Special Article

Agriculture in Poland & Hungary: Preparing for EU Accession

Almost from the day the Berlin Wall fell, serious discussion has ensued about eventual enlargement of the European Union (EU) to include at least some of the Central and East European countries (CEE's). Prospects for EU enlargement drew closer to reality in 1997, when the EU Commission agreed to open formal negotiations with five of the CEE's—Poland, Hungary, the Czech Republic, Slovenia, and Estonia. In the Commission's view, these five had made the most progress toward meeting the requirements of membership.

Formal negotiations between the EU and the five first-tier CEE's began in March 1998. Official statements by both sides continue to identify 2002 as the target date for accession. Unofficial communications, however, suggest that enlargement is not likely to occur before 2006, and discussions of a transition period have surfaced. Nevertheless, the question is still when, not whether, these countries will join.

In October 1999, the Commission recommended that the EU begin negotiations with five more CEE countries: Bulgaria, Romania, Slovakia, Latvia, and Lithuania. No target date has been set for their accession, and all of them must make substantially more progress in several areas before they can be seriously considered for membership. The EU Commission has noted shortcomings not only in agriculture, but also in the financial and energy sectors.

Potential benefits of EU accession for the CEE's are substantial. Their economies will benefit from the inflow of structural funds (e.g., for developing institutions and infrastructure) and rural development funds from the EU budget. EU membership will also help attract foreign investment. CEE farmers will benefit from the price and income supports enjoyed by EU-15 farmers. For the EU, a primary benefit is a large, integrated European market with 100 million new consumers. The EU also has political and strategic reasons for seeking the accession of its CEE neighbors. This motivation has strengthened as a result of the Kosovo crisis. The EU hopes that enlargement will bring greater prosperity, and with it more stability, to the continent and help solidify democratic institutions.

But both sides have become increasingly aware of the costs as well. Accession will require immediate adoption of all EU legislation. In the food and agricultural sectors, CEE producers, processors, and policy makers are just beginning to realize the potential costs of conforming to the entire body of EU regulations. Many producers, especially in Poland, are increasingly fearful that they will not be able to compete with high-quality EU products in a single market, particularly when the costs of adopting EU regulations raise farmers' production costs. Accession will also mean substantially higher food prices for consumers whose average income is less than half the EU average. CEE meat prices, in particular, could rise substantially,

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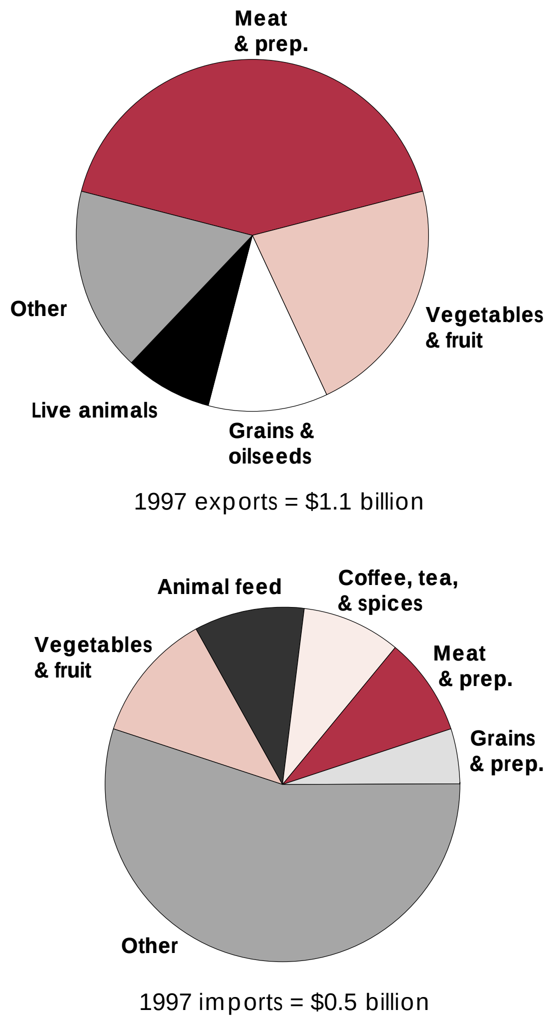
since current CEE meat prices are as much as 60 percent below those of the EU.

The EU, in turn, is concerned about pressures from additional commodity surpluses and the potential cost of providing income support to small, inefficient CEE farmers. Recent analysis by USDA's Economic Research Service (ERS) concluded that, under the current Common Agricultural Policy (CAP) modified by Agenda 2000, enlargement could bring additional surpluses of rye, beef, and pork, and that as a result the EU could have difficulty meeting its commitment to the WTO on limiting export subsidies for beef and pork.

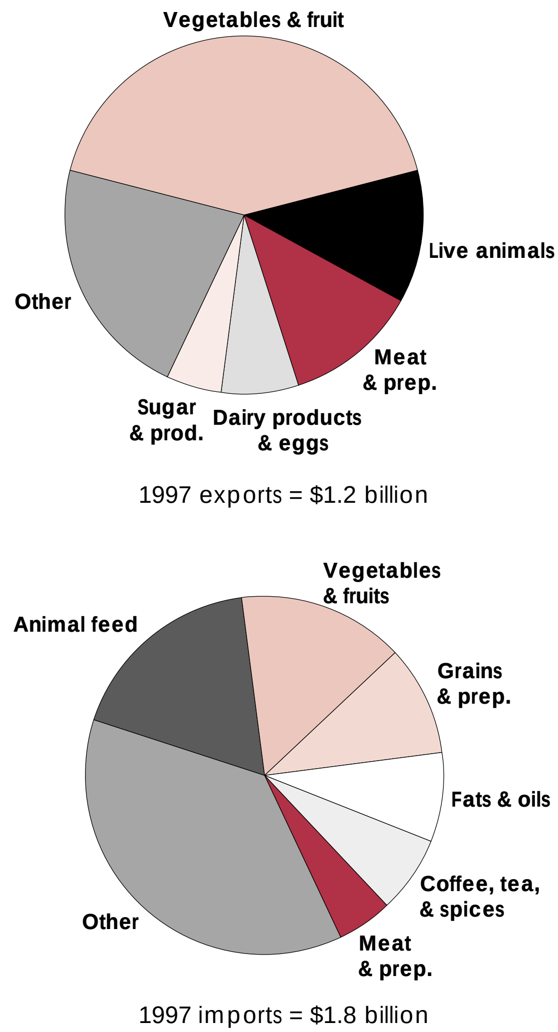
At the same time, accession will bring benefits to the nonagricultural sectors. The EU is providing substantial assistance in all sectors to help the CEE's prepare for accession, much of it directed toward infrastructure improvement. This assistance, combined with additional investment that is likely to come as the CEE's prepare for accession, can generate alternative off-farm employment for producers who cannot compete in an enlarged EU (surplus labor has been a key impediment to greater efficiency in CEE agriculture). Accession may also lead to a rise in land prices, but a lower cost of capital. All of these shifts could lead to dramatic changes in CEE production practices and thus accelerate changes that are required if the countries are to complete the restructuring process.

This article concentrates on the implications of EU accession for agriculture and food production in the CEE's. The principal focus here is on Poland and Hungary, since these are the largest agricultural producers of the five first-tier countries. However, many of the conclusions hold true for the other acceding coun-

Hungary Is a Net Exporter of Agricultural Products to the EU. . .



. . .While Poland is a Net Importer



Source: United Nations.
Economic Research Service, USDA

tries. All the CEE's face the challenge of aligning their institutions with those of the EU, and all have a long way to go.

For Poland, the challenges are greater because of its fragmented farm structure—average farm size is still just 8 hectares, up from 6 hectares in 1990 (1 hectare = 2.471 acres). But Hungarian producers, too, are beginning to worry about the costs of accession.

Slow Progress Toward Institutional & Regulatory Reform

Before any country can be accepted for membership, it must meet the following criteria:

- develop stable institutions to guarantee democracy, rules of law, and respect for human rights;
- develop an efficient market economy capable of competing on the integrated market; and
- demonstrate the ability to meet obligations of EU membership, including implementation of political, economic and monetary goals (e.g., the full range of the EU CAP and alignment of monetary policies with those of the EU.)

Nearly all CEE's applying for membership have met the first criterion. The five first-tier countries have made substantial progress towards the second, but have considerable work to do before meeting the third.

EU laws applying to agriculture and food production number 20,000, comprising 80,000 pages. Working groups in the agricultural ministries of all the CEE's are poring over these 80,000 pages and rewriting their own legislation to conform to EU laws. All the CEE's have made considerable progress toward harmonization of laws; however, building institutions to implement the laws and regulations is a much bigger challenge.

In general, Hungary is considered to be more prepared for accession than Poland; in fact, the Hungarians have expressed fears that their accession may be held up by Poland's lagging progress. But the EU Commission points out some areas that Hungary still needs to address. Areas of concern for both Hungary and Poland include the following:

Rural development policies. Both Poland and Hungary have large economic disparities among regions, and both still need to improve infrastructure and generate nonagricultural employment. In Poland, where 28 percent of the labor force is in agriculture and could be eligible for compensation payments from EU coffers under the current CAP, the EU is eager to see accelerated efforts to move some labor out of agriculture.

The EU is already providing substantial pre-accession funds to address these shortcomings, and even more money would come after accession through "Structural Funds" and rural development assistance. But the EU is concerned about a lack of coordination in developing and implementing rural policies: neither Poland nor Hungary has the administrative capacity at the regional level to administer these funds. The EU has rejected several of Poland's proposals for use of pre-accession funds, contending that the proposals were not well developed. Commission reports complain that in Hungary, nine different ministries are involved in rural policy.

Sanitary and phytosanitary regulations. Both countries have made considerable progress in harmonizing their standards and regulations with those of the EU. However, they lack the administrative structures to enforce them. Poland's Ministry of Agriculture, for example, has no staff carrying out inspections at meat plants; inspections are done by plant personnel.

The EU is particularly concerned about enforcement of sanitary and phytosanitary standards at border crossings with third countries. Facilities at border inspection posts are considered to be inadequate, and border checks are limited to controls on certificates and other documents. Actual physical inspections are done at destination, which falls short of compliance with EU import rules with third countries.

Animal welfare regulations. CEE livestock producers would be subject to a complex array of regulations involving animal welfare. Among these are regulations governing the number of hens that can be kept in a cage, limiting the number of hours animals can spend in transport, and prohibiting the tethering of cattle. Larger livestock producers are becoming more aware of the eventual need to comply with EU regulations on animal welfare, and some are making efforts to bring their operations up to EU standards. But animal welfare legislation has not yet been enacted in any of the CEE's.

Market support policies. The EU Commission has pointed out that price support schemes for pork in both countries have yet to be harmonized to EU standards. The CEE's must introduce supply control instruments such as dairy quotas and set-aside requirements in the field crops sector.

The EU has expressed serious concern about Poland's Agricultural Market Agency (AMA), which carries out intervention purchasing and administers minimum prices for wheat, rye and dairy products. But activities of the AMA go well beyond the narrower role of intervention agencies under the CAP. In addition to intervention, AMA's responsibilities include state reserve procurement, providing financing to companies purchasing grain at a minimum price, and commercial activities. It also has considerably more flexibility than EU intervention agencies in deciding when intervention should be activated. Most of these AMA activities need to be privatized in order to harmonize with the intervention and market information role of counterpart agencies in the EU.

Window on the Past

Excerpts from USDA publications

Enlarging the European Community

The European Community (EC) and the three applicant countries—Greece, Spain, and Portugal—are a major market for U.S. agricultural exports. . . . The United States has a keen interest in the accession negotiations because membership of Greece, Spain, and Portugal in the EC is likely to alter U.S. agricultural trade patterns.

The decision by the three to apply for membership in the EC was largely a political one concerned with perpetuating a democratic form of government. Political decisions are not without economic ramifications, however, and the practical problems of bringing the three countries into full EC membership are numerous. . . .

The crucial point to emphasize is that membership of Greece, Spain, and Portugal will do little towards eliminating current surpluses in the EC-9 and will likely create surpluses of other commodities. . . . Production incentives under the EC's Common Agricultural Policy (CAP) likely would stimulate production in the three applicant countries. EC Commission officials are concerned that without major changes in the CAP, surplus production will become considerably greater under enlargement.

Agricultural Outlook, November 1979

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Land markets. Most land is privately owned in Poland, and owners have clear title to their land—an improvement over many of its neighbors. However, Poland's land markets remain undeveloped. The EU Commission cites the need for a more efficient system of contracts to transfer ownership; an easy-to-apply system for using land as collateral; low-cost procedures for resolving disputes; and an easily accessible information system of land transactions, prices, and ownership.

Impediments to a fully functioning land market are even more serious in Hungary. Although most of Hungary's land went into private ownership in the early 1990's, many landowners are without clear title. Moreover, only individuals are allowed to own land; there is a prohibition on corporate land ownership, and corporations are unable to use land as collateral. Banks are reluctant to accept land as collateral, since they could be prevented from taking ownership of the land.

Statistical reporting. The EU also criticized Polish statistics, pointing to the need to update lists of farms from which samples can be drawn and the need for better data on purchasing and distribution. Poland may be unable to get EU structural funds if it fails to prepare sound regional statistics. In Hungary, regional statistics regarding unemployment and poverty need to be strengthened. Better market price quotation systems are needed in both countries.

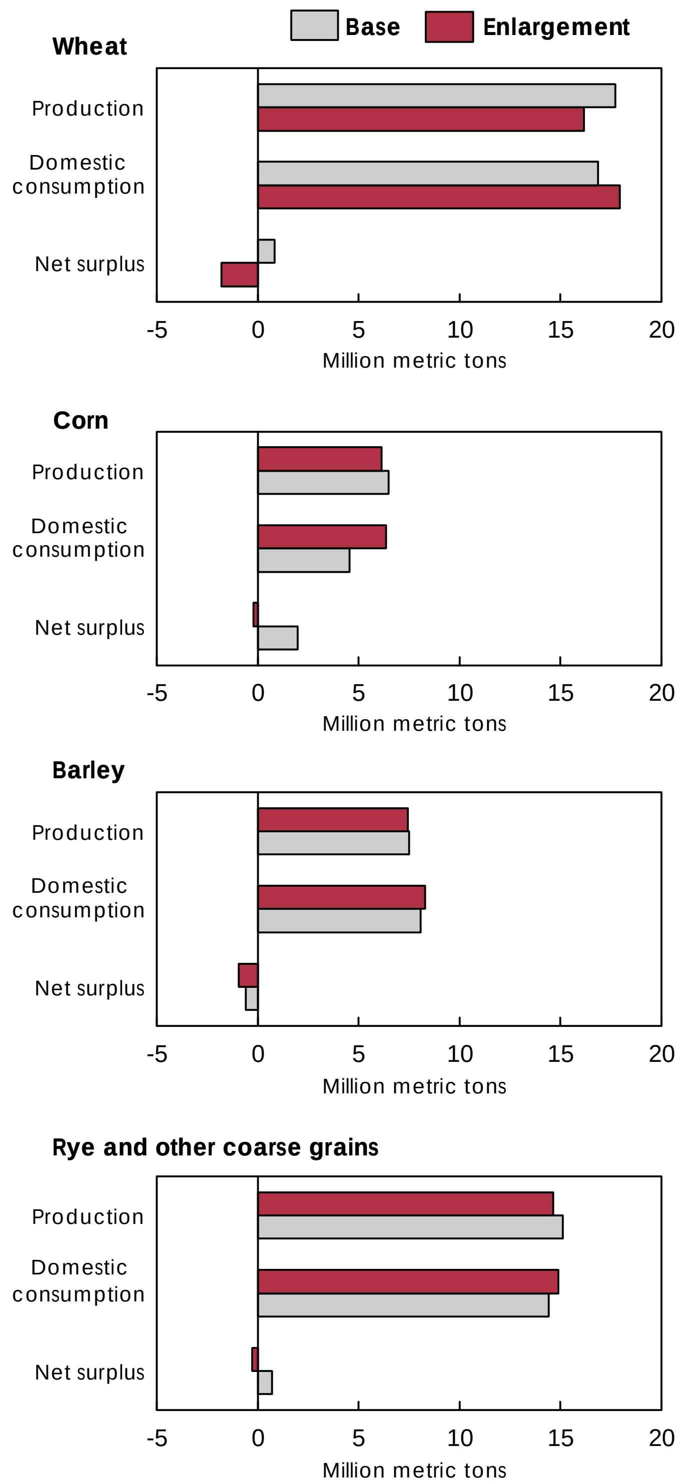
Can CEE Ag & Food Industries Compete in an Enlarged EU?

The ability of CEE agricultural and food producers to compete in an enlarged EU is a serious concern on both sides. CEE farmers and processors worry that a flood of higher quality EU products could drive many of them out of business. EU policymakers worry about budget implications of extending CAP protection to all CEE producers.

Of the five countries slated for earliest accession, only Hungary is a net exporter of total agricultural products to the EU. But both Hungary and Poland are net exporters of specific commodities to the EU—live animals (mostly cattle), meat and meat products, dairy products, and fruits and vegetables. Hungary is a net exporter of grain to the EU, whereas Poland imports grain. Both are net importers of feeds and processed foods.

Agricultural trade is an intensifying bone of contention between the EU and the CEE's. All CEE's are party to EU Association Agreements, signed in the early 1990's, which call for reduced tariffs on a wide range of products. The agreements seem to be working well for nonagricultural sectors, but implementation for agricultural products has been fraught with controversy. Most recently, Poland, upset by subsidized pork exports from the EU, retaliated by canceling most tariff preferences for agricultural products exported by the EU. Such trade disputes serve to illustrate how difficult final accession negotiations on agriculture will be.

EU Enlargement Would Eliminate Wheat Surplus for Poland, Hungary, and Czech Republic



Projections for 2005/06 under EU enlargement and Agenda 2000.

Economic Research Service, USDA

Special Article

The EU's Agricultural Policy Instruments

The basic objectives of the EU Common Agricultural Policy (CAP) are to increase agricultural productivity, ensure a fair standard of living for agricultural workers, stabilized markets, guarantee regular supplies of agricultural products, and ensure reasonable prices to consumers.

The current system is result of a reform package implemented in 1993/94, the EU's commitments in the Uruguay Round Agreement on Agriculture (URAA), and the beginnings of EU Agenda 2000. The 1992 reforms reduced support prices, implemented a system of direct compensation payments, and introduced new supply control measures. Changes implemented in 1995 as part of the EU's URAA commitments include the conversion of variable import levies to tariffs.

The EU's Agenda 2000, finalized in March 1999, builds on the 1992 reforms with further reductions in support prices for certain commodities, while partially compensating producers for the price declines through direct payments.

The principal policy instruments now in effect are:

Price support: The CAP is a price management system that supports the income of EU farmers in two ways. First, authorities buy the surplus supply of products when market prices threaten to fall below agreed minimum (intervention) prices. Second, the CAP applies tariffs at the borders of the EU so that imports of most price-supported commodities cannot be sold into the EU below the desired internal market price set by EU authorities. Methods used in managing agricultural prices in the EU include *intervention prices* and *export subsidies*.

Intervention price: A market floor price (intervention price) triggers market intervention mechanisms to support market prices. Farmers are able to sell their products to the intervention authorities at the annually adjusted intervention price. Products must meet minimum quality requirements to be accepted into intervention. The surplus commodities are then put into EU storage facilities.

Export subsidies (restitutions): When world market prices are below the EU market price, exporters are paid a subsidy to enable them to export competitively to the world market. If world market prices are above EU internal market prices, an export tax may be imposed to prevent the outflow of EU product. Such taxes are usually adjusted weekly or biweekly in line with fluctuation of world market prices. EU commitments under the URAA set limits on the value and quantity of export subsidies.

Prices for major commodities such as grains, dairy products, beef and veal, and sugar are dependent on the price support system. Other mechanisms, such as subsidies to assist with storage of surpluses, and consumer subsidies paid to encourage domestic consumption of products like butter and skim milk powder, supplement these basic underpinnings of the CAP to strengthen domestic prices. Some items, most often fruits and vegetables, are withdrawn from the market by producer organizations when market prices fall to specified withdrawal prices.

Direct payments (compensation payments): In addition to price support mechanisms, payments may be made directly to producers to help support their incomes. Compensatory payments were instituted as part of the 1992 reform package to compensate grain and oilseed producers for price support cuts. The payments, although established on a per-ton basis, are made to farmers as a per-hectare payment, based on average historical yield in the region where they farm.

Supply control: The 1992 reforms also instituted a system of supply control through a mandatory paid set-aside program. To be eligible for compensatory payments, producers of grains, oilseeds, or protein crops must remove a specified percentage of their area from production. Farmers are paid a set-aside payment for area removed from production under this program. Producers with an area planted to these crops sufficient to produce no more than 92 tons of grain per year are classified as small producers and exempted from the set-aside requirement. Supply control measures are also in effect for the dairy and sugar sectors.

Agenda 2000 reforms will continue to shift the EU away from price supports toward direct payments to producers. Key provisions of Agenda 2000 are:

- a 15-percent reduction in support prices of grains, phased in over 2 years, to be partially offset by increases in direct payments;
- a 10-percent minimum set-aside for crop land for 2000-06; and
- a 20-percent reduction in support price for beef, to be phased in over 3 years and offset by direct payments.

For more details on Agenda 2000, see *AO* May 1999 and October 1999.

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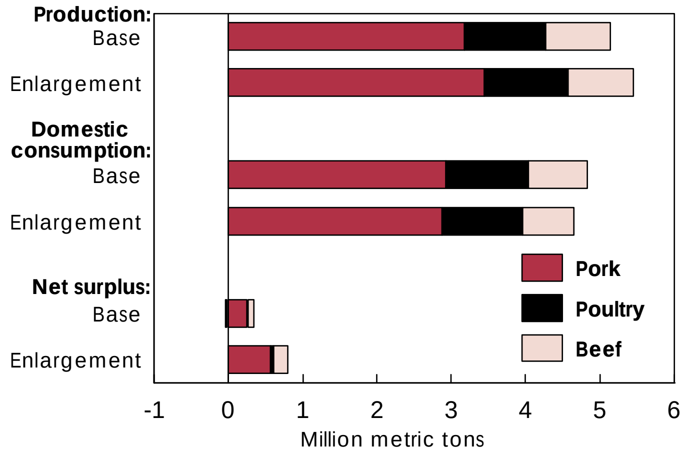
ERS recently analyzed the combined effect of EU enlargement and upcoming EU policy changes—i.e., Agenda 2000 (see *AO* October 1999)—on production and trade of grains, oilseeds, and livestock in the CEE's. The analysis covered Poland, Hungary, and the Czech Republic, with the assumption that the CEE's would immediately adopt the CAP in 2002 (i.e., no transition period). Under this simplified scenario, all CEE markets adjust to what would be prevailing prices under Agenda 2000. In addition, it was assumed that CEE producers would be eligible for compensation payments currently granted to EU-15 farmers and would be subject to EU dairy quotas. Key results for the three CEE commodity markets include the following:

- The CEE's in aggregate become net importers of wheat. Hungary becomes a slightly larger exporter, but these exports are outweighed by large imports by Poland and the Czech Republic. Wheat prices in Poland and the Czech Republic are currently above projected wheat prices under Agenda 2000. Accession will thus bring about lower prices and higher wheat imports in these two countries.
- The CEE's become exporters of corn and other coarse grains and smaller net importers of barley. All CEE coarse grain prices rise, since current coarse grain prices in all the CEE's are 20-30 percent below those in the EU.
- Oilseed production declines in all CEE's analyzed, principally because the new set of relative prices favors grain. Imports of oilseed meal increase.
- The CEE's become large net exporters of beef and pork. Because current CEE beef and pork prices are so far below those of the EU, CEE producers experience price rises of 40 to 60 percent. Output, particularly of pork, expands accordingly. The rise in beef output is constrained by the EU dairy production quota, as more than half of CEE beef production is from dairy herd culls. But higher prices cause consumption to decline sharply, leading to large surpluses.
- Accession would not have significant impacts on total U.S. agricultural exports as modest increases in CEE production would result in only slight declines in U.S. exports of pork and corn. There would be a small rise in U.S. soymeal exports.

Quality Differences, Input Changes To Affect Output

A number of complex issues not accounted for in these forecasts could significantly alter the direction and magnitude of actual change in CEE agricultural sectors in an enlarged EU. One is the question of relative quality of CEE and EU products, particularly livestock products. Much of the current differential in livestock and meat prices between EU and CEE countries is due to lower quality, even though quality varies considerably, particularly in the hog sector. Hogs slaughtered at top plants, which are licensed for export, are generally of high quality, often having a lean meat content of 58 percent or more. But less than 50 percent of Polish and Hungarian hogs are slaughtered at plants with such high quality standards. The remainder are slaughtered at smaller plants not licensed for export, which are not currently required to meet such quality standards. Hogs slaughtered at these plants tend to have a higher fat content. The leaner, higher quality carcasses generally command a higher price—both Poland and Hungary have a system of premiums for high-quality carcasses. In contrast, all hogs slaughtered in the EU-15 must meet strict quality standards.

EU Enlargement Would Increase Pork Production and Surplus for Poland, Hungary, and Czech Republic



Projections for 2005/06 under EU enlargement and Agenda 2000.
Economic Research Service, USDA

All hogs marketed in the enlarged EU will have to meet the higher quality level, and it is difficult to assess the full impact of the more stringent quality standards that will be imposed, with some farms and plants expanding and/or changing practices and others exiting the sector. Because the ERS analysis did not incorporate quality differentials within CEE countries and across an expanded EU, projected gains for CEE meat output—based only on higher prices in the CEE's—may be upper limits.

CEE meat output will also be affected by the very strict EU sanitary regulations governing meat processing. Slaughterhouses will have to install equipment for measuring back fat, apply the EU grading system to all carcasses, and conform to a wide range of regulations regarding flooring, equipment, and physical layout of facilities. Half of Poland's meat output and around 40 percent of Hungary's come from small plants that do not meet EU standards. Many of these operate on the "gray economy" (i.e. they are legal enterprises but do not comply fully with regulations governing taxes, labor, or sanitary standards), and most will have to close down upon accession.

The higher costs incurred in satisfying EU quality standards would not necessarily lead to declines in output. Preparations for accession could instead lead to increasing concentration in the industry. As smaller producers and processors are forced out of business, the more efficient firms, which currently meet EU standards, could expand. Moreover, pre-accession funds provided by the EU can also help existing plants speed up the modernization process.

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Accession will likely lead to significant changes in markets for land, labor, and capital, which could also hasten restructuring of CEE agriculture. CEE agriculture is now highly labor-intensive because wage rates are low and capital and other inputs are relatively expensive. If labor is fully mobile throughout the enlarged EU, wage levels in the EU and CEE's will tend to converge, and CEE wages could rise significantly. Moreover, the Structural Funds and additional investment that will likely come with accession will generate more employment in the CEE's, putting upward pressure on wages. Higher wages will draw much of the excess labor out of agriculture and should lead to consolidation of farms.

Land prices will likely also increase if all citizens in the expanded EU have the right to purchase CEE land. Land prices in the EU-15 are currently much higher than in the CEE's, and EU investors will be attracted by high-quality, low-priced land in the CEE's. Higher land prices would affect the production of all field crops, leading to more input-intensive production and thus higher yields. As modeled in the ERS analysis, CEE grain yields remain substantially lower than EU yields after accession, reflecting a continuation of current land-intensive production practices. With higher land prices, these practices will no longer be economically rational, and CEE producers may substitute more chemicals for land. In the livestock sector, cattle output would be more affected than hogs or poultry, because they now depend heavily on pasture for feed.

Capital will be more readily available after accession. Currently, investors consider the CEE's to be high-risk investments because of weak contract enforcement, lack of clearly defined bankruptcy procedures, and unclear property rights. EU accession will create a more stable business environment and thus attract more foreign capital.

Much Uncertainty Remains

Although all the CEE's have a long way to go before they are ready for accession, the EU is reluctant to delay enlargement indefinitely for political reasons explained earlier. In recognition of this reality, the EU Commission in mid-October 1999 officially acknowledged the possibility of a transition period. Specifically, the EU might allow a transition period "for those areas where considerable adaptations are necessary and which require substantial effort, including important financial outlays." Examples of such areas are environmental and infrastructure improvements. Other areas that may have a transition period include land and labor markets. The poorer EU countries are reluctant to allow full mobility of CEE labor; in turn the CEE's want a transition period before foreigners would be allowed to buy land. But the EU insists that all regulatory measures essential for the functioning of a single market be put in place immediately upon accession.

The Polish government, in contrast, wants no transition period, except in the area of land markets. Polish producers fear that a transition period would mean that they have to bear the costs of immediate implementation of the EU regulatory regime, but have to wait a number of years before gaining access to the full range of CAP support to agriculture.

In addition to the possible transition period, there are many other areas of uncertainty regarding the impact of EU enlargement, particularly the timetable. The initial wave of CEE's may not accede until 2006 or later, and the EU will not necessarily admit all five simultaneously.

Impacts on commodity markets are also uncertain. ERS analysis suggests increased surpluses of livestock products and rye. The inflow of Structural Funds and capital investment could bring about a dramatic shift in the structure of CEE livestock production and processing, leading to increasing concentration in both. If these shifts in production practices take place, output could increase. However, production in some of the CEE's could actually decline due to increased costs incurred by compliance with EU sanitary and animal welfare regulations.

CEE producers and processors who are able to adapt to the EU regime could benefit in the long term. Many smaller producers and processors will probably be forced out of business, and for this reason an increasing number of CEE producers are opposed to accession. However, the transition might go more smoothly than anticipated if accession generates enough nonagricultural employment to absorb labor released from agriculture. Preparations for accession could thus accelerate the restructuring process and leave remaining CEE producers better prepared to compete in a global economy.

It also appears that impacts on global commodity markets will not be as great as has been suggested by previous USDA analysis. Enlargement could lead to a reduction in U.S. meat exports and a small increase in exports of oilseeds and meal, but will likely not bring significant losses of markets. In the longer term, U.S. trade could benefit if accession brings greater prosperity and purchasing power to the region. **AO**

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