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Preparing for Accession to the EU: Transition Policies for Transition Economies

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Abstract
All or most of the Central and East European Countries (CEECs), including Estonia, Latvia, and Lithuania, are waiting for, and are at various stages of preparing for, integration with the European Union (EU). It is no longer a question of whether this will occur, but rather a question of when and how. Today, it is clear that in its enlargement strategy, the EU is likely to treat the associated countries as one or more regional blocks and strongly encourage closer cooperation within and among these regions prior to accession. Agriculture is only one of numerous sectors that have to deal with integration issues and processes, and in many cases it may not be the most important concern of policy makers preparing for integration. However, agriculture is generally the most protected sector in the CEECs and the EU alike, so integration of agricultural markets and policies is a sensitive issue on both sides of the current EU border. After reviewing several key considerations countries must face in preparing for accession, we contrast the policy approaches taken by Lithuania and Hungary. Hungary had an earlier start in the transition process, has taken a more market-oriented approach to domestic support programs, and has relied more heavily on border measures to protect domestic markets.

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Agriculture, Policy, Economic Development

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Introduction

All or most of the Central and East European Countries (CEECs), including Estonia, Latvia, and Lithuania, are waiting for, and are at various stages of preparing for, integration with the European Union (EU). It is no longer a question of whether this will occur, but rather a question of when and how. Today, it is clear that in its enlargement strategy, the EU is likely to treat the associated countries as one or more regional blocks and strongly encourage closer cooperation within and among these regions prior to accession. Agriculture is only one of numerous sectors that have to deal with integration issues and processes, and in many cases it may not be the most important concern of policy makers preparing for integration. However, agriculture is generally the most protected sector in CEECs and the EU alike, so integration of agricultural markets and policies is a sensitive issue on both sides of the current EU border. After reviewing several key considerations countries must face in preparing for accession, we contrast the policy approaches taken by Lithuania and Hungary. Hungary had an earlier start in the transition process, has taken a more market-oriented approach to domestic support programs, and has relied more heavily on border measures to protect domestic markets.

Conditions and Choices

A central issue facing many CEEC governments today is to what extent and in what manner should agricultural and agricultural trade policy decisions be influenced by future integration with the EU. It is clear that harmonization of national legislation with EU regulations and directives as formulated in the White Paper requires several things to occur:

1) Revision of national agricultural and food regulations, identification of differences and missing regulatory documents, and preparation and adoption of national legal documents by national legislative bodies;
2) establishment of the institutional structures for enforcement and monitoring; and

3) creation of the special structures to communicate with the corresponding structures and institutions in the EU, and for conducting the Structured Dialogue.

Many countries preparing for accession, Lithuania among them, view the harmonization requirement as applicable not only to legislation outlined in the White Paper but also to agricultural and trade policies. Facing severe budget constraints, they try to implement one or more of the CAP or CAP-like policy instruments, expecting them to achieve results similar to those in the EU. However, such an approach can be viewed as undesirable, if not harmful for agriculture in transition countries. The whole organizational, legal, and economic environment in CEECs is quite different from that of the EU. The complete CAP mechanism is quite expensive to implement, and in addition to the CAP, EU countries carry out national agricultural policies for products and activities not covered by CAP regulations. A policy goal aimed at reaching the level of farm prices and agricultural protection in the EU would undoubtedly have negative impacts. For example, with significantly higher commodity prices, domestic consumption would decline further and the inefficient food industry would not be able to market its products competitively. As a result, the food industry would lose competitiveness not only in foreign markets, but even more importantly–in the domestic market. For this reason, when designing farm support measures it is very important to track their potential impacts on the whole food chain, including impacts on the domestic market and foreign trade.

Another reason to avoid the "copy-CAP" approach is the decision of the EU to continue CAP reform along the 1992 pattern. As a result of continuing CAP reform as well as Uruguay Round and subsequent WTO commitments of the EU, farm price supports and border protection in the EU are likely to go down. Trying to emulate current EU policies is like trying to hit a moving target. Finally, the natural cost-price and restructuring adjustments in CEEC agriculture are not yet over. Excessive intervention in this process attempting to set higher levels of farm prices, combined with inefficiencies in the whole marketing chain, will reduce the competitive pressures that play an important role in developing a stronger and more competitive industry.

To put the Associated Countries in context, Table 1 compares several key aggregates for the EU-15, the CEECs, and Baltic subgroups. Agriculture in CEECs still employs 20 to 25 percent of the population and accounts for 8 to 11 percent of GDP. Add to this the limited tax base reflected in the low GDP per capita, and it is clear why it would be very difficult to make significant transfers to agriculture from other sectors of the economy even if this were a government priority. This data also indicates the massive differences in agricultural GDP per worker, which reflect the large restructuring and development tasks that remain ahead for the CEECs. Agricultural GDP (GAP) per worker in the CEECs is only 6.2 percent of the EU rate, while for the Baltics it is only 4.4 percent of the EU figure.

Table 1. Comparison of Lithuania to European regional blocks, 1993

Indicators	EU - 15	Associated Countries	CEECs	Baltics	Lithuania
Population, mil	369.7	105.5	97.6	7.9	3.8
Agricultural land, mil ha	138.1	60.6	60.2	7.4	3.5
GDP, bil ECU	5,905.1	188.3	182.3	6.0	2.3
per capita, ECU	15,972.0	1,786.0	1867.8	757.0	627.0
GAP, bil ECU	208.8	14.7	14.0	0.8	0.3
percent of GDP	2.5	7.8	7.7	10.7	11.0
Employment in agriculture, thou	8,190.0	9,540.0	8,823.0	717.0	399.0
percent of total employment	5.7	26.7	26.2	19.4	22.4
GAP per worker, ECU	25,415.0	1,541.0	1,587.0	1116.0	752.9

Source: Agricultural Situation and Prospects in the Central and Eastern European Countries. Summary Report. European Commission, Directorate-General for Agriculture, Working Document, 1994.

The EU does not require or even encourage prospective members from CEECs to adopt EU policies or levels of protection prior to accession. Statements to date have focused instead on restructuring, infrastructure development, and the harmonization of veterinary and phytosanitary regulations dealing with grading, standards, certification, testing, and the like. These issues are discussed in the Agriculture Strategy Paper (Fischler). In the section on Pre-accession Measures, the paper says "The main conclusion was that the CECs are less in need of a high level of price and income support for their farmers, than of targeted assistance for the restructuring, modernization and diversification of their productive capacity in agriculture and the downstream sectors and for improvement of their rural infrastructure." and ". . .the Commission believes that the support price levels should be prevented to increase much from their present levels. . ."

Recognizing the importance of the issue as well as acknowledging recent developments in CEECs, the Commission initiated a special study on price levels and pricing mechanisms in CEECs in the framework of pre-accession strategy formulation.

The EU policies are very likely to be changed prior to accession by one or more CEECs. The Agriculture Strategy Paper indicates that more reforms should be expected, so countries planning to join in the future should not use current policies as a target. The paper states that "Among the different possible options, the Commission clearly favors developing the approach that was started successfully with the 1992 reform. This implies a reduced reliance on price support, compensated where necessary by direct payments. . ."

If Brussels or current members of the EU wished to seek advantages for their own agricultural and food industries, they would encourage high levels of protection in the CEECs. Such policies would slow or prevent the process of improving competitiveness of agricultural and food industries in CEECs. These industries would then not be prepared to compete within an enlarged EU after integration, and they would be easy targets for acquisition or liquidation. It is ironic that governments of CEECs are more likely to take such short-sighted policy decisions that will slow, in the long run, the development of their agricultural sectors and impede the competitiveness of their food industries.

Policy Strategies in Lithuania

The current reform of the agricultural sector in Lithuania is often viewed as being imposed and shaped by the future integration into the EU. It is also influenced to a great extent by current developments in Lithuanian - EU trade, where the balance is negative and growing. These conditions include limited possibilities even to utilize the preferential tariff quotas, a complicated system of product certification for exports to the EU, and an underdeveloped tariff quota administration and monitoring institutional system. However, regardless of its integration into any regional trade or political bloc, Lithuanian agriculture has to be radically reformed to meet market conditions and expectations of domestic consumers as well as to be competitive in foreign markets.

Current price support measures implemented in Lithuania include minimum marginal purchase prices (MMPP) for specified quantities of farm products, direct subsidy payments to farmers for a subset of these products, import tariffs, temporary import bans on phytosanitary and veterinary grounds, and periodic ad hoc interventions that have included government stock purchases, and temporary export subsidies. At the same time, there have been selective and temporary export bans and licensing that have the effect of limiting price increases in the domestic market. These programs are not well-targeted and in many cases provide conflicting incentives to private decision makers. Thus, they are contributing neither to quality improvements nor to the development of an efficient farming structure.

Provisions for "minimum marginal prices" and direct subsidy payments for producers were included in the 1994 Law on Government Regulation of Economic Relations in Agriculture adopted by the Seimas. Under this Law, the Government issued numerous resolutions to establish MMPPs and subsidies, beginning on February 10, 1995 for cattle and milk. Later, these measures were set for pigs, food wheat, sugar beets, and other crops. Each one of these minimum prices and subsidies were applied to a specified purchase quota.

Under this program, subsidies are paid to farmers through the processors in order to reduce paperwork that would be involved in dealing with individual farmers and also to induce processors to pay higher prices to farmers. Processors can channel subsidies to their farm suppliers, provided that they pay farm suppliers at least the minimum marginal price set by the government. With the low levels of current production and substantial excess processing capacity, processors want to keep raw material volumes from declining further. This competitive pressure is virtually the only incentive that processors have to pay the minimum prices, since there are no legal penalties that the government can assess if they fail to do so. Moreover, the government has no institutional mechanisms to implement a minimum farm price, so it tries to achieve this through the processors. Since the MMPP is intended as a floor price, this program could be compared to the intervention price system in the EU. However, the government has no intervention system and must rely on processors of the raw materials to implement the minimum prices. The levels of these support prices compared with average farm prices indicate that

MPPs and subsidies in 1995 were high enough in many cases to distort price signals to producers and are likely to be more distorting at the higher 1996 levels (Table 2).

Table 2. Farm prices, minimum marginal purchase prices, and subsidies in Lithuania.

Products	1995 Farm Price	1995 MMPP	1995 MMPP Plus Subsidy	1995 MMPP Plus Subsidy
		(U.S. $/mt)		
Wheat	120	138-150	138-150	138-150
Barley	90	100-125	100-15	145-150
Cattle	538	525-750	700-925	675-1125
Pigs	1033	975-1000	975-1000	1275-1425
Milk	120	100-142	108-155	142-155

Source: W. H. Meyers and N. Kazlauskiene. Baltic Report 96-BR 22.

Current policies provide direct and indirect income support to farmers, however, they also complicate the financial situation of processing enterprises, which are forced to pay high, government determined farm prices even if domestic and external demand for the processed products is still weak. Along with other negative consequences, this limits their opportunities to invest in modernization, product diversity, and quality improvement. Artificially high farm price levels and subsidies will encourage production growth at a time when demand for these products is limited by low incomes in the domestic market and poor access, as well as by low competitiveness in foreign markets.

The National Agricultural Development Program (NADP), which is the funding source for most support programs, also includes credit subsidies, infrastructure development, environmental improvement, subsidies for low productivity areas, research and extension programs, and breeding programs. Some of these programs can contribute to restructuring and the development of rural infrastructure as emphasized in the Strategy Paper, but they receive only a small portion of the financial resources in the NADP. The main emphasis should be given to the formulation of an integrated agricultural and rural development program, paying more attention to the improvement of marketing infrastructure, introduction of environmentally friendly farming practices, and the creation of alternative employment in rural areas.

Policy Strategies in Hungary

The law of market regulation in Hungary, termed the Agro-industrial Regime Act (ARA), was enacted in February 1993 and implemented on March 1, 1993. It provides a broad set of measures and policy instruments for market regulation by the government. The law was designed to emulate the regulation methods and instruments of the EU Common Agricultural Policy prior to CAP reform and was intended to ease the integration with the EU when Hungary is accepted for membership. Since Hungary does not have the financial resources to actually implement EU support levels, many of the policy instruments in the ARA (such as threshold prices) are not used at all and others are being used to implement policies that are much less protectionist and costly than those of the EU. Still other policy instruments are unlike those in the EU.

In general, domestic market support policies have followed market-oriented objectives. Some intervention began in 1993, but the programs for "directly supported commodities" (food wheat, feed maize, beef, pork, and milk) were fully operational only in 1994. The design and operation of intervention differs across commodities, and some are more market-oriented than others.

Food wheat and feed maize have intervention prices that have been set below the average domestic farm prices (Table 3). Since no established system of intervention purchases exists, the government would buy the grain through contracts with elevators and grain processors and then sell it to millers or feed mix enterprises on the domestic market or to traders for export. In fact, this was never necessary.

The guaranteed prices for pigs and cattle are specified by quality and also have been set at levels below the average market price, but they are not necessarily below market prices in all seasons and all locations (Table 3). Intervention purchases for pigs or cattle are to occur if producers sign formal offers to sell to the government more than a certain (trigger level) quantity of animals in any county. If the trigger level for intervention is reached, an Interministerial Committee makes the decision whether to buy or not. If intervention would occur for either pigs or cattle, the government would contract with meat plants to buy, slaughter, and store the meat for a specified fee. The rules for disposal of this meat were not specified.

The dairy support scheme is quite different from the others and offers continuous rather than episodic support. Dairy plants are paid a subsidy if they purchase first class and extra

Table 3. Farm and guaranteed prices in Hungary

Products	1994 Farm Price	1994 Price Guarantee	1995 Farm Price	1995 Price Guarantee
		(U.S. $/mt)		
Wheat	88	78-81	122	70-73
Maize	94	81-84	126	76-79
Cattle	1058	855-1046	1204	796-1034
Pigs	1114	780-932	1338	724-899
Milk	231	219-238	236	223-239

Source: W. H. Meyers and N. Kazlauskiene. Baltic Report 96-BR 22.

class milk for the specified minimum prices. The subsidy to the processor is 1.0 Ft/l. ($8/mt) for first class and 1.5 Ft/l. ($12/mt) for extra class milk. In this program, the government never takes ownership of the commodity. It is not clear what the comparison to farm price reveals in this case, since continuous intervention of this type could have more influence on price than the other schemes.

Except for milk, the support programs have the appearance of EU-type market intervention programs. However, the government has kept intervention levels low enough that intervention, if it ever occurs, would have little or no effect on market prices. Despite the terminology and operational differences, this program is philosophically more similar to the U.S. price support loan program, which provides a relatively low safety net at relatively little cost.

By far the largest item in the agricultural support budget is export subsidies, which exceeded 50 percent of the budget in recent years. Given the low levels of price supports in Hungary and the pervasive use of export subsidies for meat and dairy products, it is almost certain that export subsidies have a greater price enhancement effect than do the domestic intervention prices. Moreover, export subsidy levels are not in any way linked to the domestic price support levels. In this respect, they are more like the U.S. wheat export subsidies than the EU export restitutions. However, it is possible that the price enhancing effects of export subsidies have reduced the frequency and cost of domestic intervention. The phased devaluation of the Hungarian forint has had and will have similar domestic price enhancing effects, and should create an opportunity for Hungary to reduce export subsidies without losing competitiveness.

Hungary also has a schedule of import tariffs that was revised in 1995 in compliance with the Uruguay Round commitments. Since neither import tariffs nor export subsidies are linked to domestic support prices, they will not automatically be consistent with each other or with domestic support programs.

Preparing for Accession

Building competitiveness (with imports) in domestic and export markets needs to be a priority now and in the remaining years before accession. After accession, the domestic enterprises will survive only if they can compete with the well-established agricultural and agribusiness enterprises in the EU. Policies which expose domestic enterprises to competition will make them stronger, while overly protective policies will impede the development process.

Both Hungary and Lithuania have experienced growing integration with the world market through price liberalization, trade, and exchange rate stabilization. The price data in Table 4 indicate that by 1995 pork farm prices in both countries have exceeded those in the United States, a major exporting country, while poultry prices are nearing U.S. levels. Cattle prices are still much lower, especially in Lithuania, but much of this difference could be quality related. Lithuanian milk prices are still quite low compared with Australia's, but so is the average quality of milk delivered to processors. Hungarian prices exceed Australian prices, which may indicate the price enhancing effects of domestic support and export subsidy programs. Grain prices in Lithuania and Hungary are also converging toward world market levels, but both countries have tried to limit the impact of high world prices this year by restricting exports.

Table 4. Comparison of farm prices in Lithuania, Hungary, and selected countries

	1992	1993	1994	1995	1996
Cattle					
United States	1661.0	1682.0	1517.0	`460.0	1407.0
Lithuania	173.8	382.2	447.7	538.0	718.2*
Hungary	883.7	892.0	1058.4	1203.8	
Pigs					
United States	949.0	1016.0	884.0	934.0	1014.0
Lithuania	302.8	670.1	995.0	1032.6	1213.8*
Hungary	1011.5	971.4	1114.5	1338.3	
Poultry					
United States	1160.0	1217.0	1228.0	1243.0	1182.0
Lithuania	171.1	477.2	1025.0	1115.0	none
Hungary	931.8	938.7	1046.6	986.6	
Milk					
Australia	203.8	186.2	198.7	197.5	208.4
Lithuania	46.1	71.2	75.0	120.0	135.8*
Hungary	210.6	209.1	230.9	235.5	
Wheat					
United States	119.1	119.8	126.8	165.4	140.8
Lithuania	48.6	71.4	74.3	120.0	145.6*
Hungary	86.3	102.2	88.4	121.7	
Barley					
United States	93.8	91.1	99.0	131.8	106.2
Lithuania	42.1	59.7	54.8	90.0	150.0*
Hungary	79.8	88.1	80.8	122.5	

*Minimum marginal price at mid-year.
Source: W. H. Meyers and N. Kazlauskiene. Baltic Report 96-BR 22.

Agriculture does not exist for itself and must be viewed as an integral part of the whole marketing chain. Its future depends on the links with and the increased efficiency and competitiveness of the upstream and downstream industries, as well as the establishment of foreign markets for domestically produced products. For this reason, it is extremely important to promote and encourage the development of privatization in the food industry. By this we mean not only privatization of the existing assets of processing enterprises, but also the emergence of new private operations. Freedom to enter and exit the industry as well as the free transfer of shares in food industry enterprises would speed up the process of structural adjustment.

Currently, restructuring is often understood only in a very narrow sense as mere change in ownership structure and/or modernization of the existing specialized enterprises, rather than in the broader sense of changes in production structure, production mix, and development of new products and technologies.

Concerns in Lithuania and some other CEECs about the small size of farms as a result of rapid restitution-based land reform efforts and forcible liquidation of former state and collective farms as a legitimate farming form reflect a fragmentation of ownership rather than a fragmentation of operation, since nonofficial lease arrangements are rather popular, despite the underdeveloped and poorly operating land market. In order to speed up the process of land transfer and provide a solid basis for future farming and investment in farm operations, these measures have to be considered a priority:

(a) Remove the restrictions on farm land use. The current situation shows that there is a surplus of farm land which currently remains unused because of the use restrictions;

(b) Permit land ownership by legal entities. This would provide more stability for the operation of agricultural partnerships, producer, and other cooperatives, as well as contribute to the solution of the collateral problem for farm loans;

(c) Introduce classification of farms into at least three categories for the purpose of the development of targeted support programs. These classifications would be part-time, full-time, and subsistence or hobby farms.

There needs to be consistency in the design and implementation of domestic support and foreign trade measures. Keeping in mind the difficulties in trading with the EU, foreign trade policy has to focus more on the analysis, establishment, and promotion of new foreign markets for agricultural and food products. In order to make the accession to international trade organizations and alliances smoother, as well as to benefit from foreign trade arrangements, governments should set up a clear and comprehensive foreign trade policy, identifying priority products both for domestic market protection and export promotion.

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A timely and carefully prepared accession to WTO will give Lithuania and other new entrants (some CEECs are already members) experience in dealing with various foreign trade issues on an international scale, will help to formulate and implement more consistent foreign trade policies, and will introduce the necessary disciplines required of WTO members. The accession process will enable new entrants to form trade arrangements with over 100 countries on the mutual MFN status granting principle. Membership in the WTO is viewed as a necessary prerequisite not only for the future integration to the EU, but also for further and closer cooperation with CEFTA countries.

In order to minimize the losses associated with integration and make maximum use of its benefits, it is important to work out an integration program targeted at increasing efficiency both in the farming sector and in the upstream and downstream industries. Rural development and employment training programs are needed to assist workers who are released from agricultural employment. These programs need to be accompanied by the necessary institutional development in order to utilize financial and other assistance from the EU under integrated rural and environmental policies as well as structural funds. Even prior to accession, it is necessary to better utilize the possibilities provided in the Association Agreements for EU assistance and cooperation in accession preparation.

It is important to remember that each country is not going through restructuring and the future integration process alone. We have to observe and analyze the developments in other Baltic countries as well as in the Visograd country group in order to learn from their experiences and benefit from closer cooperation.

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