World Agriculture & Trade

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EU Enlargement: The End Game Begins

Ten Central and East European (CEE) countries are engaged in intense negotiations with the European Union (EU) for eventual membership. The official position of the EU is that 8 of the 10 will be ready to join in 2004—Poland, Hungary, the Czech Republic, Slovakia, Slovenia, Estonia, Latvia, and Lithuania. Two others—Bulgaria and Romania—are farther behind in their preparations and are not expected to be ready for membership until 2008.

In December 2000, EU heads-of-state drafted the Treaty of Nice to adapt EU institutions to the increased political complexities of a Union of 27 rather than 15. In October 2002, Ireland became the last current EU member to ratify the treaty, removing the final legal obstacle to enlargement.

Accession could bring significant changes in the structure of agricultural production and trade for the CEEs themselves, including large increases in output of feedgrains, beef, and poultry. Impacts on world trade are likely to be small, but enlargement could alter the mix of U.S. exports to the region. U.S. grain exports to the CEEs have already fallen almost to zero as their livestock sectors have declined, so enlargement would have little impact on that market. But the U.S. could lose much of the large poultry market as CEEs adopt specific EU sanitary requirements. At the same time, a rise in CEE incomes as a result of EU membership could create opportunities for larger exports of other high-value products.

The Enlargement Timetable: Can It Be Met?

Some key issues need to be resolved before the CEEs can join the EU, and it is not at all certain that all eight will be ready to join by 2004. If the CEEs are to meet that deadline, all negotiations must be completed before the Copenhagen Summit on December 13, 2002. At that summit, the EU will officially decide which candidates are eligible to join and will invite those candidates to begin the ratification process. For candidates not meeting the December deadline, accession could be delayed indefinitely.

In 30 policy areas, known as *chapters*, the EU and the candidate countries must reach agreement before they can be invited to join. These chapters cover areas such as free movement of capital and labor, judicial institutions, transportation, fisheries, regional policies, industrial policy, taxation, and agriculture. Most of the chapters are now closed (meaning the EU and the candidate countries have reached an agreement on the issues.)

For most of the candidates, the only remaining chapters to be completed are agriculture, competition, and budget and finance. The competition chapter mainly concerns national-level programs providing tax breaks and other assistance to foreign investors, and officials in the candidate countries do not expect this to be much of a problem. The budget and finance chapter concerns new members' contributions to the EU budget and is somewhat contentious because the candidate countries want to ensure that they are not net contributors to the EU budget (i.e., that they not pay in more than they benefit).

The agriculture chapter is the most difficult of the open chapters, and there are serious issues to be resolved before it is closed. There are two subchapters: one concerning veterinary, sanitary, and phytosanitary issues, the other concerning direct government payments to producers. Many of the candidates have completed negotiations on the first subchapter and have won transition periods for the requirements that are most difficult to satisfy.

But a far more contentious issue is the level and timetable over which the direct payments currently enjoyed by farmers in the EU will be extended to farmers in the new member countries (*AO* October 2002). The EU, concerned about the budget impact of enlargement, is proposing to phase in these payments over 10 years, starting with 25 percent in the first year after accession. CEEs have refused so far to accept such a proposal, insisting on equal treatment. The outcome of these negotiations will have some effect on levels of agricultural output but an even greater impact on the eventual structure of agriculture in the new member countries.

A related issue is whether new members will be allowed to maintain national-level policies. In the current EU there are no national support programs, only one common agricultural policy. But some candidate countries, such as Hungary and Poland, provide significant levels of both market price support and a variety of investment aids and direct income support. If CEE farmers lose the support they now enjoy and then get only 25 percent of the support currently going to EU farmers, the result could be a significant loss in net income for some CEE farmers. The consensus that seems to be emerging is that CEE governments will be allowed to continue levels of national support necessary to keep their farmers on a par with farmers in the current EU-15.

Enlargement Will Change Some Commodity Markets

USDA's Economic Research Service (ERS) analyzed the potential impact of enlargement on commodity markets in CEE countries, assuming no change in EU agricultural policy from the Agenda 2000 agreement. The analysis focused on the three largest agricultural producers among the eight CEEs expecting to join in the first wave—Poland, Hungary, and the Czech Republic. The analysis used a partial equilibrium model known as ESIM.

In the early 1990s, producer prices in the CEEs for most commodities were substantially below those in the EU. Researchers therefore concluded that accession could lead to enormous increases in CEE output of both crop and livestock products. In recent years, however, there has been considerable convergence between CEE and EU prices. Of particular interest in observing relative prices in 2000:

- Wheat prices in Poland and Hungary were above the EU intervention price. The Czech wheat price was only marginally below the EU price.
- Corn prices in Poland and the Czech republic were above the EU price. The Hungarian price was slightly below.
- Rye prices, on the other hand, were still substantially below the EU intervention price.
- Pork prices were nearly the same in the CEEs and the EU.
- CEE beef and poultry prices remained substantially below the EU price.

Two of the most important reasons for this convergence are changes in exchange rates and the intervention policies pursued by the CEEs. Since 2000, Polish, Czech, and Hungarian currencies have appreciated against the euro. In addition, in an effort to align their policies with those of the EU, the CEEs have intervened strongly in some markets, particularly grain.

A third reason is quality, which is particularly important for pork. Prices used for comparison were prices paid for the top grade of the EU grading system. The grading system evaluates carcasses mainly in terms of lean meat content. In the three CEE countries, the average lean meat content has been increasing, and an increasingly higher share of pork meets the top three grades of the EU grading system. This trend is the result of a steady trend towards consolidation in the meat industry and investment support provided by CEE governments (see AO, January 2002 for more discussion).

Following are highlights of the potential impacts of the three countries' membership in the EU as indicated by ERS analysis:

- CEE wheat output declines in Poland and Hungary. Production rises slightly in the Czech Republic, but total output for the three declines. Total wheat output for the 18 EU member countries declines, and net exports decline.
- Output of barley and rye increases in all three CEEs. The three remain net importers of barley, but the combined imports of these crops decline. The three produce large surpluses of rye, adding to already high EU intervention stocks.
- CEE pork output and consumption change little.
- CEE beef output rises, but, because most CEE cattle are dual purpose dairy/beef animals, output rises are constrained by the EU dairy production quota. Even so, consumption falls drastically as prices rise, leading to higher net exports.
- CEE poultry output and net exports rise.
- Output and consumption of oilseeds change little.

Direct Payments: EU & CEE Proposals

Two sets of direct payments were considered in the ERS analysis:

- For arable crops—i.e., grains and oilseeds—EU producers receive a per hectare payment calculated as a per ton amount multiplied by a so-called reference yield. These were introduced in the 1992 Common Agricultural Policy (CAP) reform as "compensation payments" intended to compensate EU producers for cuts in support prices that came with the reform. The reference yield is defined for each region based on historical average yields for that region. These payments are also subject to a regional area ceiling, again based on recent historical averages.
- There are a variety of payments for beef cattle: a suckler calf premium, paid twice yearly for each calf, and a premium for bulls and steers, paid twice in a lifetime. There is also a slaughter premium paid per animal at slaughter. All these premia are limited by regional herd ceilings based on historical averages and limits on stocking density (number of animal units per hectare.)

The payments were intended to be decoupled from production decisions, but in fact, most analysts agree they are only partially decoupled, in that farmers must

EU and Candidate Country Proposals Would Differ In Impacts on Farm Income

Country	EU proposal		Candidate countries' proposals	
	2006/07	2013/14	2006/07	2013/14
	Farm payments: euros per hectare			
Poland	65.62	187.49	228.66	228.66
Hungary	94.44	269.83	319.23	319.23
Czech Republic	92.67	264.76	266.03	266.03

Exchange rate is currently about 1 euro to 1 U.S. dollar.
Source: ERS calculations based on official EU and candidate country proposals.
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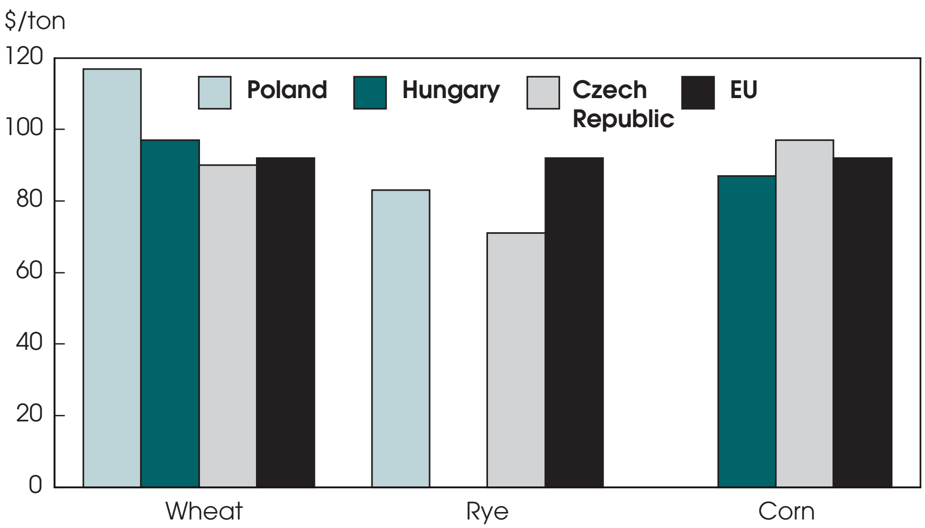
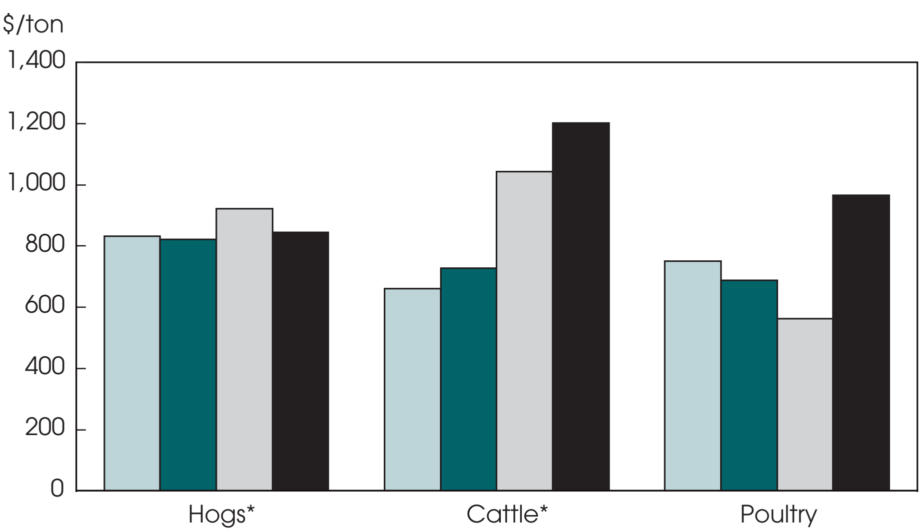
In 2000, CEE and EU Prices for Most Major Grains Were Converging. . .



. . .but CEE Cattle and Poultry Prices Were Still Substantially Lower



*Live weight.

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be operating their farms in order to receive the payments.

The EU Commission has been concerned about the cost of extending the full range of these payments to producers in the new member countries. In light of that concern, the Commission on January 30, 2002 issued its formal position regarding direct payments. The proposal calls for a 10-year transition period before CEE producers are eligible for the full range of direct payments enjoyed by current EU members. CEE producers will receive only 25 percent of the payments in the first year following accession, gradually increasing to 100 percent by the 10th year.

The CEE candidates have so far refused to agree to such a transition period, arguing that the single-market competition rules require equal treatment. They claim this will relegate CEE farmers to permanent second-class status, and that it will be impossible to compete with EU producers who receive greater income support. The EU Commission, in turn, contends that extending 100 percent of the payments to CEE producers in the first year following accession would slow down the restructuring of CEE agriculture that the Commission believes is essential if the new members are to be competitive in the single market.

A related issue under negotiation is the level at which the various supply controls under the CAP will be set for the new members. One set of supply controls involves the ceilings at which the direct payments will be capped. The other concerns national production quotas for milk and sugar. The EU has proposed to set these ceilings at the 1995-99 average area, yield, and herd levels. The candidates have all requested higher ceilings.

For each commodity, the candidates are requesting limits close to what they view as their potential. In most cases these are levels achieved in the 1980s during the Communist era. Since those levels were achieved in a system of high subsidies and distorted output prices, it is not clear that in a free market such levels would be economically feasible.

In fact, ERS analysis suggests that the differing positions on direct payments will not have a great impact on production. Two scenarios illustrate the results for Poland.

- Scenario 1 is the EU proposal: a 10-year phase-in with ceilings based on 1995-99 averages; Polish farmers receive 25 percent of payments the first year after accession.
- Scenario 2 represents the Polish request: Polish farmers receive 100 percent of the payments in the first year following accession, and ceilings are set at the levels requested by the Poles.

The results suggest that, for the most part, these differing positions would not greatly affect output of arable crops and meat. However, the dairy quota could make a larger difference. Poland currently produces over 12 million tons of milk per year. The EU proposal would entail a significant decline in Polish milk output.

Results are similar for Hungary and the Czech Republic.

However, the two proposals would have greater implications for farm income. Changes in farm income will be more serious if the candidate countries are forced to give up national support policies. One Polish expert estimated that if these policies are cancelled and Polish wheat producers do not receive full direct payments, their revenue could fall by 30 percent. Declining farm income, coupled with strict EU quality, sanitary, and veterinary regulations, could force many small producers to leave farming.

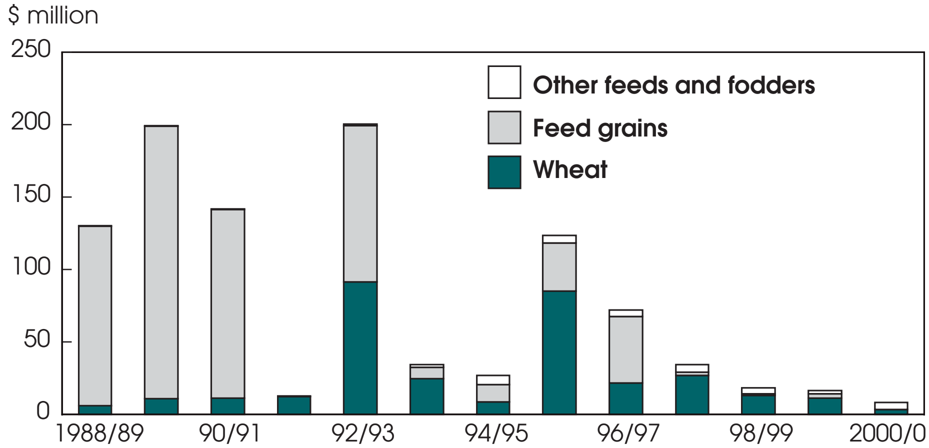
The EU proposes to offset the lower payments with increased funding for rural development through the Structural Funds, a program that already exists for funding development in disadvantaged regions in the current EU. The hope is that these funds will generate nonagricultural employment in rural areas, absorbing the labor forced out of agriculture.

U.S. Trade with an Enlarged EU

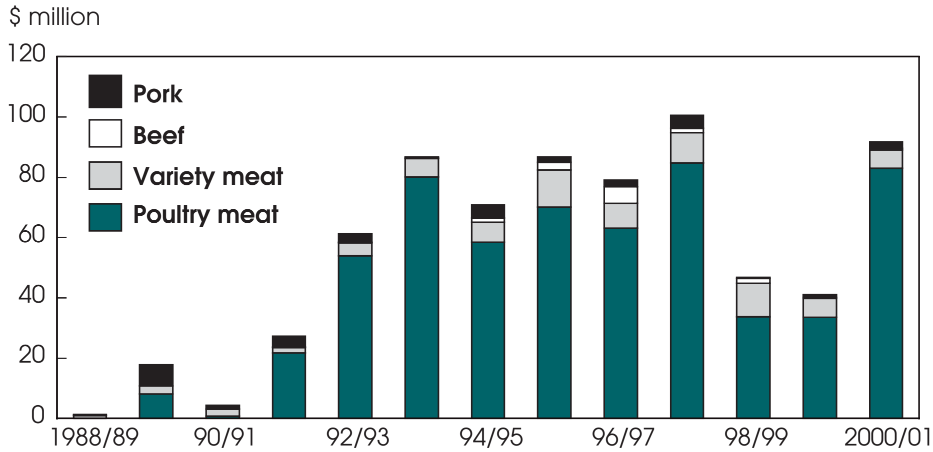
The transition of the CEEs toward a market economy has already brought about significant changes in U.S. exports to the CEEs, and EU enlargement could bring further changes. In the late 1980s, the principal products exported to the region were wheat, corn, and soybeans. As the region's livestock sectors declined, demand for these products fell off and U.S. exports of these commodities to the region dropped sharply. However, there was also a significant increase during the last decade in U.S. poultry exports to the region, principally to Poland and the Baltic States. Enlargement is likely to have little impact on U.S. grain exports to the CEEs, but the U.S. could lose much of the poultry market.

Declining feed demand is not the only reason for declining demand for U.S. grain. U.S. corn exports have also been affected by zero tolerance for ragweed seed on the part of Poland and Bulgaria. U.S. wheat exports have been undercut by low-priced Black Sea wheat—primarily from Russia and Ukraine, and to a lesser extent from Bulgaria and Romania.

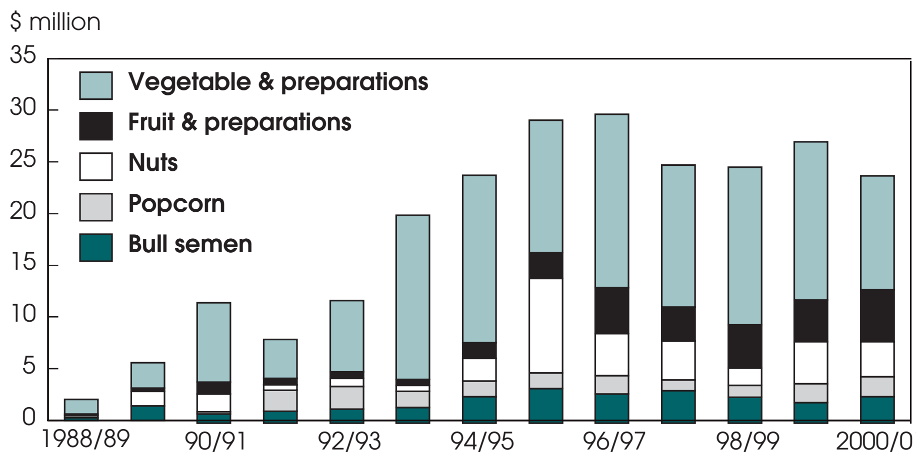
U.S. Grain Exports to the CEEs Have Dwindled. . .



. . .but U.S. Poultry Exports Increased in the 1990s. . .



. . .as Have Shipments of Other High-Value Products



CEE=Central and East European countries.

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Upon accession, the candidate countries will be required to give up their ban on ragweed seed, since the EU does not maintain a zero-tolerance policy. However, all EU restrictions on genetically modified corn will apply, and CEE corn output will also likely rise, thus reducing demand for imported corn. According to ERS analysis, CEE and EU net wheat imports could rise slightly with an enlarged EU. But it is likely that this demand will be met by Black Sea rather than U.S. wheat.

The U.S. poultry market in the CEEs was worth $83 million in fiscal year 2001. The EU currently bans all U.S. poultry meat because of a ban on treating carcasses with chlorine. Unless the issue is resolved, all acceding CEE countries will also ban U.S. poultry upon accession. Transshipments through Poland and the Baltic countries to Russia would be allowed to continue.

However, other markets could expand after accession. During the past decade, the U.S. has expanded exports of a number of high-value products. Products that bear watching include pet foods and snack foods, especially raisins, popcorn, and nuts. To the extent that EU accession generates higher incomes for the CEE populations, demand for these and other processed and packaged foods could rise.

Prospects for U.S. exports also depend on developments in the CEE livestock sectors. Any rise in CEE livestock output could increase demand for soybeans and other nongrain feeds. The U.S. has also developed a market for animal genetics—baby chicks, bull semen, and cattle embryos—in the region. The principal customer for these products so far has been Hungary, but if accession stimulates greater poultry output and the development of specialized beef herds, demand for such products could rise in other CEE countries.

Such promising developments can come about only if accession results in higher incomes for the CEE populations. Any potential for rising income depends in turn on creation of new and higher paying jobs in the region. Unemployment is already high in some of the candidate countries—reaching 18 percent in Poland in 2001. Accession will almost certainly decrease agricultural work in countries such as Poland, particularly if the EU prevails on the issue of direct payments. Whether this labor can be absorbed by other sectors is an open question.

Next Few Months Are Critical

The December Copenhagen Summit will decide which candidates are ready for EU membership. The accession treaties will be signed in March. After that, the treaties must be ratified by EU member states, and each candidate will hold a referendum.

The outcome of the ratification process is by no means guaranteed. Some member states have serious doubts about the benefits of enlargement. Likewise, there is serious opposition to EU membership in some of the candidate countries—Poland's farmers are strongly opposed, and there is considerable ambivalence in the three Baltic countries. To a large extent, the outcome of referendums in the candidate countries will depend on the results of the ongoing agricultural negotiation. AO

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