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Stefan Tangermann*

Eastward Enlargement of the EU: Will Agricultural Policy be an Obstacle?

The political preparations for enlarging the European Union to include the Central European countries are in full swing, but economic policy preparations have not yet begun. There is a need for adjustment primarily in the Central European countries, but also in sensitive areas in the EU itself, particularly the Common Agricultural Policy. Will agricultural policy be an obstacle to eastward enlargement?

The enlargement of the European Union (EU) to include Finland, Austria and Sweden has just been completed, and attention has already switched to the next round, in which the countries of Central Europe that until recently were regarded as part of the "Eastern bloc" should realise their aspiration to join the Union. Whereas the admission of the EFTA countries went extremely smoothly and caused very few headaches for economic policy in the EU, the eastward enlargement will entail far-reaching changes in both the political and the economic setting of the Union. It will be some time before the first Central European country actually becomes a member of the EU and the order of joining has not yet been decided, but it is certainly not entirely unrealistic to assume that eastward enlargement will begin soon after the turn of the century and that several Central European countries will have joined by 2005.

The political preparations for what will undoubtedly be the Union's most ambitious foreign policy initiative over the coming ten years are already in full swing. Ten Central European countries have now concluded or negotiated association agreements in which the subsequent aim of full membership is expressly reaffirmed. The European Council has repeatedly declared its desire for eastward enlargement and has invited the heads of state and government of the associated Central European countries to attend the European summit as a visible expression of its determination to work towards that goal. The main task of the EU Intergovernmental Conference to be held in 1996 will be to remodel the institutions and decision-making procedures in such a way that they will not become unworkable with 25 or more member states. Bilateral contacts between EU and Central European countries have become increasingly close, and ministers from Central Europe are even occasionally invited to meetings of the EU Council of Ministers.

The economic policy preparations for eastward enlargement, on the other hand, have barely begun in the EU. Until now it has been perceived that most of the adjustments need to be done by the Central European countries, and the Union has established programmes to assist them in the transformation process. The fact that the EU itself may also need to adjust still does not appear to be regarded as an interesting subject of debate. So far, discussion about the future of the markets and policy in the Union in the light of the eastward enlargement has concerned only a few particularly "sensitive" areas. Agriculture is one of these "endangered" areas, so that the debate about the implications of eastward enlargement for the future of EU agricultural policy is already raising the temperature. "Eastward enlargement should not be carried out at the expense of farmers in the Union": this oft repeated demand from the representatives of farming interests illustrates the fears of Western Europe's farmers better than any academic analysis can.

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Are the Farmers' Fears Justified?

What is the background to these concerns, which now spread through the farming community of the Union whenever there is talk of eastward enlargement? First, in economic terms eastward enlargement will to a large extent mean an agricultural enlargement of the Union. The combined national product of the ten Central European countries with which the EU has already concluded or negotiated association agreements[1] is equal to just 3% of that of the present Union. The agricultural area of these ten countries, however, is equal to 44% of the agricultural area of the present EU member countries.[2] The agricultural output of the ten candidate countries is not quite as large in relation to that of the EU, as yields per hectare and livestock density are lower than in Western Europe; broadly speaking, it nevertheless equals about 30% of that of the Union. If eastward enlargement were carried out today, the agricultural output of the Union would therefore increase by about ten times as much as its national product. It need hardly be emphasised that the entire scenario for agricultural markets and agricultural policy in the Union would then change radically.

The situation in Central Europe will obviously change over the next ten years, during which time a large part of the eastward enlargement will presumably take place. If all goes well, macroeconomic growth will be far more rapid in the Eastern part of Europe than in the West. At the time of accession the countries of Central Europe will therefore boost the GNP of the Union by a larger percentage than would be the case today. It is less clear, however, how agricultural production in the region will develop. It has declined substantially in all of the countries concerned since the beginning of the political and economic transition, and by between 25 and 30% overall. Many observers see this as a sign that Central European agriculture is uncompetitive and therefore assume that the region's farm output will grow only moderately. However, they are overlooking the fact that the decline in output in recent years is an almost inevitable side-effect of the far-reaching process of transition that is still taking place in society, in the economy and naturally also in agriculture in Central Europe. During this adjustment process output fell in almost all branches of activity, but closer examination of the statistics reveals that agricultural output declined by less than the output of industrial goods, for example. Agriculture therefore proved to be a relatively robust sector during the turmoil of the transition. Hence, it is not only conceivable but also probable that agricultural output will increase strongly again in the next ten years, and almost certainly more rapidly than in Western Europe. Even if the Central European countries join in ten years' time, they will therefore increase the farm output of the enlarged Union by much more than its GNP.

In addition, the prices at which agricultural products are currently traded in the markets of Central Europe are generally well below the EU level. The difference in relation to the support prices paid in Western Europe under the CAP differs from one country to another and from product to product, but in many cases agricultural prices in Central European countries are only between 50 and 70% of those obtaining in the Union. They are therefore often close to world market prices. If the CAP remained unchanged and EU prices high, the farmers of Central European countries would have a powerful incentive to increase production at the time of accession at the very latest, thus greatly boosting the growth in the supply of agricultural products in the acceding countries. It is therefore partly this fear that the agricultural markets of an enlarged Union would be swamped by the increasing supply of agricultural products from Central Europe that is leading to concern among the farmers of the EU and to debate about the future of the Common Agricultural Policy.

Need for Decisions about the CAP

How can the Common Agricultural Policy of the EU respond to the challenges posed by eastward enlargement? What course should it follow in the next few years? This can best be determined by thinking through a series of questions that build logically on one another and which the EU must therefore answer in the same order.

The first question, namely whether eastward enlargement is probable in the foreseeable future, has already been answered by the political action taken in the EU and in Central Europe: eastward enlargement will take place. Agricultural policy problems cannot and must not block the path to the integration of Central Europe into the Union. From the agricultural viewpoint, the next question is whether the accession

[1] Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia.

[2] Figures from European Commission: Agricultural Situation and Prospects in the Central and Eastern European Countries - Summary Report, Working Document, Brussels, July 1995.

of Central Europe is conceivable without agriculture, in other words whether it would be possible to exclude the agricultural sector from the internal market of the enlarged Union. If that were the case, the Central European countries would have to continue to operate agricultural policy at national level instead of integrating it into the CAP. Excluding agriculture is simply not an option. Agriculture is an important part of the economy of the Central European countries and has a far greater impact on employment and income generation than in the average Western European country. For that reason, the candidate countries are already hoping to gain free access for their agricultural products to the markets of the Union. Accession without agriculture would reduce the Central European countries to the status of second class members of the Union, both de facto and in their own eyes, which would be an intolerable situation politically.

Accession coupled with long transitional periods for agriculture, if possible almost infinitely long ones, appears to be a more conceivable scenario to many of those involved in Western Europe. Here one can point to the conditions for all enlargements up to and including the accession of Spain and Portugal. In all of these cases price differentials between the agricultural markets of the existing Community and those of the acceding countries were not eliminated instantly upon accession but over a fairly long period, which in the case of Spain and Portugal was supposed to last for up to ten years but which was shortened slightly at the time of the "early" creation of the internal market. In order to prevent arbitrage and permit exports, it was obviously necessary to levy duties and pay export subsidies (so-called accession compensatory amounts) at the borders between the old Community and the new member countries. If such a transitional period were also introduced for the eastward enlargement, the farmers of Central Europe would not be able simply to swamp markets in the West with their cheaper products, and their counterparts in Western Europe could continue to rely on selling their surpluses in the new Eastern member countries at subsidised prices. No wonder that the representatives of farming interests in the EU (and the Ministry of Agriculture in Bonn, for example) argue insistently for a long transitional period in agricultural markets after eastward enlargement.

What the advocates of this "solution" overlook, however, is the fact that the principle of the single internal market has now become an important cornerstone of the process of integration in the European Union. It is therefore difficult to imagine eastward enlargement without simultaneously including the new Central European member states in the single internal market. The only freedom that it may not be possible to extend immediately to the new member countries is the freedom of movement of workers. There is no desire to forego free trade in goods and services and free capital movements with Central European countries after their accession. The Central Europeans see it this way, and so apparently does the Commission of the EU. Its first White Paper on the eastward enlargement, dating from May 1995, is essentially an instruction manual for the "Preparation of the Associated Countries of Central and Eastern Europe for Integration into the Internal Market of the Union", which is also the title of the document. The White Paper leaves not the slightest shred of a doubt that the inclusion of the Central European countries in the internal market will be an integral part of their accession to the Union. It discusses the agricultural sector only in passing, as the Commission intends to publish a separate White Paper on the sector in the context of eastward enlargement this October. However, not one single word of the White Paper suggests that the agricultural markets might possibly be excluded from the creation of an internal market at the time of eastward enlargement.

Internal Market Prohibits Exclusion of the Farm Sector

That is just as well, for the exclusion of the farm sector from an internal market involving Central Europe would mean maintaining customs checks at the borders of the Central European countries solely in order to partition the agricultural markets. The principle of dispensing with border checks upon realisation of the internal market, which is important both politically and economically, would have to be violated solely for agricultural policy considerations if the agricultural market were to be excluded. All goods traffic would have to continue to be inspected at the borders, for it is impossible to tell from the outside whether a lorry or ship is carrying agricultural products or other goods. A transitional period for the adjustment of the low agricultural prices in Central Europe to the higher level obtaining in the markets of the existing Union would be technically feasible only if customs duties were levied and export subsidies paid on agricultural trade with the new member countries, as last occurred in the case of Spanish and Portuguese accession. As this can only be done at the borders, the principle of a single market without

internal borders would in effect have to be suspended until the transitional period had ended; in other words, in the view of advocates of such a solution, for at least ten years after the accession of the Central European countries. It would hardly be acceptable to allow the agricultural tail to wag the integration policy dog so vigorously. Moreover, the Central European countries would rightly raise vehement opposition to such a solution, for the opening-up of Western Europe's agricultural markets is for them one of the most important economic objectives of entry to the European Union.

Furthermore, the old model of the agricultural transitional period in connection with enlargements of the Union is outmoded; it was not used when Finland, Austria and Sweden joined at the beginning of this year, precisely because of the creation of the internal market and its prime importance for European integration. For the first time in the enlargement of the Union, agricultural prices in the new member countries were therefore adjusted immediately on the date of accession. Consequently, it is probably better to get used to the idea that eastward enlargement cannot and will not involve a transitional period for the agricultural markets. Upon accession, agricultural prices in the new member countries in Central Europe will therefore probably have to be adjusted fully to those prevailing at that time in the European Union.

Rise in Central European Agricultural Prices foreseeable

Unless the CAP had been revised by that time, the integration of the Central European agricultural markets with those of the Union would therefore lead to a steep rise in agricultural prices in the new member countries at the time of accession, at the very latest.[3] This would greatly reinforce the expansion in the supply of agricultural products that is expected to occur in Central Europe in any case. The agricultural markets of the Union would then be burdened with further surpluses, and the problems already confronting EU agricultural policy would be greatly exacerbated. The question whether the Union's agricultural policy is in need of further reform therefore arises again in connection with the future eastward enlargement, and in a far more pressing form. A transitional period, of whatever length, would make no fundamental difference to this pressing question, but only at best provide a few more years' breathing space.

If the CAP were not reformed as a prelude to eastward enlargement, a series of adverse consequences would ensue which need to be considered carefully. As far as the Central European countries are concerned, it should be borne in mind that food prices there are of much greater significance for real incomes in view of the far lower level of consumers' incomes; one-third or more of income is spent on food. High prices for agricultural products and food would therefore impinge much more heavily on standards of living than is now the case in Western Europe, and would attract greater political attention.

For the Union as a whole as well, it would be difficult to continue with the present agricultural policy unchanged. Two considerations are of particular importance in this connection. First, the additional burden on the Union's budget as a result of eastward enlargement in these circumstances has to be considered. The added cost will be high in any event, because the enlargement will make heavy demands on resources for the Union's structural and regional policies. This is an economic price that the Union must and can pay for an eastward enlargement that is politically desirable and indispensable for overriding reasons. The "return of the East to Europe" is such an important objective, for both Western Europe and the countries of Central Europe, that eastward enlargement must not be allowed to fail for financial reasons.

Nonetheless, that is no reason to accept avoidable and economically senseless budgetary costs. Budgetary expenditure on agricultural policy falls into this category. The additional cost of administering the agricultural markets in an enlarged Union in the absence of CAP reform is difficult to estimate, and is therefore disputed among experts. Depending on the assumptions made and the analytical methods used, the estimates produced so far range from about ECU 5 billion a year to ten times that amount. Even a very conservative estimate of ECU 10 billion would be difficult to finance, as the following consideration may show.

Agricultural policy in the EU, which in the past has caused numerous crises in the Union's finances, is now fortunately subject to a ceiling on budgetary expenditure set by the Ministers of Finance and respected by the Ministers of Agriculture. From now

[3] It is, of course, conceivable that ministers of agriculture in Central Europe would bring farm prices closer into line with those in the Union in anticipation of this, which would have the same effect on supply in their agricultural markets. This issue is addressed later in the article.

onwards, CAP expenditure may increase annually in relation to the volume in a particular base period by no more than a fixed proportion of the growth in the real GNP of the Union, namely by no more than 0.74 times GNP growth. This rule was also applied when the EFTA countries joined at the beginning of this year and led to the setting of a new ceiling for the agricultural expenditure of the enlarged Union in accordance with the growth in the Union's GNP as a result of enlargement. The application of the same rule to eastward enlargement, which would be eminently sensible, would mean that agricultural expenditure should rise by only about 4%, as the ultimate accession of all ten current applicant countries from Central Europe would increase the GNP of the Union by possibly about 5%. Even if the budgetary cost of extending an unchanged agricultural policy to Central Europe did work out at only the conservative estimate of about ECU 10 billion, the budgetary ceiling for EU agricultural expenditure would have to be raised by about 20%. If such a violation of budgetary discipline is not acceptable, policy changes will be unavoidable.

Extension of CAP to Central Europe would violate WTO Obligations

The second reason why eastward enlargement cannot leave EU agricultural policy untouched stems

Wassilios Skouris (Ed.)

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from the obligations that the Union and the countries of Central Europe have assumed within the framework of the GATT or the WTO.[4] These obligations may allow the Union to get away with its present agricultural policy until the year 2000, although even that is not certain. However, the WTO obligations of the Central European countries are so formulated that their adoption of the present CAP would violate them in several important aspects, especially as regards bound customs duties and constraints on subsidised exports of agricultural products.[5] The WTO has strict rules, set out in Article XXIV of the GATT, governing the manner in which the WTO obligations of countries joining an enlarged customs union should be treated (from the point of view of the WTO, the EU is a customs union). The Union and the Central European applicant countries cannot assume that their trading partners in the WTO would uncomplainingly accept a violation of these rules. Adjustments to EU agricultural policy in connection with eastward enlargement are therefore unavoidable for these reasons as well.

What form might these adjustments take? At first sight, one solution could be to subject the farm sector to further and tighter controls on supply in the form of production quotas and compulsory land set-aside in order to prevent the creation of further surpluses. For the Central European countries, this would be an ironic or even cynical reaction to the problems of agricultural policy. Like all producers in these countries, the farmers have just emerged from a long and bitter period of centralised state control. Their governments, with strong encouragement from the Union, are preaching the virtues of the market economy and free enterprise. Accession to a union that immediately took away these new-found opportunities for free enterprise by forcing agriculture into a straitjacket of production restrictions imposed by the state would inevitably be perceived as a cruel joke of agricultural history. The maintenance of excessively high price support, accompanied by output controls of this kind to offset the production incentives it would generate, could not compensate Central European farmers for the loss of opportunities to develop, as they do not need such high prices in view of their lower costs. Moreover, farmers in the existing Union are increasingly coming round to the view that the curbs on their entrepreneurial decision-making imposed by state output controls are less acceptable over the long term than an orderly retreat from excessive price support.

Reduction in Agricultural Prices Inevitable

The Union initiated such an orderly retreat from excessive agricultural price support in 1992, when Ministers of Agriculture decided on a "reform of agricultural policy" upon the proposal of the then EU Commissioner for Agriculture Ray MacSharry; the decision was clearly taken with an eye to the Uruguay Round of GATT negotiations, although this was consistently denied. Up to now, the reform has related essentially to cereals, oil-seeds, pulses and to a lesser extent beef. The support prices for these products have been reduced in stages. The Union's farmers have received compensatory payments since then to offset the associated loss of income. The Union could go further in this direction in preparation for eastward enlargement. Cereals prices could be reduced further until they reached the world market level. The compulsory land set-aside scheme, which was also introduced as part of the agricultural reform, could then be discontinued. The support prices of other products that have not yet been affected by the reform could also be reduced and compensatory payments granted. In the case of milk and sugar, price reductions would also provide an opportunity to abolish the "hard" production quotas that now exist for these products.

The nature of the compensatory payments to farmers would also have to be reviewed in the context of eastward enlargement, whether the existing payments were simply continued or additional payments were introduced as part of further agricultural liberalisation. In the Union there is a direct link between these payments and the reduction in support prices. They represent, as it were, the fulfilment of the promises implicitly made to farmers under the long-standing system of agricultural price support. For the farmers of Central Europe, entry to the Union would bring an increase in agricultural prices, not a reduction. There is therefore neither economic nor political justification for extending compensatory payments to them. This would cost about ECU 5 billion, which could be put to better use over the long term funding sensible structural and

[4] Some Central European countries are still negotiating their entry to the WTO and also the obligations they have to undertake in this context regarding agricultural trade and agricultural policy. However, it can be assumed that these countries will also be members of the WTO by the time they join the Union.

[5] For a detailed analysis of this aspect, see S. Tangermann and T. Josling: Pre-Accession Agricultural Policies for Central Europe and the European Union, study commissioned by DG I of the European Commission, Brussels, December 1994. The study also addresses more fully other considerations mentioned here.

regional programmes for these countries. But is it conceivable that after eastward enlargement the farmers in the West of the Union could receive compensatory payments that were denied to their counterparts in the new member countries?

The answer to this question must partly be political, but from an economic point of view it also depends directly on the form these payments take. The first condition for not making such payments to all farmers in an enlarged Union would be that they were made in a form that did not distort competition among farmers. The compensatory payments currently being granted in the Union would not meet this requirement. Up to now, they have been subject to the proviso that farmers actually use their land for agriculture (or, in the case of beef, that they actually keep beef cattle). Hence the payments made under the 1992 agricultural reform stimulate production. If they were paid in only some member states they would therefore not be compatible with the objective of undistorted competition in an enlarged Union. A decision not to extend compensatory payments to Central Europe, where they would not be economically justified or necessary, would be defensible only if such payments in the existing Union were "decoupled" from production, and hence most of their distorting effects on competition eliminated. This could be done by linking the payments not to current farm output but to a fixed reference base in the past.

Decoupled Compensatory Payments by Member Countries

A further change in the form of these payments could also make it easier to set different levels in each member country. If compensatory payments were decoupled from production, they would lose their linkage with agricultural policy and take on the character of payments motivated by social policy considerations. They would therefore no longer necessarily fall within the scope of the Common Agricultural Policy and responsibility could be transferred to national level in accordance with the principle of subsidiarity. Union-wide regulations would have to be established to ensure that member states made these payments in a way that did not distort competition among agricultural producers, or that any distortion was minimised. The level at which they were paid and the form they took could then be left to the member states. The criteria for preventing distortions to competition could be derived from the agreements on agricultural subsidies reached within the framework of the agricultural agreement of the Uruguay Round of the GATT. This agreement defines a "green box" of such farm subsidies that do not have to be reduced and which may not serve as justification for retaliatory measures by trading partners because they are regarded as largely production-neutral.

It would also make more sense for member countries to be given responsibility for financing the compensatory payments as well. A one-off lump-sum adjustment in member states' contributions to the Union would have to be made so that this change in the financing of compensatory payments did not lead to a lasting redistribution of financial burdens among the member states. From then onwards, however, member states would be free to arrange the payments as they wished, provided they adhered to the criteria for avoiding distortions to competition. If the system of compensatory farm payments were revised in this way, it would be justifiable for the payments not to be made in the Central European countries after their entry to the Union.

The apparently incontrovertible argument against such a reform of the compensatory payments is that it entails a "renationalisation" of EU agricultural policy, a sacrilege in a community of member states which at the time of the creation of the European Economic Community at the end of the fifties came together in the expectation, among other things, of establishing a common agricultural policy. In fact, this is a rather flimsy argument. First, when the EEC was founded it was not foreseen that the common budget would make substantial direct payments to farmers in the member states on incomes policy grounds, and hence this was not considered a constitutive feature. A common agricultural market and free agricultural trade among member states on that basis are constitutive features of an economic community, and especially of a single internal market.[6] On the other hand, the common formulation and financing of what are ultimately socially inspired compensatory payments unconnected with output is not really a constitutive feature of a common agricultural policy. Secondly, the Union has already taken steps in precisely this direction in another connection without being reproached for "renationalising" policy. In connection with exchange rate changes, member

[6] Even this actual constitutive feature has been ignored for decades, in that agricultural duties have been levied and export subsidies paid at the internal borders of the Community in order to protect farmers from the effects of exchange rate changes. The political assessment of what constitutes "renationalisation" of EU agricultural policy is therefore highly variable and dependent on circumstances.

states have been permitted to pay their farmers national compensatory amounts, which similarly should be production-neutral. To that extent, the dam has already been breached and the hypocrisy that it is as watertight as ever should therefore be dropped.

How should the CAP look in Future?

The considerations set out above on the future of EU agricultural policy in the light of eastward enlargement can therefore be summarised as follows:

☐ Eastward enlargement will substantially increase the Union's agricultural output, whereas GNP will rise only slightly. The CAP therefore faces new challenges.

☐ The countries of Central Europe have great agricultural potential, even though their farm sector still appears vulnerable at present.

☐ Agricultural prices in the candidate countries are substantially lower than those in the Union.

☐ A long transitional period for the agricultural sector following the eastward enlargement is incompatible with the principle of the single market and the expectations of the candidate countries. After accession, agricultural prices in the Central European countries will therefore move into line with those in the Union.

☐ If EU agricultural policy remained unchanged, accession would therefore lead to a substantial increase in surpluses in the Union's agricultural markets.

☐ The consequences for the enlarged Union's international agricultural trade would be incompatible with the obligations of the Union and of the candidate countries under the GATT.

☐ If EU agricultural policy remained unchanged, the increase in the cost to the Union's budget would be more than existing budgetary rules would permit in the light of the rise in GNP as a result of eastward enlargement.

☐ More rigorous and wider-ranging controls on the supply of agricultural products would not be a sensible way out of the agricultural policy problems that will arise as a result of eastward enlargement.

☐ There is therefore no acceptable way round a reduction in agricultural price support in the Union. Compensatory payments of the kind introduced under the agricultural reform of 1992 could limit the income losses for farmers in the existing EU countries.

☐ For farmers in the candidate countries of Central Europe, by contrast, compensatory payments are neither justified nor necessary.

☐ Restricting the compensatory payments to the farmers of the existing Union necessitates adjustments in the form of the payments. In future, payments should be unconnected with production. Ideally, the administrative and financial responsibility for the payments should be transferred to member states.

In short, the message is therefore that the Union's agricultural policy must be amended if it is not to become an obstacle to eastward enlargement. The changes that appear sensible – a reduction in support prices, the decoupling of compensatory payments from production, the transfer of responsibility for compensatory payments to member states - would have been advisable even without eastward enlargement. Not until changes of this kind are introduced will the reform of agricultural policy begun in 1992 be brought to a successful conclusion. Further reform along these lines would make sense in any case, but the effects that eastward enlargement will have in the agricultural sphere make it all the more urgent.

As the further reforms of the CAP outlined here make sense even without eastward enlargement, the Union would be well advised to begin them as soon as possible, for two important reasons. First, it would not be politically helpful if these agricultural policy adjustments were perceived as being necessitated solely by eastward enlargement. This would divert too much attention from the need for a further overhaul of EU agricultural policy in any case and place political strains on the process of eastward enlargement, which is already difficult enough in many respects. Secondly, the effect that strategic decisions about agricultural policy in the Union will have on future agricultural policy in the Central European countries should not be underestimated. If the Union gives the impression that it intends to continue steadfastly on its present agricultural policy course, there will be a strong temptation for Central European policymakers to adopt the same stance in the next few years. Agricultural prices in Central Europe would then possibly soon be aligned with those already applying in the Union. The new member states would have a rude awakening if they discovered soon after accession that the enlarged Union was unable to maintain the policy course with which they had just brought themselves into line.