A Historic Enlargement

Ten Countries Prepare To Join the European Union

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European Commission, Peter Hudec

From the day the Berlin Wall fell in 1989, the governments of the formerly communist countries of Central and Eastern Europe (CEE) began to discuss the idea of joining the European Union (EU). In May 2004, after a 14-year transition from central planning to market economies, eight CEE countries (Poland, Hungary, the Czech Republic, Slovakia, Slovenia, Estonia, Latvia, and Lithuania), plus Cyprus and Malta, will join the EU. Bulgaria and Romania are also preparing for accession and are expected to join in 2007. In 2002, Croatia submitted its application for membership, and it is possible that Croatia, too, will be ready to join in 2007 (see box, "Who Are the Acceding Countries?").

This enlargement of the EU, the largest in its history, will bring profound changes to Europe. The EU population will grow by 28 percent, with arable land increasing by nearly 40 percent. Grain area in the 10 candidate countries totaled 16 million hectares in 2000, nearly half the grain area in the current EU-15. The EU-15 is already a larger agricultural producer than the United States. The EU-25 will be an even larger presence on the global agricultural market.

Accession to the EU carries deep political symbolism for the citizens of the candidate countries. It will be a concrete signal to the world that these countries have finally broken free from their Communist past and rejoined Europe. East European voters approved accession in a series of referenda held in 2003, in the hope that membership would expand markets, raise incomes, and attract new foreign investment.

But many CEE farmers are apprehensive. In the early 1990s, many of them welcomed EU accession and the potential for higher prices and incomes. However, the expected financial gains will likely be limited by several factors. First, EU and CEE agricultural prices for many products have converged over the last decade. Second, CEE farmers will generally receive lower payments than their EU-15 counterparts. Third, though producers will receive direct payments from the EU, they will also incur the costs of complying with EU sanitary, veterinary, and animal welfare regulations.

CEE countries have already made several adjustments to their production and trade approaches in preparation for accession. As a result, the short-term impacts of enlargement on CEE and global commodity production and trade will likely be moderate. In the longer term, however, CEE producers may be forced to restructure their agriculture sectors to maintain competitiveness, which could lead to a significant rise in agricultural productivity.

EU Membership Will Bring Costs as Well as Benefits

Much has changed since the early 1990s, when most CEE farmers anticipated significantly higher incomes as a result of joining the EU. At that time, EU commodity prices were substantially higher than CEE prices, and EU farmers received generous income support. But the short-term benefits of accession will be less than initially expected, and CEE farmers have become increasingly aware that there will be costs as well.

Price gaps have narrowed. Over the past decade, the gap between EU and CEE prices has narrowed considerably, for a number of reasons:

- Exchange rates have changed. The currencies of the candidate countries have gradually strengthened against the euro.
- The EU itself underwent significant agricultural policy reform (see box, "The EU Common Agricultural Policy: A Decade of Reform"). In 1992, the EU reduced intervention prices (price supports) and introduced a system of direct payments to producers to compensate for the lost income. Agenda 2000, introduced in 1999, further reduced intervention prices.

European Commission, Mario Dudar

Who Are the Acceding Countries?

There is considerable diversity among the acceding countries, despite the fact that eight of them have a common history of 40 years under communism. Poland and Hungary are by far the largest agricultural producers. Hungary and the Czech Republic are dominated by large-scale farming, while Poland is characterized by 2 million farms, most under 10 hectares. Some countries, such as Hungary and Slovenia, are well prepared for accession; Poland, on the other hand, will face some serious adjustment difficulties.

Cyprus and Malta, unlike the other candidates, have long traditions as market economies. But they are similar to many of the CEEs in that they are dominated by small, largely part-time farmers. Their main products are fruits, vegetables, meat, and dairy products.

Hungary, the Czech Republic, and Slovakia are dominated by large-scale farming. During the early 1990s, land belonging to the state and cooperative farms was returned to private ownership, but most landowners have chosen to lease their land to new, market-oriented corporate or cooperative farms. The three countries produce large amounts of grain, and are usually net grain exporters. Hungary, however, is the only net agricultural exporter among all 10 candidate countries. Hungary has also managed to reduce the share of labor employed in agriculture, mainly by providing generous pensions to encourage retirement.

The three Baltic countries—Estonia, Latvia, and Lithuania—have smaller agricultural sectors, dominated by livestock products, mainly dairy. Only Lithuania has significant grain production. Small- to medium-sized private farms dominate in all three countries.

Slovenia, once the richest republic of the former Yugoslavia, gained its independence in 1991. The country has enjoyed rapid growth since independence and now has the highest per capita GDP of all the East European candidates. It also has the smallest agricultural sector, accounting for only 3 percent of GDP in 2001. Slovenia's agricultural landscape is dominated by small, private farms averaging just 5 hectares. The main output is dairy products, followed by meat.

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Poland is the largest of all the candidate countries, in terms of both population and agricultural production. Poland is also the largest potential headache for the enlarged EU. In many ways, Poland has been among the most successful reformers of Eastern Europe—the overall economy has achieved significant positive growth every year since 1992. However, agriculture has grown more slowly, and productivity is low—the sector employs 19 percent of the labor force but contributes only 4 percent of GDP. Even during the Communist period, 80 percent of Poland's agricultural land was in the hands of private farmers. Poland currently has about 2 million farms, averaging just 8 hectares, and many farms are highly fragmented, consisting of several noncontiguous plots. Less than half of Poland's farms produce for the market; the remainder produce mainly for home consumption. EU officials continue to fret over the cost of subsidizing Poland's 2 million farmers and are hoping to see a considerable reduction in this number after accession. At the same time, the Polish Government is under intense political pressure to get the most favorable deal for its farmers, and Polish officials in Brussels have proven to be very tough negotiators.

Basic indicators of the acceding countries, 2001

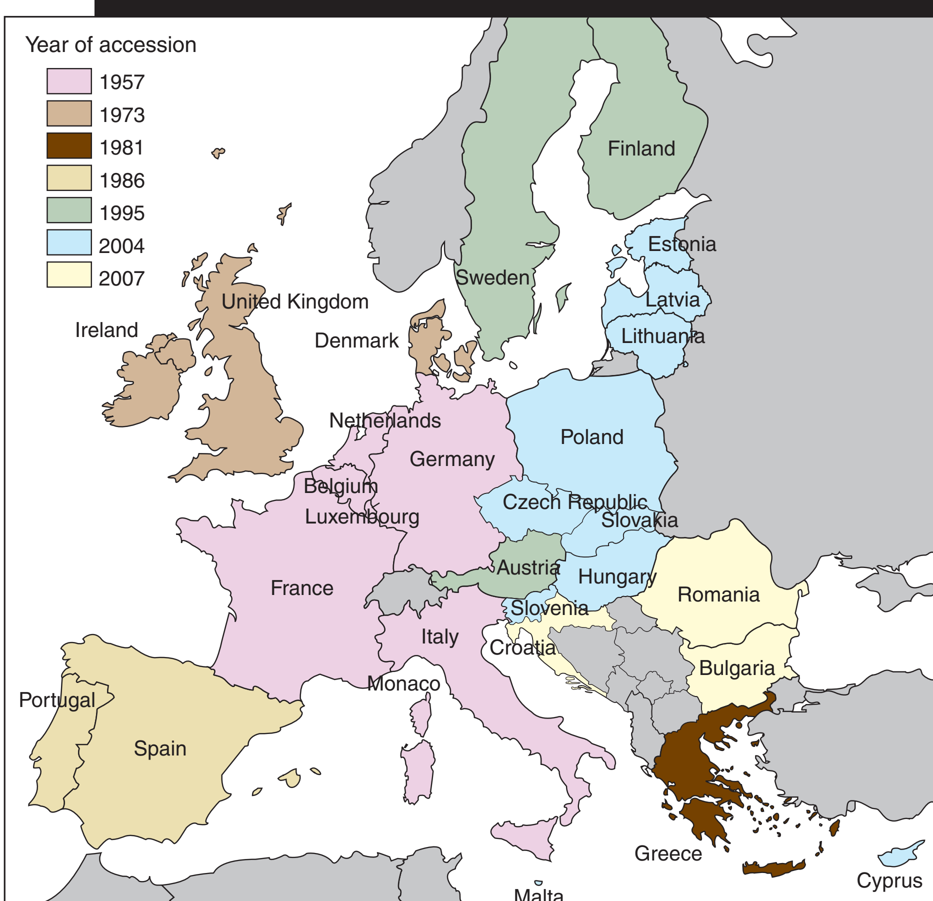
Country	Population	Per capita GDP as percent of EU average	Agricultural land	Arable land	Agricultural share of GDP	Agricultural share of employment
	1,000	*Percent*	*1,000 hectares*		*Percent*	
Cyprus	790	83	117	72	4.0	4.8
Czech Republic	10,260	61	4,278	3,076	4.2	4.6
Estonia	1,377	37	1,433	1,120	5.7	7.1
Hungary	9,917	52	5,865	4,614	4.3	6.1
Latvia	2,406	30	2,480	1,841	4.8	15.1
Lithuania	3,689	28	3,487	2,930	7.2	16.5
Malta	392	n.a.	10	9	2.6	2.3
Poland	38,577	38	18,392	13,974	3.8	19.2
Slovakia	5,403	50	2,450	1,450	4.5	6.3
Slovenia	1,985	73	510	285	3.3	9.9
All 2004 candidates	74,796	n.a.	38,479	28,496	n.a.	n.a.
EU-15	375,346	n.a.	142,614	74,470	1.5	4.7

n.a. = Not available.
Sources: Food and Agriculture Organization of the United Nations, EU Commission, Eurostat.

- During the 1990s, CEE governments, in an effort to align their policies with those of the EU, began to intervene strongly in some markets, resulting in higher CEE prices. Poland maintains an aggressive intervention program for wheat, rye, sugar, and dairy products. Hungary and the Czech Republic, on the other hand, have supported their livestock sectors more than crops.
- For many products, the price gaps of the early 1990s reflected quality differences more than policy differences. Pork and beef prices reported by the EU are for the top three grades—in terms of lean meat content—of the EU grading system (known as EUROP). CEE statistical offices have historically reported average prices for all grades. Throughout the CEE, however, the average lean meat content has been increasing, and more pork and beef now meets the top three EU grades. CEE prices for pork and poultry are now, as a result, on par with EU prices.

CEE producers will receive lower direct payments per hectare than their EU counterparts. A major bone of contention during the accession negotiations was the level of direct payments that CEE producers will receive (see box, "The EU Common Agricultural Policy: A Decade of Reform"). The EU Commission realized that it would be impossible to provide the full range of direct payments to CEE farmers without violating the budget limits agreed upon in Agenda 2000. For this reason, the final compromise provides for a 10-year phase-in of payments. The EU will provide only 25 percent of the payments from the Common Agricultural Policy (CAP) budget during the first year; this share will increase by 5 percent each year until CEE farmers receive 100 percent of EU payments. However, national governments will be allowed to top off these payments by a maximum of 30 percent each year, so that payments during the first year of accession could be as much as 55 percent of what current EU farmers receive.

The 2004 European Union enlargement will be the most ambitious ever. . .



. . .and the acceding countries have been preparing for 10 years

1994	Signing of the Europe Agreements granted important trade preferences to CEEs
1998	Formal start of negotiations
1999	EU's Agenda 2000 established the budgetary framework for enlargement
2000	Trade agreements expanded trade preferences
2002	Further trade agreements liberalized most EU-CEE trade
Dec 2002	Negotiations finalized at the Copenhagen Summit
April 2003	Signing of Accession Treaty
May 2004	Ten new members join the EU

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Direct payments will also be lower for CEE countries because of the way the payments are computed. Payments are tied to the yields associated with a reference period—1995-99—and to a reference area. Because of the disruptions caused by the transition from central planning to free markets, CEE yields during 1995-99 were substantially lower than those of the EU, which will keep CEE payment levels lower relative to EU payment levels.

CAP reforms approved in June 2003 will convert these payments to a single whole-farm payment between 2005 and 2007, so that they will be fully decoupled from production decisions. The reforms also call for additional direct payments to compensate for cuts in dairy prices. According to subsequent statements from the EU Commission, the whole-farm payment and all other new payments to CEE farmers will be phased in according to the same 10-year schedule.

The result is that per hectare payments received by the average CEE farmer during the first year of accession will be one-fourth the amount received by the average EU farmer. Payments will vary, of course, by country and by farm size. Small farms in Poland will receive less than 300 euros per year, while large farms in the Czech Republic or Hungary will receive as much as 40,000 euros ($1=0.8 euro).

Compliance with EU regulations will have costs. All the candidate countries must adopt the entire body of laws and regulations of the EU, known as the *acqui communautaire.* There are approximately 80,000 pages of EU laws and regulations relating to market regulation, veterinary and sanitary controls, animal welfare, and the administrative structures needed to implement EU price and income support programs.

To receive EU price and income supports, CEE producers will have to absorb the costs of this compliance. Grain producers, for example, will have to meet minimum quality requirements to receive the EU price. Livestock breeders will have to raise, transport, and track all animals according to the animal welfare regulations and recordkeeping requirements of the EU. All these measures will increase production costs, which will erode net returns of producers.

In addition, the administrative burden to acceding CEE governments will be considerably large, as agencies must maintain detailed databases on production, animal numbers, and other pertinent information for each farm that will receive EU payments.

Short-Term Impacts on Commodity Output Will Be Mixed

Given these facts, recent ERS analysis suggests that, in the short term, CEE out-

The EU Common Agricultural Policy: A Decade of Reform

The fundamental objectives of the EU Common Agricultural Policy (CAP) are to: (1) increase agricultural productivity, (2) ensure a fair standard of living for farmers, (3) stabilize markets, (4) guarantee regular supplies of agricultural products, and (5) ensure reasonable food prices for consumers.

To accomplish these objectives, the EU uses several basic policy instruments:

Intervention prices. The EU fixes floor prices for grains, beef and veal, dairy products, and sugar. When market prices fall below that floor, farmers can sell their produce to the EU intervention agencies at annually adjusted prices. Products must meet minimum quality requirements in order to be accepted into intervention, but intervention agencies must accept all commodities that meet those standards. Surplus commodities are then placed in member state storage facilities.

Import tariffs. The EU sets tariffs at the external borders of the EU at levels that prevent imported commodities from being sold at prices below the desired internal market prices.

Export subsidies. When world prices are below the EU market prices, EU exporters can receive a subsidy that enables them to export competitively at the lower world price. Conversely, if world prices rise above the EU internal price, EU authorities may impose an export tax.

Direct payments. These payments were introduced in the 1992 CAP reform in an effort to compensate producers for the price cuts that were imposed. These payments will be consolidated into a single whole-farm payment beginning in 2005. Under the current system, payments are only partially decoupled from production decisions, since producers must produce something in order to receive the payments, but with the upcoming CAP reform, they will be almost fully decoupled from production.

For arable crops—that is, grains and oilseeds—EU producers receive a per hectare payment calculated as a per ton amount multiplied by a so-called reference yield. The reference yield is defined for each region based on historical average yields. These payments are also subject to regional area ceilings, again based on recent historical averages.

Payments for beef cattle are limited by regional herd ceilings (based on historical averages) and limits on stocking density.

Supply controls. The 1992 reforms required producers who were eligible for direct payments to idle, or set aside, a certain percentage put changes as a result of enlargement will be mixed. Enlargement is likely to lead to a substantial decline in wheat output by Poland, which currently supports wheat producers at levels higher than the EU, but wheat output in the other candidate countries will increase slightly. As a result, net wheat exports by the enlarged EU will likely be slightly less than combined net exports of the EU-15 and the candidate countries would be without enlargement. In contrast, CEE corn and barley output could rise dramatically.

CEE beef output is likely to increase significantly, since the EU maintains intervention prices for beef that are higher than current CEE prices. As a result, exportable surpluses in the candidate countries will grow. However, only small changes are expected in CEE pork and poultry output.

Under the current EU system of direct payments, farmers must produce grain and oilseeds in order to receive the area payments, and cattle breeders must maintain certain types of beef cattle to receive the beef premiums. Under the new system, which takes effect in 2005, farmers will only need to keep their land in "good agricultural condition." They could convert their land to pasture, plant nothing, and still receive a payment; the incentive to increase output or produce anything is therefore reduced.

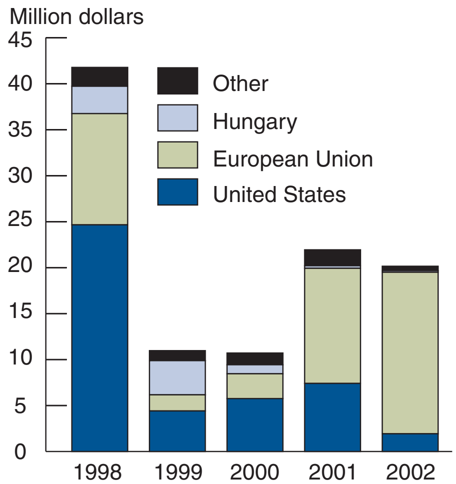
Enlargement Likely To Bring Short-Term Losses to U.S. Exporters

U.S. exports to Central and Eastern Europe will likely contract because CEE countries will have to adopt the stricter import policies of the EU. For example, the EU bans all poultry meat imports from the United States due to a ban on treating carcasses with chlorine. If this issue is not resolved, then all acceding CEE countries will also ban U.S. poultry upon accession.

But these losses will be small relative to those that have already taken place as a result of preferential trade agreements between the EU and the CEEs. In 2000, the EU signed "double zero" agreements with all the candidate countries, which provided duty-free quotas for pork and poultry trade and duty-free trade on a number of other goods. The "double profit" agreements signed in 2003 opened duty-free quotas for wheat, corn, beef, and dairy products, and allow nearly free trade in fruits and vegetables. So much of the CEE-EU trade is already completely liberalized, and this has reduced trade with third countries, including the United States.

During most of the 1990s, the United States was the principal supplier of poultry meat to Poland and the Baltic States. However, since the signing of the double

The United States has lost market share in Poland's poultry imports



Source: World Trade Atlas.

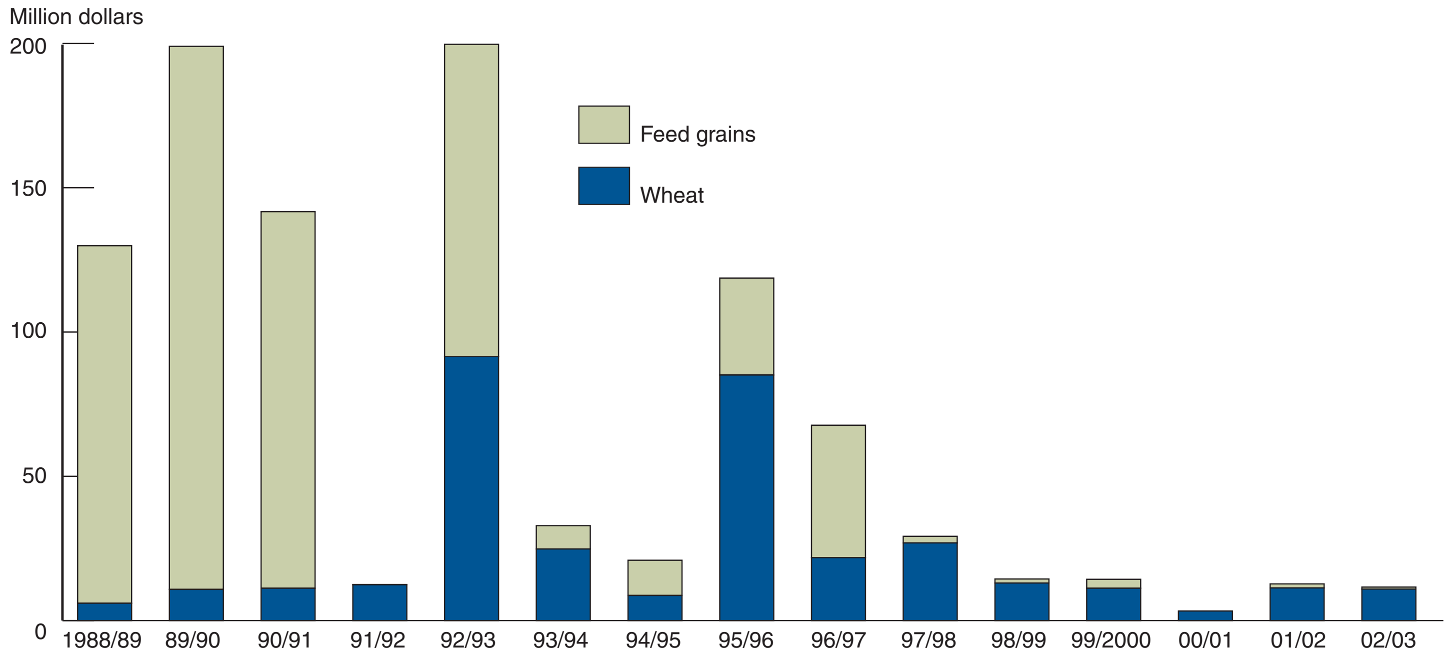
of their land each year, for which they receive an additional payment. Small producers, those who produce less than 92 tons of grain per year, are exempt from the set-aside requirement. EU policy also imposes dairy and sugar quotas. Direct payments are tied to historical "reference" areas, yields, and herd levels.

Other. Other mechanisms include storage subsidies and consumer subsidies to encourage consumption of dairy products. There is no direct government intervention in fruit and vegetable markets. However, growers must join producer organizations, which receive funds from the EU and can set minimum quality standards and withdraw products from the market when prices fall to a given level. The EU also subsidizes fruit and vegetable exports and controls imports through preferential trade agreements.

The use of these tools has changed over the last decade, though the basic EU objectives remain unchanged.

- A set of reforms introduced in 1992 reduced intervention prices, or price supports, and introduced a system of compensatory payments (now known simply as direct payments) to compensate producers for losses incurred through the reduction in support prices. The 1992 reforms also introduced a number of supply controls.
- As a result of commitments made to the World Trade Organization, the EU made further changes in 1995, such as reducing export subsidies annually.
- Agenda 2000 brought further reductions in support prices, offset by increases in direct payments. Agenda 2000 also laid out a budgetary framework for enlargement to support the new member countries through 2006.
- The newest CAP reform was announced in June 2003. The reform will eliminate price support for rye and reduce support for rice and dairy products. The EU also plans to consolidate all direct payments, described above, to a single whole-farm payment that will be decoupled from production (individual member countries will be allowed to retain up to 25 percent coupling for crops and higher degrees of coupling for beef and veal.) The reform further calls for a gradual reduction of payments after 2005 and will require farmers to comply with all EU sanitary, veterinary, and environmental regulations in order to receive these payments.

U.S. grain exports to Eastern Europe have been declining for years. . .



Source: Bureau of the Census, U.S. Department of Commerce.

zero agreement, the U.S. market share has been mostly supplanted by the EU. Remaining exports are mostly in the form of transshipments to the countries of the former Soviet Union, which will likely continue after EU enlargement.

U.S. grain exports to the CEEs also declined throughout the 1990s. In part, this is the result of a drop in CEE demand for feed grains as CEE livestock sectors contracted. In addition, Poland maintains a zero-tolerance policy for grain contaminated with ragweed seed, and U.S. grain shipments have not met that requirement. Also, many of the CEEs have barred imports of genetically engineered corn as they seek to align their policies with the EU.

Wheat imports by the enlarged EU are projected to rise slightly, but the United States may not benefit from that. Poland will be the largest net wheat importer after accession, and if Poland is forced to give up its ban on ragweed seed (the EU does not maintain such a policy), U.S. wheat exports to Poland might resume.

Even as U.S. grain exports have declined during the CEE transition period, exports of other products have grown. Significant among these are exports of nuts, raisins, popcorn, and other snack foods. CEE tariffs on most of these products will fall on accession, as the CEEs harmonize their tariffs with those of the EU, as will tariffs on wine, cigarettes, and tobacco. Rising incomes among the CEEs could stimulate increased demand for these products and lead to new markets for high-value U.S. products.

Future U.S. trade with the new member countries also depends on livestock developments. The United States is an important supplier of animal genetics (bull semen, baby chicks, etc.) to the region. Market access for these products will not change with accession, and opportunities could expand if CEE livestock producers seek to improve the genetics of their stock to become more competitive in the enlarged EU. ERS analysis suggests no immediate increase in EU imports of soybeans or meal. But demand for U.S. soybeans could expand in the longer term if the new members are able to expand pork and poultry production.

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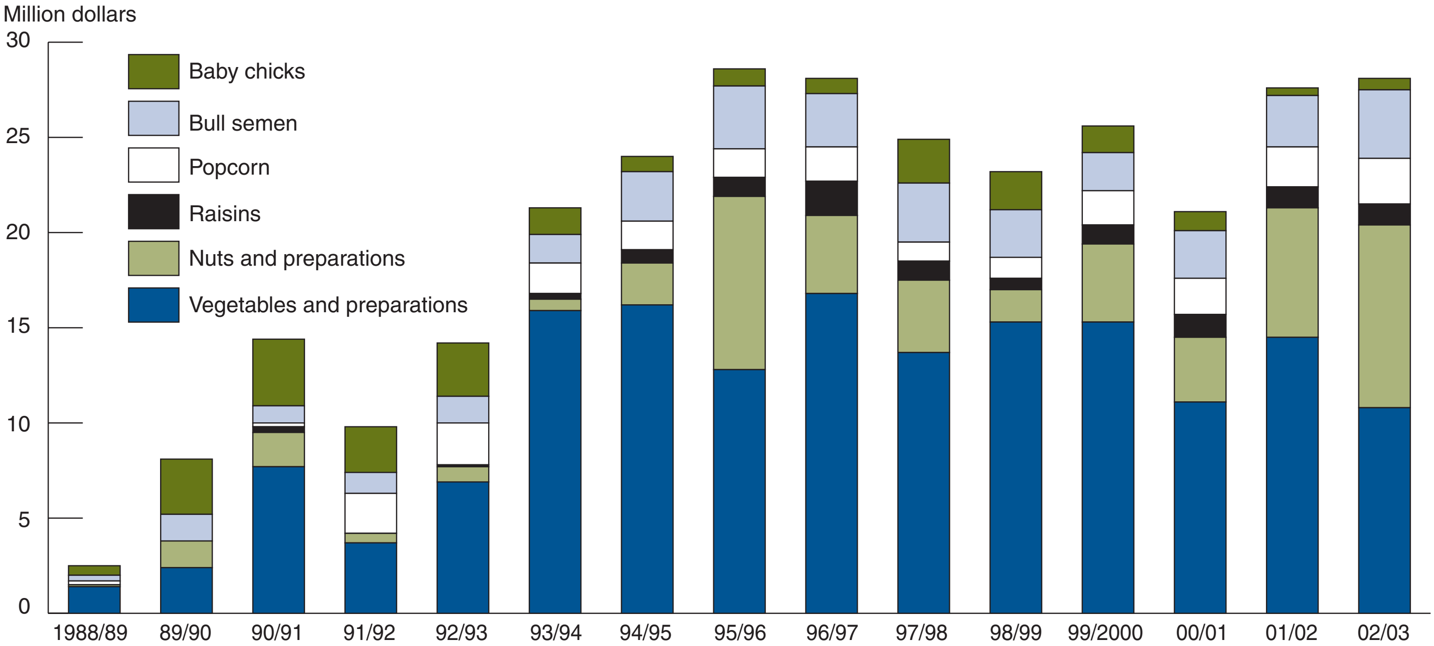

Source: Bureau of the Census, U.S. Department of Commerce.

Longer Term Pressures for Restructuring

CEE agriculture employs land and labor, both plentiful, more intensively than does EU agriculture. Use of material inputs such as fertilizers, high-quality seed, and pesticides is lower, and capital is difficult to obtain. As a result, CEE crop yields are significantly lower than those in the EU (CEE grain yields averaged 2.3 tons per hectare in 2000, less than half the EU-15 average), and a higher share of labor is employed in agriculture. Accession will bring pressures for change from several sources.

The need to meet all EU standards and compete in a single market will bring significant pressure for restructuring of CEE agriculture and food processing. Farmers will need to meet EU quality standards or be barred from the market. Slaughterhouses will have to install equipment for measuring back fat, apply the EU grading system to all carcasses, and meet a formidable array of requirements concerning flooring, equipment, and separation of the "clean" from the "dirty" stages of processing.

These foreseen pressures have already led to investment and concentration in CEE processing sectors. Similar trends may emerge at the farm level. Smaller farms unable to meet the new standards will not be allowed to sell their products on the market and will eventually be forced out of business. This momentum toward farm consolidation could mean fewer, larger, and more capital-intensive farms and a reduction in demand for agricultural labor.

Uncertainty Remains

Overall, short-term impacts of EU enlargement on EU commodity output and world agricultural trade will not be nearly as large as once believed. In the longer term, accession can bring many benefits to the candidate countries. Consumer incomes will likely rise, and pressures for restructuring will lead to more efficient agricultural sectors in the CEEs.

At the same time, accession could bring hardship to many small farmers and processors in the CEEs. Processors that cannot meet strict EU standards will be forced out of business, and some farmers will see a deterioration in their net income. It remains to be seen how quickly the CEEs can generate new employment for those displaced from agriculture. So while a majority of CEE voters have embraced EU membership, much of the farming population remains apprehensive. AW

This article is drawn from . . .

U.S.-EU Food and Agricultural Comparisons, by Mary Anne Normile and Susan E. Leetmaa, WRS-04-04, USDA/ERS, February 2004, available at: www.ers.usda.gov/publications/wrs0404/

The ERS Briefing Rooms on the European Union, Poland, and Hungary, which can be accessed from: www.ers.usda.gov/briefing/