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# Agriculture in the EU's Eastern Enlargement

## The Current Status for CEECs

*After almost a decade of preparations, with many delays caused by disagreement about the specific conditions under which CEECs will adopt the Common Agricultural Policy, the schedule for the European Union's "Eastern" enlargement has finally been set. This article deals with the current status of the enlargement and the outstanding agricultural issues for CEECs following the Copenhagen European Council.*

Accession for eight Central and Eastern Europea-Countries (CEECs)[1] to the European Union (EU) is scheduled for May 2004, and 2007 for Bulgaria and Romania. Most CEECs will seek domestic mandates for accession in referenda during 2003. The schedule for the "Eastern" enlargement became clear in October 2002, ending almost a decade of preparation and shortly before the event itself. Many delays have centered on agriculture: the specific conditions under which CEECs will adopt the Common Agricultural Policy (CAP). Moreover, the existing EU members were slow to develop a unified stance on the subject.

This paper focuses on the current status of the enlargement and the outstanding agricultural issues for CEECs following the 2002 (Copenhagen) European Council that concluded negotiations. Some background data is presented and discussed, along with results and conclusions drawn from recent reports and literature. The first part deals briefly with the unique motivations for the Eastern enlargement, and the second presents a summary of various assessments of CEECs' progress towards EU accession. This is followed by a presentation of the major remaining agricultural issues for the Eastern enlargement. Next, selected variables of structure and agricultural policy are examined to allow comment on the extent of EU-CEEC convergence prior to the enlargement. Finally, conclusions are presented and problem areas identified.

### An Unprecedented Enlargement

Throughout the 10-year enlargement era the CEECs have proceeded with domestic programs of economic transition, and integration into the world economy. In this period the EU has been building its internal market and defining the role of that market in the context of agriculture. Significant reforms of the CAP have been made, and more are proposed. Also in this period, the World Trade Organization (WTO) has expanded its membership and scope of operations: specifically into agricultural trade and domestic support. This is a unique enlargement environment.

The Eastern enlargement is unprecedented for sheer scale, and for its inclusion of former communist states. For the latter reason, the Eastern enlargement is widely regarded as an unprecedented opportunity for achieving higher goals of European unity. Accession was therefore predicated on CEECs' satisfying three systemic (so-called "Copenhagen") criteria: a democratic and transparent political system; a functioning market economy that can compete inside the single market; and the capacity to fulfill the responsibilities of membership by implementing the *acquis communautaire*, of which the agricultural "chapter" and related elements have proven the most demanding.

The CEECs' populations are generally poorer and more rural than those of most current EU members. It is often claimed that the CEECs' farmers and rural populations have been hit particularly hard by economic transition. Hence, access to the EU's rural and agricultural programs is eagerly anticipated in two senses: first as a source of transfers; and second as a means of rebuilding what was once a leading economic sector. In both senses, CEECs' expectations are very high.

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[1] Estonia, Latvia, Lithuania, Slovenia, the Czech Republic, Hungary, Poland and Slovakia.

### Regular Reports and Negotiations

The 2002 "Regular Reports"[2] accept that the Copenhagen political criterion is satisfied for all 10 CEECs. On the economic criterion, the Regular Reports state that the eight CEECs scheduled for 2004 accession are able to compete in the EU market in the short term, and that Bulgaria and Romania will be so able in the medium term. Following spasmodic progress during 2000-2002, late 2002 saw closure of a large number of the 31 chapters of the *acquis communautaire*. This process culminated in the December 2002 (Copenhagen) European Council, where all chapters were closed. The most problematic chapters, outstanding until the Council, were Agriculture (chapter 7) and Financial and Budgetary Provisions (chapter 29). Much EU legislation transposed and adopted is, however, to only be implemented at the time of accession.

In its 2002 Regular Report, the EU expresses concern about CEECs' slow development of systems necessary for the operation of CAP instruments. This particularly focuses on management, information and control systems for payment. Failure to resolve these "horizontal" issues could leave CAP funds undisbursed following the enlargement: CEECs are familiar with this possibility as development of the SAPARD aid program[3] has been plagued by delays associated with similar problems. Previous Regular Reports had focused on CEECs' implementation of the PECA protocol (regarding standard product descriptions) to the Association Agreements and implementation of the EU's Farm Accounting Data Network (FADN).

The 2002 Regular Report urges further effort with FADN, and for CEECs' establishment of the Integrated Administration and Control System (IACS) in preparation for disbursement of funds. This entails the nomination and accreditation of paying agencies, training and institutional development, establishment of registries for land parcels and identified livestock, and operational information systems. Several CEECs are identified as being badly behind schedule with implementation of many aspects of IACS. At the European Council, transitional arrangements for a small number of standardization issues in a few CEECs were agreed (seed descriptions, bovine breeds eligible for headage payments).

### Progress with CMOs

The Regular Reports identify most CEECs as facing an urgent schedule for development of Common Market Organizations (CMOs). Outstanding concerns include the adoption of harmonized quality descriptions (e.g. carcass classifications), market intelligence systems (for intervention actions) and storage and warehouse functions. In addition, many CEECs have been operating policy regimes that resemble the CAP. These conduct intervention buying, operate area payments and milk and sugar quotas. Regular Reports have repeatedly identified many of these policies, and the commodity-based organizations that administer them, as not complying with the *acquis*. The European Council ended up utilizing a few of these schemes in a transitional way in direct payments (see below) and in continued state aids programs.

### Veterinary and Food Safety Issues

Access to the EU market before and after enlargement is enabled by certification of CEECs' food processing establishments for veterinary and food safety compliance. Each CEEC has undertaken to survey all such establishments (many of which were constructed according to alternative standards) and determine the potential for each to satisfy EC directives before accession. For those that are suitable for upgrading, an action plan was to have been established by each CEEC. Progress to date has been limited (Table 1), although little information is available.

Transitional arrangements for upgrading food processing establishments have been agreed with a number of CEECs. Upgrading can be carried out over a period of up to three years following accession for red meat, dairy and fish establishments in Lithuania and Latvia. For Hungary and the Czech Republic, 2006 has been agreed as a deadline for upgrading some red meat and other animal product processing facilities. Similar transition arrangements have been applied to some recently-constructed poultry housing.

### Ownership of Farmland

Enduring CEECs' fears of large scale foreign ownership of farm land have been accommodated by transitional measures. Foreigners will not be allowed to own farmland in some CEECs for 7 years (in Hungary, the Czech Republic, Slovakia and Bulgaria) to 12 years (in Poland) following accession. A range of exemptions applies to EU citizens that are farmers, resident in the specific CEEC. In December 2002 a further "safeguard" was added, so that all CEECs can employ a 3-year moratorium following the enlargement (or extend their negotiated one by a further 3 years) where they see fit.

[3] Special Assistance Program for Agriculture and Rural Development.

[2] European Commission: Regular Report on Progress Toward Accession, all CEECs: 1999, 2000, 2001 and 2002.

**Table 1**
**Status of EU Certification of CEECs' Food Processing Plants**

| CEEC | Information available on establishments' EU certification |
|---|---|
| Bulgaria | No information |
| Estonia | 14% of fish plants,<br>66% of dairy plants, and<br>all large volume meat plants are EU-certified to export at least one product to the EU. |
| Latvia | 17% of dairy plants are EU-certified to export at least one product to the EU. |
| Lithuania | 45% of all fish plants,<br>82% of dairy plants, and<br>a few meat plants are EU-certified to export at least one product to the EU. |
| Romania | No information |
| Slovenia | No information |
| Czech Rep. | No information |
| Hungary[1] | Almost all poultry plants,<br>50% of meat plants, and<br>30% of other meat processing plants are EU-certified to export at least one product to the EU.<br>In all cases this represents the majority of processing capacity. |
| Poland | 4% of all meat plants and<br>7% of all dairy plants are EU-certified to export at least one product to the EU |
| Slovakia | 6.5% of all food enterprises export to the EU, representing 12.4% of total processing output. |

[1]Hungarian Ministry of Agriculture's estimates.

Source: European Commission: Situation and Outlook in the Candidate Countries, DG-Agriculture, 2002.

**Table 2**
**Disparities in Quota Amounts**

| | Quota amounts as percentage of the amount proposed by each CEEC | | | |
|---|---|---|---|---|
| | Milk quantities (deliveries plus direct sales)[1] | Potato starch | Sugar (A+B quota) | Sugar (iso-glucose A+B) |
| Estonia | 72 | 3 | 0 | n.p. |
| Latvia | 61 | 39 | 60 | n.p. |
| Lithuania | 76 | 14 | 62 | n.p. |
| Slovenia | 104 | 0 | 71 | n.p. |
| Czech Republic | 88 | 75 | 90 | n.p. |
| Hungary | 71 | n.p. | 84 | 98 |
| Poland | 68[a] | 56 | 90 | 134 |
| Slovakia | 87 | 41 | 88 | 71 |

n.p. = no proposal received.

[1]includes a reserve to be utilized in 2006 in recognition of likely reductions in subsistence home-consumption in CEECs.

[a] Poland's proposed milk quota entails an increase in the period 2003-2008 (2008 figures used).

Source: European Commission: Enlargement and Agriculture: successfully integrating the new Member States into the CAP, Issues Paper, 2002; Council of the European Union: Report on Negotiations, Copenhagen 11 December 2002; Council of the European Union: Conferences on Accession to the European Union, Copenhagen 13 December 2002.

### Remaining Agricultural Issues – Quotas

CEECs' quota levels were agreed at the December 2002 European Council. CEECs had proposed a quantity for each relevant commodity. The EU has formulated several offers that have steadily risen, but the agreed quantities still fell substantially short of the CEECs' proposed amounts[4] (see Table 2).

The amount of quota allocated to each CEEC is a major determinant of the number of farmers and agro-industrial establishments that can benefit from CAP instruments, and it sets a bound on intra-EU trade. CEECs' main concern is the limitations placed on their scope for expanding several key commodity sectors. At the basis of disagreement has been the EU's adopting the late 1990s as a reference period. This fails to acknowledge the CEECs' decline in both production and consumption since 1990: CEECs claim that their productive capacity is now recovering and that domestic consumption is set to increase so as to avoid surpluses. CEECs would prefer to use 1987-89 as a baseline, as did the existing EU members (particularly Austria, Finland and Sweden that acceded in the 1995 enlargement). The EU's counterarguments interpret CEECs' past production and performance as a consequence of central planning, indicating little about productive capacity in a market context, and a social and environmental role for agriculture.

### Direct Payments

*Reference Quantities for CEECs:* As for production quotas, there is dissatisfaction with the parameters for CEECs' direct payments (see Table 3). The third column in Table 3 is calculated by multiplying the first two columns together, to provide an indicator of differing perceptions on overall arable crop production. The base numbers allocated by the EU have steadily risen throughout 2002, but in many cases are still far less than the CEECs' proposed amounts.

*Amounts and Timing:* CEECs have sought full eligibility for direct payments immediately upon accession. In March 2002, the EU proposed[5] partial CEEC eligibility entailing a transitional program of steadily increasing

[4] European Commission: Enlargement and Agriculture: successfully integrating the new Member States into the CAP, Issues Paper, Brussels 2002.

**Table 3**
**Disparities in Reference Amounts for Direct Payments**

| | Reference amounts as a percentage of the amount proposed by each CEEC | | | | | | |
|---|---|---|---|---|---|---|---|
| | Arable crops | | | Beef (head of animals eligible) | | | |
| | Base area | Reference yield | Implied arable production[1] | National envelope | Slaughter premium (adult) | Special beef premium | Suckler cow premium |
| Estonia | 56 | 69 | 38 | n.q. | 94 | 19 | 84 |
| Latvia | 64 | 70 | 45 | 38 | 85 | 94 | 77 |
| Lithuania | 85 | 77 | 65 | n.q. | 110 | 97 | 76 |
| Slovenia | 83 | 86 | 72 | 66 | 99 | 100 | 58 |
| Czech Republic | 94 | 100 | 94 | n.q. | 82 | 80 | 39 |
| Hungary | 96 | 94 | 90 | 20 | 45 | 17 | 39 |
| Poland | 102 | 83 | 85 | n.q. | 90 | 42 | 22 |
| Slovakia | 101 | 81 | 81 | n.q. | 78 | 98 | 56 |

n.q. = not quantified in communications with EU.

[1] Author's calculation.

Sources: European Commission: Enlargement and Agriculture: successfully integrating the new Member States into the CAP, Issues Paper, 2002; Agra Europe: EU offers CEECs new compromise on farm aid and quotas, No. 2031, November 29, 2002; Council of the European Union: Report on Negotiations, Copenhagen 11 December 2002; Council of the European Union: Conferences on Accession to the European Union, Copenhagen 13 December 2002.

payment based on a proportion of that paid to existing EU farmers. The proportion would begin at 25% of the rate of payment to farmers in the EU-15, and culminate in parity (100%) in 2013. The proposal included simplified administration procedures in the form of the direct payments not being tied to specific crops for the first 3-5 years of the transitional period. In December 2002 (just prior to the European Council) the EU further proposed that CEECs could "top up" their direct payments to 40% of current EU members' rates in the first year, by using national funds, or by transferring funds from rural development funds (up to specified limits). At the 2002 European Council this offer was extended to 55%, and some alternatives for implementation were provided: either the "25%+" formula or topping up of CEECs' existing CAP-like direct payment schemes. Agreement was reached at that point, so that CEECs' direct payment levels may begin at a higher rate (55%, 60% and 65% respectively in the first three years) and converge to parity with the EU-15 states earlier.

The main argument[6] against immediate full payment to CEECs had been that direct payments are compensation to EU farmers for past price reductions not suffered by CEEC farmers. The EU also claimed that direct payments to CEEC farmers would slow down much-needed restructuring of farms, and that CEECs' administrative capacity is unlikely to be able to accommodate direct payments.

Several counterarguments exist, particularly the invocation of CAP principles of equality of support throughout the EU. More practically, it is argued that direct payments are now an integral part of the package of support received by EU farmers, with the CAP's other instruments (notably commodity support prices) having been reduced to reflect this. As a precedent Austrian, Swedish and Finnish farmers receive the payments in full, despite these countries' having acceded to the EU after the 1992 birth of the direct payments program. Finally, the asymmetric treatment of small farmers in CEECs *c.f.* existing member states would have a perverse effect on farm restructuring, especially through land markets.

### Post-accession Trade Patterns

Although agricultural trade patterns during the accession era have largely favored the EU, a fear persists that cheap CEEC production could "flood" EU markets. Swinnen[7] suggests that production quotas will prevent trade adjustments for dairy, beef (through dairy quotas) and sugar products. For most other products, Swinnen's assessment is that supply response is likely to be weak because of small EU/CEEC price differentials immediately prior to enlargement. He identifies coarse grains as an exception, where the CEECs' post-enlargement price increases are likely to be significant.

[5] See European Commission: Enlargement and Agriculture: successfully integrating the new Member States into the CAP, op. cit.

[6] Arguments for and against CEECs' eligibility for direct payments are presented in A. Buckwell, S. Tangermann: Agricultural policy issues of European integration: the future of direct payments in the context of the eastern enlargement and the WTO, in: MOCT-MOST, Vol. 9, No. 3, 2001, pp. 229-254. A strong case for eligibility, in the Polish context, is made by SAEPR (Agricultural Policy Analysis Unit, Warsaw): Analysis and Evaluation of the European Commission Proposal of January 30th 2002 for Candidate Countries, 2002.

[7] J. Swinnen: Will Enlargement Cause a Flood of Eastern Food Imports, Bankrupt the EU Budget, and Create WTO Conflicts?, in: EuroChoices, Spring 2002, pp. 48-54.

Assumed low production costs in the CEECs have been proposed as a basis for CEECs' comparative advantage. Poulinquen[8] largely rejects the idea that CEECs can compete on EU markets with similar quality goods. His analysis is a resource-based view of farm production costs, which concludes that a lack of profitability undermines CEECs' prospects for expansion into new markets. It focuses on high labor usage on CEEC farms, and identifies the lack of a fodder-based livestock production system as a major impediment to CEECs' competitiveness in livestock products. In particular, he attributes observed increases in CEECs' self-sufficiency in unprocessed products to their high import tariffs and favorable exchange rate movements, not to comparative advantage.

Increased EU-CEEC trade in agricultural products is generally interpreted as evidence of integration, and attributed to the trade protocols to Association Agreements (e.g. in Regular Reports). However, trade access under the Association Agreements has been poorly utilized by the CEECs. Duponcel[9] discusses this outcome for the CAP-related commodities. In the early years, the low available preference margins appear to have constrained importers' willingness to source CEEC products, given the associated risks (e.g. quality, sanitary and supply regularity). However, Duponcel notes that recent higher preference margins have not resulted in substantially higher quota utilization. On the supply side, sanitary factors (e.g. EU certification of slaughterhouses), animal disease events, and EU-standardization issues are also proposed as contributing factors. Duponcel notes that the tariff rate quotas (TRQs) were based on existing trade patterns, that developed under central planning with limited EU access.

In a case study, Duponcel explains low EU imports of Hungarian processed foods by their quality differential. Swinnen also suggests that the EU/CEEC quality differential for many products is large and will persist. Bergschmidt and Hartmann[10] examine fruits and vegetables, for which CEECs' quota access under the Association Agreements is subject to minimum entry prices reflecting a quality level that is largely unattainable by CEECs. These authors identify an unstable policy environment in some CEECs as a further difficulty for EU importers in sourcing product. Bergschmidt and Hartmann question the Association Agreements' allocation of quota amongst EU importers (rather than CEEC exporters) and the generally high administrative and informational costs are likely to have limited TRQ utilization.

Trade complementarity is an expected outcome of economic integration, particularly where factor prices differ. Notably, this contradicts the view that similarities in production and trade patterns indicate integration.[11] Evidence of such complementarity has been found using intra-industry trade data[12] or the amount of trade based on re-exports following processing.[13] Josling and Tangermann[14] show that expanded EU food and agricultural exports to the CEECs during the 1990s favored the export of value-added products from the EU to the CEECs, over trade in raw materials. They propose this as a basis for a "European Food Industry" empowered by EU enlargement.

### CAP Reform

Officially, CAP reform is an item of EU business unconnected to the Eastern enlargement. In practice, it continues to have serious implications for the enlargement process and the final conditions offered to CEECs in the agricultural sector. The most direct impact has been budgetary guidelines for the CAP, that have incorporated CEECs' accession (generally associated with the Agenda 2000 reform). Two specific instruments of CAP reform have had enduring consequences for the Eastern enlargement: restructuring of producer support to include direct payments; and continued use of production quotas.

The longevity of direct payments and production quotas was confirmed in the 2002 Mid-term Review of the CAP (MTR). However, the MTR advocated "decoupling" of direct payments by conversion to a transferable income supplement paid per farm and not tied to any crop or production level. The MTR also advocated "modulating" direct payments (transferring funds to regional development assistance, subject to special consideration of small farms and those employing many workers). Further features of the MTR's proposals are increased "cross-compliance" whereby

[8] A. Poulinquen: Competitiveness and farm incomes in the CEEC agri-food sectors. Study Commissioned by DG Agriculture, 2001.

[9] M. Duponcel: Restructuring of food industries in the five Central and Eastern European front-runners towards EU membership, CERT working paper, 1998.

[10] A. Bergschmidt, M. Hartmann: Agricultural Trade Policies and Trade Relations in Transition Economies, IAMO discussion paper No. 12, 1998.

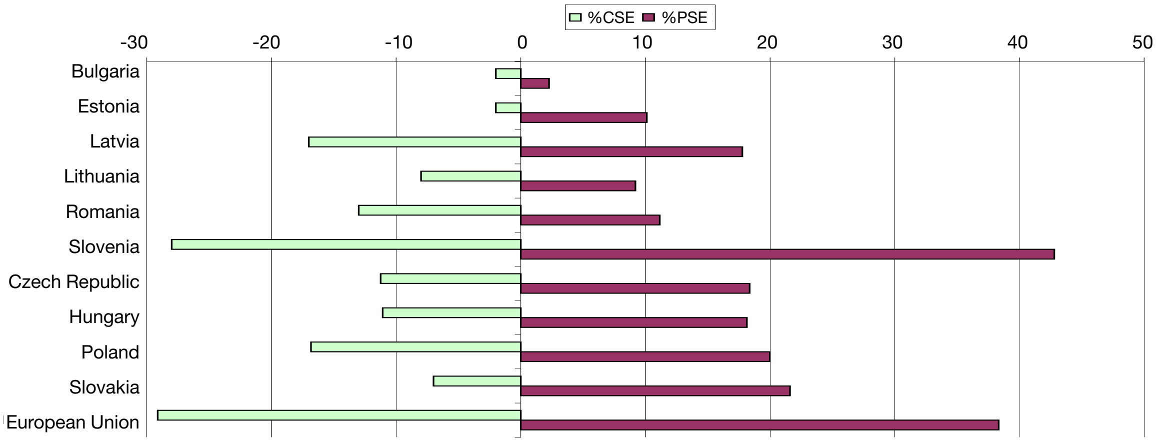
[11] See J. F. Francois, M. Rombout: Trade effects from the Integration of the Central and East European Countries Into the European Union, Sussex European Institute Working Paper No. 41, 2001.

[12] S. Bojnec: Trade and Revealed Comparative Advantage Measures, in: Eastern European Economics, Vol. 39, No. 2, 2001, pp. 77-98.

[13] See A. Bergschmidt, M. Hartmann, op. cit.

[14] T. Josling, S. Tangermann: The Agriculture and Food Sectors, BRIE working paper No. 103 from Proceedings of Conference: Foreign Direct Investment and Trade in Eastern Europe: the Creation of a Unified Europe, June 1997, Vienna.

**Figure 1**
**Support to Producers and Consumers, 2000**




Source: OECD.

direct payments are dependent on farmers' delivering environmental and other social benefits.

In late 2002 several EU communications have confirmed the Agenda 2000 budget, and the 2004 schedule for the Eastern enlargement (albeit moving it from January to May). Simultaneously, EU members agreed to maintain direct payment expenditures under the CAP at 2007 levels thereafter: this will include payments made to the initial eight CEECs.

## Policy Convergence – Measures of Producer and Consumer Support

Agricultural and other rural policies differed amongst the CEECs under communism, and have developed in disparate directions since economic transition began.[15] The evolution of CEECs' aggregate support to farmers is one of some convergence, with substantial variation remaining.[16] Figure 1 shows OECD estimates for Producer Subsidy Equivalent (PSE) and the effective tax paid by consumers, the Consumer Subsidy Equivalent (CSE) for 2000.

Enlargement will deliver substantial increases in support to CEEC farmers, although constraining factors will be access to direct payments, quota levels, and (as outlined in Regular Reports) the need to satisfy EU strictures for administration and for compliance (e.g. set-aside). The increased burden on CEECs' consumers will have fewer mitigating features. Both changes will, of course, be sudden.

Aggregate support levels mask the very different commodity emphases in the support profiles of the CEECs. Moreover, the CEECs' patterns of support differ substantially from that in the EU. Figure 2 presents PSE estimates for major commodities, expressed as a departure from the EU level. Six CEECs have a higher PSE for sugar than does the EU (at 49%), but for all other crops, producer support is substantially higher in the EU (see EU's PSE levels in parentheses in the key to Figure 2). CEECs' producers of other grains, for example, receive support that is less than that in the EU by between 20% (Latvia and Romania) and 80% (the Czech Republic).

The dominant feature of Figure 2's right-hand panel is that all CEECs support beef producers much less than does the EU. Most CEECs effectively tax their beef producers, while in the EU beef's PSE is 75%. For extreme cases like Romania, differences in PSE reach 150 percentage points. Most CEEC producers of eggs, however, are supported to a greater extent than those in the EU. Pigmeat producers in Latvia, Lithuania, Slovenia, the Czech Republic and Slovakia all receive greater support than those in the EU. The CEECs' dairy farmers receive less support than those in the EU, the difference being 40-60 percentage points in Latvia, Lithuania and Poland. Lithuania is notable in that its PSE for dairy is negative, resulting in a differential with the EU of –60 percentage points.

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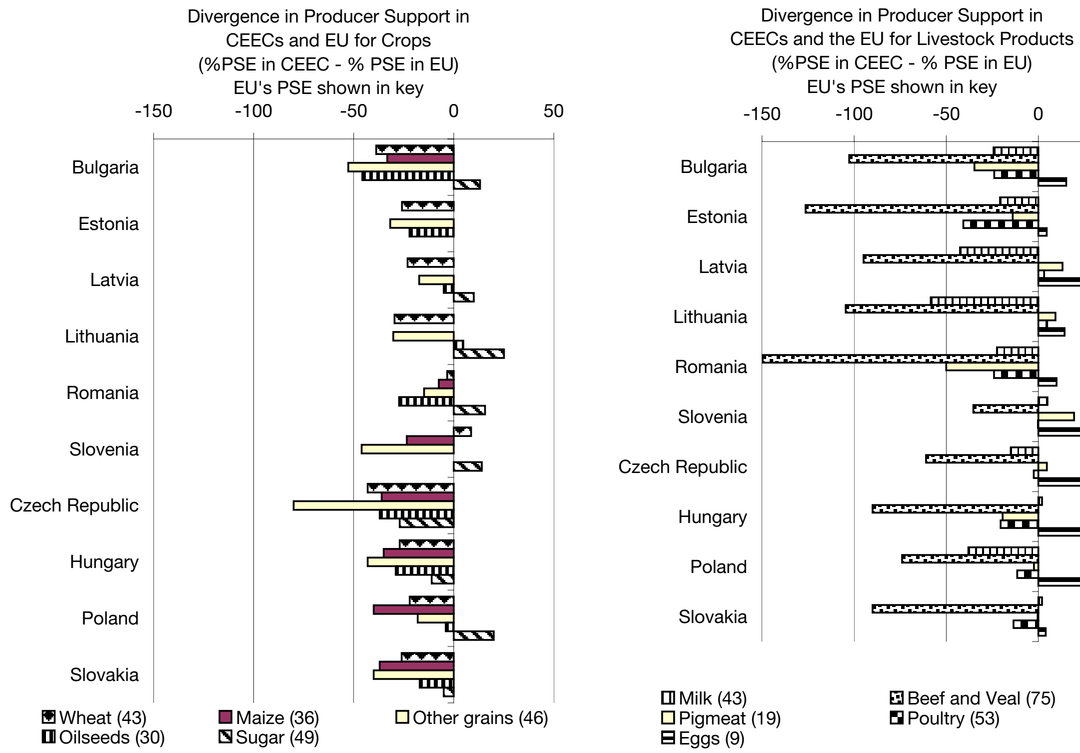
[15] For reviews see Z. Lerman: Agriculture in the Transition Economies: from common heritage to divergence, in: Agricultural Economics, Vol. 26, No. 2, 2001, pp. 95-114; and J. Hartell, J. Swinnen: European Integration and the Political Economy of Central and Eastern European Agricultural Price and Trade Policy, in: S. Tangermann, M. Banse (eds.): Central and Eastern European Agriculture in an Expanding European Union, CAB International 2001, pp. 157-184.

[16] See also S. Bojnec, J. Swinnen: The patterns of agricultural price distortions in Central and Eastern Europe, in: Food Policy, Vol. 22, No. 4, 1997, pp. 289-306; and S. Davidova, A. Buckwell: Transformation of CEEC Agriculture and Integration with the EU: Progress and Issues in Central and Eastern European Agriculture in an Expanding European Union, in: S. Tangermann, M. Banse (eds.), op. cit., pp. 1-27.

**Figure 2**
**Producer Support by Commodity (2000)**




Source: OECD.

Figure 2 emphasizes differences in the level of support between the EU and the CEECs. Table 4 presents differences in "relative support": one commodity's % PSE divided by another's for each country. A "parity" result of 1.0 implies equal support to both commodities. Where data is missing, both PSEs are negative, or one PSE is equal to 0, the measure is not reported in Table 4.

The left hand column shows the variation amongst CEECs in the relative support given to other grains and wheat. In the EU these commodities receive almost equal support, as the ratio of PSEs is near parity at 0.9. For CEECs, the ratio shows variation from –0.6 (Bulgaria) to 5.3 (Hungary).

The relationship between support to beef and support to other grains is also highly variable and most CEECs' measures are opposite in sign to those in the EU. In the EU, support to grain producers has been matched by support to livestock producers owing to the resulting high feed costs (this implies a positive value for the third column of table 4, *viz.* 1.6).

For the relative support to milk and beef, no CEEC's ratio of protection is close to that of the EU (0.6), and for many CEECs this relationship differs in sign to that in the EU. The right hand column shows that relative support for pork and beef ranges from parity (in Slovenia) to pork receiving 17 times the support of beef (in Poland). In the EU, pork producers receive just one third of the support given to beef producers (a value of 0.3). Because beef is taxed in many CEECs, the ratios take negative signs for those countries.

The marked differences in support between CEECs and the EU have the consequence that incentives across commodity sectors will change substantially in the CEECs following enlargement. Furthermore, they will change in a different way in each CEEC. To the extent that existing policies have encouraged investment in one sector in favor of another, then returns on those investments will diverge from expectations upon accession. Furthermore, CEECs' claims for quota and reference areas leading up to the enlargement will reflect the payments available under the CAP, whereas the existing production pattern is a consequence of very different policy environments.

### Policy Instruments Used

Instruments used by the CEECs and the EU in producer support are presented in Figure 3, subdivided by shares of total cost of producer support. In most

**Table 4**
**Relative Levels of Protection 2000, Selected Countries and Measures**

| | Ratios of PSEs [1.0 implies parity] | | | |
|---|---|---|---|---|
| | PSE (wheat)/ PSE (other grains) | PSE (beef)/ PSE (other grains) | PSE (milk)/ PSE (beef) | PSE (pork)/ PSE (beef) |
| Bulgaria | -0.6 | * | -0.7 | * |
| Estonia | 1.2 | -3.6 | -0.4 | -0.1 |
| Latvia | 0.7 | -0.7 | 0.0 | -1.6 |
| Lithuania | 0.8 | -1.9 | * | -1.0 |
| Romania | 1.3 | -2.4 | -0.3 | * |
| Slovenia | n.a. | n.a. | 1.2 | 1.0 |
| Czech Republic | ** | -0.4 | 2.0 | 1.7 |
| Hungary | 5.3 | -5.0 | -3.0 | ** |
| Poland | 0.8 | 0.0 | 5.0 | 17.0 |
| Slovakia | 2.8 | -2.5 | -3.0 | -1.3 |
| European Union | 0.9 | 1.6 | 0.6 | 0.3 |

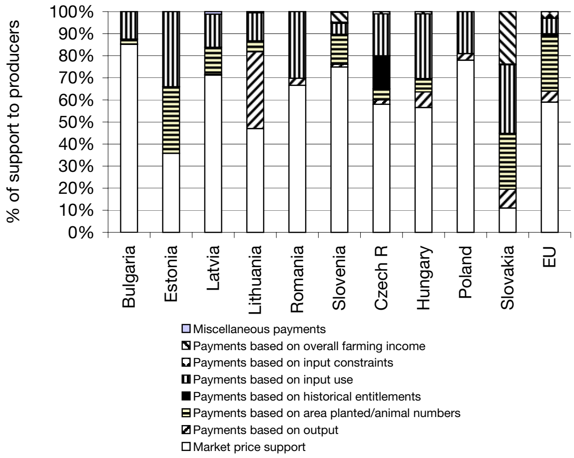
* PSE negative for both commodities

** Czech PSE for wheat, Hungarian PSE for pigmeat = 0.0.

n.a. = not available

Source: Author's calculations from preceding tables.

**Figure 3**
**Composition of Producer Support**
(all commodities, 2000)




Source: OECD.

CEECs and the EU, price support dominates: only in Slovakia, Estonia and Lithuania does price support play a smaller role than in the EU (about 60% of all support). Slovakia offers a profile much different to that of other CEECs: only 11% of producer support is implemented as price support, with payments based on area and animal numbers, input use and overall farming income, each contributing 20-30%. The EU's profile features payments based on input constraints – primarily agri-environmental elements of the CAP. No CEEC has such a support component.

Recent policy changes in the EU are reflected in its emphasis on area and animal numbers (about 25% of producer support) as direct payments. This theme has been adopted only by Estonia (at about 30%) Slovakia (25%) and Latvia (12%), while some CEECs provide almost no producer support of this type (e.g. Bulgaria, Poland and Romania). In almost all cases, CEECs subsidize input use (e.g. seeds, breeding animals, seasonal inputs) to a greater extent than does the EU: particularly Slovakia, Poland, Hungary and Estonia.

The substantial differences in the composition of support probably reflect fiscal necessity: the budgetary impacts of tariffs and trade barriers are much smaller than those for area payments and agri-environment incentives. For farmers accustomed to seasonal credit subsidies, however, the changes can be traumatic and constrain access to those CAP instruments for which production is a requisite. The profound re-orientation of producer support required at the time of enlargement is at the basis of the Regular Reports' concerns over CMO development, information and payment systems, and the future of CAP-like institutions in the CEECs. At stake is the CEECs' capacity to absorb producer assistance using the new policy instruments. The CEECs have their own concerns on this topic, specifically that their farmers' access to support will be constrained by quota and direct payment limits.

### Trade Policy

It has been widely anticipated that the eastern enlargement would involve greater tariff reductions on the part of the CEECs than the EU, as their tariffs were generally higher.[17] Agriculture was supposed to be an exception, as EU tariff rates were thought to be higher in the case of agricultural products. Data for 2000[18] do not entirely support this: four CEECs have higher average applied tariff rates on agricultural products than does the EU; Poland, Hungary and Romania's average applied tariff rates on agricultural products are double those of the EU. Like the EU, all CEECs have tariff rates for agricultural products that are substantially higher than the rates in other commodity sectors.

As is the case with commodity support, disaggregated data (Table 5) demonstrate a significant range of tariff rates amongst CEECs. The two left-hand columns in Table 5 compare tariffs on imports from the rest of the world: MFN rates for the CEECs and 3rd

[17] J. F. Francois, M. Rombout: Trade effects from the Integration of the Central and East European Countries Into the European Union, Sussex European Institute Working Paper No. 41, 2001.

[18] A.D. Baker: Agriculture in the EU's Eastern Enlargement – current status for CEECs. Danish Research Institute of Food Economics Research Report, Copenhagen 2002.

country rates for the EU, for a selection of products.[19] The range of rates in the second column is that observed amongst the CEECs. In general, the EU's rate falls within the range exhibited by the CEECs, with the anticipated exceptions of oats, beef and some fresh products. The variety of MFN tariff rates amongst CEECs is remarkable, with just one product (hides and skins) for which all CEECs charge the same tariff rate.

The two right-hand columns of Table 5 report tariff rates applied to trade between CEECs and the EU. These tariffs apply, in many cases, to tariff rate quotas. These rates include those levied under the Association Agreements. In the third column, the range indicates the variation in EU tariff rates applied to different CEECs. In the fourth column, the range is the variation amongst CEECs in the rates levied on imports from the EU. The EU's range of tariff rates is much smaller than the CEECs', being uniform for 7 products. The CEECs exhibit a very broad range of tariffs for almost every product.

**Table 5**
**Tariff Levels for Selected Products, September 2002**
(% ad valorem[1])

| | Tariff rates on imports from 3rd countries | | Tariff rates on trade between CEECs and the EU | |
|---|---|---|---|---|
| Product | EU 3rd country tariff rate | Range of CEECs' MFN tariff rates | Range of EU tariff rates applied to CEECs | Range of CEEC tariff rates applied to EU |
| Wheat | 2 | 5 - 135 | 0 - 2 | 0 – 135 |
| Barley | 25 | 8 - 50 | 0 - 25 | 0 – 45 |
| Oats | 89 | 0 - 50 | 0 - 89 | 0 – 45 |
| Wheat flour | 78 | 0 - 93 | 0 - 78 | 0 – 93 |
| Rapeseed | 0 | 0 - 60 | 0 - 0 | 0 – 60 |
| Sugar beet | 56 | 0 - 45 | 56 - 56 | 0 – 45 |
| White sugar | 161 | 0 - 261 | 161 - 161 | 0 – 261 |
| Cooked, stuffed pasta | 16 | 3 - 45 | 8 - 15 | 0 – 38 |
| Sweet biscuits | 9 | 5 - 56 | 0 - 8 | 0 – 51 |
| Ice cream | 37 | 15 - 51 | 26 - 29 | 0 – 45 |
| Beer | 0 | 0 - 248 | 0 - 7 | 0 – 248 |
| Skins and hides | 0 | 0 - 0 | 0 - 0 | 0 – 0 |
| Live piglets | 9 | 0 - 89 | 2 - 9 | 0 – 89 |
| Live sheep | 64 | 0 - 100 | 0 - 10 | 0 – 100 |
| Beef carcasses | 80 | 9 - 71 | 0 - 16 | 0 – 71 |
| Boneless beef | 98 | 7 - 71 | 0 - 19 | 0 – 71 |
| Pork carcasses | 43 | 11 - 76 | 22 - 22 | 0 – 76 |
| Hams | 66 | 11 - 76 | 33 - 33 | 0 – 76 |
| Chicken pieces | 28 | 11 - 68 | 14 - 14 | 0 – 68 |
| Roses[2] | 12 | 0 - 45 | 0 - 12 | 0 – 45 |
| Potatoes | 12 | 10 - 100 | 0 - 12 | 0 – 100 |
| Tomatoes[2] | 79 | 13 - 60 | 7 - 79 | 0 – 60 |
| Sour cherries[2] | 38 | 0 - 38 | 0 - 9 | 0 – 38 |
| Strawberries[2] | 13 | 5 - 45 | 0 – 13 | 0 – 45 |

[1] In the case of EU tariffs, calculated from specific tariffs relative to world prices from: AMAD: Collaborative Trade Barriers database, 2002.

[2] Highest of seasonally adjusted rates.

Source: DG TRADE: Trade Access database, 2002.

### Food Self-sufficiency

The CEECs are largely self-sufficient[20] in wheat, barley, sugar and potatoes, with significant surplus production limited to wheat (130-140% in Latvia, Lithuania and Hungary) and barley (131% in Romania). While several EU members have low levels of self-sufficiency in these crops (Portugal, Italy except for sugar, and Greece) some exhibit over 200% self-sufficiency for sugar (Belgium, Denmark and France), and over 120% self-sufficiency for barley (Denmark, Germany, France (260%), Finland, Sweden and Britain). For potatoes, almost all CEECs are close to 100% self-sufficient, but this is observed for only 6 EU members.

For livestock products, almost all CEECs are approximately self-sufficient for beef, milk, pork and eggs, with values typically lying in the range 90-110%. As exceptions, Hungary is 130% self-sufficient in pork, and Lithuania is 142% self-sufficient in beef. Several existing EU members are in substantial surplus for livestock products: for pork, Belgium is at 254%, Denmark at 431% and the Netherlands at 196%. For beef, Denmark, Germany, Spain, Ireland (1000%), the Netherlands and Austria are all at over 110%.

### Employment in Farming

In most CEECs, employment in agriculture is falling rapidly: at 1-2% per year in the 1999-2000 period[21] and even faster between 1989 and 1996.[22] The Czech Republic now lies above the EU average in this regard (Figure 4). The shares of Greece, Portugal and Ireland remain amongst the highest for a projected EU-25. Although CEECs occupy the bottom end of the spectrum of Figure 4, most CEECs fit easily within the existing pattern of the EU's agricultural employment. Poland has marginally more employment in agriculture than does Greece, yet Poland is likely to be shedding farm labor more quickly than Greece. Bulgaria and Romania have another five years of adjustment prior to EU membership, which at current rates of decline could mean an aggregate 10 – 15% reduction.

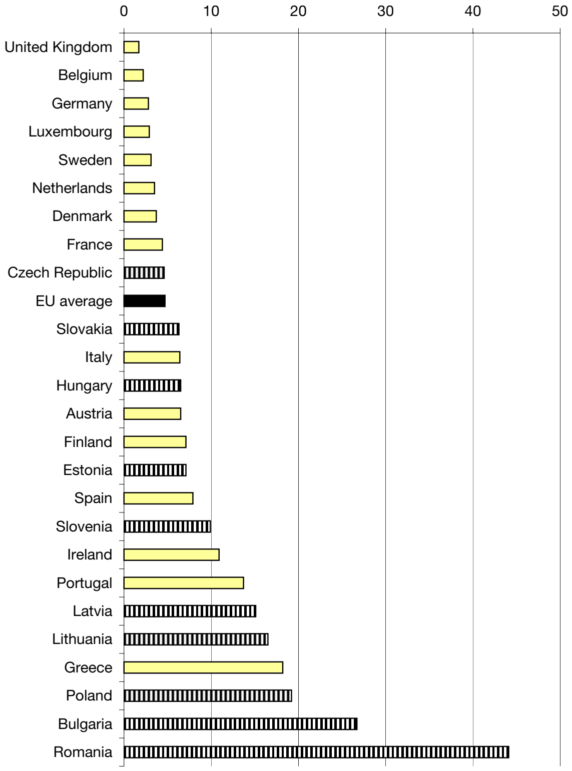
[19] The products were selected to encompass a variety of commodity groups and a number of points in the value-adding chain.

[20] See A.D. Baker, op. cit.

[21] European Commission: Enlargement and Agriculture: successfully integrating the new Member States into the CAP, Issues Paper, Brussels 2002.

[22] M. Banse: Macroeconomic Implications of EU Accession, in: S. Tangermann, M. Banse (eds.), op. cit., pp. 133-155.

**Figure 4**
**Share of Employment in Agriculture, 2001**
(percentage of workforce)




Source: OECD.

As is the case for self-sufficiency in major commodities, the CEECs' shares in farm employment fit within the distribution of existing EU members. The same is true to farm size distribution[23] (Figure 5). Owing to various historical developments (including recent land allocation policy) most CEECs have a structure featuring large numbers of small farms. This has been of concern to the EU from the point of view of fiscal costs, but also as an administrative burden following enlargement. In terms of the distribution of farm sizes, the CEECs shown here do not appear to be dominated by small farms to any greater extent than do the existing EU members. This is true in terms of the shares of the area occupied by small farms and the share of all farmers that operate small farms, for the countries shown. The more inflammatory topic in EU negotiations concerns the absolute numbers of farmers in CEECs, and their capacity to absorb transfers under the CAP.

## Conclusions

*Outcomes of formal evaluations:* Having satisfied political and economic criteria, CEECs have also now closed all chapters of the *acquis communautaire*, including agriculture. While the Regular Reports are optimistic and encouraging in nature, they identify information systems and control systems as serious omissions in preparation for the enlargement. In addition, CAP-like policy regimes and CMO-like administrative bodies are of concern to the EU in that they do not comply with the *acquis*. The CEECs' lack of requisite procedures on land holdings and livestock is of considerable concern for the administration of direct payments, for which the proposed interim procedures will not address all problems. Transitional arrangements have, to some small extent, delayed the necessary changes for CEECs. A large volume of CEECs' transposed agricultural legislation is to be activated only upon accession. Little is known about how successful implementation will be and how existing institutional structures can adapt to administer it.

*Policy convergence:* CEECs' current agricultural policies have not converged to the CAP. There remains substantial variation in the form, and commodity emphasis of CEECs' agricultural policies, and few provide a producer or consumer incentive base that is similar to the CAP's. This means that the form and extent of support to producers, and the cost to consumers, will change radically on the day of accession. One component of domestic protection is tariff levels, for which great variation exists both in CEECs' treatment of the EU and other countries, and in the tariffs levied by the EU on various CEECs. Another component is the CEECs' policies' focus on inputs, which will change abruptly upon enlargement. Transitional measures agreed in Copenhagen extend to a few tax differentials in a few CEECs.

Notably, convergence in rural development policy is embedded in EU assistance to the CEECs. SAPARD procedures have, from the start, required the development of administrative structures that can convert to EU Structural Funds at the time of accession. Agricultural assistance has not followed this path.

*Structural alignment:* CEECs' self-sufficiency in basic food commodities is generally in line with that in the EU. Given the imminent consumer price increases at enlargement, major CEEC growth in food demand seems unlikely and cannot alone justify CEEC claims for increased quota allocations. However, some individual EU members exhibit far greater surpluses than does any CEEC. CEECs whose production is not in surplus are understandably unwilling to accept bind-

[23] The data used to construct Figure 5 are approximations at best, drawn from various sources and subject to author's adjustments. The data has been truncated at 20 ha, in order to achieve some consistency amongst countries: in any case this does not detract from an analysis focused on small farms. Data are available for a limited number of CEECs.

ing production controls that result in imports from EU members, perhaps those in significant domestic surplus.

The prevalence of agriculture in the economies and labor force of CEECs is generally higher than the average in the EU. However, the individual CEECs fit within the EU's existing distributions. Convergence in these general measures of structure has been rapid and is continuing, as CEECs' farm populations are shrinking far faster than those in the EU. CEECs also fit into the EU's distribution of farm structures, but convergence will be subject to a wide variety of factors.

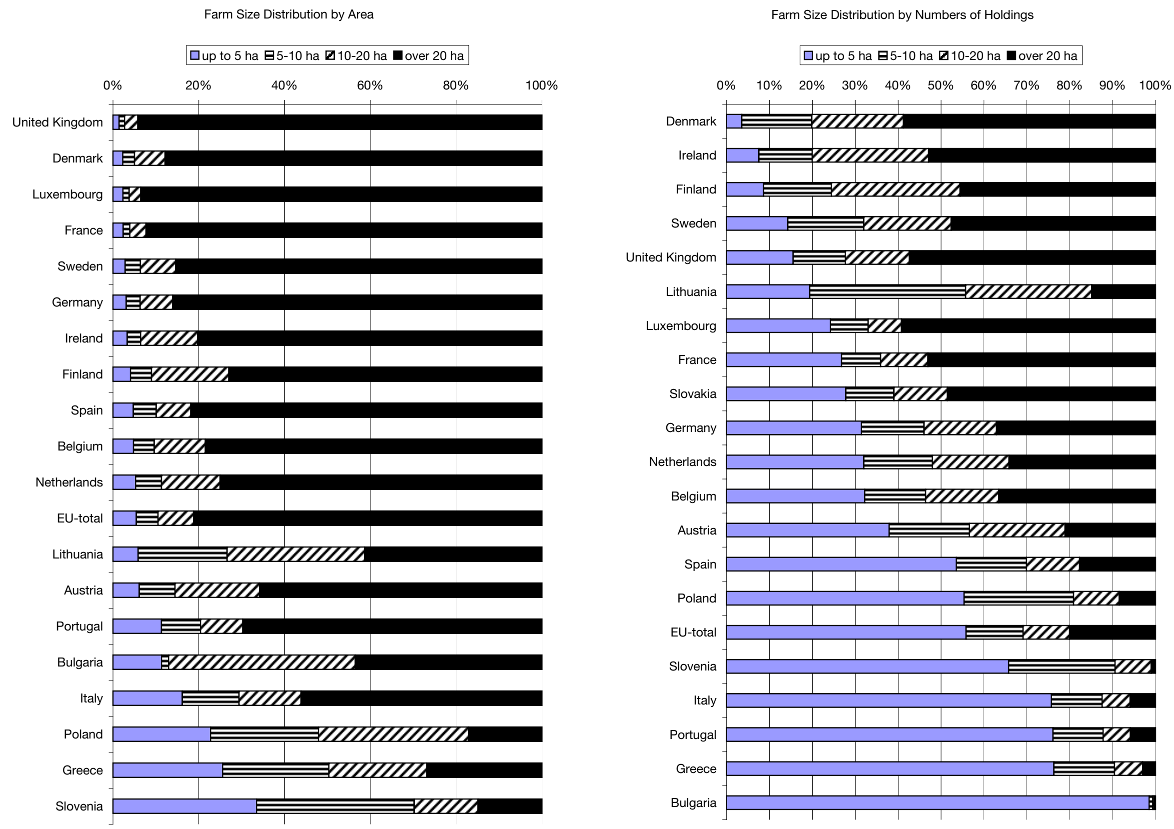
*Trade and competition:* The development of EU trade surpluses with most CEECs has highlighted CEECs' difficulties in competing on EU markets even in the presence of limited preferential entry under the Association Agreements. A major constraint on CEEC agro-processors will be the limited number of CEEC food processing plants certified for export to the EU, in the face of free access for exports from the existing EU members. Economic fundamentals might indicate complementarity within the food chains of the expanded EU, with CEECs intuitively expected to occupy the production end of the chain. However, CEECs' farm-level competitiveness may currently be constrained by surplus farm labor and quality differentials. Poor CEEC competitiveness under the Association Agreements may have been expected, in that they adher to trade patterns established administratively, rather than according to comparative advantage.

The capacity for CEECs to generate large production surpluses and export them within the EU has been widely discounted for all commodities except coarse grains. For this commodity, the EU's WTO commitments on subsidized exports may be exceeded. No contingency exists for special post-enlargement instruments to avoid this outcome. Production con-

**Figure 5**

**Farm Size Distribution, Percentage of Total Area and Percentage of Numbers of Holdings**

(latest available year)




Sources: Eurostat (2002); CEECs' national statistical agencies; Z. Lerman: Agriculture in the Transition Economies: from common heritage to divergence, in: Agricultural Economics, Vol. 26, 2001, pp. 95-114; W. Guba: The Size Distribution of Polish Farms, Central Statistical Office, Warsaw, Poland, 1999; amended by author's adjustments.

straints due to quota will cement the existing trade patterns following enlargement.

Enlargement will exact a heavy cost on CEEC food industry participants specialized in exporting to, or importing from, third countries. Most CEEC exporters to third countries will not achieve EU-certification of their processing plant before enlargement, effectively leaving them with no export market at all. In addition to these trade diversion impacts, CEEC importers forced to source product within the EU face large investments in human and technical capital, while dealing with competitors that are far more familiar with the EU markets' procedures and administrative requirements.

*Quotas:* Quota levels, particularly for milk, constrain CEECs' potential for using and expanding current resources in dairy and beef production and processing. Just as CEECs claim that their agriculture is in a recovery phase and cannot be constrained to late-1990s production levels, EU members dismiss late-1980s levels as irrelevant. CEECs' livestock data remains difficult to find and interpret.

No procedures have been proposed for re-allocation across borders. Cross-border trade of quotas (not permitted under the CAP), would take account of the shortage of development capital available to the CEECs' farm and agro-industrial sectors. One scenario would involve allocation of a quota amount to CEECs as a whole, for which CEECs, or existing EU members, would bid on behalf of their dairy and sugar industries. Another option is to allocate a tradable quota volume to each CEEC. Any CEEC giving up quota would then receive compensation for doing so at no cost to the CAP: restrictions could be placed on the uses of the proceeds; for example investment in agro-industry.

*Direct payments:* The impact of the transitional program governing CEECs' access to direct payments is to dilute the principal means of CEECs' immediate benefit from the CAP. While facing the same prices as other EU farmers, their incomes will be significantly lower. Transitional arrangements do not feature conditions under which CEECs can accelerate access to the payments, for example by improving their information and administrative systems, or addressing farm structure.

As the levels of CEEC payments (which are not tied to specific commodities) converge on current EU members' levels (which are), the question eventually will arise as to which model will be adopted by whom. The EU as a whole may either opt for the CEECs' "simplified" form of direct payment, or maintain the existing model. The former case complements MTR-inspired efforts to decouple direct payments in the EU, which is likely to allow direct payments to be moved from WTO's blue box to its green box. In the latter case where payments to CEEC farmers revert to the current system, the EU may be confronted with demands for compensation for lost payments on the non-commodity crop areas. Notably, this choice will need to be made within one or two years of the enlargement (the simplified scheme is available only in the first 3 years, with some extensions) to allow CEECs' planting and breeding decisions to be taken with full information.

While the simplified nature of direct payments in CEECs tends to equalize benefits across commodity sectors, it will distort the pattern of farm incomes, and therefore incentives, within the EU. CEEC farmers producing crops ineligible for direct payments in the existing EU will be relatively well-supported by the payments. CEEC farmers producing CAP-relevant products will receive a lower income than farmers in the existing EU. While this may encourage diversification in the CEECs, it will accentuate the shocks of policy re-alignment: this is particularly the case where changing crops requires capital investments.

The capacity for CEECs to top up direct payments with rural development funds is also complementary to decoupling of farm support. However, it contradicts the principle of the MTR's proposed dynamic modulation, which transfers funds from income support to regional development. In any case, disbursement of EU regional development aid in the CEECs has been slow, so unspent funds are available. In the short and medium term, CEECs will benefit from dynamic modulation within the EU. In the long term, however, it dampens the incentives for restructuring (specifically, reducing labor on) CEEC farm holdings. A lack of investment in machinery would further reduce CEECs' competitiveness in the single market.

CEECs' access to direct payments will be capitalized into farmland values. Moratoria on foreign ownership of farmland will expire over the next decade, just as CEEC farmers are entitled to full direct payments. CEEC farmers will however be denied the income over the next decade to pay the elevated land prices. EU farmers, on the other hand, will be well positioned to buy land in the CEECs having received superior direct payments during the period of the moratoria.