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CENTRAL & EASTERN EUROPE AG. TRADE OUTLOOK

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Good afternoon. It's a pleasure to join you today at this year's annual forum, and to speak to you about the trading and agricultural outlook in Central & Eastern Europe. I live in Vienna Austria, and my Central European responsibilities for Pioneer over the past five years has allowed me to see first hand the transition these emerging markets are undergoing. It's both a very difficult but exciting market: one filled with both peril and hope.

I have prepared some overheads showing grain areas, production levels, livestock, and net-export levels for all of the Central European countries. These countries are defined as Poland, the Czech Republic, Slovakia, Hungary, the former Yugoslav States, Romania, and Bulgaria. I'll also briefly address the Ukraine.

Many of the people here today are interested in the trading opportunities in the CEEC's for grain and livestock products. However, one cannot look at the data without having a sense of the historical context which these numbers and trends represent. Everyone knows the dramatic political changes which occurred in 1989 have affected these countries significantly. So let me first step back and provide some historical context, talk about the current reform program, and then we'll look at the data and trends. Finally, I'll conclude with some observations and thoughts regarding how these collective countries might improve their agricultural capabilities to western levels.

BACKGROUND

Combined, the ten Central European countries have a population of about 106 mil and a land area of 1.1 mil square km. This is about 29% of EU-15 population and 33% of EU-15 area. In terms of area, contribution to GDP and, in particular, share in total employment, agriculture is relatively more important in the CECs than in the EU. On average over 25% of the work force is employed in agriculture (*e.g.* a total number 9.5 mil, compared to 6% or 8.2 mil in the EU). Agriculture still contributes 8% to GDP (compared to 2.5% in the EU).

It is well known that the initial impact of the changes which resulted from the collapse in 1989 was a severe recession throughout the Central and Eastern European region. Sharply higher consumer prices, coupled with falling real income, led to a dramatic decline in overall food consumption. This led to lower prices for agricultural producers who, at the same time, faced sharply higher input prices and caused livestock inventories to plunge. The crop sector's response was slower, with 1990 and 1991 characterized by surplus production and high net exports. It was only in 1992 that crop production began to drop, due principally to yield decreases resulting from lower input use and poor weather. Area - particularly grain area - has changed little. Since 1995, the agricultural sector has begun to recover, building new, often informal, networks to supply farm services and inputs, and to distribute food to city markets. Farm credit systems have developed, prices have now stabilized, and trade arrangements are being re-established.

By the end of 1997, all of the CECs have begun the process of recovery, in particular in the crop sector; however agricultural output remains below pre-transition levels (except Slovenia and Romania). Output was affected by the fall in demand as consumer subsidies were removed and the general economic situation deteriorated; also by the price/cost squeeze that agriculture faced (*e.g.* input prices rising much faster than output prices).

The degree of privatization and de-monopolization achieved in the up- and downstream sector differs between countries. Delays in the privatization and in the breaking-up of the large state monopolies in these up- and downstream sectors was one of the reasons for the price-cost squeeze the farm sector experienced in the first years of transition. When considering the relatively low level of farm-gate prices in the CECs, these downstream inefficiencies contributed (in the case of wheat, for example) to an almost doubling of the farm-gate price in order to get the product to the border. A return to profitability of farming will, to a large extent, depend on a competitive downstream sector and on a reorganization of the farm sector itself (*e.g.,* in bundling supply and strengthening its negotiating position vis-a-vis the food-processing industry and distribution channels).

AGRICULTURAL REFORM IN THE TRANSITION ECONOMIES OF CENTRAL AND EASTERN EUROPE

Extending the present CAP to the CECs will be too costly for the EU budget. The major obstacle is, however, not just the high cost. High food prices would make food expensive to the poor. Moreover, the use of supply management policies, which are a cornerstone of CAP, is highly inappropriate for CECs. The cost to the EU budget would be considerably lower if direct payments were not extended to farmers in CECs, the argument being that they should not have compensatory payments for incomes they never enjoyed. Regardless, EU support prices are expected to be reduced anyway as a result of the ongoing “Agenda 2000” and CAP reform discussions.

For the CECs, there are limitations to the extent prices can be allowed to rise. As long as food expenditures still consume 30% to 60% of household income and as long as inflation rates remain in the range of 10% to 30% a rapid increase in agricultural and food prices would be economically damaging and socially dangerous. The price gap between the CECs and the EU can therefore be expected to continue to exist for the foreseeable future, even if it will decrease more or less noticeably, depending on the product. Over time the price gap can be expected to be eroded to a certain extent by a relatively high inflation (not fully compensated by currency depreciation) and by a rise in domestic agricultural prices as food demand will recover more quickly than supply. In a situation of rising output, production costs will be more fully reflected.

I’ve already mentioned the up- and downstream inefficiencies that exist in the CEC’s . According to a recent study published by the European Commission, farm gate prices for soft wheat in Poland and the Czech Republic were, in 1995, 80% and 60% (respectively) of EU prices, whereas producer prices for chicken stood at 100% in both countries. It stood at 80% for pork in Poland but at 100% in the Czech Republic and Hungary. Internal producer prices for cereals reached around 65% of Union prices for the period 1994-1996, whereas pig and poultry prices stood at EU price levels. Consumer prices have also been lower than in the EU. Retail prices for bread in Poland and in the Czech Republic were at 30% of EU level in 1995, whereas retail prices for chicken was at 70% in Poland and 50% in the Czech Republic. According to a study done in 1996 by the French agricultural research institute INRA, Hungary retail prices for bread in 1995 were 23% of the French level; for chicken it was 62% and 42% for pig meat. Given the expected economic growth in the applicant countries, it is estimated that their price levels will come closer to the European Union level before they become members. Currency movements will have an effect on this as if the accession countries' currencies appreciate in value (in relation to the Euro), the gap will narrow. The opposite occurs if their currencies devalue.

In all the applicant countries, agriculture is being supported and protected in various ways. With the exception of Estonia, in all other countries the market price of at least one cereals crop, normally wheat, is supported by market agencies which apply a minimum purchase price. In the oilseeds sector, only Lithuania provides market price support for rape-seed. Cereals' tariffs are relatively high and close to Union levels with the exception of the Czech and Slovak Republics.

When we look at the livestock sector, the picture of support is more varied. With the exception of Bulgaria and Estonia, milk prices are supported in all ten countries concerned. Market price support for meat production is found in Lithuania, Romania, Slovakia, and Hungary. For the region as a whole, pork and poultry consumption and production have recovered from the slump of the first half of the nineties, but consumption has not yet reached the level it had before communism fell. It is expected to increase as income levels improve. However, higher consumer prices as a consequence of membership in the Union may have an effect. The European Commission in a working paper on „Long term Prospects of Grains, Milk and Meat Markets", published in April, expressed the view that *consumption* of pig-meat will remain stable after accession while the growth in poultry consumption may slow. The Commission, on the other hand, forecasts that *production* of pork and poultry products will continue to rise, leading to a growing surplus in an enlarged Union.

Current members of CEFTA include the Czech Republic, Hungary, Poland, Slovakia and Slovenia. The general pattern emerging in these countries is a process of rationalization of their agriculture towards a market economy but with decreased levels of output, especially in the livestock sector. In terms of trade in food and agriculture, Hungary has maintained its position as a net exporter, but may be a net importer of corn and barley by 2000 unless yield levels improve. Net imports have risen in the Czech Republic, Poland and Slovenia while the net imports of Slovakia have remained stable. All CEFTA members have increased their agricultural and food imports from the EU but have made less progress in terms of exports to the EU.

EU-associated non-CEFTA countries include Bulgaria, Estonia, Latvia, Lithuania and Romania (although Romania, as of July 1st, has now joined the trade pact). These countries have also witnessed sharp declines in agricultural production during the transition period. As in the first group, the decline has been more severe in the livestock sector than in the crop sector. With respect to trade, the Baltic states have significantly increased their imports of food and agricultural products, Romania has remained an overall net importer but with variations from year to year and Bulgaria has retained its trade surplus despite the sustained shortfall in production.

EXAMINATION OF CEE GRAIN & FEED TRENDS

The ERS baseline for Central and Eastern Europe projects the region to become a growing net exporter of wheat, maize, and beef; a declining net exporter of pork and poultry; and a growing importer of soybean meal and soybeans over the projection period of 1997 to 2006. The region includes Poland, the Czech and Slovak Republics, Hungary, Romania, Bulgaria, Albania, and the former Yugoslavian states. The major shortcoming of their projection is that it assumes that none of the applicant countries will join the EU during this period….an assumption I do not share.

With this backdrop, let's now take a look at some of the data to see what's happening with grain, oilseeds and meat trends, focusing mainly on the net export trends so you can see where the opportunities for U.S. producers may lie. The Central Europe region is known primarily for being a wheat producer ***(slide 1).*** Poland is the most dominant, while Poland, Romania, and Hungary collectively make up about 60% of all CEC production. ***(slide 2)*** For corn the picture changes with the former Yugoslav states making up about a third, Romania a third, and Hungary providing about a fourth of all production. ***(slide 3)*** For barley, the dominance is spread out a bit more evenly across the northern countries with Poland contributing a third, then probably the Czech Republic a fourth, and with Slovakia, Romania, and Hungary making up the lion's share. ***(slide 4)*** When we look at grain production, wheat is almost double the output of corn for the primary C.E.E.C. countries, with barley trailing by a third. ***(slide 5)*** For oilseeds, sunflower is clearly the winner, and as you can see, soybeans are almost non-existent. ***(slide 6)*** Meat production-wise, this graph shows the slump caused as a result of the 1989 political changes, but also shows that the key meat product in these countries is pork, then increasingly poultry, followed by beef (whose levels have been trending downwards due to price).

One of the reasons for the continuation of this slump for beef is the low prices for both dairy and beef reflect the de-capitalization of herds (the costs to maintain production potential in quantity and quality terms are not being met). Also, for beef, the lower quality of production is based on *dairy herds* as most CECs have no specialized beef herds. So, for the livestock sector the recovery will be less dramatic. For dairy, we expect the net export potential to be significantly lower than in the pre-transition period, for while the *supply and demand* for meat will remain (more or less) in balance, it will be at a lower level as compared to the pre-transition period.

Moving to the individual countries, **Poland** is one of the largest agricultural producers, but is a consistent net importer for grains ***(slide 7),*** oilseeds ***(slide 8),*** and meat ***(slide 9).*** Although crop yields have been improving, productivity has not been able to keep up with increased consumption, forcing the country to be a net importer for much of their agricultural needs. In **Hungary,** we see a continued rise in wheat exports ***(slide 10),*** but corn may be in danger of becoming a net import crop as we see livestock numbers increase, and a shift toward using more corn in that feed-mix. In the oilseeds area ***(slide 11)*** we see increasing levels of sunflower oil exports, matching the hectarage increases, with rape-seed moving to a net export status after 1995, but soybeans remaining a net import. For meat ***(slide 12)*** the steady pork export trends probably correlate to the net corn comments I've already spoken to with beef and poultry remaining at fairly constant levels.

As we move down to the southern Balkans, **Romania** net **meat** exports ***(slide 13)*** show the increasing need to import beef and poultry, with pork exports trending downward. The disappearance of many of the export markets available during the communist era has reduced production levels for pork, coupled with some increasing domestic consumption as their recovery starts to take hold. For **grain** ***(slide 14)*** wheat exports will remain close to 800,000 MT, but corn exports will be reduced as local consumption for livestock will increase faster than yield gains in the field. For **oilseeds** ***(slide 15)*** we may see more sunflower exports as hectarage continues to rise. Soybeans will continue to be a net import crop for the foreseeable future. In **Bulgaria,** 1996 was a catastrophic year agriculturally as 1997 was politically and economically. ***(Slide 16***) As you can see here, uncontrolled exports of **grains** in 1995 caused a bread crisis in 1996 resulting in a need for the government to import a high level of wheat. Good yields this past year resulted in a small level of net exports, which should continue to rise as yields return to pre-1989 levels. In **oilseeds** ***(slide 17)*** the drop in sunflower hectares combined with bad growing conditions have significantly reduced sunflower exports. Moving briefly to the **Ukraine**, the rising trends in grain exports ***(slide 18)*** is due more to decreased local consumption as a result of the recession. Hectarage planted remained more or less level (increasing for wheat, matching decreases in barley, with corn staying relatively flat). ***(slide 19)*** The Ukraine is a big sunflower producer and will consistently be a net exporter, while their net meat exports ***(slide 20)*** will be reduced for beef, and they will end up needing to import pork and poultry until their animal production capacity is restored. This next slide ***(slide 21)*** shows the decreasing production trends in this region for primarily beef and pork.

Moving briefly to the former **Yugoslavian** states ***(slide 22)***, dominated by Serbia, has seen and continues to see disruptions, not only from the events of 1989, but the fallout from the 1991 war. Corn is king with net exports reaching 1 Million MT this past year. In oilseeds ***(slide 23)*** they are net importers for soybeans, sunflowers, and rape-seed. Until the political problems for this region are fully resolved, it will be difficult to predict the agricultural trends for this region.

Finally, finishing off with the former Czechoslovakian state ***(slide 24)*** we see in the **Czech Republic**, for **grain**, they will remain net importers of barley and corn while wheat exports will soar. In **oilseeds** ***(slide 25)*** they'll continue to import soybeans and sunflower while rape-seed exports (which the country is more suited to grow) should level off around 40,000 MT. In **Slovakia** ***(slide 26)***, wheat will continue to be exported and barley imported, while in oilseeds ***(slide 27)***, sunflower exports will increase as hectarage planted to this cash crop continues to rise. Rapeseed imports will primarily come from their Czech neighbors.

I did not plan to cover the **Former Soviet Union** (FSU) countries, however ***(slide 28)*** this slide shows their problems are continuing with no foreseeable turnaround in sight. We start to see some slight upturns beginning in 1999.

So, when we look at the region as a whole, the data begins to reveal the negative impact of the recession that followed after the 1989 transition period, but it also shows the recovery that is now beginning to occur. Demand for local consumption is increasing more rapidly than the population growth. Rising prosperity in this region will mean a shift toward consumption of more animal products, and that, in turn, will require higher levels of cereal crops to be used as feed to produce the animals. This *multiplier effect* means that a greater amount of cereals will be needed to supply the same amount of calories at the dinner table.

SUMMARY & CONCLUSIONS

The CEC agricultural sector stands ready to enter the new millenium with significant potential for increased output and gains in productivity over the next ten years. However, this conclusion is based on the following assumptions:

- The general income growth in the CECs will lead to a certain recovery of demand for agricultural products - in particular for livestock products - although the pre-transition levels of per-capita consumption will likely not be reached. A rise in animal production will also increase the feed demand for cereals.

- Agricultural production can thus be expected to continue to grow in coming years, albeit at a slow rate. Undoubtedly, the CECs have a significant production potential. The big structural difficulties to realize this potential in the foreseeable future should, however, not be overlooked.

- In most countries, completion of land reform and restructuring of the food chain will take at least another ten years, while farm structures can be expected to evolve even more slowly as the capability of agriculture to attract investment will remain limited.

- The use of inputs is recovering and will contribute to an increase in productivity, but is not likely to attain pre-transition levels, when taking into account the development of input-output price relationships and the previous practice of wasting inputs unnecessarily.

- By 2000 supply and demand patterns in CEC agriculture are expected to have fully adjusted to the transition shock. In the crop sector there will be a certain shift towards cereals and oilseeds. Over the longer time horizon, as crop yields begin to approach western Europe levels, the CECs will increasingly become net exporters, surpassing their potential compared to the pre-transition era.

So, although the CEE markets represent good export potential for U.S. producers in the short term, this picture will begin to change as their recovery progresses. Near-term, as their rate of GDP increases and diets improve, consumption trend increases will outstrip internal capability and these markets will be attractive to US producers. Longer term, however, we will see significant improvement in capability and capacity of their grain, dairy, and livestock sectors to the extent that these countries will be net exporters, and compete with US producers for the world's growth markets.

Even though existing structural problems remain as obstacles, the picture is becoming increasingly brighter. While the transition period is taking longer than expected, trade pacts (like CEFTA) are helping to gradually integrate the CEC economies, trade restrictions are being increasingly abolished, the volume of foreign direct investment is rising, and good progress is being made in the area of structural institutional reforms. The USDA painted the following optimistic scenario for the future in their recently published "Central & Eastern Europe: An Emerging Agricultural Exporter" (July 1997): "During the period to 2006, most of these obstacles will be overcome. As the CEC governments bring inflation under control, interest rates should fall, thus encouraging more investment. As land tenure becomes more permanent and capital markets improve, true land markets will develop. Eventually these developments should lead to more efficient farms."

Thank You!