

# **SHOULD THE CEEC ADJUST TO THE COMMON AGRICULTURAL POLICY IN THE EU?**

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## **Summary:**

Association agreements between CEEC-10 and EU-15 can be considered as a first step towards integration. Therefore it is reasonable to ask, whether the CEEC should adjust to the present CAP. Integration of the agricultural markets is extremely difficult. The CEEC have agricultural problems because of the transition to market economy. The CAP raises problems in the EU. If the CEEC adjust to the present CAP it will create several serious problems in the future. In addition an adjustment to the CAP cannot be considered as an appropriate instrument to solve the present agricultural problems in the CEEC. An alternative policy for the CEEC and the EU is suggested.

## **Anotace:**

Asociační smlouvy mezi CEEC (země Střední a Východní Evropy) a EU (Evropská Unie) mohou být považovány za první krok ke sjednocení. Z toho důvodu je na místě otázka, zda by se země Střední a Východní Evropy měly přizpůsobit Současné společné zemědělské politice (CAP). Sjednocení zemědělského trhu je nesmírně obtížné. Země Střední a Východní Evropy mají problémy v zemědělství kvůli přechodu na tržní hospodářství. Společná zemědělská politika přináší nové problémy v Evropské Unii. Jestliže se země Střední a Východní Evropy přizpůsobí současné Společné zemědělské politice, způsobí to v budoucnosti několik vážných problémů. Kromě toho nelze přizpůsobení se společné zemědělské politice považovat za vhodný nástroj k vyřešení současných problémů v zemědělství v zemích Střední a Východní Evropy. Pro země Střední a východní Evropy a Evropskou Unii je navržena alternativní politika.

**Key words:**

Transition to market economy, European integration, CAP, problems with the CAP, alternative solution.

**Klíčová slova:**

Přechod na tržní ekonomiku, integrace Evropy, Společná zemědělská politika (CAP), Problémy Společné zemědělské politiky, alternativní řešení.

**1. Integration of the EU and the CEEC**

A main topic at the new government conference in the EU starting in 1996 is to integrate the present EU consisting of 15 member countries and the Central and Eastern European Countries (the CEEC).

Today ten countries in Central and Eastern Europe are expected to apply for membership of the EU in the nearer future. These countries are the four Visegrad countries, (Poland, Czech Republic, Slovakia and Hungary), the two Balkan countries (Romania and Bulgaria), the three Baltic countries (Estonia, Latvia and Lithuania) and Slovenia.

The so-called association agreements between each of the CEEC countries and the EU are considered as a first step towards membership of the EU.

The first 9 countries mentioned above have already signed association agreements with the EU and Slovenia will soon obtain a similar agreement.

The CEEC are preparing themselves for membership in the different areas. They are e.g. preparing internal free trade in a free trade area.

The four Visegrad countries have already formed a Central European Free Trade Area (CEFTA) to obtain free internal trade for industrial products but not for agricultural products, where protection will still exist.

The CEFTA will soon be enlarged by Slovenia and the intentions are later to enlarge by the five other countries which have association agreements with the EU.

CEFTA is not considered as an alternative to membership of EU but as a kind of preparation towards membership in the future.

The conditions in the agricultural sector are different in the different countries. The economic policy and the agricultural policy have not been exactly the same in all the CEEC. Nevertheless, there are also some common trends.

The general pattern since 1989 has been a price reform according to which the prices are free to be formed on the market. In addition the foreign trade was liberalized and a convertible currency for traded goods and services was introduced.

Since the first move of total liberalization in the agricultural sector there has been a shift towards protecting the agricultural sector by introducing instruments also used in the Common Agricultural Policy in the EU. The protection level in the CEEC is far below the level in the EU, but the protection level has been increasing. Not unexpectedly the farmers' unions in the CEEC are in favour of further protection.

What kind of agricultural policy should the CEEC conduct before the expected entry into the EU? Three options are frequently discussed:

Total liberalization

Continuation of the present policy

Adjustment to the present CAP.

The analysis in this paper leads to the conclusion, that it will be a severe mistake to adjust to the present CAP.

## **2. Problems with the agricultural sector**

To integrate the agricultural markets in the CEEC and the EU is a very difficult task. Firstly because of the agricultural problems in the CEEC. Secondly because of the problems related to the CAP. Thirdly because of the size of the agricultural sector in the CEEC.

### **a. Problems in the CEEC**

The problems in the agricultural sector are not specific for the sector but general in nature. They are related to the difficult transition from a bureaucratic commando economy to a market economy.

It is necessary simultaneously to introduce reforms relating to

competitive markets

private ownership

prices and income

A transition period is difficult, because the negative results turn up immediately whereas the positive results only are realized later. It is important but difficult to choose the sequence of reforms so that the negative elements are not self-perpetuating.

As a result there have been severe macroeconomic imbalances, negative growth rates, high inflation, high unemployment, balance of payment problems and public deficits. However, it should be emphasized that the situation has improved recently. The production decline took place in the period 1989-1993. Since then the production has increased.

The interrelationship between free prices and wages, competitive markets and private ownership is very important. Prices and wages can quickly be liberalized. It can be done overnight. But it takes time to establish competitive markets and to privatize, especially the large scale state enterprises. Privatization by itself without an efficient management may also create problems.

If prices are liberalized in an economy, where we do not have competitive markets, we will get higher prices than if the competitive markets existed. If the wages are also free to increase, we will easily get inflation and other macroeconomic imbalances. When those imbalances exist it becomes more difficult to privatize and to create competitive markets. People become more reluctant to buy real estate and to invest when prices are inflated and relative prices are distorted.

Therefore there is much to say in favour of a price revision prior to price liberalization. A revision of prices instead of price liberalization avoids the emergence of a cost-push inflation spiral and a deep decline in production. This will foster stabilization, which is a precondition for structural reform.

It is reasonable to speak of market integration at two levels, the national or internal level and the international level.

The problem in the CEEC is the lack of internal integration in the economy. The different subsectors in the primary agricultural sector have not been integrated. The primary agricultural sector and the food processing sector have not been integrated. The agricultural sector has not been integrated with the rest of the economy.

When it comes to international integration the CEEC are far ahead of the EU. At the beginning of the transition period the CEEC abolished trade barriers and introduced a convertible currency. Even though the initial liberalization has been replaced by some slight protection, one

can conclude that the CEEC have to a large extent integrated the agricultural sector internationally.

b. **Problems in the EU**

The agricultural sector is nearly totally integrated internally. The quota system in the milk sector and the set-aside programme in the crop sector are exceptions from the internal integration. The problem in the past has been, that the CAP is disintegrated from the international agricultural markets.

As a result a CAP reform was decided in May 1992. It is a reform which broadly speaking is limited to the crop sector. In December 1993 an agreement between USA and EU on the agricultural issues opened up for a new GATT agreement with a new set of rules for the agricultural sector.

Both the CAP reform and the new GATT agreement are steps in the direction of liberalizing the agricultural trade. The question is whether these reforms are sufficient in the longer run.

c. **The size of the integration problem**

The enlargement of the EU with CEEC-10 raises a lot of general questions about the future of European cooperation. It is a big enlargement because the number of nations are increased by 2/3, and the population and the total area by 1/3.

The relative size of the problem is even bigger in the agricultural sector, because the agricultural sector is so important in the CEEC. The arable land in the CEEC is 55 per cent of the arable land in the EU, and the agricultural employment in the CEEC is 116 per cent of the agricultural employment in the EU.

The agricultural integration is felt especially difficult in the EU because agriculture together with textile and steel production are declining sectors which are sensitive to changes.

Recently the trade balance for food products has turned in favour of the EU and disfavour of the CEEC. This recent trend can be partly explained by the decrease in agricultural production caused by the reforms of the economic system. This production fall will not be permanent but only temporary.

3. **An adjustment to the present CAP will create severe problems**

Firstly, the adjustment to the present CAP will create problems for the accession negotiations. Even at the present price level there are reasons to believe that the production will increase above the pre-reform level when the reforms are fully implemented.

If the price support level is drastically increased - which will happen if the CEEC choose the CAP support level - there will be a further production increase. That will add to the surplus production problems already in the present EU.

Secondly, it is unlikely that the present CAP can survive the integration of the agricultural markets in the EU and the CEEC. It would be very costly for the present members of the EU to extend the single market to the CEEC without reforms. If the enlargement took place to-day the agricultural budget costs would increase by 15-20 billion ECU, which is a 50 per cent increase in the present agricultural costs. When the CEEC expand their production level the costs will further increase.

The enlarged union will also get problems in relation to the recent GATT reform.

If the CEEC are quickly adjusting to the present CAP support level, the CEEC will allocate funds to an agricultural sector, which cannot be maintained. The result is a misallocation of resources in the longer run.

Thirdly, one can ask whether a CAP-like policy is compatible with the existing constraints for agricultural policies in the CEEC. Let us look at those constraints.

One constraint is not to hurt the consumers and the producers of non-food products too much. The consumer price increase can create social distress and discontent. The share of the food expenditures in the total budget is already high in the CEEC especially in the lower income groups. Higher food prices also lower the demand for products from other sectors.

Another constraint has to do with the macroeconomic imbalances which can be aggravated by the agricultural policy. If food prices are increased it will increase the inflation directly. The pressure for wage increases will undoubtedly also be more intense.

The high price level will increase the surplus production, which has to be bought by an intervention authority publicly financed. The desubsidization just after the start of the transition period in 1989 will be reversed. The public expenditures will increase the public deficit, which occurs because of all the public expenditures connected with the transformation of the economy.

There also exists a constraint for the CEEC in relation to the GATT agreement concluded in 1993. Several of the CEEC are members of GATT/WTO, e.g. the Visegrad countries. According to the GATT agreement the members have to fulfil some obligations in relation to tariff protection, internal support and export subsidies.

Fourthly, a heavily subsidized agricultural sector will distort the economy. A subsidy to one sector is a taxation of the other sectors, where the adjustment will be impaired.

Fifthly, the Common Agricultural Policy has caused problems in the EU. It is important that the lesson learnt by the EU is widely known.

The CAP is a bureaucratic price fixing system, which has distorted the price level and the relative prices. The CAP has caused a waste of resources. The system has created international tensions and contributed to the spread of protectionism. The CAP has not even solved the farm income problem in the longer run, and it has contributed to an unequal income distribution. The CAP as such cannot solve the economic problems in the poorer agrarian regions. The CAP has contributed to the environmental problems.

It should also be remembered, that if one has first launched a CAP-like policy, it is very difficult to change. A new support scheme and a higher support level will soon be considered as a permanent right by the farmers.

#### 4. **The Common Agricultural Policy is not a solution to the present problems in the CEEC**

Above we have looked at the agricultural problems in the CEEC. Is an adjustment to the CAP an appropriate answer to these problems? The CAP is a sector-specific policy with a high degree of protectionism.

Do we have a need of a specific agricultural policy in the CEEC? An affirmative answer is not very convincing.

In the transition period since 1989 there has been a general fall in production. There is no special problem in the agricultural sector. The output in agriculture has fallen less than the average fall in output in the whole economy. Therefore it is difficult to argue, that there is a special need for an agricultural policy. There is a need for a general policy.

The agricultural production fall is caused by several factors. The agricultural terms of trade have dropped significantly. The price for outputs divided by prices for inputs in agriculture has deteriorated. The selling prices have been lower because of monopsony structures in the processing industries. The input prices have been higher because of monopolies in the input sectors and because the prices of essential inputs like energy have shown a big increase.

The demand has decreased because of lower internal demand due to the higher consumer prices. The consumer subsidies were removed. The real purchasing power among consumers fell because of the general fall in production and employment.

The external demand from the CIS countries fell because of the breakdown of the former COMECON cooperation.

Finally, the sequence of the political initiatives in the transformation process was often unfavourable.

The fall in the animal production was bigger than the fall in the cereal sector. This fall is directly related to the way in which the cooperative farms were transformed.

When members of the cooperatives and former landowners received land to be farmed privately, they were not interested in taking livestock as well. In other cases the privatization procedure has been such that acreage and livestock are effectively separated. Landowners could claim their land from cooperatives at an early stage in the process, but other assets including livestock could not be distributed before the overall plan for asset allocation was agreed upon. Therefore the cooperatives had to cut down on the herd size.

These transformation problems cannot be solved by agricultural price support.

The real problems are restructuring and efficiency. These problems are not solved by price support. Another strategy should be chosen.

Firstly, instead of price support, efforts should be made to establish efficient markets for agricultural products. Big price fluctuations can be a sign of inefficiencies. Instead of policy intervention it would be better to get market improvements by establishing better storage facilities, future markets, better transportation possibilities, better access to credit and crop insurance systems.

Secondly, the CEEC should not protect themselves behind high tariff walls. Instead it would be a better idea to try to establish a free trade area or a customs union also for agricultural products.

In a larger market the price fluctuations will be reduced. It might be easier to establish new institutions such as commodity exchanges and future markets in a larger market.

The CEEC could gather experience before joining the EU. The CEEC might get a stronger bargaining position if they have established a common market for agricultural products.

Thirdly, if there is an income problem in the agricultural sector it should be solved by the national social policies. If people become unemployed because of the restructuring of agriculture then they should receive the unemployment benefits, which other unemployed people receive.

To facilitate the restructuring the CEEC should have some ideas about regional policy initiatives. There should be organized training programmes for displaced agricultural workers.

#### 5. **The assistance from the EU**

It is a task for the EU to help, so that the economic situation in the CEEC will improve, and so that the CEEC are not tempted to adjust to a CAP-like agricultural policy.

Through an efficient PHARE-programme the EU could contribute also to the restructuring of the agricultural sector including the processing industries. When speaking about agriculture one should not only look at the primary sector, but instead at the whole agroindustrial sector including the input sectors and the processing sectors. The competitiveness of the agroindustrial sector is very much dependent on the capabilities of the food processing industries. Cheap raw materials are not sufficient for selling competitive food products to the consumers.

The EU could also contribute to the establishment of a free trade area or a customs union among the CEEC including food products.

It is often mentioned that the EU should avoid selling subsidized products in the CEEC, because the EU products are outcompeting the local products. The figures are not really confirming this tendency. It is correct that the CEEC imports of food products have increased. But these increased imports consist for a large part of non-subsidized products and highly processed products. So the question is how much the CEEC have to gain by the removal of the EU export restitutions for exports to the CEEC.

The EU could help the CEEC to regain some of the former markets in the CIS by avoiding exports of subsidized food products to those markets.

According to the association agreement there are quotas for imports from the CEEC at a reduced tariff rate. The benefits accruing to the CEEC seem quite marginal. The size of the quotas is relatively small. The quota system is based on import quotas being given to the EU importing firms. Most of the terms of trade benefits accrue to the importing firms. If the licences were given to the exporting countries they would get the benefits.

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