

## **The East-Enlargement of the European Union and its Implications for the Common Agricultural Policy**

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### **1. Introduction**

At several occasions the European Council has confirmed the conclusion of its Copenhagen Summit in June 1993 that the central and east european countries being associated to the European Union can become members of the European Union (EU) if they desire so and as soon as they are able to fulfil the necessary conditions. While the desire to become member of the EU is obvious – most of these states have already applied for membership – it is less obvious what the necessary conditions are that these countries must be able to fulfil before their application is accepted by the EU. A pre-accession strategy was decided on by the European Council in Essen in December 1994 which may unveil those necessary conditions. That strategy was maintained to be tailored to the needs of the countries with which Europe Agreements were already concluded at that time. The strategy shall nevertheless be applied also to those countries, with which Europe Agreements are to be concluded in the future. The Baltic States and Slovene were named in this context. The pre-accession strategy is being politically implemented by "structured relations" between the institutions of the EU and the authorities of the associated central and east european states; besides the Visegrad countries (Poland, Hungary, Czech Republic, Slovakia), Bulgaria and Romania are associated to the EU.

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The outcome of the former negotiations must be disappointing to the associated central european states which strive after membership for some time and are adopting their laws and institutions according to the requirements provided by the Europe Agreements set in force in 1994. These agreements provided central and east european and east states already with a complete program for the preparation for membership and encouraged the countries' expectations to become member of the EU by the year 2000. The Europe agreement establishes an association similar to the former associations between the EC and countries like Portugal, Spain, Greece, UK, Ireland or Denmark, being member countries of the EU for some time. Association is recognised as a pre-membership. Its objective is to tighten the economic, political and institutional ties between the Community and the applicants for membership. The Europe Agreement between the EC and Poland, Hungary, the Czech Republic, Slovakia, Bulgaria and Romania (ACEEC, in short) provide for a regular political dialogue, co-operation in numerous economic and cultural fields, an approximation of laws to community law, and, last but not least, the establishment of a free trade area within up to ten years. Trade with textiles, clothing products, agricultural products and food are not covered fully by the free trade agreement. These so-called sensitive products more or less remain the objective of the EU's and ACEEC national trade policies.

Exemptions from free trade have all associations in common the Community has established since its first association with the UK in 1954. And its common knowledge that these exemptions have several negative consequences not only for the economies but also for politics.

In the case of the Europe Agreements the existence of sensitive sectors – as agriculture, steel, textiles, clothing – causes disputes on ACEEC trade practices (Charles Goldsmith, 1995). Those disputes might deteriorate the political ties between the Community and ACEEC. A major economic

effect of sensitive sectors is that the structure of specialisation both in ACEEC and the EU can not fully adjust to what the theory of comparative advantage would suggest under conditions of free trade. ACEECs cannot specialise fully in labour and land intensive products and the EC – and within the EC foremost Germany – in human capital and technology intensive lines of production. Due to the trade distortions gains from trade are kept below their potential level. ACEECs have to bear losses in terms of income and employment mostly in rural areas and in labour intensive industries while the EC – and within the EC mainly Germany – has to relinquish job gains in the manufacturing and service sector.

It is not arguable that it was the EC and not the ACEEC which demanded agriculture and other sectors to be exempted from the free trade arrangement of the Europe Agreement. The member states of the EC, France in particular, wanted the West European farmers to be shielded against the suppliers from ACEEC. The political rationale behind the EC position can be seen in the desire to buy time for the adjustment of its policies and its structure of production. Fears are widespread that the envisaged need of adjustment dwarfs the adjustment need of any other former enlargement of the EC. The reason for these anxieties is foremost the economic structure and development of the applicant countries, which differ significantly from the EC and former applicants. The divergencies between the EC and ACEEC are most visible with respect to wages, productivity and prices of immobile factors of production. They are far more pronounced than in earlier accessions. To some extent the divergencies are the out-come of different policy approaches. The EC's support of agriculture is far higher than the support granted to agriculture in ACEEC. In this respect one could also say the EC itself is politically not yet able to fulfil the necessary conditions for an enlargement by ACEEC countries and needs a comprehensive strategy to prepare itself for the enlargement.

The European Council may have arrived at a similar conclusion. At its Essen summit the European Council called on the Commission to submit a white paper on the effects of an east-enlargement in the context of the Union's current policies and of the means of developing relations in the agricultural sector. The Commission (1995) came out with a study in July 1995, but did not dwell on the EC's agricultural support measures and their implications.

This paper dwells on the implications of an accession of ACEEC to the EC for the EC's agriculture markets, budget, and Common Agricultural Policy (CAP).

The paper is organised as follows:

Chapter II focuses on the economic divergencies between ACEEC and the EC, namely the resource endowment, the overall productivity, and the composition of trade of ACEEC and examines the current state of agriculture in ACEEC.

The third chapter assesses production and export capacities up to the year 2000, given the status quo ante 1990 will change gradually (status quo scenario);

In the fourth chapter the comparative (cost) advantage of the agricultural sector as a whole in relation to the non-agricultural sector is considered; the potential development of ACEEC' agricultural export under free trade conditions is examined; the analysis will allow for alternative assumptions about the degree of integration of ACEEC.

Chapter V describes the institutional impediments to exports of ACEEC'. The final chapter investigates into the effects of the accession of ACEEC' to the EC.

## **2. The Starting Economic Position of Associated Central and East European Countries (ACEEC)**

This section will focus on the resource endowments, the productivity and the composition of current trade.

The first aspect of the economic potential of ACEECs is simply the size of the countries' market measured by the number of consumers (Table 1). ACEEC Population totals approximately 100 Mill. This market seems larger than, say, the integrated markets of Germany, Belgium, Netherlands and Luxembourg, where 96 Mill. people live. However, due to the lower productivity and income, the size of the ACEEC market is smaller in economic terms. According to recent estimates of GDP the per capita income in ACEEC was close to 2000 US-Dollars in 1993, which makes up for 11 percent of the per capita income in the EU. The per capita income of the ACEEC' is lower in Bulgaria and highest in Hungary. In Poland which is the largest market the per capita income is 2270 Dollar well above the ACEEC' average. Some ACEEC showed stronger economic growth than EU member states in the last two years (1993 and 1994). ACEEC are forecasted to grow faster than the EU in the near future. Thus, it is likely that the income gap between ACEEC and the EU will narrow gradually but will still remain quite large by the year 2000. To keep their growth path ACEEC have to take care of their macroeconomic stability which – with the exemption of the Czech Republic – is jeopardised by inflation and budget deficits which are too high compared to necessities of a growth oriented economic policy.

The agricultural sector and food industry contributed to the overall economic growth mainly by stabilising effects on labour and goods markets. The agricultural sector absorbs large amounts of labour. The share of the agricultural labour force in total employments varies between 9 percent in the Czech Republic and 35 percent in Bulgaria. Poland's agricultural sector

employs more than 20 per cent of the Polish labour force. In Poland the migration from agriculture slowed down or even came to a halt in the 1990's (OECD, 1994) That indicates favourable income and job opportunities in agriculture compared to other sectors during the transformation process. In the Czech Republic and in Hungary agriculture experienced an outflow of labour. In the Czech Republic more new jobs were offered in the manufacturing and service sector. In Hungary unemployment has risen to near 35 percent in rural areas.

Compared to EC standards land is more abundant in ACEEC (Table 1). As the arable land base per capita in ACEEC is 1-36 times larger than the land base of the EC so the land based production per capita would be higher than in the EC, if all other factors determining production were equal. The actual production depends on the techniques of production, productive knowledge and the human capital base, and, at last, on the endowment of land and the fertility of the soil.

In the past (before 1990), food production per capita in ACEEC was high by world standards. Production per capita of cereals, meat, milk was above the global average, yet below West European average. Production of vegetables and of fruit per capita was below West European standards, but higher than say in West Germany. Since 1990 live stock production has declined while crop production kept its pre-1990 level – bar from 1992 when extreme drought prevailed in most areas of ACEEC.

Productivity of agricultural labour ACEEC is low by West European standards and so is productivity of labour in the manufacturing industry and the service sector. As to the low productivity of labour in Polish agriculture this is commonly attributed to a factor specific to Poland, namely, the pre-dominance of small farms in the ownership of land. Poland had not collectivised its farm sector after World War II but, on the contrary, had reduced the concentration of land ownership. The other ACEEC have started



to de-collectivise their farm sectors after 1990 and to reduce the size of farms. There are about 2.1 million farms with 1 hectare or more land in Poland. In other ACEEC the number of farms is increasing with a remarkable speed. The average size of private farms with 1 or more hectare is only 6.3 hectares in Poland. There were state-owned farms too. They operated approximately 24 percent of Poland's arable land and are currently being split up and privatised (H. Dicke, J. Misala, 1993).

Exports of agricultural goods and food represent over 10 percent of total ACEEC exports and imports of food and agricultural goods made up more than 10 percent of total imports in 1993. In recent years the regional structure of trade has changed significantly. Trade with the EC increased while trade with the Central and East European Countries (CEECs) decreased.

Before 1990, the command system of the Council of Mutual Economic Assistance, CMEA in short, and of each of its member states tied the member states and the regions within the states to a centrally planned interregional and inter-industry division of labour. The central bodies provided for the economic interactions among and within the member states of the CMEA. Trade intensities which were measured as trade in percent of GDP were rather high (R. Langhammer, 1991).

The political interference with the orientation of trade flows and resource allocation met with difficulties when trading partners were located outside the CMEA. In the 1980s more than 50 per cent of the total trade of the East European trading area was intra-regional trade, 30 per cent of total exports went to developed countries, around 15 per cent to the EC. As of 1987 Poland like other CEECs tried to shift its exports away from the Eastern European trading area to developing and developed countries. Not unsurprisingly, these efforts yielded different results, depending on the character of the goods. The CEECs were quite successful in directing raw

materials and food exports to developed countries. On the average, the share of agricultural and food exports to developed countries in total food exports increased significantly (GATT, 1990). In 1993, 58 percent of Polish exports of food and agricultural goods were directed to the EC and 57 percent of Polish imports were from the EC (SAEPR, 1994). By and large the same holds for the regional trade structure of the other ACEEC.

In contrast to the large size of the Central and Eastern European trading area, its involvement in the world market was rather small. The share of CEEC in world merchandise trade was below 11 per cent in 1989, with the Soviet Union alone holding a share of 5 per cent and Poland 0,6 per cent, which is low by USA or West European standards. In the world market for agricultural and food products the picture was slightly different. CEEC's share in world agricultural imports was around 12 percent, and Poland's share was 0.8 per cent. In world agricultural exports, however, East Europe held a small share of just 5.2 percent, and Poland had one of 0.7 percent. In few product categories only CEECs played a major role on the global agricultural export market. For instance Poland's and Hungary's shares in world exports were similar to or exceeded those of, say, France for meat, prepared and preserved.

The capability of a country to compete with foreign suppliers of agricultural and food products as measured by the Concept of Revealed Comparative Advantage (RCA) was high in the case of Poland before and after 1990. Also Hungary, Bulgaria, and Romania had a comparative advantage in agriculture (under the rules of a centrally planned economy). The assumption that those economies were able to compete successfully on Western markets for resource-intensive goods but not on markets for more sophisticated products was supported by several studies (B. Heitger, K. Schrader, E. Bode, 1991).



Productivity in general and productivity of agriculture in particular was high by world standards but low by Western European standards. The low productivity compared to Western standards, resulted in lower per capita income compared to Western countries. Surprisingly, consumers in East Europe had access to very large quantities of food (at low relative prices). According to FAO statistics ACEEC consumed less meat and vegetables but significantly more grain, potatoes and sugar than West Europeans; the difference in meat consumption was rather small.

The ante-1990 production and consumption patterns depicted above were mainly determined by both a hierarchy directing centralised economic planning and central economic agents reacting in a country specific organisational structure of agricultural and food production. The organisation of agribusiness (agriculture plus forward and backward industries specialised in supplying agriculture and in processing agricultural commodities) differed between ACEEC and the EC. Farms disposed of large amounts of land and labour, machinery and fertiliser. On average agriculture in ACEEC used labour and fertiliser per km<sup>2</sup> intensively compared even with Western standards (FAO, 1990).

### **3. Agricultural Outlook for ACEEC (Status Quo Scenario)**

The transformation of the institutional setting in ACEEC towards the economic order of a market economy is going on for five years now and is not yet completed. The economies are responding – after a short-term slump – in a positive and dynamic way. Growth rates are high by EC standards for the last two years. The structure and level of consumption and production, as well as productivity and real income, are changing gradually and so does the composition of exports and imports. Trends in trade which prevailed in the ante-reform area are changing in accordance with the emerging patterns of production and consumption structures. In which direction past trends will

change further depends not only on the utilisation of comparative cost advantages in an competitive international environment of full-fledged market economies but also on ACEEC access to the world market.

Any assessment of production capacities, domestic consumption and net exports in the year 2000 – when accession to the EC is going to take place – is extremely speculative in its nature. A rather conservative approach rests on the assumption that past trends will last because structural factors built up during the old regime will not vanish over night and are of influence for the future. Productivity gaps in agriculture and food processing between the East and the West, for instance, are an indicator of structural divergencies which will diminish only gradually in the wake of ACEEC transformation into a market economy.

Conventional approaches for projecting future production, consumption and net exports, which are based on econometrically estimated elasticity and coefficients, are not applicable in this context. Projections could be based, in principle, on the past performance of major agricultural sectors. Adjustments could be made according to the experts' more or less arbitrary judgement concerning responses to production and consumption within the emerging price patterns. Projections of this kind have been made and their outcomes will be briefly described. In the available projections, past trends were derived from the data base which was compiled by the US Department of Agriculture (USDA).<sup>1</sup> Export and import projections reflect projected supply (= production and changes of stocks) and consumption, which balance each year. Yields and land use are projected on the basis of the past and on the assumption that land productivity grows. It is not intended here to list all the underlying assumptions, the procedure and outcome of the available projections sector by sector. In general, the projected trends do not differ markedly from those of previous periods. The projections of domestic food consumption are based on the expectation that

income will grow by a rate of 3 percent during the 1992-2000 period, that relative food prices will change only slightly, that population will increase slowly (according to World bank projections) and that the size of land used for agriculture remains stable and agriculture's productivity is not going to change much compared to the 1980s; projected grain use patterns mirror patterns observed during the 1980s. The outcome of such a projection is

- Bulgarian exports will expand from 420,000 mt in the year 1990 to 512,000 mt, with the composition of exports staying unchanged;
- Exports of the Czech Republic and Slovakia taken together will increase from 901,000 mt to 1,784,000 mt in the year 2000, which is by far the largest rise in exports in absolute terms: the share of cereals in total food exports will increase from 50 per cent in 1990 to 62 per cent in the year 2000;
- Hungarian exports will change only slightly, from 1,903,000 mt in 1990 to 2,158,000 mt in the year 2000;
- Romania's exports will be twice as much in the year 2000 as in 1990, the largest percentage increase.

The World Bank report on Poland (1992) renders some explanations for the relative sluggish growth of Poland's exports in the years to come that may also hold for the other ACEEC: relatively high production costs, slow improvements of the quality of processed food, competition from the EC and limited access to the EC markets. One has to mention here that competition (from highly subsidised) EC goods and limited access to the EC markets are impediments to growth which all Central and East European countries have to cope with. On the other hand, high production costs may mirror distorted exchange rates, what could be corrected, and improvements of the quality of processed food could be speeded up.

#### **4. Comparative Cost Advantages of Agriculture in ACCEC and Specialisation in Trade**

##### **1. Introductory Remarks**

The trade scenario described above was basically derived from past trends. From the viewpoint of classical trade theory, this scenario is not convincing, because it seems to be in contrast to the basic tenets of the utilisation of comparative advantages in production and trade. Central and East European countries – has more natural resources and less capital than, say, Germany or the Netherlands, both being net-exporters of a couple of agricultural commodities. Therefore, the hypothesis seems to be plausible that ACEEC will become net exporter of agricultural products, nonfarm raw materials or resource-intensive commodities and increase exports in contrast to what extensions of past trends might suggest. Thus, it would seem to be worthwhile to analyse this hypothesis in greater detail. In the following, this will be done in three steps:

- by assessing the natural advantages and disadvantages of the agricultural sectors of ACEEC in relation to the non-agricultural sectors and in comparison with Western countries,
- by assessing the comparative advantages of ACEEC in relation to world market prices and in relation to EC prices and
- by assessing possible complementarities in EC and ACEEC agriculture and the scope for mutual specialisation and intrasectoral trade.

##### **2. Natural Comparative Advantages and the Structure of the Economy**

To be sure, ACEEC is less productive in agriculture and food processing than the West, but ACEEC is also less productive in

manufacturing industries; in other words, Poland has an absolute disadvantage in the production of all tradable goods but that does not mean ACEEC has not a comparative advantage in one or more industries. The comparative advantages or disadvantages of agricultural and non-agricultural sectors can be calculated roughly using national account statistics and national employment statistics, whereby the contribution of agriculture to the GDP per agricultural worker is defined as agricultural labour productivity and the contribution of non-agriculture to the GDP per non-agricultural worker as non-agricultural labour productivity. The relation between agricultural labour productivity and non-agricultural labour productivity is defined as the relative labour productivity of agriculture. The calculation of ACEEC relative labour productivity of agriculture results in a coefficient of between 0.9 and 1.4 (Table 2). This indicates that the relative labour productivities of agriculture is significantly higher in ACEEC than in West Germany or in the United States where the coefficient is 0.4 and 0.7 respectively. Consequently, it can be concluded that in a world with more liberalised international trade in agricultural goods, ACEEC will become net exporter of agricultural goods and food because it brings their comparative cost advantages into play.

The differences between the agriculture's relative labour productivities in the East and in the West are rather large, and therefore the statement "comparative advantage of ACEEC" will hold also if various inaccuracies in the statistics are taken into account. Inaccuracies are probably caused by various redistribution measures. Agriculture and food processing have been affected negatively by various redistribution measures applied by the communist regimes in the past, which favoured the non-agricultural sectors, whereas the opposite policy was applied in Western Europe and in North America.



C It is often argued that the agricultural sectors of the CEEC are characterised by an allocation of too much labour. This argument implies, that not enough labour is allocated to the non-agricultural sector. In the following it is shown that the argument is most probably not valid. Compared to Western Europe and other developed regions, agriculture's shares in the total labour forces is high in ACEEC (up to 27 per cent in 1993). However, this per se does not mean a misallocation of labour. Labour is available at quite low wages while non-labour inputs are expensive. As international cross-sectional analyses suggest, the more highly developed a country is, taking its relative per capita income as an indicator, the smaller the share of agriculture is in total employment and the smaller is the contribution of agriculture to the gross domestic product. Taking the figures of per capita income in ACEEC and inserting them into equations obtained by international cross-sectional analyses it turns out that in recent years the share of agricultural labour in the total labour force of ACEEC fits well into the normal pattern and that here is only a small difference between the actual and the 'normal' structure of employment (Bode, Heitger, Schrader, 1992). From the expected changes of the relative market prices and the incentive structure the following rearrangements in the structure of agriculture could be expected:

- Farmers will tend to specialise more in labour-intensive lines of production and reduce the use of materials and energy.
- Managers of larger farms will reduce capital and energy input by reducing capital-intensive production lines.

In the transition to a market economy, the restructuring of agricultural production will depend to a large extent on the subsector-wise comparative cost relations in the food processing industries. Those food processing industries which are characterised by a high labour-capital ratio and by an intensive use of agricultural raw materials will have comparative

advantages compared to other subsectors in the food industry. In this context it should also be mentioned that large food processing plants which serve urban areas or export markets usually have more difficulties in replacing capital for labour.

One can assume that the factor intensities which were estimated for the German food processing industry (H. Dicke, 1977) in the early 1970s will not be much different in ACEEC in the 1990s. Thus, the following food processing industries are the ones that appear best suited to export food at least to low- and medium-income countries:

- slaughter-houses and meat processing,
- vegetable and fruit processing,
- starch production,
- oil-mills and margarine factories,
- dairy products,
- wheat-based food processing mills,
- sugar refineries,
- beverages.

The comparative advantage is presumably highest in meat (fresh, chilled, frozen, or preserved, or as sausages) and is lowest in beverages. This assessment results from a comparison between ACEEC and Western countries. ACEEC will have to compete, however, with other transforming countries in Central and East Europe. ACEEC export performance on Western markets depend largely on their competitiveness vis a vis its neighbouring countries in Central and East Europe.

### **3. Comparative Advantage of ACEEC vis à vis competing CEECs**

With regard to the different endowments with human and physical capital and arable land of the CEEC, it can be expected that the pattern of specialisation in foreign trade with agricultural goods and processed food,

will differ among countries. Russia, Belorussia and the Ukraine will probably be competitive in exporting unprocessed agricultural commodities and will tend to import processed foods (see table 3), while ACEEC will become competitive exporters of processed agricultural products and importers of high-protein feed, seed, breeding cattle and sophisticated processed food (see table 3).

#### **4. ACEEC Export Potential in Agriculture**

An increase of agricultural exports is welcomed because it contributes to the expansion of agricultural production and living standards in the rural areas of ACEEC. Agriculture is likely to play a pivotal role in the overall growth process since also its starting economic conditions in the transition process are more favourable than in the manufacturing sector:

- the abundance and quality of land as one of the most important factors of agricultural production is not altered by external and internal liberalisation,
- physical and human capital in agriculture is more useful for market production than in industry, because the gap between modern methods of production and marketing and the actual methods in CEEC is smaller in agriculture than in industry,
- the potential for improvements in material and energy intensity is higher in agriculture,
- farms and food processing enterprises generally require less time and investment to alter the structure of production,
- the private sector in agriculture is already significantly more developed.

China's reform experience can also serve as an example in support of the hypothesis that agriculture will be the growth locomotive in the ACEEC.

All in all, the transformation of ACEEC will most probably result in a positive supply shock which stimulates production in agriculture and the food industry. The rise of production, in turn, will lead to an activation of the farm trade balance.

Any assessment of the quantitative effects of the supply shock must necessarily be highly speculative. Neither are the magnitude of the exogenous variables and the coefficients of supply to relative price and incentive changes known nor are the income and price elasticity of demand known. In the first place the supply shock will result in less waste of output and less waste of agricultural and non-agricultural input. and in higher productivity in the second place.

The following model calculations are based on the three assumptions: (1) during the period 1990-2000 the total productivity of crop production will increase by 10 per cent, (2) the allocation of land to agriculture in terms of hectares will remain the same, (3) feed productivity in live-stock production will increase (among other things the conversion rate for grain in live-stock production is expected to be in the range of 4-5 tons of grain per 1 ton of meat in the year 2000).

To understand the results of the model calculations more readily land can be conceived of in terms of efficiency units. Thus land is defined here in terms of efficiency units as the mathematical product of land in terms of physical units (ha) multiplied by the change of land productivity ( $T = 1.10$ ) during the period 1990-2000. Because we assume no changes in the input of land in terms of physical units<sup>2</sup>, in the year 2000 the utilisation of land in terms of efficiency units will be 10 per cent higher than it was 10 years ago. Using this approach the following scenario arises:

ACEEC will have at their disposal up to 6,0 Mill. ha. additional arable land in terms of efficiency units: ACEEC will tend to reduce their imports of land intensive agricultural goods, mainly grain, and to expand

exports of agricultural goods in which they have a comparative cost advantage. In terms of grain the additional production would amount to 3,0 Mill. tons in ACEEC.

The changes in crop production in ACEEC would have a strong impact on foreign trade. Currently negative agricultural trade balances of the ACEEC could turn positive, and positive agricultural trade balances could improve further. Instead of importing millions of tons of grain, vegetable oil, and oil seed, the region could export millions of tons of grain or other land intensive products. The production surplus of ACEEC available for export could amount to approximately 5 Mill. tons of grain or an equivalent amount of grain substitutes, e.g. meat, eggs, oil seed, sugar beet.

Domestic demand responses to both lower per capita income and higher relative food prices will also affect trade balances. Due to higher relative food prices households will reduce their demand for relatively expensive meat, meat products (including sausages) and eggs in favour of relatively cheap vegetables (like potatoes), cereal-based products (bread, etc.) or fish. Consumption patterns in Western European market economies at an earlier stage in their development can be useful in predicting the changes in the demand structure in ACEEC. In 1967/68 the per capita consumption of meat in the EC amounted to 65 kg, 70 per cent of the 1990 level, while per capita income amounted to 56 per cent of the level in 1990. If, in an optimistic scenario, income levels in ACCEC reached the EC level of the mid-1960s by 2000, the per capita consumption of meat, assuming equal attitudes of consumers, would be 15 per cent below the level of the year 1990. This reduction in domestic meat consumption could alter meat trade balances or trade balances for grain due to saving the grain feed.

The reduction of meat consumption alone could bring about the following changes in the trade balance of ACEEC: The net imports of meat



could vanish, the export potential for grain could improve by 1 million tons, and meat exports could increase in the range of 0,3 million tons by 2000.

The consumption effect due to changing relative prices and income will add to the supply effect and further improve the agricultural trade balances of the ACEEC. The model calculations suggest that export earnings of ACEEC and savings by substituting imported agricultural goods for domestically produced goods – could increase. How strong the trade balance of ACEEC will improve depends on their competitive position vis a vis other CEEC and its access opportunities to foreign markets.

An increase of export earnings would strengthen the import capacity of ACEEC and of other Central and East European countries alike. The import demand for agricultural products, incorporating special know-how, for instance, breeding cattle and seed, or food with a Western image of high quality would rise, and even stronger imports of investment goods, in particular, land machinery, food processing machinery, distribution (storage, transportation, etc.) equipment and equipment for the ailing mining and manufacturing sector. As a matter of fact, a surge in exports of investment goods from the EC will contribute significantly to better income and employment opportunities in the EC's manufacturing sector.

## **5. Institutional Impediments of ACEEC**

### **1. The GATT 94**

The period 1995-2000 will be characterised by a liberalisation of international agricultural trade on the basis of the Uruguay Round Accord (GATT 94) set in force in 1994, the reform of the Common Agricultural Policy (CAP) of the EC, the ongoing transformation of Central and East European Countries to market economies, and the evolution of ACEEC's agricultural policies.

The GATT 1994 (Gupta, 1994) comprises an Agreement on Agriculture by which members declare

- to establish "... a basis for initiating a process of reform of trade in agriculture ...",
- "... to establish a fair and market-oriented agricultural trading system ..."
- "... to provide for substantial progressive reductions in agricultural support and protection sustained over an agreed period of time, resulting in correcting and preventing restrictions and distortions in world agricultural markets", and
- to achieve "... specific binding commitments in each of the following areas: market access; domestic support; export competition".

In Part XII, Article 20, the members recognise "... that the long-term objective of substantial progressive reductions in support and protection resulting in fundamental reform is an ongoing process ..." and agree "... that negotiations for continuing the process will be initiated ...". Major elements of the commitments of the EC are:

- measures of domestic support like, for instance, quantitative import restrictions, variable import levies, minimum import prices, discretionary import licensing, voluntary export restraints, and similar border measures, other than ordinary customs duties, are required to be converted into ordinary customs duties; direct payments under production-limiting programmes shall not be subject to the commitment to reduce domestic support<sup>3</sup> – and, thus, are not required to be converted into customs duties – if such payments are based on fixed area and yields, or such payments are made on 85 per cent or less of the base level of production, or livestock payments are made on a fixed number of head.

- customs duties – after conversion – shall be reduced by 36 percent up to the year 2000;
- budgetary outlays for export subsidies of different kind shall not be greater than 64 per cent of the 1986-1990 base period levels at the end of the implementation period of the GATT Accord (2000);
- export quantities benefiting from export subsidies shall not be greater than 79 per cent of the 1986-1990 base period levels at the end of the implementation period;
- member countries of the GATT are granted access opportunities to import market equal to a minimum share of 3 per cent of imports in domestic consumption; imports under minimum access commitments shall be allowed to rise up to 5 per cent of domestic consumption by the conclusion of the implementation period.

Although the Agreement on Agriculture of the GATT 94 incorporates some special safeguard provisions (Article 5) and allows for the protection of agricultural markets well above protection levels for industrial goods one cannot say but that the outcome of the Uruguay Round in the framework of GATT has substantially brought down barriers to trade in agricultural goods. Nevertheless, import barriers and subsidisation of exports in agricultural markets of the EC, US or Japan remain and result in depressed world market prices, distorted trade flows, and instabilities.

Under conditions of free trade, with prices determined by the marginal producer – and not by Finance Ministers of developed countries still providing subsidies for the export of surplus production of agricultural commodities – the world market prices for agricultural goods would be higher than the actual prices. Several studies (H. Dicke, J.B. Donges, K. Kirkpatrick, 1989) have shown that the introduction of a free trade regime in agriculture would result in higher prices, the projected increase being in the range of 10 to 40 percent, higher trade volume and greater stability. ACEEC

would have a grater chance to be among the intra-marginal suppliers of some agricultural goods and food and could become net-exporters of various crops, meat, eggs and dairy products. Agricultural imports could be confined to high-protein feed components, tropical products and a few highly processed speciality foods.

Trade between ACEEC, the EC and third countries is also subject to economic obstacles. In the OECD area, income elasticities of the demand of Western households for agricultural goods in general and for goods from ACEEC and other CEEC in particular can be considered low. Most Eastern export goods are imperfect substitutes to exports from traditional agricultural export countries like the US, Canada, Australia or New Zealand. Due to a scarcity of knowledge, skills or techniques to fulfil Western requirements in respect of the quality of goods or export marketing ACEEC exporters have to sell at cheaper prices. Apart from these economic factors, a rapid growth in the export of ACEEC is not likely to occur due to the protective trade measures of Western countries which GATT 94 still allows.

## **2. The Common Agricultural Policy (CAP)**

International agricultural trade will be distorted by border measures and product-specific domestic support as well as non-product-specific domestic support of the farm sector all of which have a depressing and destabilising effect on the world market and, thus, on ACEEC exports. In the EC, for instance, major agricultural products will remain subject to border measures which shield the farm sector against import competition. On the export side the EC's common agricultural policy will assist farmers in selling their products on international markets by granting them export subsidies which bridge the gap between internal market prices and prices that can be obtained on export markets. To be sure, the total amount of EC's

outlays for export subsidies is fixed by the GATT 94, but it nevertheless remains considerably.

It is hard to imagine that without further dismantling of agricultural policies of the EC and other trading partners private farmers and food processors in ACCEC or else where in Central and East Europe could take market shares away from suppliers in the EC or in North America either on foreign markets nor on their domestic markets (in the case of no import protection). In fact, studies of Polish agriculture, for instance, revealed that Polish suppliers of agricultural goods would not be able to compete on world markets given actual world market prices (A. Kwiecinski, 1994). Poland and other ACEEC have begun to introduce a policy regime similar the EC's. Border measures help to decouple domestic prices from the prices on international markets. These border measures comprise custom duties for most products, even variable levies and export subsidies. The tariff rates of Poland, for instance, range between 18 and 35 percent and are above tariff rates for manufactured goods (Dicke, Misala 1993). Without protection against subsidised exports from the EC or other countries private farmers and food processing enterprises would hardly be able to thrive in Poland. Existing state farms, co-operatives and small farms would go bankrupt and agricultural workers who became unemployed would leave rural areas in search of better income opportunities in urban areas, including urban areas in the EC. ACEEC have introduced border measure in order to put a brake on surging imports from EC sources and they also started to support exports of agricultural goods by subsidies on few occasions. Nevertheless, agricultural support in ACEEC as measured by producer subsidy equivalents is far lower than in the EC and will remain lower for one simple reason: ACEEC' agricultural sectors are too large and overall productivity and income too low to be capable to support agriculture in the same way as the EC.



If ACEEC could accede to the EC and could charge EC prices for their products, their agricultural sector would be highly competitive vis à vis EC producers, which may have some policy-makers in Central and Eastern Europe in mind when they demand access to the EC and why some West European politicians are reluctant to give into these demands. Given the current excess production capacity in the EC, additional supply from new entrants into the EC would result in an increase of the production overhang of the EC. Since the commitments made in the GATT 94 limit the opportunity to expand exports or to reduce imports the EC has to embark on production-limiting programmes. Those programmes could comprise the reduction of support prices, input subsidies or production quotas. Each programme would result in losses of the incomes of farmers in the EC. It is quite probable that the EC will be inclined to avoid these income losses by introducing a scheme of compensatory direct payments. This in turn would harm the EC taxpayers via higher outlays of the EC's budget. These possible effects of an enlargement of the EC by Poland and other CEEC may explain why the EC demanded to exempt the sensitive products from the free trade regime in the framework of the Europe Agreements and why EC member states did not yet embark on an accession strategy for Poland but on a pre-accession strategy only as the Essen summit in 1994 approved once more.

## **6. The Need for Adjustment in the EC**

### **1. Overall Implications for the EC**

An enlargement of the EC by Poland and other ACEEC will have effects on consumers, producers and state budgets of the member states of the EC and of the acceding states. These effects will differ from the association's effects. While the effects of the association are fore-most welfare gains due to the establishment of a free trade zone the enlargement

has above all budgetary consequences and distributive effects and – *ceteris paribus* – welfare losses in the new member countries. The enlargement would affect:

- the structural and social funds of the EC,
- the European Agricultural Guidance and Guarantee Fund (EAGGF); changes of the surplus of agricultural production and the extending of support programmes to the new EC member states would create additional needs for funds, and
- consumer and producer rents mostly in the acceding countries due to the adoption of regulated agricultural prices.

With regard to agriculture, the economic and financial effects of the enlargement will mainly depend on the feature of the common agricultural policy (CAP) in the year 2000. The economic status of agriculture as well as the agriculture policy in the countries joining the EC bulk large too. Neither the competitiveness of ACEEC' agriculture and the feature of the ACEEC economic and agricultural policies nor the conditions of the EC' agriculture remain unchanged over the next four years. Yet, what change exactly will happen can hardly be foreseen. Changes of the CAP took place during the last years and it is most probably that further changes will occur in the late 1990s. It may well be that those changes reflect the perceived need for policies to adjust to the challenges of an East enlargement.

There are several studies available which focus on these effects of an East enlargement of the EC. They differ with respect to the numbers but not to the qualification of the enlargement effect. In general the available studies arrive at the conclusion that expenditures of the structural funds, the cohesion funds and the EAGGF would increase significantly while the contribution of the new member states to the EC's budget would be rather small. The eastern widening of the CAP to the Visegrad countries (Polen, Hungary, Czech Republic, Slovakia) would increase agricultural budget

expenditures of the EU in the range of 18.4 Mrd. ECU (R. Baldwin, 1992) and 37.6 Mrd. ECU (H. Dicke, 1995); an integration of all six ACEEC would lead to additional agricultural budget cost of 37.6 Mrd. ECU (Baldwin 1995). Thus, the old members of the EC would have to contribute more to the financing of the EC budget unless they reform the CAP more thoroughly than they did in order to abide by the obligations of the GATT 94.

### 7. Tables

*Table 1 - Population, resource Endowment, Per-Capita Income of ACEEC (1994)*

Country	Population Mill.	Agricultural Land (1000 qkm)	Per Capita Income 1993 US-Dollar	Agricultural Land per Capita ha
Bulgaria	9,000.000	6,100.000	1160	0,678
Czech Republic	10,000.000	42,84 (1993)	2730	0,428
Slovakia	6,000.000	24,46 (1993)	1900	0,408
Hungary	11,000.000	65	3330	0,591
Poland	39,000.000	189	2270	0,485
Romania	24,000.000	150	1120	0,625
Total	99,000.000	533	1971	0,538
European Union	369,752 (1993)	1467,07	18200	0,397

Source: Central Statistical Office of Germany, Statistical Yearbook for the Foreign Countries 1995; Statistical Yearbook of the Slovak Republic, 1994; Own calculations.

Table 2: Relative Labour Productivity of Agriculture in Selected Countries, 1987

Country	Relative labour Productivity $I^a$	Relative labour Productivity $I_i^b$
Bulgaria	1.03	1.24
CSFR	1.28	1.68
Hungary	1.32	1.28
Poland	0.90	1.10
Romania	1.04	1.32
Yugoslavia	0.65	n.a.
Central and Eastern Europe	0.94	n.a.
United States	0.67	-
West Germany	0.44	-
<p><sup>a</sup> Agricultural labour productivity (GDP/employee) divided by the economy's labour productivity: GDP (GDP/employee) at realised prices.</p> <p><sup>b</sup> Agricultural labour productivity relating to manufacturing's productivity; GDP at factor cost.</p>		

Source: US Congress, 1989; Alton, 1988; own calculations.

*Table 3: Patterns of Specialisation in Foreign Trade of Agricultural Products and Foods in Eastern Europe by the Year 2000*

Country Region	Rank regarding abundance of capital	Rank regarding abundance of land	Exportable (highly competitive domestic production)	Importables (highly competitive foreign supply)
Russia	1	1	cereals, cattle, wool	meat, fresh, processed; fruit and vegetables; processed fruit and vegetables; wheat-based foods; dairy products; vegetable oil
Belorussia	3	2	cereals; cattle; starch;	as above
Ukraine	2	3	cereals; cattle; cotton; vegetable oil; processed fruit and vegetables;	selected dairy products; seed; breeding cattle;



Bulgaria	8	4	meat, fresh and prep. <sup>a</sup> ; eggs dried; cheese;	high protein feed; seed; breeding cattle; processed foods;
Romania	9	5	meat, fresh and prep.;	as above
Hungary	5	6	meat, fresh and prep.;; eggs dried, processed and unprocessed fruit and vegetables;	as above
Yugoslavia	6	7	meat, fresh and prep.;; eggs dried;	as above
Poland	7	8	meat, fresh and prep.;; starch;	as above
CSFR	4	9	meat, fresh and prep.;; eggs dried;	as above
<sup>a</sup> Including sausages				

Source: Own inquiry.

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- <sup>1</sup> This bank is more useful than the FAO data in this context, because it presents exports, imports, production, stocks, etc., in a more consistent form and for more items. A comparison between the USDA data bank and the FAO reveals differences. At the moment, there is no reasonable criterion for determining which data bank is more reliable.
- <sup>2</sup> Experts predict a decline of the amount of land used for agriculture from 18.7 million hectares to 16.9 – 18.2 million by the year 2000 because a deterioration of the input/output price ratio in agriculture (Kwiecinski, 1994).
- <sup>3</sup> Article 6, paragraphs 3,4,5 of the Agreement on Agriculture.