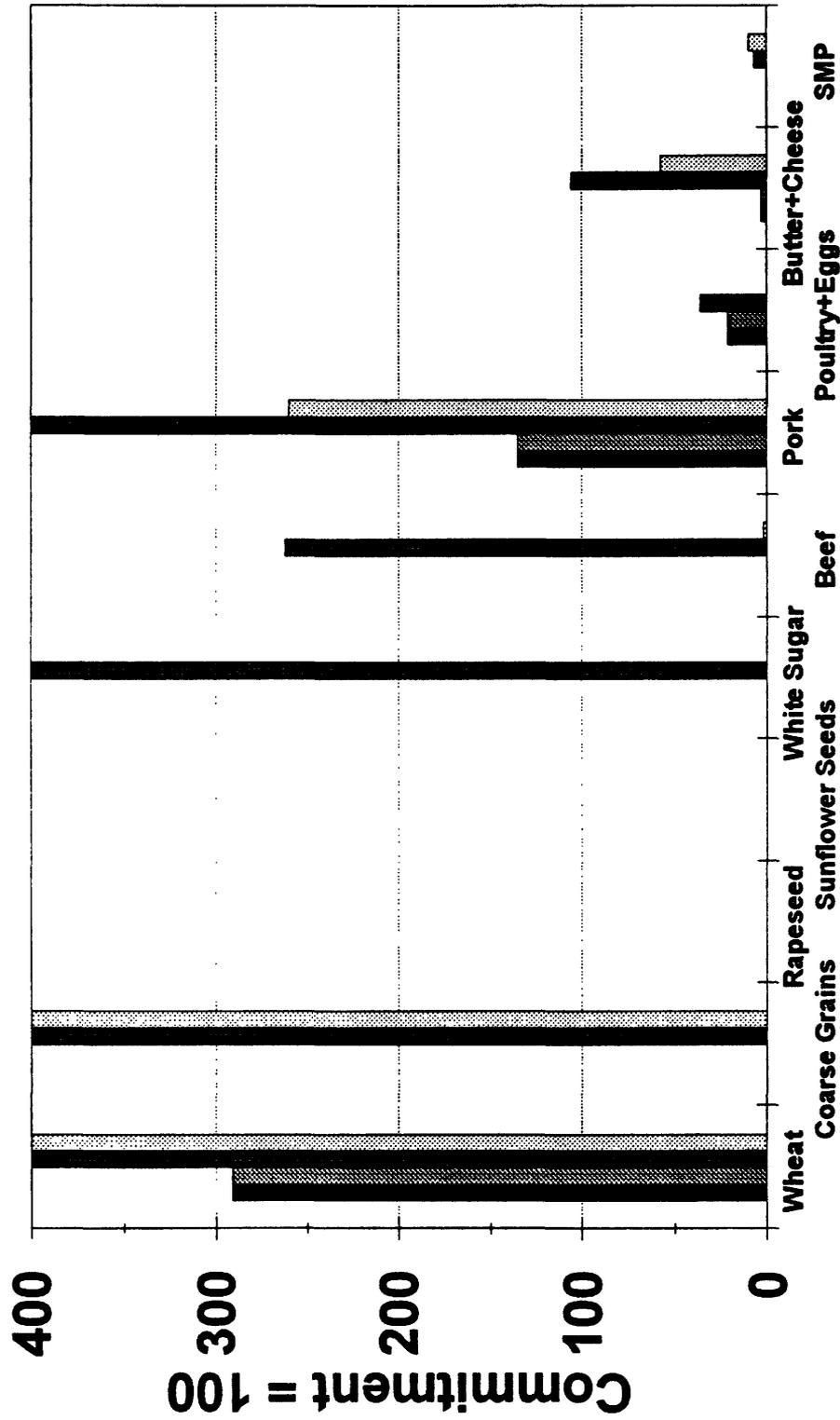
**Graph 5: Scenario: Poland  
Tariff Bindings, Year 2000**



**Graph 6: GATT Schedules and Scenario  
Domestic Support, Selected products**

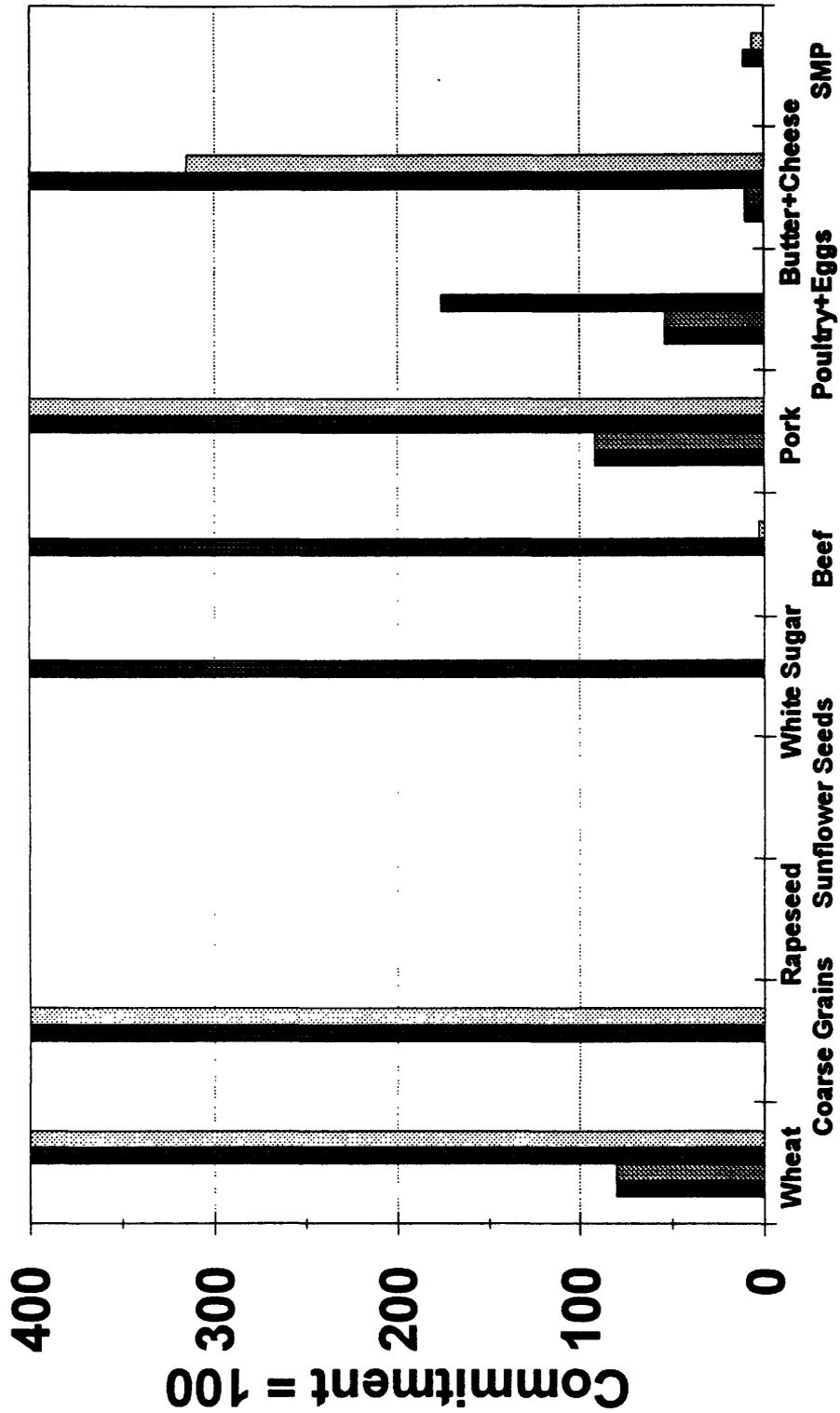


# Graph 7: Scenario Analysis: Czech+Slovak Rep., Export Quantities



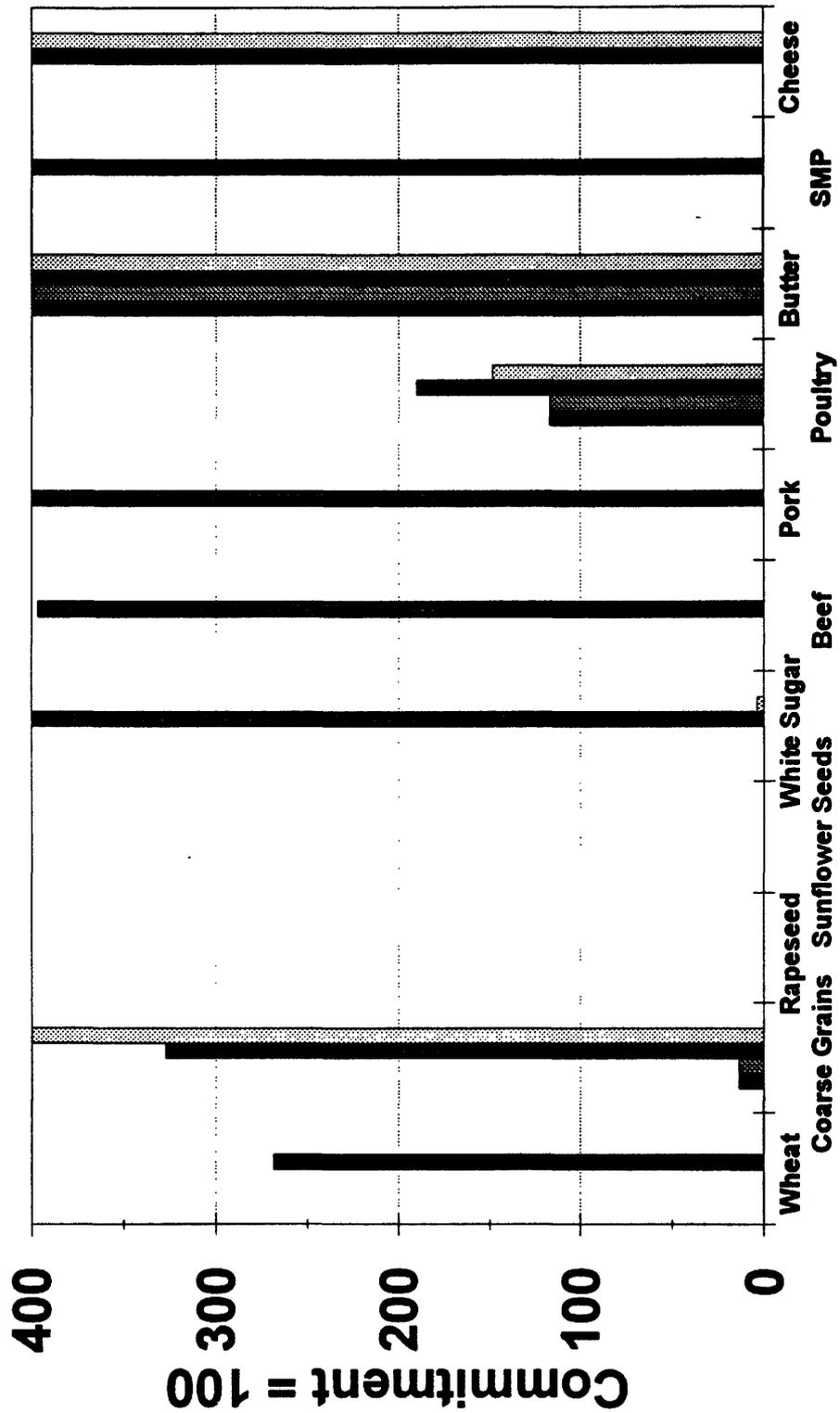
Scen. 1, 1995
  Scen. 1, 2000
  Scen. 2, 1995
  Scen. 2, 2000

**Graph 8: Scenario Analysis:  
Czech+Slovak Rep., Budgetary Outlay**



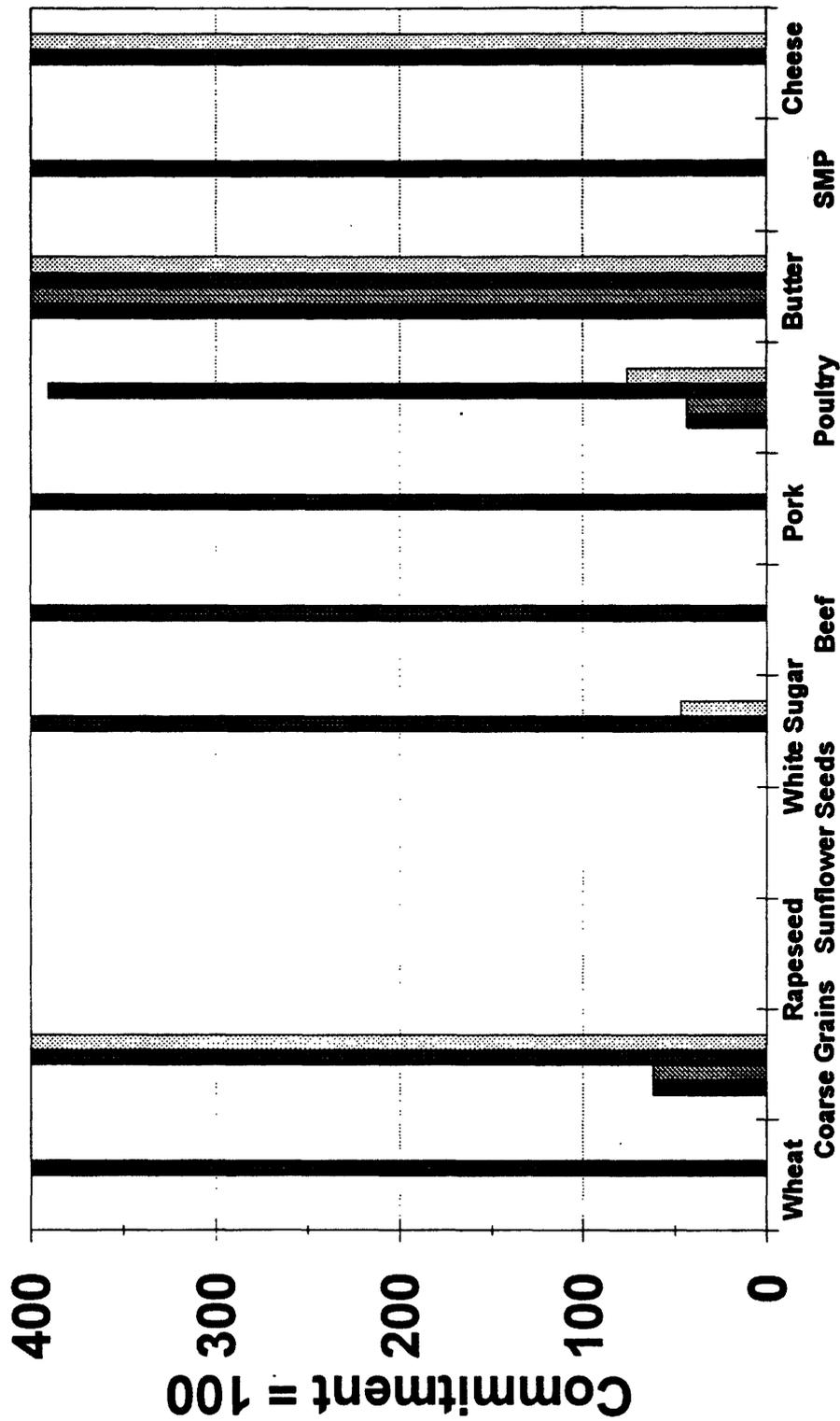
■ Scen. 1, 1995    ▨ Scen. 2, 1995    ▩ Scen. 2, 2000

# Graph 9: Scenario Analysis: Hungary, Export Quantities



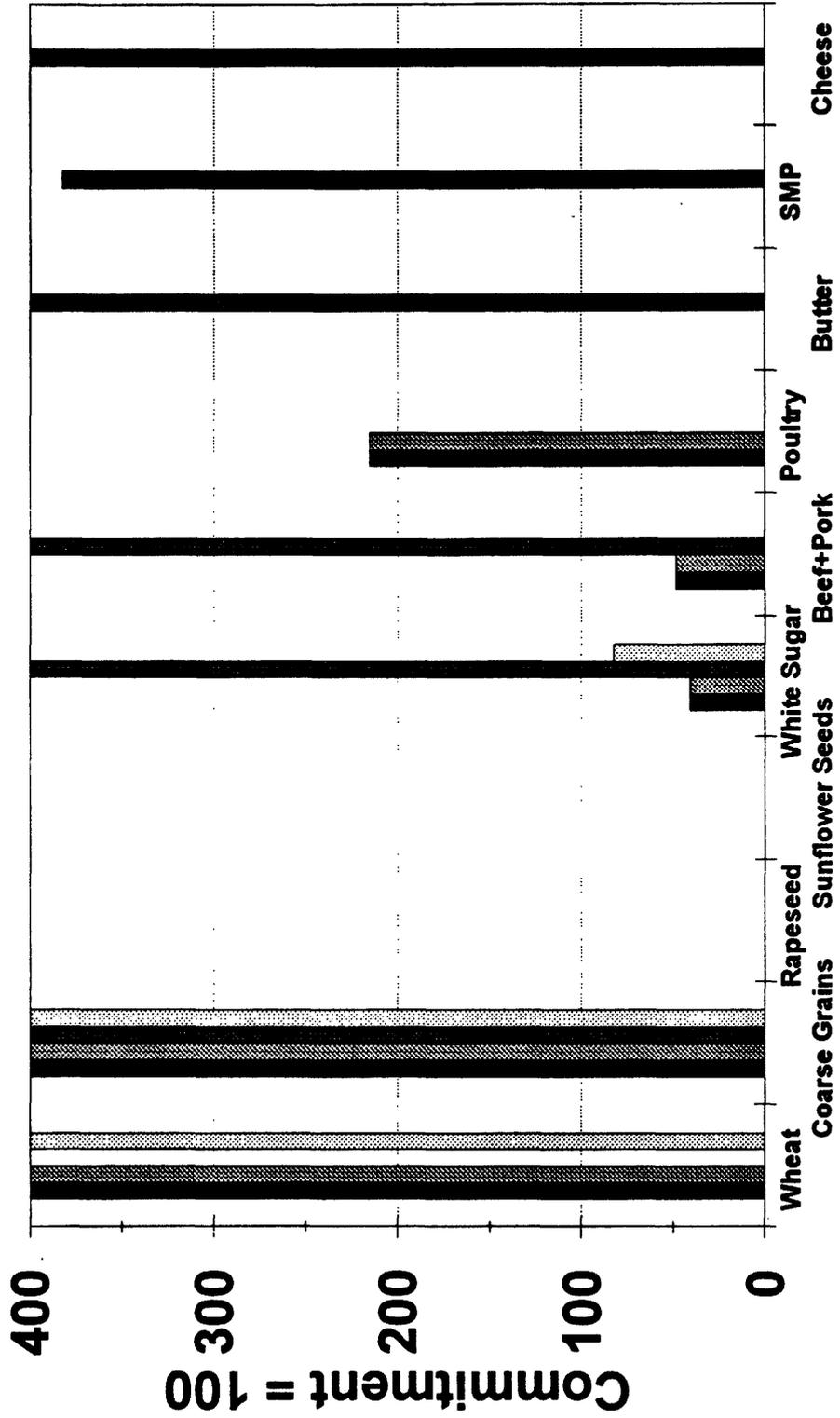
Scen. 1, 1995
  Scen. 2, 1995
  Scen. 1, 2000
  Scen. 2, 2000

# Graph 10: Scenario Analysis: Hungary, Budgetary Outlay



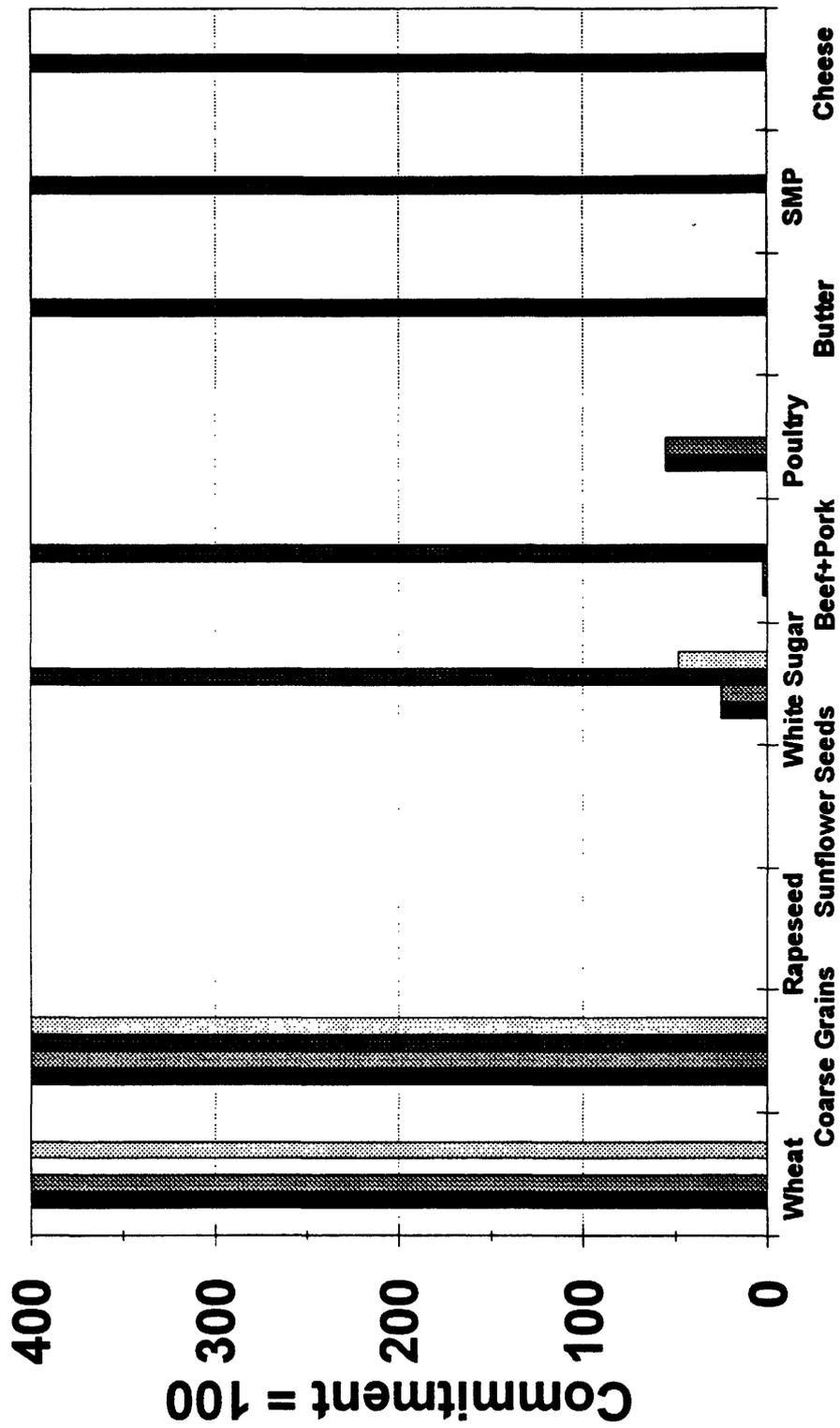
Scen. 1, 1995
  Scen. 2, 1995
  Scen. 1, 2000
  Scen. 2, 2000

# Graph 11: Scenario Analysis: Poland, Export Quantities



■ Scen. 1, 1995   ■ Scen. 2, 1995   ■ Scen. 1, 2000

# Graph 12: Scenario Analysis: Poland, Budgetary Outlay



Scen. 1, 1995
  Scen. 2, 1995
  Scen. 1, 2000
  Scen. 2, 2000

## Appendix III

### The Commodity Composition of EU Agricultural and Food Exports to the CEECs<sup>1</sup>

The analysis presented here aims at providing information on the nature of EU agricultural and food exports to the six CEECs associated with the EU. The background is that EU agricultural and food exports to the CEECs have grown substantially since the beginning of the transition process. The major focus of this analysis is the commodity composition of EU exports and any changes of it that may have taken place in recent years.

Data on export values in ECU have been analysed for the period 1988 to 1993.<sup>2</sup> Total agricultural and food exports have been defined, as usual, to be those under CN headings 01 to 24. The upper part of Table AIII.1 presents information on EU exports at the two digit CN level. All information in that table relates to changes between the average of 1988-90 and the most recent year for which data are available, 1993.

There are three blocs of columns in Table AIII.1. In the first bloc, percentage growth rates of export values from 1988-90 to 1993 are given. Total EU exports of agricultural and food products to the six CEECs have grown by 135 per cent from 1988-90 to 1993. Among the Visegrad countries, growth of EU exports to the Czech and Slovak Republics (aggregated in this analysis) was highest, with a 243 per cent increase, while exports to Poland increased least, at a rate of 91 per cent. Growth rates of EU exports differ significantly among product groups. In percentage terms, growth was highest for malt, starches, inulin (CN group 11), with an increase by nearly 1700 per cent, while EU exports of meat (CN 02) stagnated and exports of vegetable materials (CN 14) decreased.

The second bloc of columns in Table AIII.1 gives shares of product groups in total 1993 EU export value. The largest single item in EU exports to the CEECs as a group in 1993 was cereals (CN 10). However, in 1993 EU cereals export to the CEECs were above trend, because of the drought in some of the CEECs. Other product groups with large export values include edible fruit and nuts (CN 08), residues from the food industry (CN 23), and miscellaneous edible preparations (CN 21).

In the third bloc of columns in Table AIII.1, the composition of the overall growth of EU agricultural and food exports to the CEECs from 1988-90 to 1993 is given by product group.

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<sup>1</sup> We wish to thank Alfred Gerken and Bernhard Overberg for doing the calculations and helping with the analysis.

<sup>2</sup> EUROSTAT, EEC External Trade, CD ROM Version, var. issues.

More than 12 per cent of the increase in EU exports from 1988-90 to 1993 was in miscellaneous edible preparations (CN 21). The two other product groups with a more than 10 per cent share in export growth are edible fruit and nuts (CN 08) and cereals (CN 10).

In order to gain a better impression of the nature of changes in EU exports, products were also grouped according to two criteria. First, three groups were defined regarding the level of processing which the commodities concerned have undergone before export. In forming these categories, treatment of different products under the CAP could be used as one criterion. Basic products in CAP market regimes, but also other unprocessed commodities, were classified as "raw materials". Examples of these products are live animals, cereals, and cocoa beans. Other products covered in Annex II of the Treaty of Rome, and other products of a similar character, were classified as "lightly processed products". Examples are meat, butter, flour, and cocoa powder. Non-Annex II products were classified as "highly processed products". Examples are confectionery, pasta, ice cream, and chocolate. Second, two product categories were defined according to the extent to which the EU subsidizes exports. Products where export subsidies are either not granted at all or are insignificant relative to the product value were classified as "products without export subsidies". Examples are fish, flowers, manioc, coffee and (since the MacSharry reform) oilseeds and their products. All other products were classified as "products with export subsidies". The grouping according to both processing and export subsidization was done at the four digit CN level, and data were analysed at that level. The allocation of products to categories is shown in Table AIII.2.

In the lower part of Table AIII.1, some results of this analysis of different product categories are presented. As far as processing goes, the strongest growth in EU agricultural and food exports to the CEECs was in the category of highly processed products, with an increase of 220 per cent from 1988-90 to 1993. With regard to export subsidization, exports of subsidized products have grown less (by 121 per cent) than exports of products with subsidies (158 per cent). On the other hand, of the total increase in export value from 1988-90 to 1993, products with export subsidies had a larger share (59 per cent) than products without export subsidies (41 per cent).

If classifications according to processing and export subsidization are combined, there are six groups of products. For these six product groups, Graphs AIII.1 and AIII.2 show the changes in EU exports to the CEECs between 1988 and 1993. The most significant changes visible at this level of aggregation are an increase of the share of highly processed products with subsidies, and a decrease of the share of lightly processed products with subsidies. In Chapter 9 above, Graphs 9.1 and 9.2 show changes at the more aggregate level of subsidized versus not subsidized products, and for the three different degrees of processing.

Table AIII.1: Changes in EU Agricultural Exports to the Associated Countries in Central and Eastern Europe, 1988-90 to 1993

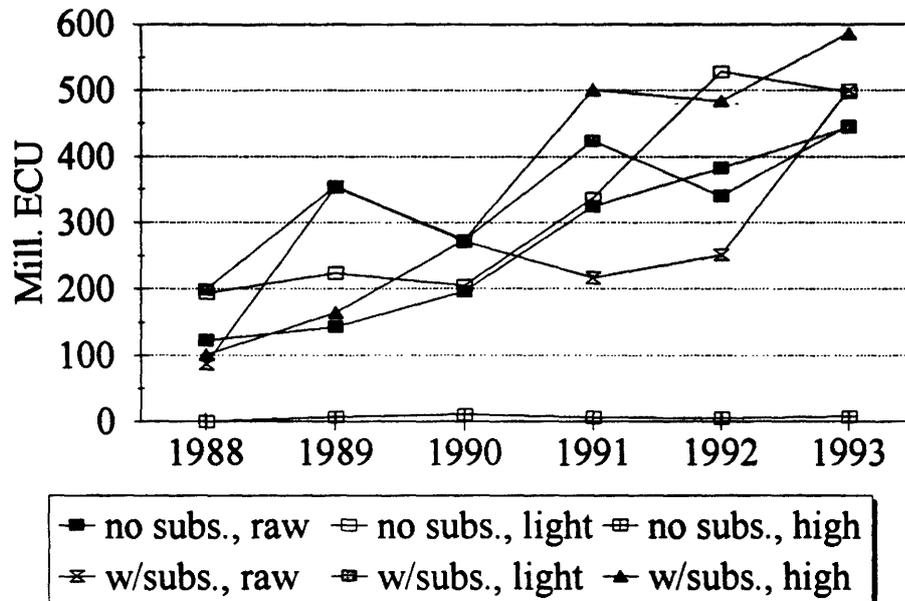
PRODUCT GROUP	Change in EU Exports from 1988-90 to 1993 in Per Cent of 1988-90 Export Value				Share of Product Group in Total Value of EU Agricultural Exports to the Country Concerned in 1993				Share of Product Group in Change of Total Value of EU Ag. Exports from 1988-90 to 1993			
	Poland	Hungary	Czech+Slov. Republics	Total 6 Assoc. Countries	Poland	Hungary	Czech+Slov. Republics	Total 6 Assoc. Countries	Poland	Hungary	Czech+Slov. Republics	Total 6 Assoc. Countries
LIVE ANIMALS	209	23	130	100	0,7%	1,1%	1,5%	0,9%	1,0%	0,3%	1,2%	0,8%
MEAT	27	626	365	1	6,0%	10,0%	1,2%	4,8%	2,6%	12,6%	1,3%	0,1%
FISH AND CRUSTACEANS	115	176	12	77	3,8%	0,4%	1,9%	2,3%	4,3%	0,4%	0,3%	1,8%
DAIRY P., EGGS, HONEY	53	1313	721	47	3,8%	4,2%	3,6%	3,7%	2,7%	5,6%	4,5%	2,1%
PROD. OF ANIMAL ORIGIN	412	188	879	359	2,6%	2,8%	1,1%	1,8%	4,3%	2,6%	1,4%	2,5%
TREES, PLANTS, FLOWERS	436	741	1176	584	1,8%	4,9%	2,4%	2,0%	3,0%	6,3%	3,1%	2,9%
EDIBLE VEGETABLES	3651	204	677	804	5,1%	4,2%	4,9%	4,0%	10,3%	4,2%	6,0%	6,2%
EDIBLE FRUIT AND NUTS	258	150	173	200	10,2%	6,7%	16,0%	9,9%	15,4%	5,9%	14,4%	11,5%
COFFEE, TEA, MATE	26	19	622	71	2,9%	0,8%	2,2%	2,1%	1,2%	0,2%	2,7%	1,5%
CEREALS	-14	131	343	68	13,7%	3,7%	6,6%	14,4%	-4,6%	3,0%	7,2%	10,2%
MALT, STARCHES, INULIN	1736	562	1657	1682	1,8%	0,4%	0,2%	1,2%	3,5%	0,5%	0,2%	1,9%
OIL SEEDS	231	107	468	199	2,0%	4,7%	3,1%	2,3%	2,9%	3,6%	3,6%	2,7%
LACS, GUMS, RESINS	205	100	88	135	0,6%	0,6%	0,6%	0,5%	0,8%	0,4%	0,4%	0,5%
VEG. MATERIALS	-68	-18	-30	-56	0,0%	0,0%	0,1%	0,0%	-0,1%	-0,0%	-0,0%	-0,1%
AN. OR VEG. FATS	114	92	240	130	7,0%	3,5%	6,3%	5,7%	7,9%	2,5%	6,3%	5,6%
PREP. OF MEAT+FISH	1	288	132	53	1,3%	1,0%	2,0%	1,4%	0,0%	1,1%	1,6%	0,9%
SUGAR+S. CONFECTIONARY	184	1137	6	150	3,5%	5,2%	3,1%	3,5%	4,8%	7,0%	0,3%	3,7%
COCOA+C. PREPARATIONS	151	519	337	249	3,9%	7,5%	4,0%	4,7%	4,9%	9,2%	4,3%	5,9%
PREP. OF CEREALS	157	1565	371	268	2,6%	4,9%	3,8%	3,5%	3,3%	6,7%	4,2%	4,4%
PREP. OF VEG. +FRUITS	235	224	579	218	2,8%	2,3%	3,1%	2,9%	4,2%	2,3%	3,7%	3,5%
MISC. EDIBLE PREP.	504	561	344	503	8,8%	11,5%	7,6%	8,3%	15,3%	14,2%	8,3%	12,1%
BEVERAGES, SPIRITS	-36	119	373	75	3,4%	6,4%	7,2%	6,5%	-4,0%	5,1%	8,0%	4,8%
RESIDUES FR. FOOD IND.	208	25	140	116	9,8%	9,3%	11,1%	8,5%	13,8%	2,7%	9,1%	7,9%
TOBACCO	116	167	675	349	2,2%	3,9%	6,3%	5,0%	2,5%	3,6%	7,8%	6,7%
TOTAL AG.+FOOD EXPORT 1-24	91	216	243	135	100,0%	100,0%	100,0%	100,0%	100,0%	100,0%	100,0%	100,0%
Raw Materials	65	169	288	141	38%	28%	40%	38%	32%	26%	41%	39%
Lightly Processed Products	106	171	174	95	42%	41%	37%	38%	46%	38%	33%	32%
Highly Processed Products	108	409	334	220	20%	31%	23%	24%	22%	36%	25%	29%
Products without Export Subsidies	161	111	180	158	41%	38%	45%	38%	54%	29%	41%	41%
Products with Export Subsidies	58	355	326	121	59%	62%	55%	62%	46%	71%	59%	59%

Table AIII.2: Classification of Products

CN Code	Degree of processing 0=no 1= raw material 2=lightly processed 3=highly processed	Refunds 0= no 1= yes	Description	Degree of processing 0=no 1= raw material 2=lightly processed 3=highly processed	Refunds 0= no 1= yes	Description
0101	1	0	LIVE HORSES	1	0	ONIONS, SHALLOTS, GARLIC, LEEKS
0102	1	1	LIVE BOVINE ANIMALS	1	0	CABBAGES, CAULIFLOWERS, KOHLRABI
0103	1	1	LIVE SWINE	1	0	LETTUCE
0104	0	0	LIVE SHEEP AND GOATS	1	0	CARROTS, TURNIPS
0105	1	1	LIVE POULTRY	1	0	CUCUMBERS AND GHERKINS
0106	0	0	LIVE ANIMALS	1	0	LEGUMINOUS VEGETABLES
0201	1	1	MEAT OF BOVINE ANIMALS	1	1	OTHER VEGETABLES
0202	1	2	MEAT OF BOVINE ANIMALS, FROZEN	2	1	VEGETABLES, UNCOOKED OR COOKED BY STEAMING
0203	1	2	MEAT OF SWINE	2	1	VEGETABLES PROVISIONALLY PRESERVED
0204	0	2	MEAT OF SHEEP OR GOATS	2	1	DRIED VEGETABLES, WHOLE, CUT, SLICED, BROKEN OR IN POWDER
0205	0	2	MEAT OF HORSES	2	0	DRIED LEGUMINOUS VEGETABLES, SHELLED
0206	1	2	EDIBLE OFFAL OF BOVINE ANIMALS	2	0	DRIED LEGUMINOUS VEGETABLES, SHELLED
0207	1	2	MEAT AND EDIBLE OFFAL OF FOWLS OF THE SPECIES GALLUS DOMESTICUS	2	0	MANIOC, ARROWROOT, SALEP, JERUSALEM ARTICHOKES
0208	0	2	MEAT AND EDIBLE OFFAL OF RABBITS	2	0	COCONUTS, BRAZIL NUTS AND CASHEW NUTS
0209	0	2	PIG FAT	1	1	OTHER NUTS, FRESH OR DRIED
0210	1	2	MEAT AND EDIBLE OFFAL, SALTED	2	0	BANANAS, INCL. PLANTAINS, FRESH OR DRIED
0301	0	1	LIVE FISH	1	0	DATES, FIGS, PINEAPPLES, AVOCADOS, GUAVAS, MANGOES
0302	0	1	FISH, FRESH OR CHILLED	1	0	CITRUS FRUIT, FRESH OR DRIED
0303	0	2	FROZEN FISH	2	1	GRAPES, FRESH OR DRIED
0304	0	2	FISH FILLETS AND OTHER FISH MEAT	2	0	MELONS, INCL. WATERMELONS, AND PAPAW'S 'PAPAYAS', FRESH
0305	0	2	FISH, FIT FOR HUMAN CONSUMPTION	2	1	APPLES, PEARS AND QUINCES, FRESH
0306	0	2	FISH, FIT FOR HUMAN CONSUMPTION	2	1	APRICOTS, CHERRIES, PEACHES INCL. NECTARINES
0307	0	2	MOLLUSCS, FIT FOR HUMAN CONSUMPTION	2	0	STRAWBERRIES, RASPBERRIES, BLACKBERRIES
0401	1	1	MILK AND CREAM	1	0	FRUIT AND NUTS, UNCOOKED OR COOKED BY STEAMING
0402	1	2	MILK AND CREAM, CONCENTRATED	2	0	FRUIT AND NUTS, PROVISIONALLY PRESERVED
0403	1	2	BUTTERMILK	2	0	APRICOTS, PRUNES, APPLES, PEACHES, PEARLS, PAPAW'S, TAMARINDS
0404	1	2	BUTTER AND OTHER FATS	2	0	PEEL OF CITRUS FRUIT OR MELONS, INCL. WATERMELONS
0405	1	2	CHEESE AND CURD	2	0	COFFEE, COFFEE HUSKS AND SKINS; COFFEE SUBSTITUTES
0406	1	2	BIRDS' EGGS, IN SHELL	2	0	TEA, WHETHER OR NOT FLAVOURED
0407	1	1	BIRDS' EGGS, NOT IN SHELL	1	0	MATE
0408	0	1	NATURAL HONEY	1	0	PEPPER OF THE GENUS PIPER, DRIED OR CRUSHED
0409	0	1	TURTLES' EGGS, BIRDS' NESTS	1	0	VANILLA
0410	0	1	HUMAN HAIR, UNWORKED	1	0	CINNAMON AND CINNAMON-TREE FLOWERS
0501	0	2	PIGS' HOGS' OR BOARS' BRISTLES AND HAIR	2	0	CLOVES, WHOLE FRUIT, CLOVES AND STEMS
0502	0	2	HORSEHAIR AND HORSEHAIR WASTE	2	0	NUTMEG, MACE AND CARDAMOMS
0503	0	2	GUTS, BLADDERS AND STOMACHS OF ANIMALS	2	0	SEEDS OF ANIS, BADIAN, FENNEL, CORIANDER, CUMIN OR CARAWAY
0504	0	2	SKINS AND OTHER PARTS OF BIRDS	2	0	GINGER, SAFFRON, TURMERIC "CURCUMA", THYME, BAY LEAVES, CURRY
0505	0	2	BONES AND HORN-CORES	2	1	WHEAT AND MESLIN
0506	0	2	IVORY, TORTOISE-SHELL	2	1	RYE
0507	0	2	CORAL AND SIMILAR MATERIALS	2	1	BARLEY
0508	0	2	NATURAL SPONGES OF ANIMAL ORIGIN	2	1	OATS
0509	0	2	AMBERGRIS, CASTOREUM, CIVET AND MUSK	2	1	MAIZE OR CORN
0511	0	2	ANIMAL PRODUCTS N.E.S.	2	1	RICE
0601	0	1	BULBS, TUBERS, TUBEROUS ROOTS	1	0	GRAIN SORGHUM
0602	0	1	LIVE PLANTS INCL. THEIR ROOTS	1	0	BUCKWHEAT, MILLET, CANARY SEED AND OTHER CEREALS
0603	0	1	CUT FLOWERS AND FLOWER BUDS	1	2	WHEAT OR MESLIN FLOUR
0604	0	1	FOLIAGE, BRANCHES	1	2	CEREAL FLOURS (EXCL. WHEAT OR MESLIN)
0701	0	1	POTATOES, FRESH OR CHILLED	1	2	CEREAL GROATS, MEAL AND PELLETS
0702	1	1	TOMATOES, FRESH OR CHILLED	1	2	CEREAL GRAINS OTHERWISE WORKED
					0	FLOUR, MEAL, FLAKES, GRANULES AND PELLETS OF POTATOES
					0	FLOUR AND MEAL OF PEAS, BEANS, LENTILS



**Graph AIII.1: EU Ag. Exports to CEECs**  
Export Value by Product Group



**Graph AIII.2: EU Ag. Exports to CEECs**  
Composition by Product Group

