IMPACT OF EU ENLARGEMENT ON
EUROPEAN AGRICULTURE

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Introduction: The structure of the presentation

Enlargement is one of the main challenges in the decade ahead. However, enlargement of the European Union (EU) is a quite natural process and an ongoing process. Obviously, the EU is so attractive that the file of applicant countries is fairly long and has increased significantly over the last years. The desire of countries to become members of the EU may be seen as a compliment for the EU, being a member seems to be a favourable status. However, even if the EU is in principle an open community and is generally prepared for enlargement it is not willing to accept new members which have not met specific accession criteria as specified in Copenhagen. Some of the Central and Eastern European countries meet, by and large, these accession criteria and, hence, the EU has at least a moral obligation to accept some of them as new members in the very near future. Indeed, the first applicants can expect to join the EU already in 2003.

Even if enlargement becomes reality soon, it has to be noted that this enlargement is more affected by political considerations than the previous ones. The applicant countries expect increased political stability and the Union expects enlargement contributing to a more stable Europe. These expectations are certainly well founded, but the final outcome may largely depend on the economic effects of the enlargement. Regional integration may stimulate growth in the region as the foundation of the European Economic Community and the former enlargements have proven. However, economic theory only predicts growth due to market integration if the economies are able to adjust to the changes in the economic environment. Otherwise, increased unemployment in some countries may show up and disparities between the countries may even increase. The experience of German unification is a special case in point. The eastern part still suffers from high unemployment and growth rates are even lower in the East than in the West. One should note that the eastern part of Germany performs economically badly in spite – or because – of huge transfers from the West to the East. This experience supports the view that regional integration is not at all a guarantee for economic success. What matters most is the institutional framework in the countries. Institutions are the rules of the game; they affect the ability of a country to adjust to changes in the economic environment. Institutions are most important for agriculture in the EU. Market forces are heavily distorted by governmental interference. One should keep in mind that most farmers in the EU derive more of their income from direct transfers than from the market place. Hence, the impact of enlargement on agriculture widely depends on the political decisions concerning the Common Agricultural Policy (CAP). Therefore, it is investigated in this paper first
whether the CAP will change due to enlargement and what the new CAP may look like. The structure of the paper is presented in Figure 1. It is hypothesised that agriculture in the present member countries and in the new member countries will be affected by basically three different sets of determinants, those determined by the CAP, by changes in the political and economic environment in the countries and by specifics on products and factor markets.

Figure 1. The determinants of the impact

Changes in political and macroeconomic environment

Changes in the Common Agricultural Policy

Changes in Agriculture

Changes on markets
- Product markets
- Factor markets

**East Enlargement: an unprecedented case**

The next enlargement will not be comparable to earlier enlargements.

First, the EU has progressed over time from a mere customs union to an economic union with a common market. As – in principle – no border controls are imposed on trade among the union members it is not feasible to have a transition period with different prices for the new member countries as it was accepted for earlier enlargements. A free flow of goods has to be accepted from the very beginning if membership is supposed to become effective.

Second, the quantity matters more than in the past. Figure 2 and Table 1 inform on the importance of agriculture in the applicant countries and on the agricultural resource base.
Figure 2: Importance of Agriculture for CEEC and EU-15

Agriculture plays a much more important role in these countries. Hence, these countries are more interested in the policy framework than the average of the EU countries. However, for the future of the CAP is also of importance that the EU agricultural sector will be significantly enlarged. Arable land in the fully enlarged Union will be nearly fifty percent larger than at present and the agricultural labour force will be higher by about 137 percent. Thus, changes in the CAP are more important from the macroeconomic point of view for the new member countries than for the present EU members.

### Table 1: Resource Endowment of Agriculture in CEEC and EU-15 (1996)

<table>
<thead>
<tr>
<th>Country</th>
<th>Arable Land (in 1000 ha)</th>
<th>Agricultural work force (in 1000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Poland</td>
<td>18474</td>
<td>4130</td>
</tr>
<tr>
<td>Hungary</td>
<td>6184</td>
<td>298</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>4279</td>
<td>211</td>
</tr>
<tr>
<td>Slovenia</td>
<td>785</td>
<td>61</td>
</tr>
<tr>
<td>Estonia</td>
<td>1450</td>
<td>74</td>
</tr>
<tr>
<td>CEEC-1</td>
<td>31172</td>
<td>4774</td>
</tr>
<tr>
<td>Romania</td>
<td>14789</td>
<td>3975</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>6164</td>
<td>769</td>
</tr>
<tr>
<td>Slovakia</td>
<td>2445</td>
<td>169</td>
</tr>
<tr>
<td>Lithuania</td>
<td>3151</td>
<td>398</td>
</tr>
<tr>
<td>Latvia</td>
<td>2521</td>
<td>208</td>
</tr>
<tr>
<td>CEEC-2</td>
<td>29070</td>
<td>5519</td>
</tr>
<tr>
<td>CEEC-total</td>
<td>60242</td>
<td>10293</td>
</tr>
<tr>
<td>EU-15</td>
<td>135260</td>
<td>7514</td>
</tr>
</tbody>
</table>


Third, the new member countries are much poorer than the present member countries (see Figure 3). Hence, policies which are supposed to level income within the Union have to redirect transfers from the present receiving countries and regions to the new member countries. The future will show whether the change in the focus will be politically feasible. It will certainly be a political challenge for the Union.
Figure 3: Income per capita in EU and Accession countries

Fourth, the CAP is much more constrained by international agreements in the future than in the past. These constraints will become even more binding due to enlargement. If the new member countries succeed in expanding agricultural production – see the arguments below – the Union would be forced to change the CAP more radically than without enlargement.

**Determinants of changes in the CAP**

The CAP will affect agriculture in the enlarged Union not only because the policy might change due to enlargement, but also because the policy has to be changed irrespective of the enlargement. This reasoning is quite important as the applicant countries might be tempted to trust in a continuation of the present policy. Such a trust is not based on realistic judgement of the determinants of the CAP.

First, the commitments imposed by WTO demand changes. It is well known that policymakers in all WTO member countries have lost freedom to a large extent to conduct their domestic policies. The EU is most constrained by the limits accepted for subsidised export quantities. Figure 4 and 5 demonstrate the emergence of exportable surpluses for wheat and coarse grain. The avoidance of these surpluses asks for policy changes above what has been decided in the Agenda 2000 decision. Changes in grain policies are needed if world market prices continue to be below the institutional prices in the Union. However, development of world market prices is highly affected by the CAP. The Union has an enlarged share of world production (see Figure 6) and if production in the Union is not curtailed world market prices may remain on a low level.

Second, the EU has signed some trade agreements which allow for preferential access to EU markets. The agreement with the 48 least developed countries is one which will become important over time. Others are Free Trade Agreements with South Africa, Mercosur and Mexico. Recently, the Balkan countries received a nice gift, allowing them free access to nearly all EU agricultural markets. These agreements pose further constraints on the CAP. The exportable surplus will grow and measures to curtail domestic production will gain more prominence.

Third, the CAP will certainly be short of funds if the present policy would be instituted for the new member countries without any modification. The financial allocation is known up to the year 2006 and does not allow to provide unchanged benefits to agriculture in an enlarged EU. It is highly
questionable whether funds will be increased after 2006 sufficiently. The transfers among the EU countries are quite visible and it is doubtful whether the present net gainer will give up some benefits in favour of the new member countries.

Figure 4: Availability of wheat for EU exports and WTO limitations for subsidised exports

Figure 5: Availability of coarse grain for EU exports and WTO limitations for subsidised exports
Fourth, the future of the CAP will be affected by the acceptance of this policy by the public. The BSE crisis has called to attention the effects of the present policies and the public is much more aware of the present problems in agricultural policy. Hence, it is not unlikely that the policy is more and more questioned. Moreover, the present policy is based on intensive regulation and gives incentives for fraud. Recent research on causes and effects of corruption and state capture has revealed that corruption is highly related to the intensity of regulations in an economy. The ranking of countries with respect to the corruption perception index shows that corruption is much more pervasive in the applicant countries than in the EU (see Figure 7). Even those EU countries which fare badly, rank much better than that applicant country which ranks the highest (i.e. has the lowest corruption). Hence, it is likely that the European Court of Auditors will report on more fraud in the new member countries than in the present EU countries. It can be expected that the public in the EU will increasingly question the present policy and demand changes.
Expected Changes in the CAP

If the diagnosis presented above is correct, policy makers have not many alternatives. Production growth at present prices is not feasible as it leads to high not exportable surpluses. However, further cuts in producer prices and full compensation as decided in 1992 will likely lead to financial needs which surpass available funds. Moreover, payments tied indirectly to production or factors of production – as at present – do not slow down production growth. Hence, it is most likely that institutional prices for beef, milk and grain will be lowered and transfers will be less tied to production. It is reasonable to assume that payments will be more targeted to rural development and to awarding production of ecological effects.

The most recent proposals by the Commission hint to a new direction in agricultural policy. It is likely that member countries will enjoy greater freedom in pursuing agricultural, ecological and rural economy policy objectives; however, the price will be that they have to pay a higher share of support out of their own budget. This approach is certainly attractive from an economic point of view; there is both significant variance in the national willingness to pay for environment and in the preference for having ecological effects. Unfortunately, it is hardly possible to separate support for ecological reasons from that provided for agricultural
production. Hence, the consequence is likely a wider variance in agricultural support among the member countries.

**Expected changes in the macroeconomic environment**

It is not known at the moment whether product and factor markets will be fully integrated from the very beginning. It is quite possible that there might be some restrictions on labour movement and access to land. However, the main effects will arise soon after enlargement.

**Effects in the EU member countries**

It is often pointed out that wages in the applicant countries are much lower and, hence, these countries might be more competitive in labour intensive products. Of course, this expectation is well founded. However, what counts is not only wages but more so labour costs per unit of production. Labour productivity is much lower in the transition countries than in the present EU member countries. The experience of the former Democratic Republic of Germany may serve as an example. Wages were much lower after unification – about 40 percent on average – and nevertheless the eastern part was not competitive as compared with the western part of Germany or compared to foreign competitors. Anyway, the fear that eastern countries may flood the western market with labour intensive products and the EU may wipe out capital intensive production in the eastern countries is certainly exaggerated. Changes in the exchange rate will constrain the exchanges of goods and avoid an imbalance in the trade balance. Nevertheless, labour intensive production in the EU will be under pressure to adjust. Market integration demands changes in the national pattern of production. These changes have to be the most significant in countries neighbouring the new member countries. Hence, Germany may benefit the most from enlargement, but only if it is able to adjust to the new conditions. Based on past experience, it is more likely that Germany is not able to remove the rigidities in the economy and, hence, the likelihood for higher unemployment is high. Of course, this outcome will be even more pronounced if migration is free from the very beginning in the enlarged Union. One should have in mind the proximity of the markets, which reduce migration costs, and the benefits of the German social system. Social security benefits in Germany are far higher than the average industrial wage in Poland, the applicant country with the highest wages.

The changes in the economy are crucial for the agricultural sector. Experience with earlier enlargements and with liberalisation has shown that the development of the agricultural sector is not mainly affected by the situation on agricultural product market, but more by the per-
formance of the overall economy. Factor markets in the EU markets are fairly well integrated, hence, depressed agricultural prices will stimulate outmigration from agriculture to the non-agricultural sectors. However, this mechanism will only work if the agricultural labour force has a real employment alternative outside the agricultural sector.

Effects in the applicant countries
There are also chances and risks for these countries. Countries may gain on the following grounds:

- Improved access to the large EU market provides incentives for division of labour and growth effects. It has been estimated that the creation of the European single market has lowered border transaction costs by 0.75 percent of EU intra-trade flows, ranging between 1.5 percent for UK and 0.6 percent for Spain\(^1\). The reduction of border transaction costs between the new and old member countries will likely be higher as customs control between the EU countries had already been abolished before 1992, the year when the Single Market came into force. Reduction in border cost by one percentage point is significant; one should have in mind that profit over revenue is often in the range of 3 to 5 percent.

- Increased political and economic stability in the countries may attract foreign direct investment

- As all of these countries are not at par in technology with the present EU countries they can expect to gain from imports of technology which is partly related to FDI, but not completely. This catching up effect can be significant, more than 0.5 percentage points of growth rates as the experience of other catching up countries has shown\(^2\).

- Transfers to the new member countries might be significant. All of these countries are poorer than the poorest EU country (see Figure 3 above). Hence, all of them benefit from special funds provided from Brussels. The aim is to equalise standard of living among the European regions. Transfers are significant in the present EU: It is estimated that the poorest countries, Ireland, Portugal, Spain and Greece received between 2.33 and 5.31 percent of GDP annually from Brussels. Those countries benefited the most which could draw on the specific agricultural provisions, Ireland received 5.31 percent out of which 3.00 from agriculture, Greece got 4.94 out of which 2.5 from ag-

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riculture. The new member countries will likely receive even more than Greece and Ireland; hence, it could be in the range of more than 5 percent.

Nevertheless, there are also some risks involved for the accession countries. Again, the East German experience as well as the low growth rates of Greece in spite of the transfers should serve as a warning. What matters most are adequate domestic policies in these countries. Two issues are of main importance: First, future growth is more than in the past based on knowledge. If the new member countries do not succeed in building up human capital, catching up may never appear. One should have in mind some backward regions in Europe which in spite of all support have not succeeded in closing the GDP gap. In the case of the accession countries the prospects might be even worse. It is most likely that the present EU member countries are generous in opening up their border for highly qualified persons. Hence, a brain drain may be the consequence, if the applicant countries are not able to remain attractive for this part of the labour force. Of course, the attractiveness is not just a function of wages at present, but the overall living standard at present and expected in the near future. One should have in mind that the language barrier for highly qualified persons has been lowered in the last decade. English is used in many companies at least as a second language. Second, labour market policy may become a special issue. The applicant countries suffer even more from unemployment than the EU countries, but may be badly affected if they are constrained in their policy by EU regulations. Social policy which has been partly supranationalised may become a high burden for the new member countries.

Consequences for the agricultural sector in the present member countries

The agricultural sector will be affected by the changes in the macroeconomic environment and by changes in the CAP. Both determinants increase the pressure to adjust.

1. Relatively higher capital cost and lower labour costs in the Union will affect the agricultural sector on balance negatively as most of agriculture produces highly capital intensively. Costs for some part of farming will go up. A decline in land prices is likely improving the competitiveness of low input farming and labour intensive production. Organic farming will become relatively more profitable. Small and medium size farms will come under pressure either to expand farm sizes, to cooperate in using machinery or to specialise in labour intensive production.

2. Lower product prices and direct payments less tied to production will exert pressure to adjust for conventional farming. Farms have to grow, switch to part-time farming or
have to specialise in niche products, organic farming may be one alternative. Some of the present farm population may find employment opportunities in landscape activities.

3. If the Germans succeed in incorporating their view in the CAP the pressure to adjust will become even stronger for conventional farming in the EU. Direct payments tied to labour and restriction on specialisation in agriculture will affect the present efficient farms adversely. The German view will harm present EU farmers more after enlargement. Labour input in agriculture is much higher in the applicant countries than in the EU and, hence, a larger share of EU transfers will flow to the new member countries. Moreover, agriculture is called less “industrial” – according to the German understanding as published in a document of the Chancellor’s Office – if farms buy only a small share of inputs. If support were actually focused on such extensive farms the present conventional farms will be under strong pressure to adjust.

4. Land prices will be negatively affected by two causes. First, lower product prices for grains, beef and milk make use of land less profitable. Second, decoupling of direct payments from the use of land will reduce the willingness to pay for land.

5. The change in policies will affect agriculture less adversely if there are sufficient employment activities outside agriculture. Hence, the macroeconomic environment is crucial. The ability of the farm sector to adjust has increased in many EU countries over the last couple of years. The potential successor of the farm manager is in many cases employed outside the agricultural sector and is in a waiting position. Adverse conditions for the farm sector will keep some of these people outside the farm sector, leaving room for extending farm sizes.

6. The effects of changes in the CAP and changes in the macroeconomic environment will cause less problems for conventional agriculture if future world market prices for the main agricultural products surpass present prices in the EU. Such a scenario is realistic. The change in domestic support will likely affect the regional production pattern, leading to less crop production. Actually, it may be a reversal to what happened in the UK and Denmark after EU accession. Crop production did increase significantly as fodder production, including pasture, declined.

7. The expected changes will open new opportunities for some farmers. Those who are able to build up new productive capacities based on low labour costs and low land prices and find niches for their products will be better off than at present.
Consequences for the agricultural sector in the new member countries

1. Generally, agriculture in the applicant countries will gain from accession. Producer prices are somewhat lower than in the EU, especially for milk and pork (see Figure 8). Some analysts conclude from this fact that production in the applicant countries will not be stimulated from EU accession. However, one should take into consideration that prices have gone up only recently and that supply reaction normally lags by some years. Moreover, budgetary support is less than in the EU (see Table 2). Even if support will not go up to the EU level it will be likely higher than at present. Hence, I assume that these countries will enjoy a positive price climate.

Figure 8: Producer prices in selected Central European Countries and Germany

Percent of German Prices

2. Agriculture in the applicant countries has recovered somewhat from the collapse after the beginning of transition, but not completely. It is now well recognised that the collapse was mainly due to the restructuring of the sector, to the lack of market institutions, to the unstable economic and political environment and to malfunctioning land and credit markets. Some of these obstacles have been removed, but some are still working. EU accession will contribute to a more stable economic and political environment, making the countries more attractive for Foreign Direct Investment. Moreover, the access to know-how will be eased, land and credit markets will be improved. Hence, one can expect more favourable conditions for agriculture in these countries.
Table 2: OECD Producer Support Estimate for CEEC member countries  
Percentage PSE of producer value  

<table>
<thead>
<tr>
<th></th>
<th>1997</th>
<th>1998</th>
<th>1999p</th>
</tr>
</thead>
<tbody>
<tr>
<td>Czech Republic</td>
<td>9</td>
<td>21</td>
<td>25</td>
</tr>
<tr>
<td>Hungary</td>
<td>7</td>
<td>13</td>
<td>20</td>
</tr>
<tr>
<td>Poland</td>
<td>22</td>
<td>23</td>
<td>25</td>
</tr>
<tr>
<td>European Union</td>
<td>38</td>
<td>45</td>
<td>49</td>
</tr>
<tr>
<td>OECD total</td>
<td>31</td>
<td>36</td>
<td>40</td>
</tr>
</tbody>
</table>

Notes: p: provisional.  
Sources: OECD, PSE/CSE database

3. Even if overall conditions for agriculture will turn out to be positive some farmers will come under pressure. The differentiation among farmers will widen and the competition on the land market will increase. Small farmers may lose in competing on the land market. In general, the inflow of liquidity for the larger farms will increase mechanisation of large farms, contributing to rural unemployment.

4. Competition on the land market will become stronger if the land market will be liberalised from the very beginning and if foreigners are allowed to buy and rent land without any restrictions. The experience of the New Laender in Germany has shown that the inflow of know-how of farmers from the West has contributed to the dynamics of the sector. However, the experience was not necessarily positive from the economic point of view. Foreigners normally tend to produce more capital intensively and dismiss labour. Hence, the trade-off to a booming agricultural sector might be more unemployment in rural regions. Possibly the EU policy for rural areas can take care of this problem.

5. Some policy makers in the applicant countries expect a market potential for organic farming. Indeed, it is very likely that the EU is going to support this type of farming more than the conventional type. However, it is highly questionable whether the new member countries will actually gain from this switch in support policy. Organically produced products are credence goods. The consumer does not know the quality of the products at the time of purchase and even not at consumption time. Hence, the confidence in the production process and the content of the products is crucial. Experience has shown that consumers’ trust is greater if the production side can be visited or if the last seller conveys signals that quality management is secured. These reasons contrib-
ute to the fact that most bio-products consumed are produced in the region. Hence, the regional income per capita and the willingness to pay in the region are main determinants of the potential for organic farming. It is questionable whether conditions in the new member countries are favourable for organic farming.

6. Agriculture in the new member countries may gain from increased competition in the food industry. Margins in some of these countries are higher than in the Union as the food industry is less competitive than in the EU. Accession to the EU will put the food industry under pressure to adjust. Inflow of FDIs will ease the adjustment process. Hence, farmers will gain from reduced margins.
Summary

1. European agriculture will be highly affected by East enlargement. The impact is not mainly due to changes in market conditions, but to changes in the macroeconomic environment and in the Common Agricultural Policy (CAP).

2. The overall economic situation of the economies is critical for agricultural adjustment as the agricultural sector is highly integrated and, hence, structural adjustment is more dependent on conditions in the overall economy than on agricultural product markets.

3. There is a chance that enlargement will spur up economic growth and stimulate employment positively in the old and new member countries. However, that will only happen if macroeconomic policies ease the adjustment of the economy. There is a high risk that unemployment in some EU countries, especially Germany, increases and even in rural areas of applicant countries.

4. The CAP has to change anyway, even without enlargement, in order to comply with WTO commitments. However, the changes in the CAP are more compelling with enlargement. The new CAP will likely rely more on market prices linked to world market prices and on direct payments decoupled from use of factors such as land, numbers of animals or quotas. Direct payments will likely focus on the production of ecological effects and on extensive farming.

5. Relatively higher capital cost and lower labour costs in the Union will affect the agricultural sector in the present EU countries on balance negatively as most of agriculture produces highly capital intensively. Costs for some parts of farming will go up. Agriculture in the present member countries has either to enlarge farm sizes or to specialise in high priced products (organic farming is one alternative). If the Germans succeed in incorporating their view in the CAP the pressure to adjust will become even stronger for conventional farming in the EU.

6. The effects of changes in the CAP and changes in the macroeconomic environment will cause less problems for conventional agriculture if future world market prices for the main agricultural products surpass present prices in the EU. Such a scenario is realistic.

7. Generally, agriculture in the applicant countries will gain from accession. Producer prices are somewhat lower than in the EU, especially for milk and pork.

8. Even if overall conditions for agriculture in the applicant countries will turn out to be positive some farmers will come under pressure. The differentiation among farmers
will widen and the competition on the land market will increase. Depending on policies, there is a risk that unemployment in rural areas will go up.

9. The expectation of some policy makers in the applicant countries to have a market potential for organic farming will not likely materialise.

10. Agriculture in the new member countries may likely gain from increased competition in the food industry.
Table 1: Use of export subsidy commitments in 1997 as percent of commitments in 2002

<table>
<thead>
<tr>
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<th></th>
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</thead>
<tbody>
<tr>
<td>Czech Republic</td>
<td>Dairy products</td>
<td>58.6</td>
<td>77.3</td>
</tr>
<tr>
<td>Poland</td>
<td>Sugar</td>
<td>169.1</td>
<td>27.5</td>
</tr>
<tr>
<td>Slovak Republic</td>
<td>Dairy products excl.SMP</td>
<td>111.3</td>
<td>82.1</td>
</tr>
<tr>
<td></td>
<td>Sugar and confectionary</td>
<td>115.4</td>
<td>30.3</td>
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<tr>
<td>Hungary</td>
<td>Maize</td>
<td>15.4</td>
<td>170.4</td>
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<td>Dairy Products</td>
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<td>Pork</td>
<td>98.9</td>
<td>170.7</td>
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<td>Poultry</td>
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<td>Fruits</td>
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<tr>
<td></td>
<td>Wine</td>
<td>48.6</td>
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Maize