Analyzing the Czech Republic's EU Accession

By Petra Chŏteborská

With the collapse of Soviet authority in 1989, Czechoslovakia regained its autonomy through a peaceful change of government, called the "Velvet Revolution," and for a short time was known as the Czech and Slovak Federal Republic. On Jan. 1, 1993, the country underwent a "Velvet Divorce," which separated it into two nations, the Czech Republic and Slovakia.

The Economic Basics

One of the most stable and prosperous of the former Communist states, the Czech Republic has moved toward integration in world markets, a development that poses both opportunities and risks. The EU (European Union) ranked the Czech Republic just behind Poland and Hungary in preparations for accession, giving further impetus and direction to structural reform.

The Czech Republic has been recovering from a recession for the past several years. Economic growth has varied from 3.3 percent in 2000 to 2 percent in 2002, and is projected at 2.8 percent in 2004. Growth has been supported by exports to the EU, primarily to Germany, and a near doubling of foreign direct investment. In addition, domestic demand for consumer goods and services is growing by 3 percent a year. Inflation is under control.

Moves to complete banking, telecommunications and energy privatization will encourage additional foreign investment, while intensified restructuring among

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large enterprises like banks and improvements in the financial sector should strengthen output growth.

But revival in the economies of other European countries remains essential to stepped-up growth in the Czech Republic. Moreover, high current account deficits—averaging around 5 percent of GDP (gross domestic product) in the last several years—could become a persistent problem.

EU Accession and Producer Payments

In 2004, Czech agricultural producers will receive 25 percent of full EU direct payment levels that producers in older EU member countries receive, which may be topped up by 30 percent from the national budget. The EU payments will increase by 5 percent per year until 2006, and thereafter will rise by 10 percent per year until 2013, when direct payments should reach 100 percent.

The simplified area payment scheme will be applied–direct payments will be based on area. The Czech Republic has a total area of 8.57 million acres and will receive a total of $582 million in 2004-2006.

Accession and Production

Wheat, barley and rapeseed are currently highly profitable. After accession they are expected to remain so, which could prompt increases in area planted to these crops. The Czech Republic may become a net exporter of these commodities.

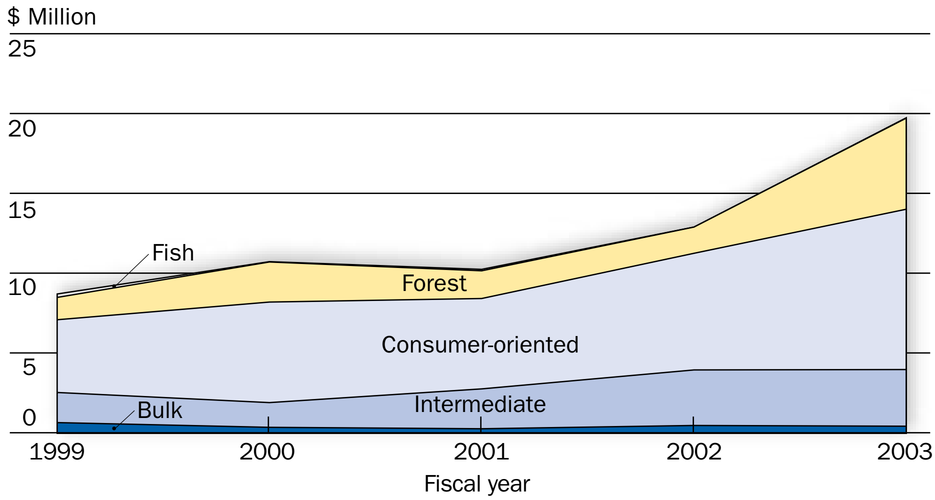
Under the EU sugar regime, which consists of production quotas, high tariffs and administered prices, sugar production is profitable in the EU generally and in the Czech Republic. With accession, sugar prices are expected to rise by over 40 percent, making sugar production within quota highly profitable.

Milk production is limited by quotas, and milk is one of the most supported commodities, with strong measures protecting the domestic market and high export subsidies. Nevertheless, milk production on arable land (near fields of wheat and rapeseed, which are used as feeds) is not profitable.

On the other hand, milk production in less favorable areas that have grass pastures is profitable. Milk prices are expected to increase by about 15 percent after the accession, and milk production will probably shift from arable land to hilly, grassy areas.

Beef production is also heavily supported by the government. With accession, prices could rise by 30 percent, and

U.S. Agricultural, Fish and Forest Exports to the Czech Republic Have Climbed Steadily in Recent Years*



*Official statistics understate U.S. exports because they do not account for products transshipped through other EU countries.

U.S. Products Facing Higher Tariffs

Below are old and new tariff rates for U.S. products that had at least a 7-percent share of total imports prior to EU accession.

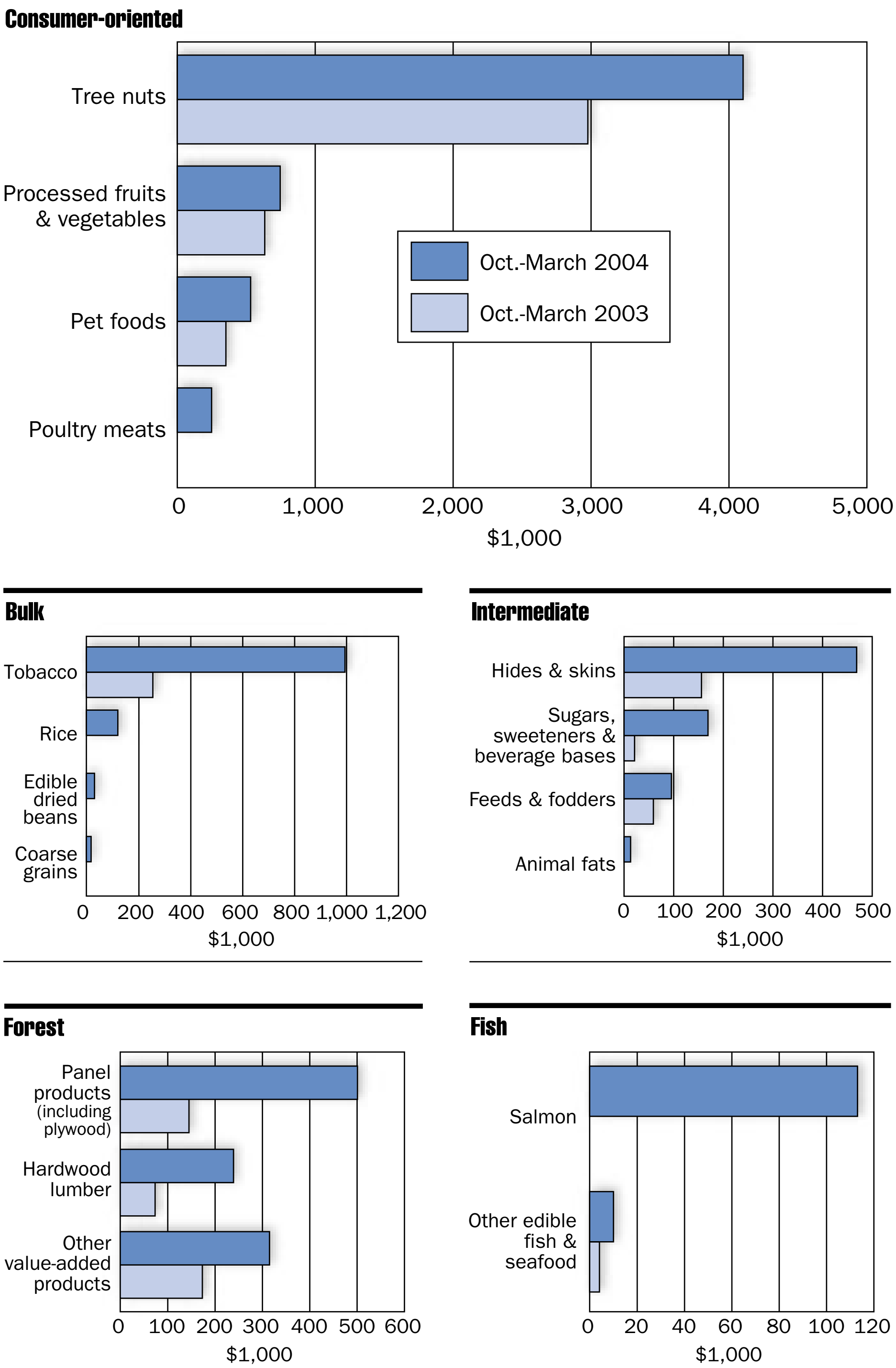
	% Tariff	
	Before	After
Tobacco	6	18.4
Fructose	0	16
Palm oil	0	9.6
Prunes	0.8	9.6
Dogfish	0	8
American salmon	0	2

U.S. Products Facing Lower Tariffs

Below are old and new tariff rates for U.S. products that had at least a 7-percent share of total imports prior to EU accession.

	% Tariff	
	Before	After
Whiskey	8.5	0
Veneer	1.6	0
Cigars	40	26
Lumber	2.5	0
Veneer sheets	2.9 or 1.6	0
Edible flours	20	15.4
Plywood	4.8 or 4.3	0

Numerous U.S. Products Across Categories Made Big Growth Gains in the First Six Months of Fiscal 2004



cattle production should be profitable, especially on grassland in less favorable areas.

Pork production is currently highly profitable even without any direct payments. Pork prices are relatively high, in some cases higher than in the EU generally, due to market protection. After accession, prices are expected to go down, which could decrease production. Additional outlays to bring Czech pork operations up to EU animal welfare standards may also push some producers out of the market.

Poultry production is highly concentrated. The domestic poultry market is highly protected, and even though prices exceed world prices, Czech operations are only slightly profitable. Poultry production is not directly subsidized in either the EU or the Czech Republic. After accession, prices of poultry may decrease slightly, and some producers will go out of business. Additional outlays to meet EU animal welfare standards may also push some producers out of the market.

The Czech Republic uses export subsidies for milk and dairy products, potato starch and beef. With accession, the EU's export subsidy system is being applied.

Accession and Trade

U.S. trade losses due to the Czech Republic's accession are being influenced by two major factors: legislative changes that restrict some U.S. products (beef, poultry, products derived from biotechnology), and zero tariffs on products traded with other EU members. The total amount is estimated to be in the range of several million dollars.

U.S. trade losses are not happening overnight; rather, declines have been influenced by the Czech Republic's

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preparations for its accession over several years. It must also be pointed out that statistics understate actual U.S. exports, because they do not account for products transshipped through other EU countries.

The Czech Republic now has the same veterinary and phytosanitary rules as the rest of the EU. The rules exclude shipments of U.S. fresh and frozen meats, although the Czech Republic's market for such imports is about $70 million a year and is served by at least 15 countries outside the EU.

There is demand for high-quality U.S. beef and poultry for retail sale, but these products continue to be constrained by sanitary restrictions.

In one area, EU accession will remove a nontariff barrier: the Czech Republic will accept all varieties of biotech products approved by the EU.

Accession and the Food Market

Consumer food and beverage consumption patterns have changed significantly since 1989. Consumption of soft drinks has doubled, and tap water has been replaced by bottled water, soft drinks and fruit juices.

Consumption rates for milk and other dairy products have decreased to below EU averages. Vegetable oils are replacing animal fats, although U.S. animal fat sales increased sharply in the first six months of fiscal 2004. Consumption of red meats dropped significantly.

On the other hand, poultry consumption has increased by 70 percent in the past 10 years. Fruits and vegetables are accounting for a higher share of menu items. Dark bread is gradually replacing white bread.

More affluent people are spending more money in restaurants, even though restaurant prices jumped when the value-added tax changed from 5 to 19 percent upon EU accession. Sales of prepackaged meals are growing in supermarkets and hypermarkets. These dietary trends are expected to continue after accession.

Czech producers are more concerned about price competition from new EU member states than from older members. Overall food prices are forecast to rise about 5 percent a year. ■

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