Nancy Cochrane

Pressures for Change in Eastern Europe's Livestock Sectors

Twelve years after the fall of Communism in Central and Eastern Europe (CEE), the meat and dairy processing sectors of the CEE countries are undergoing a rapid process of concentration and modernization. The process is most evident in Poland and Hungary, but similar trends can be observed in all the CEE countries. This restructuring has been accelerated by the European Union (EU) accession process, both because of pressure to meet EU sanitary standards and because of generous assistance provided by the EU to the food processing industry.

Drastic declines in livestock inventories and production during the early years of the transition have been well documented. There are still few signs of significant growth in livestock output in most of the CEE countries. In general, cattle inventories and beef output are still declining, although at a slower rate. Output of poultry meat has begun to grow in several countries, especially Poland, and pork output is also turning around. Many of the other CEE countries have also seen some growth in poultry, while pork has stabilized at lower levels. The principal exception to these positive developments is Romania, where inventories of all species continue their decline.

Structural changes are underway that could eventually lead to significant shifts in production and trade patterns in CEE countries. A combination of pressures is leading to a steady increase in concentration in CEE meat sectors. This trend is most apparent at the processing level, but there is evidence of farm consolidation as well. The result could be a dramatic reshaping of these sectors in the next 5 to 10 years.

The main driving force behind the changes is the preparation for membership in the EU. Once the CEE countries become members, all CEE meat and dairy plants will have to meet strict EU standards or close down. With the help of foreign investment and EU assistance, the larger CEE plants are gradually retooling to meet these standards. Smaller plants are already being closed.

Other factors have reinforced these changes. The loss of Russian markets following the 1998 ruble devaluation forced CEE countries to seek alternative markets in the West. However, Western markets remain difficult to penetrate because of the generally low or uneven quality of CEE output. The BSE crisis in the EU has led to tighter standards for cattle imported into the EU and is forcing a restructuring of the cattle/beef sector throughout the CEE countries.

Decline & Recovery

The early years of transition saw steep declines in livestock inventories and production in all CEE countries. Between 1989 and 1993, cattle inventories in Poland fell by 29 percent; hog inventories fell by 36 percent in Hungary and 31 percent in Romania. Meat output declined similarly, and for a brief period the CEE countries, formerly net meat exporters, became net importers. In brief, the following factors contributed to the decline.

- Elimination of subsidies caused prices of feed and other inputs to rise substantially.
- Real income of the population was falling.
- Liberalization of retail prices caused meat prices to rise, as consumer purchasing power fell. The result was a drastic decline in demand for meat.
- In many of the countries, state and collective farms were privatized or liquidated. As part of the liquidation process, animals belonging to the state farms were given to former landowners. These new private farmers were often unable to feed the animals and simply slaughtered them.
- With the opening of international borders, domestic meat products could not compete with attractively packaged imports from the West.

Since the early 1990s, the situation has been changing. By 1997, declines in pork and poultry sectors had virtually stopped; only cattle numbers were still declining.

Output of poultry meat has stabilized nearly everywhere, and output is growing rapidly in Poland. Other countries, including Hungary, Bulgaria, and Romania are seeing some increases in poultry meat output. This growth is in part due to changing preferences of consumers, who increasingly substitute poultry for beef because of price and health concerns. In 2001, consumer fears of BSE in cattle have accelerated this trend. Stronger demand has led to higher domestic poultry prices, which in turn has stimulated output.

World Agriculture & Trade

In addition, the poultry sector has attracted a great deal of investment recently at both the production and processing levels. Investors have been attracted to the sector by increased demand, the short growing cycle of broilers, and the ease with which the technology can be transferred across borders within CEE.

Hog inventories and pork output have also stabilized. Output has increased in several of the countries in recent years, but, there is no clear trend of sustained growth. Rather, this sector is experiencing cyclical increases and downturns in response to fluctuating grain prices and changes in government policy.

Cattle numbers and beef output are still in decline throughout the region. Cattle are still mainly dairy animals, and beef comes from young bulls and culled dairy cattle. The resulting meat is thus of a relatively low quality, and consumers prefer pork and poultry.

In contrast, the dairy sectors in Poland, Hungary, and a few other countries are beginning to see some growth. Some significant increases in milk yields have increased output even as cattle numbers continue to decline, and quality has also improved. In Poland, for example, half the milk now produced meets the highest EU standard (known as "extra class"). These improvements are the result of significant investment and foreign technical assistance to the sector.

Preparing for EU Accession

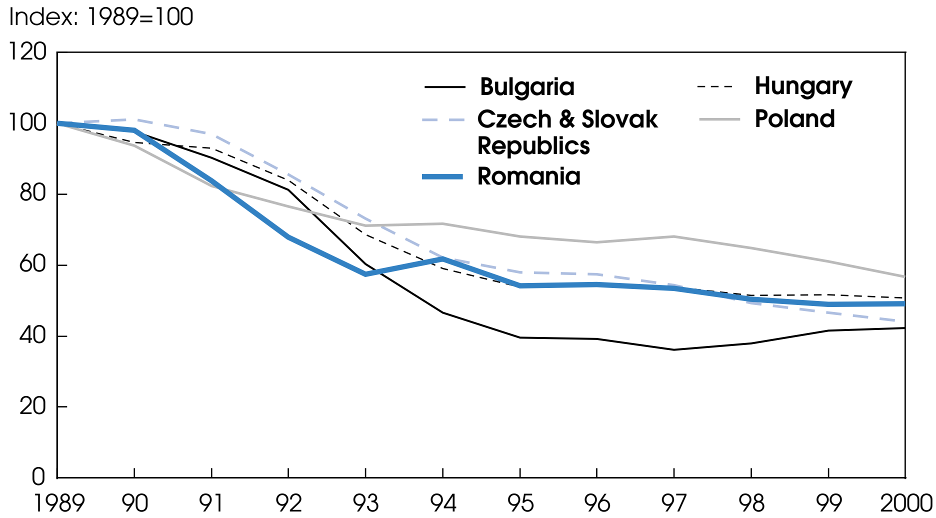
Ten of the CEE countries are officially candidates for EU membership. Poland, Hungary, the Czech Republic, Estonia, and Slovenia are in the so-called first wave that began negotiations in 1998. Slovakia, Latvia, Lithuania, Bulgaria, and Romania constitute the second wave. Some of the second wave has caught up and it is entirely possible that as many as eight CEE countries could join the EU by 2005.

Livestock production and processing sectors throughout the CEE continue to be divided between modern commercial operations, subsistence farms, and small one-room slaughterhouses. The large enterprises have received considerable investment in recent years and will have little difficulty meeting EU standards. Smaller units will find it much more difficult to meet the strict standards.

Regulations that meat plants will face include animal welfare rules, sanitary requirements at the plant, and environmental rules.

- Animal welfare rules will restrict the animals time in transit, regulate the number of hens kept in a cage, prohibit tethering of cattle and pigs, and strictly regulate slaughtering procedures.
- EU rules require a thorough system of identification and tagging of animals to assure the ability to trace the animal back to the farm of origin.
- "Dirty" phases of processing (slaughter and evisceration) must take place in a separate room from "clean" phases (cutting and further processing.) Many

CEE Cattle Inventories Stagnant



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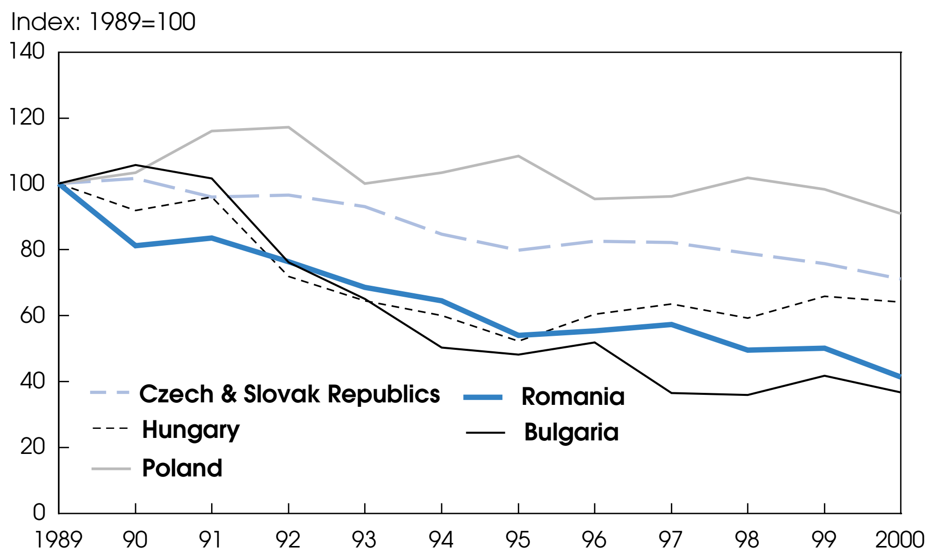
Hog Inventories Rise Slightly in Hungary; Stagnant or Falling Elsewhere



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small plants have only one room and cannot expand.

- Live animals must enter the plant on a separate road from which finished meat exits. Owners of the smallest plants do not own sufficient land to build new driveways.
- Plants must have equipment for measuring back fat of hogs and must apply the European grading system (known as EUROP).
- Environmental regulations require plants to have water purification systems. EU environmental regulations will force some plants to close because their locations are too environmentally sensitive.

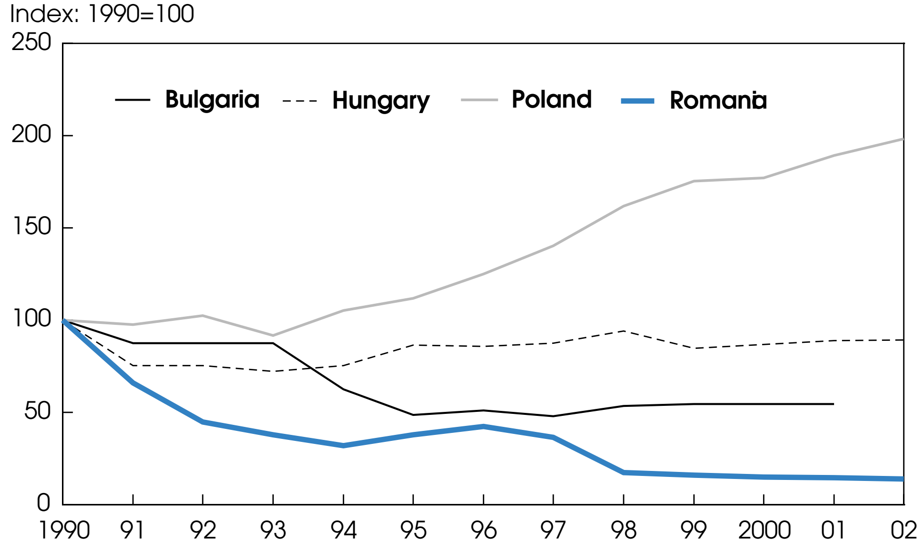
The CEE governments have all been phasing in some of the EU regulations over the past 5 years. For example, slaughterhouses in Hungary and Poland are required to have equipment for measuring back fat. Dairy plants are not allowed to buy milk that is below the second class as defined by EU standards.

Hungary has made more progress than its neighbors. But even there, only a third of the 600 meat plants meet all EU requirements. The situation is more critical elsewhere. In Poland, of 4,150 meat plants operating in 2001, only 19 slaughterhouses and 23 processing plants were licensed for export to the EU—between 40 and 60 others are applying for EU export licenses. Bulgaria has only three EU-approved slaughterhouses for sheep and lamb, none for broiler chickens, and six for ducks and geese.

Polish officials estimate that the total investment needed to bring the nation's meat plants into compliance with EU regulations will be about $900 million, or about $300 million per year. Of this, EU preaccession funds are expected to provide only $35 million a year, including cofinancing from the Polish side. The Polish Agency for Reconstruction and Modernization is providing some subsidized credit, but the bulk of the required capital will have to come from the plants' own profits or from foreign investors.

Some CEE countries—Poland for example—have negotiated a 3-year transition period following accession, during which

Poultry Output Rises in Poland, Holds Steady in Other CEE Countries



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plants that do not meet EU requirements can continue to operate as long as they sell only on the domestic market. Accession will almost certainly mean the eventual closure of hundreds of smaller plants.

Fallout Remains from Russia's Financial Crisis

As early as 1993, many CEE countries resumed their positions as net meat exporters. But their largest export market turned out to be Russia. Because of dependence on the Russian market, the Russian financial crisis of 1998 had severe negative impacts on CEE livestock sectors, particularly in Poland. Polish pork exports to Russia for 1998 were down by 26 percent from 1997, and producer prices for live hogs fell by 40 percent during 1998. Poultry prices dropped similarly, depressed by the sudden oversupply of pork on the domestic market.

Hungary's food exports to Russia fell by 20-25 percent in 1998, and meat exports to Russia ceased. Live hog prices in January 1999 were 36 percent below year-earlier levels. Romania's exports of livestock products were down by 20-25 percent in 1998.

Three years later, Poland and Hungary have partially recovered from the negative impacts of Russia's financial crisis. Polish pork and poultry prices in 2000 had returned to the pre-crisis level, and output of both meats rose in response. Meat exports to Russia have also risen.

CEE countries have not fully recovered the lost markets in Russia, mainly because Russian import demand remains well below pre-1998 levels. Poland has regained some of its pre-crisis market in Russia, but Russian imports of Polish half carcasses and sausage in 2000 were still only half the 1997 level. Hungary's pork exports to Russia were only 37 percent of the 1997 level.

The CEE countries have attempted to reorient their trade toward the EU. The "double-zero trade agreements" the CEE countries signed with the EU in 2000 have had some positive impact. In particular, CEE poultry exports to the EU have risen since the agreements were signed. But in many cases the tariff-rate quotas granted by the EU have remained unfilled because of quality problems. The EU has banned imports of fresh or frozen pork from Poland and Bulgaria because of swine fever outbreaks. More generally, the EU allows meat imports only from plants that have been inspected by EU veterinarians and found to meet all EU sanitary standards; few CEE plants meet those standards. The EU permanent vet-

Double-Zero Trade Agreements

Between July and September 2000 the EU signed so-called “double-zero” trade agreements with all the CEE candidate countries. These agreements establish three lists of goods: tariffs are abolished for goods on the first list; for goods on the second list, the agreement calls for zero tariffs within quotas; for the third list preferential tariffs are granted within quotas. For most CEE countries, pork and poultry are on the second list. For these goods, the two sides not only grant zero tariffs within the quotas, but also refrain from subsidizing exports. For more information see *Agricultural Outlook*, December 2000.

erinary committee now recognizes Poland as free from swine fever, which may improve Poland’s exports.

BSE Forces Restructuring Of Cattle Sectors

During the recent outbreak of BSE in Western Europe, most CEE countries did not experience a single case. Two cases occurred in the Czech Republic, four in Slovakia, and one in Slovenia. Even so, the presence of BSE in Western Europe had significant short-term impacts on CEE cattle sectors. The BSE crisis will also accelerate the restructuring of the CEE meat industry that was already underway.

In April 2001, the EU, reluctant to trust testing procedures in CEE countries, declared all CEE countries to be “at risk” of BSE. This meant a temporary ban on all cattle imports from the CEE until governments could demonstrate they had valid testing procedures in place. Most CEE countries have traditionally exported large numbers of live cattle to the EU, their largest customer. The result of the ban was a virtual halt of live cattle exports.

In an effort to resume cattle exports to the EU, nearly all the CEE countries have now imposed mandatory testing of all slaughtered cattle. The EU requires that all cattle above 30 months of age be tested for BSE. Poland went one step further and now requires testing of all cattle over 24 months that are to be slaughtered.

The cost of testing reportedly ranges from $22 per animal in Poland to $55 per animal in Hungary. The Hungarians estimate that their testing program will cost the cattle industry $10 million per year. Polish authorities estimate the cost of their testing program for the remainder of 2001 to be 68 million zlotys (US$17 million). Both governments are allocating funds to offset these costs at least partially. But in the long run, these measures will greatly increase the cost of beef production.

Production costs will also rise as a result of a ban on use of meat and bone meal in feed and the need to build specialized rendering plants for all cattle carcasses. These new regulations will accelerate concentration in the processing sector, as smaller plants will find these costs prohibitive.

The Move to Greater Concentration

These changes are already creating a trend of increasing concentration, particularly in the processing sector. For example, the current number of red meat plants in Poland—4,150—is down from nearly 7,000 in 1997. About 350 produce 60 percent of meat output. Four large capital groups control an ever larger share of the industry.

Poland’s poultry industry is even more concentrated than red meat production and is better prepared for EU accession. There are about 25-30 large poultry plants that account for 60-70 percent of all birds slaughtered. As with red meats, four capital groups control most of this market, and there is a substantial share of foreign ownership in the poultry sector. The Poultry Producers Council expects that all poultry plants will meet EU standards in 2 or 3 years. Those that are unable to meet EU standards are already being closed down.

Hungary’s meat and dairy industries have been highly concentrated since the beginning of the economic transition. In the dairy sector, the six largest plants control 70 percent of the milk market, and one Dutch-owned capital group accounts for 27 percent of the market. Three poultry processing companies control over 90 percent of Hungary’s poultry market.

Experts in Poland and Hungary believe that the small number of larger plants meeting EU standards will be able to produce enough meat to satisfy domestic demand and allow for exports. The principal concern is that many of the smaller plants are in rural areas where unemployment is already high. CEE concerns about the social costs of this restructuring are also having a strong influence on the direction of negotiations. For CEE countries, accession will be politically difficult without some assurance of a stronger social safety net for workers displaced by this process.

The phenomena of concentration and modernization adds a new dimension to projections of the impacts of EU enlargement on livestock production and trade. Analysis by USDA’s Economic Research Service suggests a potential for significant increases in beef and pork output in CEE countries once they join the EU. CEE prices are currently well below EU prices, and as prices rise to EU levels, it will stimulate increased output. At the same time, CEE producers will be subject to stringent regulations regarding product quality and animal welfare. But compliance will raise production costs, which may, in turn, dampen expected output increases.

Compliance with these regulations will significantly increase production costs, and many smaller producers could be forced out of business. But restructuring of the industry already underway could raise the efficiency of the CEE meat and dairy industries to the point where they can compete in the enlarged EU despite higher costs. AO

Nancy Cochrane (202) 694-5143
cochrane@ers.usda.gov

More details on the ERS web site

Livestock Sectors in the Economies of Eastern Europe and the Former Soviet Union: Transition from Plan to Market and the Road Ahead (forthcoming report)
www.ers.usda.gov

Enlargement to the East, Europe-International Agriculture and Trade Report (details on model results)
www.ers.usda.gov/publications/Wrs992/Enlargement.pdf