DISCUSSION PAPER

Institute of Agricultural Development in Central and Eastern Europe

PROMOTING CEA AGRICULTURAL EXPORTS THROUGH ASSOCIATION AGREEMENTS WITH THE EU - WHY IT IS NOT WORKING -[1]

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ABSTRACT

This paper analyzes why the Association Agreements between the Central and Eastern European countries, referred to as Central European Associates (CEAs), and the European Union (EU) have failed with respect to agriculture. In the first part of the paper the development and importance of agricultural trade in the CEAs is described. It is shown that the EU is the most important trading partner in agricultural and food products for the CEAs. However, in recent years the trade balance for agricultural and food products between these countries and the EU has changed in favor of the latter; this is contrary to the aim of these agreements.

Important external and internal factors determining trade relations between the EU and the CEAs are identified and discussed in the second half of the paper. These include the development of the real exchange rates, restrictions in the levels of domestic production, inadequate food quality compared to EU products, and insufficient sanitary standards in and a lack of competitiveness of the processing industry. These factors offset agricultural and food policies which have been aimed at protecting and supporting agriculture and the food processing industry in all CEAs but Bulgaria and Romania. In the last two countries, agricultural and food policies have primarily protected consumers at the expense of these two sectors.

ZUSAMMENFASSUNG

Die Assoziierungsabkommen zwischen den Mittel- und Osteuropäischen Ländern (MOEL) und der Europäischen Union haben im landwirtschaftlichen Bereich nicht den erhofften Erfolg gebracht. Der vorliegend Beitrag untersucht die Gründe für dieses partielle Scheitern. Im ersten Teil des Papiers wird die Entwicklung und Bedeutung des Agrarhandels der MOEL beschrieben. Dabei zeigt sich, daß die EU für die meisten MOEL im Agrarbereich der wichtigste Handelspartner ist. Die Handelsbilanz für Agrar- und Ernährungsgüter zwischen den MOEL und der EU hat sich in den letzten Jahren jedoch zu Gunsten der Europäischen Union verändert; eine Entwicklung, die dem Ziel der Assoziierungsabkommen widerspricht.

Wichtige externe und interne Faktoren, die die Handelsbeziehungen zwischen der EU und den Assoziierungsländern bestimmen, werden im zweiten Teil des Beitrags aufgezeigt und diskutiert. Hierzu gehören die Veränderung der Realen Wechselkurse, Begrenzungen in der inländischen Agrarproduktion, unzureichende Nahrungsmittelqualität im Vergleich zu den in der EU erzeugten Produkten, unzureichende sanitäre und phytosanitäre Standards und mangelnde Wettbewerbsfähigkeit in der Verarbeitungsindustrie. Diese Faktoren können auch nicht durch die Agrarpolitik dieser Länder kompensiert werden, die mit Ausnahme von Bulgarien und Rumänien in allen Assoziierungsländern auf einen Schutz des landwirtschaftlichen Sektors ausgerichtet ist.

CONTENTS

LIST OF TABLES

LIST OF ABBREVIATIONS

CEAs	Central European Associates
CMA	Centrale Marketing-Gesellschaft der Deutschen Agrarwirtschaft mbH
CPI	Consumer Price Indices
DM	German Mark
EFTA	European Free Trade Association
EU	European Union
FSU	Former Soviet Union
GATT	General Agreement on Tariffs and Trade
NIS	Newly Independent States
PPP	Purchasing Power Parity

1 INTRODUCTION

Between December 1991 and July 1995, Association Agreements commonly referred to as the Europe Agreements were signed between the European Union and ten Central and Eastern European Countries, referred to as Central European Associates (CEAs), namely Poland, the Czech Republic, the Slovak Republic, Hungary, Bulgaria, Romania, Estonia, Latvia, Lithuania and Slovenia (TRACY 1994, p. 1; AGRA EUROPE 1995, p. 31). The main purpose of these agreements has been to strengthen the new democracies by promoting closer economic and cultural co-operation between the European Union (EU) and the CEAs. The establishment of free trade areas was central to this process. As with other trade agreements concluded by the EU, full liberalization of agricultural trade was considered impossible, since there would have been strong opposition from EU farmers fearing that Western Europe would be flooded with cheap foodstuff from the CEAs if the EU market opened. The EU has thus limited preferential access to its agricultural markets, mainly to a series of tariff quotas that stretch over a period of some years, with quotas being raised and tariffs reduced progressively over the course of the agreement[3]. Following the general principle of asymmetry in favor of the CEAs, tariff concessions granted for EU exports to the CEAs are less far-reaching.

Up to now, the Europe Agreements have not fulfilled the CEAs' expectations. Throughout 1993, 1994 and 1995, all CEAs fully utilized their EU preference quotas for only a few products. While the EU's agricultural exports to these countries rose substantially in the period 1992 to 1996, the CEAs' exports to the EU only increased slightly, making most of those countries net importers of agri-food products from the EU. Thus it is not surprising that politicians and farmers in the CEAs claim that in reality the EU is the sole beneficiary of the Europe Agreements (AGRA EUROPE 1995, No. 150, p. 2; AGRA EUROPE 1995, No. 153, p. 17). In their view, it is the EU countries with their agricultural and food products who threaten the CEAs' farm sectors rather than the other way around.

What are the main factors to have caused a reversal in agricultural trade positions between the EU and most CEAs, preventing the CEAs from fulfilling the preference quotas? Is this rather poor result primarily due to the agreement, or are there other reasons for this development? These are some of the questions the paper attempts to answer. Accordingly, section 2 discusses the development of the CEAs' agricultural trade performance. In section 3 possible internal reasons for the failure of the Europe Agreements are discussed, while section 4 focuses on the analysis of externally induced deficiencies hampering their success. In the final section recommendations are given on how preferences granted could be better utilized, and how to generally improve the export and import conditions of the CEAs.

2 AGRICULTURAL TRADE PERFORMANCE OF THE CEAS

The development of trade in agricultural and food products in the CEAs shows a very diverse picture. From 1989[4] to 1996 exports increased considerably in the Baltic and the Visegrad countries, while Bulgaria and Slovenia experienced a fall in their agricultural export values

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3 For some commodities the EU has also granted the CEAs preferences, all without quantitative restrictions, some of them also without tariffs, others with ad-hoc reduced tariffs. However, imports of sensitive products to the EU are generally restricted by quotas (see also OVERBERG 1996, p. 18-26).

4 For Slovenia and the Baltic States, trade figures have only been recorded since 1992.

(see Table 1[5]). Imports, on the other hand, increased for all CEAs except Bulgaria and Romania in the period considered. The expansion of trade in the Czech and Slovak Republics from 1989 to 1996 is partly due to the fact that pre-1992 figures did not record trade between these two countries. The rather strong changes in this period therefore have to be interpreted with care.

Most countries started out as net exporters of agricultural and food products in 1989. This also holds for the Baltics, although the earliest figures available for them date from 1992. However, since imports increased far more than exports, all CEAs but Bulgaria and Hungary became net importers in 1996. As a group the CEAs turned from being a net exporting region in 1992 to becoming a net importer in 1996 (see Table 1).

Agriculture is important for the overall economy in the CEAs. An indicator for this is the share of agriculture and the food industry in total exports and total imports in the CEAs. Table 2 reveals that this share in total exports declined slightly from 12 % in 1993 to 11 % in 1996, revealing a decrease of 6 % over the considered period. Imports follow a similar pattern. However, the share of agricultural imports in total imports is lower, while the decrease is slightly higher.[6] With 21 to 22 %, Hungary has the highest export share and, at the same time, the lowest import share (6 to 8 %). A similar pattern can be observed for Bulgaria. In Estonia, agriculture also accounts for a relatively large proportion of total exports (16 to 25 %), but in contrast to Hungary and Bulgaria, it has an equally large share of agriculture in total imports (14 to 16 %). In the Czech and the Slovak Republics agriculture is of minor importance for total trade, both on the export and the import sides.

In most CEAs, the regional structure of trade in agri-food products followed a similar pattern from 1989 to 1996. With the end of the socialist era, traditional export markets in the east were lost. This was followed by a significant orientation of trade towards the West European market. In 1996 the EU was the most important agricultural trade partner for nearly all CEAs (see Table 3), accounting for 55 % of the CEAs' agri-food imports and for 38 % of their exports. This clearly shows the importance of the EU for the CEAs' agricultural trade. Especially the CEAs' agricultural imports primarily come from EU countries. However, while imports from other CEAs and the Newly Independent States (NIS) are of minor importance for most CEAs, they are quite important trade partners in terms of export. This holds especially for the three Baltic countries and Bulgaria, and thus for the countries that were either part of the Soviet Union or, in the case of Bulgaria, had strong trade relations with the NIS already prior to transition.

It is interesting to note that in some countries a reorientation towards the market of the Former Soviet Union (FSU) is taking place. Poland, for example, almost doubled its share of exports to the NIS in the last three years, while its share of exports to the EU is declining (see Table 3). There are two major reasons for this. Firstly, western markets are highly protected, making it almost impossible to expand into these markets. Secondly, there are still large differences between East and West European countries in terms of product quality and sanitary standards for agricultural products (see also section 3.3). It is therefore much easier for Poland to export to markets in the east where such trade impediments do not exist. These reasons probably also explain the generally strong deviation between the export and import flows of the CEAs' agricultural and food trade (EUROPEAN COMMISSION 1997, p. 79).

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5 All tables are listed in the appendix.

6 In 1994 this share amounted to 9 % on the import and export sides in the group of OECD countries and is thus smaller compared to the CEAs, especially on the export side (OECD 1996b, p. 13).

Although the share of exports to the EU in total agricultural and food exports slightly declined in the region (see Table 3), EU purchases of agricultural and food products from these countries increased in absolute value over the years 1992 to 1996[7] (see Table 4). However, imports from the EU rose on average far more over the same period. Since 1992, the trade balance for agricultural and food products between the CEAs and the EU has become increasingly negative for all CEAs but Bulgaria and Hungary (see Table 4). This is especially remarkable since the Interim Agreements between the EU and Hungary, Poland and Czechoslovakia came into force during 1992, and those with Romania and Bulgaria in 1993, providing these countries with preferred access to the European market. At first glance, one could conclude that, instead of promoting agricultural exports from the CEAs to the EU, the agreement might have had the opposite effect. However, in addition to structural flaws in the Association Agreements, other external and internal factors might have led to the poor export performance of the CEAs in recent years. These will be discussed in more detail in the following sections.

3 Failure of the Europe Agreements due to Internal Factors

3.1 Exchange Rate Policy

Agriculture is influenced by many macroeconomic variables. This holds especially with respect to the exchange rate. Due to its development over the last 7 years, the value of most CEAs' currencies has had a strong impact on agricultural trade in these countries. Tables 5 and 6 reveal that all countries but Estonia and Latvia have devalued their currencies compared to the German Mark (DM) considerably since the beginning of the transformation process.[8] This devaluation has been especially substantial in Romania, Bulgaria and Slovenia. Devaluation raises domestic prices, thereby leading to an implicit protection of trade-related sectors such as agriculture. Thus at first glance it seems that the development of the exchange rate should have encouraged net exports in agricultural and food products instead of hampering them.

This view, however, neglects some important aspects. The nominal exchange rate is merely an undeflated conversion factor between the domestic currency and a foreign currency. It can therefore not measure a country’s competitiveness in international trade, since quantities demanded and supplied depend on relative rather than on absolute prices. Changes in the exchange rate only affect the price of tradables. Nominal exchange rates must therefore be corrected, taking into account inflation, to determine their possible impact on relative prices and the volume of trade. One way to account for inflation is to construct a real exchange rate based on purchasing power parity (PPP). This PPP rate is the nominal exchange rate adjusted by the ratio of foreign to domestic prices. Thus the PPP real exchange rate can be expressed as:

$$e^R = e^N \cdot \frac{p^F}{p^D}$$

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7 There was a change in trade statistics in 1993. Since then, trade figures have included the exchange of goods with the Slovak Republic which had not been recorded separately for earlier years. This partly explains the decline in exports from the Czech and the Slovak Republics to the EU in 1993.

8 Estonia has fixed its exchange rate to the German Mark since independence.

where e^R is the real exchange rate, e^N is the nominal exchange rate expressed in units of domestic currency per one unit of foreign currency, and p^F and p^D are the appropriate foreign and domestic price deflators. In this paper, the consumer price indices (CPI) of the respective CEAs and Germany are used as price deflators (see Table 7). For the purpose at hand, other inflation measures such as the implicit GDP price deflator would usually be preferred. However, these statistics are not available for all countries considered in the analysis.

In Table 8, the development of the real exchange rate is summarized. The results reveal that nominal devaluation in the CEAs was not sufficient to fully compensate for the differential developments in the inflation rates between the respective CEA and Germany, thus leading to real appreciation in all countries during the period 1990 to 1996.[9] This was a steady process in the Czech and Slovak Republics, and also, although to a lesser extent, in Estonia and Lithuania, while in Poland considerable real appreciation took place only in 1990. Since then the real exchange rate has been kept constant. In Bulgaria, Slovenia, Romania and Hungary the direction of change in the real exchange rate has varied over time. In Hungary, for example, real appreciation took place in the period 1990 to 1993. However, in 1993 and 1994, trade and budget deficits rose to unsustainable levels (see OECD 1996a). To reduce this twin deficit, considerable nominal devaluation of the Hungarian Forinth was introduced. This was able to more than offset the inflation differences between Hungary and Germany, thus inducing a real depreciation of the Forinth versus the German Mark in 1994.

A decline in the real exchange rate indicates an implicit appreciation of the currency relative to the DM in the country considered. The implicit appreciation of the CEAs' currencies in the years of transition has made it more difficult for all CEAs' export industries to compete on the world market. This might be a first explanation for the deterioration of the trade balance in most CEAs since 1990.

3.2 Restrictions in the Quantity of Domestic Production

One group of factors preventing Hungary, Poland, the Czech Republic, the Slovak Republic, Bulgaria and Romania from fulfilling the quotas in previous years are restrictions on the production levels of the countries considered. Serious drought conditions in some of the countries in 1992 and 1993, and substantially reduced production of almost all animal products, especially meat products, in all CEAs since the beginning of the transition period have been detrimental to agricultural trade performance and preference quota utilization in these countries. The latter was further hampered by a shift away from products for which the CEAs had been awarded preference quotas, such as buckwheat in the case of Poland.

3.3 Lack of Quality and Insufficient Sanitary Standards

One of the main reasons for the pronounced deviation in the development between import and export flows in agri-food products between the EU and the CEAs are differences in product quality and sanitary standards between these groups of countries. Generally speaking, the quality, especially of processed goods, is not always satisfactory in the CEAs, which makes it difficult to export these products to the highly sophisticated and demanding consumer markets of Western Europe.

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9 For Bulgaria 1991 to 1996, for Estonia and Lithuania 1993 to 1996, and for Latvia 1992 to 1996.

In most CEAs quality assessments according to the classification system EUROP have not yet been introduced. In the Czech Republic for example, only four meat processing plants have been equipped with technology meeting the requirements of this classification. The picture is even more problematic for other CEAs such as the Baltics, where at present no single slaughterhouse fulfills EU standards (e. g. EUROPEAN COMMISSION 1995a, p. 18-26), making exports to the EU impossible. In Bulgaria no slaughterhouse for cattle or poultry has been approved by the EU commission, which makes beef and chicken exports to the EU impossible. Although some slaughterhouses for pigs do meet EU requirements, exports of pigs and pork to the EU amount to zero. This is not due to a lack of competitiveness, but to the fact that Bulgaria is situated in a high-risk region where the vaccination of pigs against pig fever is mandatory. Imports of meat from vaccinated animals are, however, banned under EU veterinary legislation. Thus the preferences granted to Bulgaria for beef and veal, as well as for pigs and pork are of no relevance to the country at present (KOLAROVA et al. 1994, p. 17 and p. 21).

Although the Baltic countries have been given preference quotas for butter, skimmed milk powder and meat products since the beginning of 1995, the Commission expects inadequate hygiene standards to provide a significant barrier for the Baltics' export of these products to the EU for a considerable time (AGRA EUROPE 1995, p. 16; EUROPEAN COMMISSION 1995b, p. 33-34). Especially the lack of cooling equipment on farms leads to a deterioration of the quality of milk.

This reveals that higher standards in EU and EFTA countries often impose considerable restrictions on CEA exports to Western Europe. In extreme cases, this can even lead to an import ban against countries with lower sanitary standards, as mentioned above. This happened during 1993 and 1994, when the EU banned all imports of pork originating from Central and East European countries, because of pig fever. These standards, as well as the unsatisfactory quality especially of meat and dairy products manufactured in the CEAs, partly explain why preferential import quotas granted by the EU in the Europe Agreements were hardly used during the last years.

On the other hand, Central European consumers generally do have two reasons for buying imported food products. First, because the product they want to buy is not available domestically (e. g. exotic fruits) or second, because they desire food items with a higher level of quality, packaging or presentation than are available from domestic producers. It is especially for the latter reason that imports of Western European products to the Central European region have soared, while purchases from neighboring countries have more or less stagnated. (AGRA EUROPE 1995, p. 1). However, as in the new *Länder*, this development is expected to slow down due to an increasing market orientation of domestic firms on the one hand, and a reorientation of consumers in the CEAs towards domestic products on the other hand. The latter can be explained by a new national consciousness, the former is partly encouraged by an inflow of foreign capital that has accelerated industrial restructuring and favors the implementation of new technologies, new management and new organizational techniques.

3.4 Inefficient Food Industry

In the CEAs the food industry of the pre-1990 era consisted of state-owned, highly concentrated and strongly regulated enterprises. All agricultural products were supplied directly by farms to processing or trading companies. Competition between different enterprises in the food industry existed neither on the supply nor on the demand side, since all companies were assigned specific regions where they would purchase raw materials from and sell their products. Food marketing chains were vertically co-ordinated by state planners and prices at all levels were fixed by the government. This ensured total state control of all activities related to the food industry. The marketing infrastructure was generally poorly developed in most CEAs during socialist times. The distribution of processed products was managed by state-owned companies that were supplemented by consumer co-operatives on the wholesale as well as on the retail level (see e. g. OECD 1996c, p. 64).

In the privatization process, most food processing companies in the CEAs were transformed into state-owned joint stock companies and then privatized, mostly through voucher privatization. Smaller companies were either returned to their original owners through restitution or sold during small-scale privatization. Since the beginning of the transition process, the number of food-processing enterprises has thus risen substantially in all CEAs. Since the processing volume has declined rather than increased as is discussed below, the average scale of operation and capacity utilization has decreased considerably.

At the same time, food consumption has fallen during the transformation process, leading to a decrease in food industry output measured in gross revenue. The decline of the latter was, however, more pronounced than the fall in food consumption, since part of the preparation and processing of food was reoriented to the household level. The sharp drop in food industry output was especially pronounced in the meat and dairy industries, reflecting an increasing problem with overcapacity, particularly in these sectors. A decline in the rate of utilization leads to an increase in unit costs.

Other factors impairing the economic performance of the food industry in many of the CEAs in the transition process are higher prices for energy and other inputs[10], huge debts, an outdated and inefficient capital stock, and little change in the management or decision-making structures compared to pre-transformation times (HARTMANN und WANDEL 1997). In addition, labor costs in most countries have increased far more than productivity. In the Slovak Republic, for instance, labor productivity in 1994 went up by 5 % compared to 1993, whereas wages increased by 16 %. This led to a total increase in labor costs of 7 % in the Slovak food industry (AGRARINFORMATIONSDIENST OSTEUROPA 03/1995, p. 15). Consequently, profitability of the food industry has declined in many countries, making it difficult to keep up or even increase investments. These are also the main reasons for lack of quality in processed food, and thus the main impediments for export to the EU. In addition, grading, sorting and packing equipment are often also missing, yet they are necessary to comply with EU standards.

3.5 Agricultural Policies

Agricultural and food policies differ somewhat between the various CEAs. It goes beyond the scope of this paper to provide a detailed account of the policies each individual country has pursued. Nevertheless, one can state that all CEAs but Bulgaria and Romania have implemented measures aimed at stabilizing domestic markets, reducing imports and enhancing exports.

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[10] At this point it should, however, be noted that retail prices of food, which can be used as a proxy for output prices of the food industry, rose much faster than the prices companies in this industry have to pay for agricultural raw materials. This apparent advantage of the food industry was obviously overcompensated by other impediments discussed in the text.

The types of policy instruments used in the CEAs include especially minimum prices and import tariffs, but also export subsidies. In situations where domestic supply was severely interrupted, some of these countries also used export quotas to ensure sufficient supplies for domestic consumers. Protection was generally reduced immediately after the collapse of the communist system. However, an increase in import protection has taken place in most CEAs since 1992. Together with the export subsidies granted, this should have caused the trade balance for agricultural and food products between these countries and the EU to develop positively. However, as indicated above, the reverse happened (EUROPEAN COMMISSION 1997; OECD 1996a).[11] One point to be mentioned , however, is that both the kind of trade policy and its stability matter. Especially in Bulgaria, but also in other CEAs, trade measures that had been approved and implemented were changed several times in the course of one year (EUROPEAN COMMISSION 1997, p. 117). This has certainly had considerable negative effects for farmers.

While agricultural policies in most CEAs were primarily aimed at protecting producers, Bulgaria and Romania pursued policies that focused on protecting the consumer. In these two countries agricultural exports have been prevented by taxes, quotas or even bans, while in some cases agricultural imports have been facilitated by waiving import duties (EUROPEAN COMMISSION 1995a and 1995c). Thus the negative agricultural trade balance for these countries, and the underutilization of the quotas granted by the EU, have been partly induced by discriminating against agriculture with trade policies. An example might illustrate this point. In 1994, zero utilization of Bulgaria's preferential quota for common wheat and millet could be observed. This was due to the fact that the Bulgarian government had banned all exports of these products to prevent food shortages for domestic consumers.

4 FAILURE OF THE EUROPE AGREEMENTS DUE TO EXTERNAL FACTORS

4.1 EU Agricultural Policy Reform, the Uruguay Agreement and EU North Enlargement

Both the EU Agricultural Policy Reform of May 1992 and the agreement reached in the Uruguay Round have led and will continue to lead to a reduction in agricultural protection in the EU. This induces increased market access of all third countries to the EU, thus reducing the relative advantage enjoyed by the CEAs under their bilateral arrangements with the EU. (AGRA EUROPE 1995, p. 5). Smaller preference margins and therefore lower benefits have been the results of this development. The objective of the CEAs has been to maintain the advantages originally granted in the Europe Agreements. The CEAs also intend to ensure that they will be not negatively affected by the EU North Enlargement , the accession of Austria, Finland and Sweden to the EU. The integration of the preferential terms agreed by the CEAs and the three former EFTA countries into the Europe Agreements is of vital importance for the profitability of exports for some CEAs countries. This holds especially for Hungary (AGRA EUROPE 1995, p. 22).

An arrangement has been reached between the CEAs and the EU on this issue. They will revise their bilateral agricultural trade agreements to take into account the EU agricultural

[11] The Czech Republic is an exception in this respect. Agricultural protection has declined gradually since the beginning of the transition process.

policy reform, the North Enlargement and the impact of the GATT Uruguay Round agreement. It has, for instance, been decided to reduce import tariffs and customs duties on agricultural imports by 80 %. The maximum tariff reduction had originally been set to 60 %. In addition, import quotas are to be increased by 5 % annually over the next five years (OECD 1996a, p. 13).

4.2 Design and Content of the Association Agreements

The underutilization of the preference quota can be partly explained with the specific design of the Association Agreement. Imports under preferences are hampered by several administrative conditions. Licenses for importing commodities with preference quotas are distributed by the European Commission to Member States on an equal-share basis. The annual quota is also spread evenly over all four quarters of the year. In addition, the preferred country cannot compensate for unfulfilled quotas expected in a later quarter by exporting more in an earlier quarter of the same year. This essentially means that preference quotas are not entirely annual quotas, but rather resemble quarterly ones. Hence, the EU will not suddenly be facing a sudden large volume of cheap imports from CEAs. The fact that preferential quotas were based on pre-reform export flows, which took place under quite different economic conditions, as well as the very detailed product specification of the granted quotas prove to be further impediments to utililizing the preferential allowance.

However, additional reasons can be forwarded why the CEAs have not fulfilled the preference quota, among them the high likelihood that the preference value does not accrue to traders and producers in the CEAs. It is very difficult to show whether this is the case, since the Commission neither surveys nor checks import prices, and customs officers are only responsible for collecting the correct import tariffs.

In general, distribution of the quota rent between the EU (importer) and the respective CEA (exporter) very much depends on the

- structure of the preferential agreement;
- access to information about the utilization of the quota;
- market power in the exporting and importing country.

The way the Commission issues the import licenses for the preferential quotas, the lack of transparency concerning the utilization of quotas, and the distribution of market power all make it very likely that the preference value will indeed remain with the importing agent. These three aspects will be discussed below.

As for the issuing of licenses, the Commission delegates this task to the Member States as already mentioned above. Thus only importers can apply for a license. The procedure adopted requires the importer interested in obtaining a license to pay a certain deposit, in order to show his or her sincere interest in importing from the CEAs. The license handed out is valid for a specific period, depending on the product concerned. If nothing is imported during this time, the deposit is lost for the importer. This shows that importing using preferential arrangements can be a rather risky undertaking. The risk was especially pronounced in the first years of the agreement, since business relations between firms in the EU and the CEAs still had to be established. There was also little knowledge on the side of EU traders about the supply capabilities in the CEAs, or about the dependability of export firms in these countries

(OVERBERG 1996, p. 134). In any case, the cost of importing goods under the preferential agreement seems to be far from negligible if one considers the risks discussed above, the time lag between making the deposit and having the imports arrive, and the considerable bureaucratic costs of applying for a license.

These aspects certainly reduce the overall benefit of the preferences granted and might also be responsible for the underutilization of the quotas. However, by themselves they would not necessarily result in the rent accruing to the importing agent. If there was transparency about the utilization of quotas, and market power existed neither on the supply nor on the demand side of the trading chain, exporters could negotiate for a price that would secure them at least part of the quota rent. Thus the distribution of information from the EU to the exporters and importers is an important issue in determining who is able to capture the preferences.

This is in fact a crucial problem. Statistical data on quota utilization are not issued by the EU. This shortage of information on the side of the exporters considerably weakens their negotiating position in comparison with their counterparts on the import side. The exporters do not know whether the negotiated trade will be carried out under preferential conditions or not, since they have no information as to whether the importer was successful in obtaining a license for the preferential trade. This lack of transparency, combined with the fact that licenses are issued to importers, leads to asymmetric information among importers and exporters and makes it very likely that the quota rent accrues to the importer.

This problem could be reduced if a private or state trading monopoly existed in the CEAs, an option, however, which would certainly have considerable negative side effects and therefore cannot be recommended. Alternatively, an up-to-date, detailed trade information system in the respective Central and Eastern European Countries would partly compensate for the lack of information from the EU. However, these conditions do not apply for most CEAs.

5 SUMMARY AND RECOMMENDATIONS

Preferential export quotas granted to the CEAs under the Europe Agreements have not been fully utilized. In many cases underutilization of the total quota has reached 50 %, and in much of the trade the quotas have not actually been used. At the same time the CEAs' export performance in the agri-food sector has been rather disappointing, especially in the area of exports to the EU. This paper has proposed a range of possible reasons for this development. In this section more general actions to improve the functioning of the Association Agreements and the export performance of the CEAs are suggested.

Reconsidering Exchange Rate Policies

It was pointed out above that for all CEAs an appreciation of their real exchange rates versus the German Mark has taken place since the early 90s. Since this effect could hardly be compensated for by cost-cutting measures, export industries in these countries have found it increasingly difficult to compete on foreign markets.

Improving Food Quality

To compete on EU markets, imports from the CEAs must be of a similar quality and meet the same standards as those produced in the EU. It is therefore of great importance to ensure that CEA exports are of comparable quality. A number of steps need to be considered in this respect, including setting up organizations which control and issue certificates on product quality, and others that carry out and oversee grading and classifying. In addition, sanitary and phytosanitary regulations need to be implemented or tightened. Most of these organizations and regulations are in place, but may not be sufficiently aligned with EU standards or with GATT sanitary and phytosanitary regulations.

Making the Food Industry More Competitive

The discussion in section 3.4 has shown that the food industry in many CEAs is facing serious structural problems. To regain competitiveness in this industry, the following challenges have to be met (OECD 1995):

- reduction of overcapacities in a way that future processing capacities are adapted to lower demand levels;
- increase in labor productivity to at least keep pace with rising labor costs;
- improvement of the co-ordination of purchasing, processing and selling operations, to ensure the supply of raw materials for processing facilities, but also to guarantee the sale of the processed products;
- improvement of the distributional network in the areas of transportation, administration and goods handling;
- investments in improved processing facilities to guarantee not only higher efficiency, but, even more importantly, to ensure a higher quality of agricultural products. Foreign direct investments could partly help to bridge the gap in capital availability in the considered countries;
- investments in advertising.

There is generally a need for a more market-oriented attitude in the food industries of the CEAs. Competition requires not only production at low costs, but also the willingness to explore and expand product varieties and to ensure high quality standards.

Improving the Marketing of the CEAs' Agricultural and Food Products

It would be advisable to create an institution that specializes in improving the marketing of agricultural and food products. In most - if not all - Western countries, such marketing agencies exist. In the FRG, this agency, the so-called Centrale Marketing-Gesellschaft der Deutschen Agrarwirtschaft mbH (CMA), is entirely funded by farmers and wholesalers through commodity sales.

Changes in Managing the Association Agreements

The importance of ensuring that the preferential margin is passed on to the exporting agent needs to be understood. It affects not only the money he or she receives, but also the quantity exported - if the preference quota is not binding[12]. There are several ways of achieving this.

The most certain one would be to do without quotas. In this case exporters would achieve a higher export price for the whole quantity exported into the EU (OVERBERG 1996, p. 178). The problem of asymmetric information between exporters and importers discussed in section 4.2 would no longer be of relevance, and a misallocation of preferential benefits could be prevented. This alternative would be very likely to even benefit the CEAs if the EU were to considerably reduce the tariff benefit. Nevertheless, without a further liberalization of EU agricultural policies, granting unrestrained preferences for sensitive agricultural products such as milk, beef and sugar is politically not enforceable.

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[12] TANGERMANN 1993: Estimated the preference value to be about 35 to 40 mill. ECU or 1.15 to 1.32 billion Kc for the CR in 1995.

Alternative ways of ensuring that the preferential margin is captured by the importers would be to

- completely bypass EU importing agents and sell directly to customers in the EU. The EU member states would then co-ordinate the quantities with the Commission. The non-violation of possibly existing preference quotas would thus be ensured. This procedure was adopted for the preferential exports of ducks and geese from Poland and Hungary to the EU in the late 80s (BANSE 1992). Exporters from the CEAs were thus able to sell their products on EU markets at the going prices and only pay the preferential tariffs. A precedent for this move has been set by handing over the responsibility of managing quotas for sheep and mutton to Hungary's Sheep Council (AGRA EUROPE 1995, p. 18).
- sell the preferential import licenses in an auction. This auction could be administered in the EU by the Commission itself or another institution, or handed over to the CEAs. The latter procedure has already been adopted for the preferential exports of mutton from Bulgaria to the EU, which has so far proven to be quite successful (OVERBERG 1996, p. 181).

The European Commission seems to have realized that some changes in quota management are needed to ensure quotas are used more in the future. Thus the Commission has arranged a series of information seminars to improve the understanding of the quota arrangements among both exporters in the CEAs and importers in the EU. A review of license management to establish whether the system can be simplified is also deemed necessary. In addition, it has been realized that more licenses should be made available to newcomers. Finally, the Commission is reviewing its phytosanitary and veterinary arrangements under the Equivalency Agreements with the CEAs. It has been suggested that the CEAs be granted technical assistance under the PHARE program if weaknesses are discovered in their veterinary control procedures (AGRA EUROPE 1995, p. 5). Greater flexibility within product sectors has already been realized.

So far, however, the Commission seems to be very reluctant to change the general procedure for issuing licenses. Thus it should be investigated whether it would be viable for CEA exporters to establish an import company inside the EU and also undertake the tasks of an importing agent with all the advantages and disadvantages implied. Another approach for preventing the gains from preferential trade from accruing to the CEAs would be to collect and publish detailed information on exports to the EU and on the EU's minimum prices for imports. For most products, if not for all, the minimum import price minus transportation costs is equivalent to the importer's selling price for the product on internal EU markets. Deducting the preferential tariff and the importing costs, one obtains the amount the importer can (and should) pay the exporter as long as the quota is not fulfilled.

If the CEAs are, however, successful in capturing the quota rent, they have to ensure that it is properly passed on to the producers. It can be assumed that the beneficiaries of the rent were intended to be the producers of any specific commodity included in the preferential agreement.

Ultimately, these changes in the Association Agreements might also be in the EU's interest. While the Union may initially appreciate the positive balance in agricultural and food trade with the CEAs, it may eventually lead to stagnation in the CEAs' agriculture. Inefficient and non-competitive agricultural sectors in the CEAs will cause a permanent dependency on budgetary subsidies in the agriculture of these countries, a burden which would upon integration be borne by EU taxpayers.

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APPENDIX

Table 1: Value of CEA Trade in Agricultural and Food Products over the Years 1989 to 1996

Country	Exports						Imports						Net Trade			
	Mio. US$				% Change		Mio. US$				% Change		Mio. US$			
	1989	1992	1995	1996	1996/1989	1996/1992	1989	1992	1995	1996	1996/1989	1996/1992	1989	1992	1995	1996
Bulgaria	2364	1011	1119	891	-62	-12	1003	377	393	373	-63	-1	1361	634	726,4	518
Czech Republic	348	758	1268	1201	245	58	1006	833	1741	1970	96	136	-658	-75	-473	-769
Estonia	n.a.	72	300	328	-	355	n.a.	38	361	500	-	1215	n.a.	34	-61	-172
Hungary	2267	2653	2886	2892	28	9	710	660	1230	1297	83	96	1557	1993	1656	1595
Latvia	n.a.	89	216	245	-	175	n.a.	60	189	311	-	418	n.a.	29	27	-66,5
Lithuania	n.a.	146	496	556	-	281	n.a.	45	488	577	-	1182	n.a.	101	8	-21
Poland	1850	2002	2511	2737	48	37	1402	1952	2978	3955	182	103	448	50	-467	-1218
Romania	527	290	532	677	28	133	367	997	896	758	107	-24	160	-707	-363,8	-81,2
Slovak Republic	89	304	539	423	375	39	206	203	747	819	298	303	-117	101	-208	-396
Slovenia	n.a.	542	430	445	-	-18	n.a.	690	953	923	-	34	n.a.	-148	-523	-478
CEA-10	n.a.	7867	10297	10393	-	32	n.a.	5855	9975	11482	-	78	n.a.	2012	321,6	-1089

Source: Own calculations based on data from OECD (Ed.) (1996a), OECD (Ed.) (1997).

Table 2: Share of Agriculture and Food Industry in Total Exports and Imports, 1993 to 1996 (in %)

Countries	Share in Total Exports					Share in Total Imports				
	1993	1994	1995	1996	% Change in the Share between 1993 and 1996	1993	1994	1995	1996	% Change in the Share between 1993 and 1996
Bulgaria	19	23	22	19	**-2**	10	12	8	8	**-28**
Czech Republic	8	7	7	5	**-41**	9	9	8	7	**-23**
Estonia	25	22	16	16	**-55**	15	16	14	16	**4**
Hungary	22	21	22	22	**-2**	6	7	8	8	**20**
Latvia	17	13	17	17	**1**	7	11	11	14	**49**
Lithuania	7	24	19	18	**58**	2	10	13	13	**82**
Poland	12	12	11	11	**-5**	12	11	10	11	**-11**
Romania	7	6	7	9	**24**	15	9	9	8	**-95**
Slovak Republic	6	6	6	5	**-22**	9	9	9	7	**-18**
Slovenia	6	6	5	5	**-16**	10	11	10	10	**-4**
CEA-10	**12**	**12**	**12**	**11**	**-6**	**10**	**10**	**9**	**9**	**-7**

Source: Own calculations based on data from OECD (Ed.) (1997).

Table 3: Destination and Origin of CEA Agricultural Trade: Share of Country Groups in Total Value

		EU		Other OECD		CEAs[1]		NIS		Other	
		Exports	**Imports**	**Exports**	**Imports**	**Exports**	**Imports**	**Exports**	**Imports**	**Exports**	**Imports**
Bulgaria	1993	22	44	13	19	12	7	28	4	25	26
	1996	22	21	1	15	15	8	40	9	12	47
Czech Republic	1993	33	37	9	11	40	26	11	0	7	26
	1996	38	57	3	6	38	16	15	0	6	20
Estonia	1993	18	49	9	28	20	5	44	9	9	9
	1996	20	64	3	8	15	12	59	10	2	6
Hungary	1993	45	42	16	16	10	7	20	3	9	32
	1996	47	43	6	8	17	5	20	1	10	43
Latvia	1993	9	36	5	12	20	17	65	25	1	10
	1996	15	51	0	0	12	27	72	12	1	11
Lithuania	1993	16		4		12		66		2	
	1996	18	45	4	3	12	17	63	21	4	14
Poland	1993	57	57	14	22	3	3	19	4	7	14
	1996	49	70	2	5	6	10	36	6	7	9
Romania	1993	29	45	20	23	8	8	18	1	25	23
	1996	22	40	13	15	10	6	18	5	37	35
Slovak Republic	1993	16	24	8	10	57	51	13	1	6	14
	1996	17	36	2	4	56	43	19	1	7	17
Slovenia	1993	36	32	6	19	3	11	6	2	49	36
	1996	32	47	4	9	3	14	5	2	57	29
CEA-10[2]	**1993**	**39**	**44**	**13**	**18**	**15**	**13**	**21**	**3**	**12**	**22**
	1996	**38**	**55**	**4**	**7**	**16**	**14**	**29**	**5**	**12**	**20**

1) Includes Poland, Hungary and Czech Republic which became members of OECD in 1996.
2) Weighted with the share of each CEA in total CEA exports and imports. In 1993 data for Lithuania were not available. However, since in 1993 the share of Lithuania in total CEA exports (imports) was only 2% (1%). the exclusion of Lithuania has hardly any effect on the overall results.

Source: Own calculations based on data from OECD (Ed.) (1997).

Table 4: Value of CEA Trade in Agricultural and Food Products with the EU (in Mio ECU)

Countries	Exports to EU-15						Imports from EU-15						Net Trade with the EU				
	1992	1993	1994	1995	1996	change (1996/1992)[2]	1992	1993	1994	1995	1996	change (1996/1992)[2]	1992	1993	1994	1995	1996
Bulgaria	172	165	189	217	198	**16%**	122	209	218	222	145	**19%**	49	-45	-29	-4	53
Czech. Rep.[1]	267	219	250	280	269	**23%**	408	414	543	743	832	**104%**	-140	-195	-293	-463	-563
Estonia	8	10	18	27	38	**376%**	64	80	84	178	219	**241%**	-56	-71	-66	-151	-181
Hungary	754	670	741	872	935	**24%**	224	332	424	424	363	**62%**	530	337	317	447	573
Latvia	5	11	9	13	18	**296%**	68	91	124	194	215	**215%**	-64	-80	-115	-182	-197
Lithuania	22	36	31	46	61	**181%**	114	157	171	164	209	**84%**	-92	-120	-140	-118	-147
Poland	859	729	791	877	858	**0%**	898	1.059	1.060	1.226	1.467	**63%**	-39	-330	-269	-349	-609
Romania	74	79	100	121	130	**76%**	316	312	174	278	293	**-7%**	-242	-233	-74	-157	-163
Slovak. Rep.[1]	267	37	48	60	62	**67%**	408	108	125	197	213	**-48%**	-140	-71	-77	-137	-150
CEA-10	46	69	68	58	65	**41%**	68	205	263	359	363	**434%**	-22	-136	-195	-301	-298
CEA-10	2.474	2.025	2.245	2.570	2.635	**7%**	2.689	2.969	3.187	3.985	4.318	**61%**	-216	-943	-942	-1.415	-1.682

1) Between 1993 and 1996 for the Czech Republic and the Slovak Republic

Source: Own calculations based on data from EUROSTAT.

Table 5: Development of the Nominal Exchange Rate of the CEAs Compared to the German Mark (DM)

	Poland	Czech Republic	Slovak Republic	Hungary	Slovenia	Romania	Bulgaria	Estonia[1]	Latvia	Lithuania
	ZL/DM	CZK/DM	SK/DM	HUF/DM	SIT/DM	Lei/DM	Lv/DM	EEK/DM	Lat/DM	LT/DM
1990	0,5882	11,08	11,08	39,14	11,3	52,0				
1991	0,6383	17,76	17,76	45,03	21,6	297,0	11,30			
1992	0,8757	18,14	18,14	50,67	52,4	285,0	14,95		0,51	
1993	1,0969	17,64	18,64	55,62	68,7	460,3	16,17	8,0	0,35	2,42
1994	1,4050	17,75	19,51	71,47	79,5	1027,9	44,84	8,0	0,35	2,47
1995	1,6910	18,52	20,74	87,88	82,8	1424,9	49,35	8,0	0,37	2,79
1996	1,7930	18,06	20,38	101,45	90,0	2045,3	116,21	8,0	0,37	2,65

1) In Estonia the nominal exchange rate was fixed to 8 EEK/DM

Source: STATISTISCHES BUNDESAMT (Ed.) (various years), OECD (Ed.) (various years), DEUTSCHE BUNDESBANK (Ed.) (1997), DEUTSCHE BUNDESBANK (1997): Inquiry.

Table 6: Development of the Nominal Exchange Rate of the CEAs Compared to the German Mark (DM) (where the value is 100, this indicates the base year)

	Poland	Czech Republic	Slovak Republic	Hungary	Slovenia	Romania	Bulgaria	Estonia[1]	Latvia	Lithuania
1990	100	100	100	100	100	100				
1991	109	160	160	115	191	571	100			
1992	149	164	164	130	464	548	132		100	
1993	187	159	168	142	608	885	143	100	68	100
1994	239	160	176	183	703	1977	397	100	68	102
1995	288	167	187	225	733	2740	437	100	73	115
1996	305	164	184	259	797	3933	1028	100	73	110

1) Due to lack of data the base year of the nominal exchange rate differs among the countries

Source: STATISTISCHES BUNDESAMT (Ed.) (various years), OECD (Ed.) (various years), DEUTSCHE BUNDESBANK (Ed.) (1997), DEUTSCHE BUNDESBANK (1997): Inquiry.

Table 7: Consumer Price Indices for the CEAs and Germany (where the value is 100, this indicates the base year)

	Poland	Czech Republic	Slovak Republic	Hungary	Slovenia[1]	Romania	Bulgaria[1]	Estonia[1]	Latvia[1]	Lithuania[1]	Germany
1990	100	100	100	100	100	100					100
1991	170	152	158	135	218	275	100				104
1992	244	169	174	166	656	853	191		100		108
1993	330	203	214	203	868	3331	331	100	256	100	112
1994	436	223	243	242	1041	7888	649	142	348	172	115
1995	599	243	272	310	1196	9521	985	191	435	241	118
1996	719		259	383	1312	14938	2335	234	512	300	121

Source: STATISTISCHES BUNDESAMT (Ed.) (various years), OECD (Ed.) (various years), DEUTSCHE BUNDESBANK (Ed.) (1997), DEUTSCHE BUNDESBANK (1997): Inquiry.

Table 8: Development of the Real Exchange Rates for the CEECs Compared to the German Mark (DM) (where the value is 100, this indicates the base year)[1]

	Poland	Czech Republic	Slovak Republic	Hungary	Slovenia	Romania	Bulgaria[1]	Estonia[1]	Latvia[1]	Lithuania[1]
1990	100	100	100	100	100	100				
1991	66	109	105	88	91	215	100			
1992	66	104	101	84	76	69	72		100	
1993	63	88	88	78	79	30	47	100	27	100
1994	63	83	84	87	78	29	68	73	20	61
1995	56	81	81	85	72	34	50	55	17	50
1996	51		86	82	73	32	51	46	14	39

1) Due to lack of data the base year of the nominal exchange rate differs among the countries

Source: STATISTISCHES BUNDESAMT (Ed.) (various years), OECD (Ed.) (various years), DEUTSCHE BUNDESBANK (Ed.) (1997), DEUTSCHE BUNDESBANK (1997): Inquiry.

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