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AVRUPA TOPLULUĞU ENSTİTÜSÜ
AVRUPA BİRLİĞİ İKTİSADI ANABİLİM DALI

FUTURE OF COMMON AGRICULTURAL POLICY IN THE CONTEXT OF TRADE LIBERALISATION ISSUES AND ENLARGEMENT

Yüksek Lisans Tezi

ÖZLEM TOPLU YILMAZ

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Tez Danışmanı: Yrd. Doç. Dr. Sevgi İneci

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ABSTRACT

This MA thesis is an analysis of agricultural trade liberalisation process and of the stimulus behind this process in European Union. The main focus of this study is the shift of protective agricultural support policy to a more liberal policy. The starting point is the problems that protectionist agricultural policy has caused. Effects on agricultural policy changes are analysed in the thesis by distinguishing between internal and external factors. Internal factors are regarded as budgetary costs of CAP, over-production and costly storing of food surpluses, trade-distorting instruments of CAP, losers of CAP (consumers, taxpayers, third countries) and non-agricultural sectors' pressure. In this sense, the failures and successes of the CAP reforms are analysed.

The new agricultural trade regime under three aspects (domestic support, export subsidies and market access) that GATT Uruguay Round established is explained as external factors that led the EU to apply less protectionist measures. These three aspects are taken as the basis to measure the support level in EU. Besides the GATT/WTO notification, OECD indicator 'Producer Support Equivalent (PSE)' is used the show the support level in European agriculture. In accordance with this focus of the thesis, its objective is to analyse the enlargement effect on agricultural trade liberalisation in EU. The way, in which the new member states have shaped their agricultural support and their liberalization process are explained. Poland and Hungary have been chosen as examples to indicate the new member states' agricultural support level. WTO and OECD notifications are used to measure their support level. And as a candidate country, Turkey's agricultural support level is analysed in this part with the help of the same indicators.

The way, which is proposed in the thesis to reach the objective that EU has tried to shift its agricultural policy to a liberal policy due to GATT/WTO forces. The thesis proposes that EU has changed its support structure and reduced the support level. Now European Union is less protectionist than before. However, the level of agricultural support has not decreased to desired level.

ÖZET

Bu tez çalışması, Avrupa Birliği'nde tarım ticaretinin serbestleşme sürecinin ve bu süreci tetikleyen etkenlerin analizidir. Çalışmanın ana odak noktası, korumacı tarım politikasından liberal politikaya geçiştir. Başlangıç noktası, korumacı tarım politikasının yol açtığı problemlerdir. Tarım politikasındaki değişimin etkileri, içsel ve dışsal faktörler şeklinde ikiye ayrılarak incelenmiştir. Değişimin içsel faktörleri, Ortak Tarım Politikası'nın (OTP) bütçeye olan maliyetleri, üretim fazlası ve bunun maliyetli depolanması, OTP'nin ticareti bozan araçları, tarım politikasının kaybedenleri (tüketiciler, vergi kaybedenler, üçüncü ülkeler) ve tarım dışı sektörlerin baskısı olarak ele alınmıştır. Bu bağlamda, OTP reformlarının başarılı ve başarısız yanları analiz edilmiştir.

DTÖ Tarım Anlaşmasının, tarım sektöründe Uruguay Turu ile başlayan ve pazara giriş imkanlarının artırılması, ihracat sübvansiyonları ve iç destek kullanımının süreç içinde azaltılması yönündeki reform programına uyumda AB'nin yükümlülükleri, tarım politikasında değişiminin dışsal faktörleri olarak ele alınmıştır. Bu yükümlülükler AB'deki tarımdaki destek seviyesini göstermek için baz alınmıştır. GATT/WTO yükümlülükleri dışında, OECD tarafından geliştirilen "üretici destek tahmini (PSE)" ölçütü, yine AB tarımındaki destek seviyesini ölçmek için kullanılmıştır.

Bu ana odak noktasının yanısıra, tezde, AB'de tarım ticartei serbestleşmesinde son genişlemenin etkisi ölçülmüştür. Yeni üye olan ülkelerin tarım destek politikalarını nasıl şekillendirdiği ve bu ülkelerin tarımda serbestleşme süreci açıklanmıştır. Polonya ve Macaristan yeni üye ülkelerden örnek olarak seçilmiş, WTO ve OECD göstergeleri, ülkelerin tarım destek seviyelerini ölçmek için kullanılmıştır. Ve aday ülke olarak, Türkiye'nin de tarımdaki destek seviyesi aynı göstergeler yardımıyla ölçülüp, analiz edilmiştir. Tezdeki amaç, AB'nin tarım politikasını GATT/WTO baskısıyla, korumacılıktan sıyrılıp, serbestleşme yolunda adım atmaya çalışmasını göstermektir. Tez, AB'nin destek şeklini değiştirp, seviyeyi azalttığını göstermektedir. Artık, AB eskisine göre daha az korumacıdır. Ancak, tarımdaki destek seviyesi ve serbestleşme gerektiği ölçüde azalmamıştır.

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ACP	:	African, Caribbean and Pacific countries
AMS	:	Aggregate Measurement of Support
ARIP	:	Agricultural Reform Implementation Project
ASCU	:	Agricultural Sales Cooperatives Union
AU	:	African Union
bn	:	billion
CAP	:	Common Agricultural Policy
CEECs	:	Central and East European Countries
CET	:	Common External tariff
CMOs	:	Common Market Organisations
CSE	:	Consumer Support Estimate
CU	:	Customs Union
DDA	:	Doha Development Agenda
D-G	:	Directorate for General
DIS	:	Direct Income Support
DM	:	Deutsche Mark
EAGGF	:	European Agricultural Guidance and Guarantee Fund
EBA	:	“Everything but Arms” Initiative
EC	:	European Community
EEC	:	European Economic Community
EFTA	:	European Free Trade Area
EMS	:	Equivalent Measure of Support
EMS	:	European Monetary System
EMU	:	European Monetary Union
EPA	:	Economic Partnership Agreement
ERM	:	Exchange Rate Mechanism
EU	:	European Union
EUR / €	:	Euro
EUROSTAT	:	Statistical Office of the European Communities
FAO	:	Food and Agriculture Organisation of the United Nations

FSU	:	Former Soviet Union
FTA	:	Free Trade Area
FVO	:	Food and Veterinary Office
GAP	:	Güneydoğu Anadolu Projesi
GATT	:	General Agreement on Tariffs and Trade
GDP	:	Gross Domestic Product
GSP	:	Generalised System of Preferences
GVA	:	Gross Value Added
ha	:	Hectare
IMF	:	International Monetary Fund
LDC	:	Least Developed Countries
MCA	:	Monetary Compensation Amount
MEDA	:	Mediterranean
MFN	:	‘Most Favored Nation’ clause
mn	:	million
MPS	:	Market Price Support
NAC	:	Nominal Assistance Coefficient
NAFTA	:	North America Free Trade Area
OECD	:	Organisation of Economic Cooperation and Development
P	:	Price
PSE	:	Producer Support Estimate
Q	:	Quantity
SAPARD	:	Special Accession Programme for Agriculture and Rural Development
SAPS	:	Single Area Payment Scheme
SEE	:	State Economic Enterprise
SPS	:	Sanitary and Phytosanitary
SSG	:	Special Safeguard Clause
t	:	tonne
TDCA	:	Trade, Development and Cooperation Agreement
TMO	:	Toprak Mahsulleri Ofisi
TRQ	:	Tariff Rate Quota
TSE	:	Total Support Estimate
UAA	:	Utilised Agricultural Area

UK	:	United Kingdom
UR	:	Uruguay Round
URAA	:	Uruguay Round Agreement on Agriculture
US $	:	United States Dollar
USA	:	United States of America
WTO	:	World Trade Organisation

INTRODUCTION

From the standpoint of its contribution to economy, of its consumption as food, agricultural sector has an important place in the economies of nations. Each country implements an agricultural policy, whether agriculture has a great contribution to its economy or not.

The agricultural conditions vary from one country to another in the world, that some of them have more efficient agricultural structures than others. The uneven distribution of land resources and the influence of climatic zones on the ability to ensure agricultural products lead to trade between countries. But most countries apply more protective agricultural policies that can be an obstacle for agricultural trade between the countries.

Some studies conclude that protectionist agricultural trade policies in developed countries are widely seen to have significant negative impacts on developing and least developed countries. Some studies claim that *trade liberalisation* in agriculture have positive effects for agricultural growth.

This thesis deals with agricultural trade liberalisation process in European Union, and the stimulus behind it.

In the European Union, protectionism of the agricultural sector was formalized under the Common Agriculture Policy (CAP). European Union set up its own agricultural policy in the early years of its foundation, when there was a lower self-sufficiency in almost all products. European Union had to protect and support its agricultural sector in order to ensure production and stabilize the markets.

But soon the protectionist agricultural policy occurred problems inside and outside the Union. The internal factors have forced European Union to make reforms in agricultural policy. However, the main impact was the external forces (GATT/WTO) that forced the European Union to make more radical reforms in order not to distort world trade. The EU tried to shift its agricultural policy towards a more liberal (free-trade-oriented) policy. Since 1992, due to the reforms and GATT/WTO rounds, European Union has taken steps for a trade-friendly farm policy in the world, regarding the third countries especially developing and least developed countries.

Now European Union is on the way to be a big trading power in the world including ten new member states of Central and East Europe and expecting to include Bulgaria and Romania in 2007.

An important aim of the Agenda 2000 and fundamental reform of CAP 2003 has been the preparation of the CAP for the challenges of the next century, i.e. in particular for the EU enlargement and the WTO rounds on trade liberalisation. So the future of the CAP will be shaped through trade liberalisation in the world and the last enlargement process.

First chapter gives information about the importance of agriculture in world economy and trade. In this part, 'why there is protectionist support policy in agriculture' is briefly explained. The reasons and the effects of protectionist policy in agriculture are discussed.

Second chapter summarises the concept of Common Agricultural Policy and the importance of agricultural trade for EU.

Third chapter explains the internal effects on agricultural trade liberalisation. It gives information about the evolution of support and protection in European agriculture. Firstly, the problems of support policies and reforms in CAP are explained. Secondly, the reform effects on reducing protection in agriculture are summarised.

Fourth chapter examines the external effects (GATT/WTO effect) on agricultural trade liberalisation in European Union, thus in fact, all radical changes in CAP started with the external factors. In this chapter, the steps taken towards agricultural trade liberalisation by the EU are discussed. GATT/WTO commitments of “market access, export subsidies and domestic support” are taken as the basis, whether European Union has shifted the Common Agricultural Policy (CAP) from protectionist policy to a less-trade distorting policy.

Fifth chapter gives information about the openness of European agriculture to third countries (esp. developing and least developed countries). In this part, agricultural trade liberalisation between European Union and third countries is analysed through the European Union’s trade preferences to developing and least developed countries and trade relations with them.

The sixth chapter looks at the new countries’ perspective on agricultural trade liberalisation. In this respect, enlargement is a turning point for the European Union. The challenge of enlargement can be a problem, if new member states will create problems in WTO commitments of EU and in applying the trade preferences to third countries. In this part, Hungary and Poland are analysed as an enlargement case. Furthermore, Turkey’s point of view to agricultural trade liberalisation will be presented. As a candidate country, liberalization of trade in agriculture is expected to become top priority in Turkey. Apart from bilateral trade agreements and WTO commitments, Turkey will also begin negotiations with European Union on November 3, 2005. The steps towards membership will provide full liberalization of agricultural trade with the European Union.

Finally, some conclusions will be presented at the end of this study.

1 AGRICULTURE IN ECONOMY

1.1 Agriculture in world trade

The last 50 years have witnessed an impressive growth in international trade. The volume of global merchandise trade has increased 17-fold, more than three times faster than the growth in world economic output (FAO, 2003, p.233).

Agricultural trade has also grown during the last 50 years, but only at about the rate of global economic output. Notable among the factors that contributed to this relatively slow growth in trade was the failure to include agriculture fully in the multilateral trade negotiations under GATT that were successful in reducing industrial tariffs.

Table 1-1: World exports of merchandise and commercial services, 2000-04
Billion dollars and percentage

	Value	Annual percentage change			
	2004	2000-04	2002	2003	2004
Merchandise	8907	9	5	17	21
Agricultural products	783	9	6	16	15
Fuels and mining products	1281	10	0	23	32
Manufactures	6570	9	5	16	20
Commercial services	2125	9	7	14	18
Transportation	500	10	4	14	23
Travel	625	7	4	10	18
Other commercial services	1000	11	10	16	16

Source: WTO 2005.

Agriculture has been one of the most protected sectors in the world. So, world trade in agricultural products has not increased much (Table 1-1).

World exports of agricultural products expanded by 15 %, to 783 billion dollars in 2004. Export growth was not only less rapid than in 2003, but also lower than world merchandise trade back to its long-term low of 8.8 %. The rise in the dollar value of global agricultural trade is attributable largely to price developments, as unit values of agricultural products are estimated to have increased 11 % in 2004 (WTO, 2005).

The deepest decline in agriculture was experienced in the period 1980-85, when there were global recession, debt crisis in developing countries and high protectionism in world trade (Table 1-2).

After the establishment of new regime in agricultural trade (thanks to GATT Uruguay Round), world trade in agricultural products have increased.

Table 1-2: World trade in agricultural products 2004
(billion dollars and percentage)

Value	**783**
Annual percentage change	
1980-85	-2
1985-90	9
1990-95	7
1995-00	-1
2002	6
2003	16
2004	15
Share in world merchandise trade	**8,8**
Share in world exports of primary products	**37,9**

Source: WTO 2005.

The major actor in world agricultural trade is European Union (Table 1-3).

Table 1-3: Leading exporters and importers of agricultural products, 2004 (billion dollars and percentage)

	Value	Share in world exports/imports				Annual percentage change			
	2004	1980	1990	2000	2004	2000-04	2002	2003	2004
Exporters									
European Union (25)	344,52	-	-	42,5	44,0	11	9	21	13
extra EU-25 exports	78,41	-	-	10,1	10,0	9	9	16	12
United States	79,57	17,0	14,3	12,9	10,2	3	-2	11	4
Canada	40,10	5,0	5,4	6,3	5,1	4	-3	3	19
Brazil	30,85	3,4	2,4	2,8	3,9	19	4	26	27
China	24,12	1,5	2,4	3,0	3,1	10	13	18	9
Importers									
European Union (25)	373,78	-	-	42,4	44,6	10	8	22	13
extra EU-25 imports	107,67	-	-	13,3	12,9	8	4	17	13
United States	88,11	8,7	9,0	11,6	10,5	6	5	8	14
Japan	65,43	9,6	11,5	10,4	7,8	1	-3	6	12
China	42,28	2,1	1,8	3,3	5,1	21	9	40	39
Canada	19,37	1,8	2,0	2,6	2,3	6	5	10	8

Source: WTO 2005.

European Union is the first leading exporter of agricultural products with a share of 44% in world exports. The other leading exporters of agricultural products are United States, Canada, Brazil and China. The main leading importer of agricultural products is again

European Union with a share of 44,6 % in world imports. The other leading importers are as follows: United States, Japan, China and Canada (Table 1-3).

1.2 The necessity of establishing a policy in agriculture

Agriculture is an important economic part of overall economic activity in most countries. It plays a major role in domestic agricultural production, employment and food security. The fact that many agricultural products are vital interests induces many governments to apply an agricultural policy.

Given the characteristics below mentioned, the agricultural policy applied in most countries is for the government to intervene in the market on a large scale, often regulating both prices and quantities:

Security of supply:

Agricultural products are mainly intended for consumption as food, which is one of humanity's basic needs. Most countries have therefore placed great importance on providing and developing agricultural production (European Commission, 1992, p. 21).

Stable prices for farmers and consumers

Despite all the technical and biological progress made in recent years, agriculture continues to depend on natural conditions such as the soil and the weather, under the influence of which production may fluctuate widely from one year to another, not to mention the threat posed by diseases and pests (European Commission, 1992, p. 21-22). The demand for agricultural products and foodstuffs, on the other hand, remains at a fairly constant level in most industrial countries. The fluctuations in supply would lead to sharp price swings which would not be in the interests of either the farmer or the consumer. One of the tasks of agricultural policy is, therefore, to regulate prices and markets, thereby ensuring the stability desired by all concerned.

Agriculture and environment

Over the past 30 or 40 years, the pressure on the rural environment has become much greater, not only as a result of increasing industrialization, heavier traffic and urban growth, but also as a result of ever more intensive farming (European Commission, 1992, p. 23). In many areas modern farming is now approaching its ecological limits: the pollution of groundwater with nitrates and pesticides is assuming dangerous proportions, the number of wildlife species is shrinking and the appearance of the countryside is changing the worse. Agriculture has an essential part to play in preventing the depopulation and dereliction of the countryside.

Employment

For centuries agriculture has been, and still is, not just an economic activity but also a way of life. Since there is frequently no other employment available in rural areas, many farmers remain on the land for as long as possible, even after they find their income inadequate.

Close links with the rest of the economy

The agricultural sector has many links with its suppliers and customers. For example, farmers buy in machinery, plant, pesticides and fertilizers and produce raw materials for a wide range of processing industries. Developments in agriculture are not, therefore, without implications for the rest of the economy and the rest of the working population (European Commission, 1992, p. 24). In many rural areas agriculture and related sectors are still the determining factors in the economy. Agricultural policy, therefore, has a decisive influence on general economic policy and on regional policy.

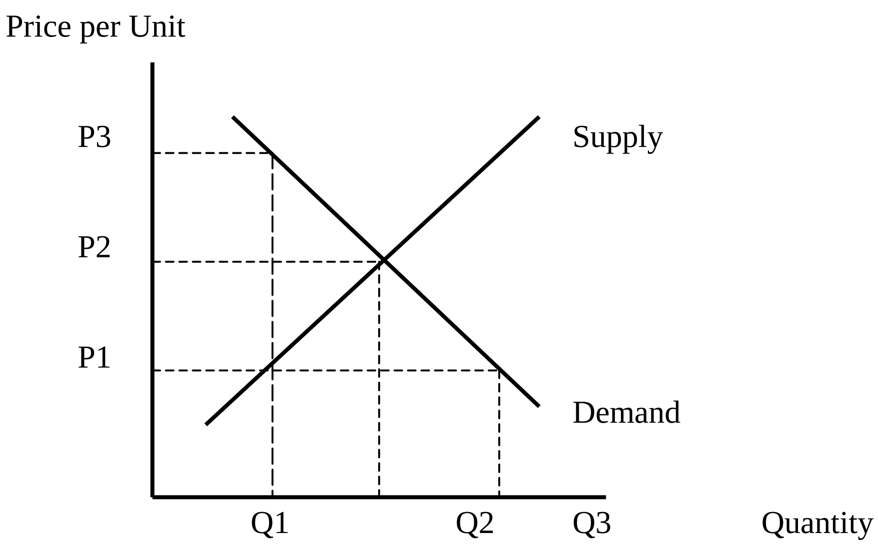
1.3 *Why there is Protectionist Support Policy in Agriculture: Reasons and Effects*

For centuries countries have relied on trade in agricultural and food commodities to supplement and complement their domestic production. The uneven distribution of land resources and the influence of climatic zones on the ability to raise plants and animals have led to trade between and within continents (FAO, 2003, p.3).

However, agriculture remains one of the most protected areas of international trade. The cost of protection falls particularly hard on developing countries, where agriculture typically accounts for a much higher share of economic output, exports, and employment than in developed countries (Thomas C. Beierle, 2002, p. 1089).

Achieving a supply and demand equilibrium in agriculture is particularly different (Figure 1-1).

Figure 1-1: Supply and demand in agriculture



High price levels represented by P3 occur as s result of shortages due to low production levels Q1 such as those that result from poor weather conditions. Exceptional farming conditions generate high production levels Q3 and low prices Q1. Equilibrium occurs at production levels Q2 and price levels P2. However, the price will fluctuate around this equilibrium level. The more price inelastic the demand curve, the greater will be the magnitude of these fluctuations. Agricultural products are also susceptible to price fluctuations arising from the fact that output can not be immediately adjusted to current market prices.

If the price of a good is very unstable, it becomes hard to make a sensible judgement about how much of good to produce. The underlying reason why surpluses and shortages occur in agriculture is the influence of variable weather patterns (Wyn Grant, 1997, p. 29).

Food security was an understandable preoccupation in the years following the Second World War in Europe, when there were real shortages of food in a number of countries. In the immediate post-war period of food shortages, the aim was to expand agricultural production by all possible means, both to raise food supplies and to relieve balances of payment (Tracy, M., 1989, p. 219). World economic growth and its associated technological changes have greatly increased international food security during this century (Gale Johnson, 1991, p. 156). Those who suffer hunger do so ‘because they are poor, not because the world does not produce enough food’ (Atkin, M, 1993, p.5).

There are a number of countries which implement protectionist policy in agriculture, such as Japan, USA. But European Union is such a significant player in the world agricultural economy, that its protectionist policy has serious distorting effects.

The distorting effects of high level of protection in agriculture (especially effect of subsidised European exports) can be summarised (Wyn Grant, 1997, p. 28-29):

1. A substantial transfer of resources from the population at large to a small segment of the population (farmers) takes place. Subsidies principally benefit larger farmers, who are in least in need of them: they could survive in a free market.

2. Consumers have to pay higher prices for agricultural products than they would have to do in a free market.

3. Agricultural tariff effect in developing countries: Producers elsewhere in the world who have a comparative advantage in agricultural production may be denied access to the EU market by import restrictions, and may face competition in third country markets from subsidised exports. Despite the EU's special arrangements with a number of Third World countries under the Lome Conventions, the losers include relatively poor countries.

4. Agricultural subsidy effect in developing countries: Agriculture plays a dominant role in most of the economies of the developing countries. Subsidies applied by developed countries, put exporters from developing countries at a disadvantage .Many of which have lost out from limited market access opportunities and the difficulties of competing with subsidised exports from developed countries (Carmel Cahill & Jonathan Brooks, October 2001).

5. Because of its complexity it offers opportunities for large scale fraud. So the administration of the policy involves substantial costs.

6. It is a source of damaging tensions in relations between the European Union and the other countries such as the United States and the Cairns Group.

To summarise, agricultural policies in nearly all industrialised countries raise prices, redistribute income regressively and towards a small section of society, and impose economic costs at both home and abroad (Winters, L. A., 1993, p. 11).

2 ECONOMICS OF COMMON AGRICULTURAL POLICY

In the mid-1950s the Community of Six had some 65 million hectares (ha) of utilised agricultural area ranging from the north German plains over the Alps and down to the coasts of southern Italy. The farming population consisted of some 17.5 million people. And the average size of farm was 5 ha. (Commission of the European Communities Agriculture in Europe, 1992, pp. 24-26).

Farming in the Community has changed since 1958. Enlarging of the Community from 6 to 15 member states changed the structure of agriculture in Europe. The utilised agricultural area has almost doubled over the last 40 years and increased to 130 million ha in 2002, while the number of persons working in agriculture has fallen by more than half to 7 million, accounting 4% of the working population of EC-15.

In the 1950s, Community produced only some 85% of its own requirements (Commission of the European Communities Agriculture in Europe, 1992, p. 26). Improvements in farm efficiency and incentives offered by the Common Agricultural Policy led to a major increase in food production from the 1960s onwards. There were improvements in production and self-sufficiency levels. Now European Union is self-sufficient in almost all products.

At the same time farmers' incomes rose, helped in many cases by growth in the size of farms. For instance, the average size of farms is increased to 19 hectares in 2002 (WTO).

Now European Union is self-sufficient in most agricultural products and the world's leading trader of agricultural products due to the Common Agricultural Policy.

2.1 Development of CAP

Even before the European Community came into existence in 1957, agriculture was a sensitive issue for most European governments. The memory of post war food shortages was still fresh from the experience of World War II and thus agriculture constituted a key element in European Community. So Common Agricultural Policy (CAP) of the European Union is one of the oldest and the most important policies of the European Union.

CAP is essentially the product of a compromise between France and Germany. France's interest in negotiations leading to the establishment of common market was to ensure that its farmers secured outlets for their production in Germany. If this objective was secured, France would allow German manufacturing exports to French market (Wyn Grant, 1997, p.63).

When the Treaty of Rome established the Common Market, agriculture in the 6 Member States was affected at that time by state intervention. If agricultural production was to be included in the free movement of goods, national intervention mechanisms had to be removed. This is the basic reason on which the Common Agricultural Policy is founded.

Common Agricultural Policy is comprised of a set of rules and mechanisms which regulate the production, trade and processing of agricultural products in European Union. It is covered by Articles 32 (Rome Treaty 38) to 38 (Rome Treaty 46) of the Treaty of Rome. The crucial article is the Article 33 (Rome Treaty 39), which sets out the objectives of CAP. The first is to increase agricultural productivity by promoting technical progress and by ensuring the rational development of agricultural production and the optimum utilisation of the factors of production, in particular labour. The second is to ensure a fair standard of living for the agricultural community, in particular by increasing the individual earnings of persons engaged in agriculture. The third is to stabilise markets. The fourth objective is to assure the availability of supplies. The final objective is to ensure that supplies reach consumers at reasonable prices.

In fact, the second and the last objectives of CAP are compatible with each other. To increase the individual earnings of farmers, the prices were set at high levels. Consumers paid more for their products than necessary. As final objective was to ensure that supplies reach consumers at reasonable prices, that could not be achieved in CAP.

2.2 Principles of CAP

Three main principles, defined in 1962, characterise the common agricultural policy:

1. *A single market*: this denotes the free movement of agricultural products within the area of the Member States; for the organisation of the unified market, common means and mechanisms should be used throughout the EU;

2. *Community preference*: this means that EU agricultural products are given preference and a price advantage over imported products; also, the protection of the internal market from products imported from third countries at low prices and from considerable fluctuations in the world market;

3. *Financial solidarity*: all expenses and spending which result from the application of the CAP are born by the Community budget.

The principle of “Single Market” required the free circulation of goods and common pricing. But to ensure common prices throughout the Community was not so easy. The fact that prices that were set in a common currency (Ecus) had to be converted into national currencies with varying exchange rates raised problems. The European Community applied agri-monetary system to abolish the currency problems. The agri-monetary system resulted in major distortions. “Monetary compensatory amounts” and the “green rates” created advantages in competition for countries with a strong currency.

The introduction of the "Euro" ended most of the problems that were caused by the agri-monetary system.

The principle of "Community Preference" was extended to European farmers in the form of price supports and export subsidies. Price support system has been an important source of distortions and costs (Patrick A. Messerlin, 2001, p.81). With this price system, European Community became less dependent on imports, prices were stabilised, production increased greatly, farmers enjoyed a fair standard of living, food security was assured.

The principle of "financial responsibility" means that all expenses and spending which result form the application of the CAP are born by the Community budget. European Agricultural Guidance and Guarantee Fund (EAGGF) were set up in 1962 to finance these expenses.

2.3 Characteristics of CAP

2.3.1 Common Pricing of the Agricultural Products

One of the fundamental principles of the CAP is common pricing. Establishment of CAP brought about price levels in agriculture which were significantly higher than those in member states before the introduction of CAP.

Under pressure from a significant farm lobby, the German government refused to open its borders to a free community agricultural market unless common prices for cereals were set at levels favourable to its own members. (This set a high price policy in CAP). The price of the *wheat* was the crux, determining the price of bread and through its influence on grains for feeding animals, of meat and other livestock products. The highest prices were in Germany, if these had been adopted across the common market, they would have pushed production up to unacceptable levels, as well as protecting German farmers from French competition. (Wyn Grant, 1997, p. 68-69)

From 1964, when common price levels for cereals were set at German price levels, CAP has provided farmers with a strong incentive for expanding production.

Wheat price was above the world prices and the average in the member states was higher than the Commission and French wanted. And the high prices promoted over-production. Although other member states might benefit from decisions, the outcomes are comprises between French and German interests. However, Germany saw itself as the loser. But Germany sarted to protect its national interests in the future, with agrimonetary system serving as a device to sustain the incomes of German farmers within the common market. (Wyn Grant, 1997, p. 69).

Agrimonetary System (System Failures)

The basic goals of the Agrimonetary System were at one time achieved through the application of a system of monetary compensation (Monetary Compensation Amounts / MCA, in the period 1969-1992) and with the application of the Switchover mechanism (period 1984-1994), and at another time through a method of continuous adjustment of the Green Rates, with the reinforcement of the institution of the "operative events for the Green Rates" and the granting of monetary compensation.

Monetary Compensation Amounts / MCAs (1969-1992)

System of border levies and subsidies known as monetary compensation amounts (MCAs) divided the EU into 12 national markets. It was introduced in 1969 when the French franc devalued and German marks revalued. MCAs were created to ensure that French consumers and German producers were not penalised by the effects of the exchange changes on agricultural prices and by speculators moving production from one member state to another to gain advantage from exchange rate windfalls. Farm prices, levy and subsidy rates were fixed in Brussels in ECUs and converted into national currencies by Commission at fixed exchange rates called *green rates*. When green rates were lower than market exchange rate, then MCAs were charged as a subsidy on imports and levy on exports. (Mc Donald F./Dearden, 1999, p.292-293).

This system gave incentive to smuggling and fraudulent activities. This was propelled by the establishment of EMS in 1979 and the moves towards EMU.

In 1984, process of eliminating the system was complicated by a method of calculating MCAs. This included the creation of Switchover mechanism.

Switchover Mechanism (1984-1994)

Switchover ensured that, if a strong currency (usually DM) climbed within ERM (Exchange Rate Mechanism) against EU, the effect was not a revaluation of Germany's green rate but a devaluation of everyone else's.

The result was that German prices expressed in DM would remain constant and prices expressed in all other national currencies would rise.

In July 1988, Council of Agriculture Ministers and European Commission declared the end of system by the end of 1992 and return CAP pricing to "real ECU" basis. In July 1990, all British MCAs had been eliminated by the strength of sterling. Only Greece, Portugal and Spain in July 1991 still had green rates which were not perfectly aligned with market rates. EU maintained the goal of abolishing MCAs on 1.1.1993, but switchover mechanism remained for at least 2 years. (Mc Donald F./Dearden, 1999, p. 293).

Near-collapse of the ERM in August 1993 led to further crisis and consideration of further options to save CAP pricing structure. The solution arrived at in mid-1995 was to allow a partial introduction of national compensatory aid for farmers in those member states affected by currency fluctuations of others. It was clear that, unless EMU came about soon and eliminated such an expensive and complex agrimonetary system, CAP might disintegrate and be renationalised by member states. (Mc Donald F./Dearden, 1999, p. 293).

ERM (1992)

"With a single currency, there would be no need for green currencies". This was one of the most convincing reasons for introducing a single currency. In 1988 it was decided to phase out the MCAs in the narrow band EMS by 1992. In 1992, variable MCAs remained in UK and 3 southern countries. By the end of 1992, Italy and UK left the ERM. With the creation of the single market in January 1993, MCAs were abolished. Adjustments of the green rates were supposed to occur only if currencies moved outside the narrow ERM margins. (Wyn Grant, 1997, p.90-91).

When the ERM collapsed in August 1993, a new green money crisis ensured. The Commission decided to freeze green currency rates. This decision made the food processing industry angry. In December 1993, the green rates were unfrozen. And the Agrimonetary system continued to be costly for EU citizens. The solution arrived at was to remove the difference between the green ECU and the market ECU by dividing all green rates by the switchover coefficient which, by the end of 1993 had risen to 1.207509. The basic spread of monetary gaps was allowed to move up to 5%.

One EU Currency – The Euro

The Treaty on European Union signed at Maastricht in December 1991 committed the European Union to establishing a single currency. 3 stages were proposed at Maastricht for achieving European Monetary Union (EMU). The final stage of EMU started with eleven countries on 1 January 1999, and it led in 2002 to the replacement of national currencies by the Euro. (Denmark, Sweden and the United Kingdom retain their national currencies).

After all these currency adjustment applications, with the use of “Euro”, the problem of common pricing in agricultural products is solved.

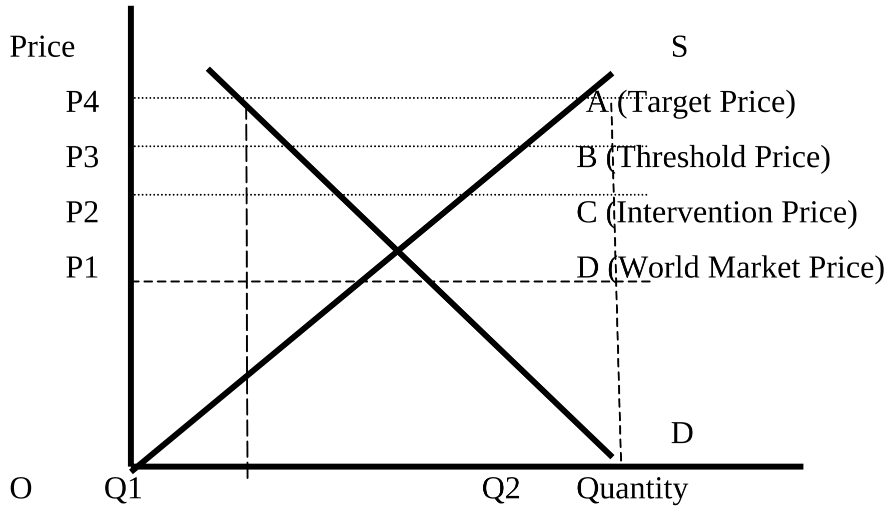
2.3.2 Price policy instruments

The CAP is a price management system that supports the income of EU farmers in two ways (Figure 1-1). First, the authorities buy the surplus supply of products when market prices threaten to fall below agreed minimum (intervention) prices. Second, the CAP applies tariffs at the borders of the EU so that imports of most price-supported commodities cannot be sold into the EU below the desired internal market price set by EU authorities. Methods used in managing agricultural prices in the EU include *intervention prices* and *export subsidies*.

Intervention price: A market floor price (intervention price) triggers market intervention mechanisms to support market prices. Farmers are able to sell their products to the intervention authorities at the annually adjusted intervention price. Products must meet minimum quality requirements to be accepted into intervention. The surplus commodities are then put into EU storage facilities.

Export subsidies (restitutions): When world market prices are below the EU market price, exporters are paid a subsidy to enable them to export competitively to the world market. If world market prices are above EU internal market prices, an export tax may be imposed to prevent the outflow of EU product. Such taxes are usually adjusted weekly or biweekly in line with fluctuation of world market prices. EU commitments under the Uruguay Round Agreement on Agriculture (URAA) set limits on the value and quantity of export subsidies.

Figure 2-1: CAP Pricing System



Target price results in excess supply of the amount Q1-Q2 (figure 1). To keep the market price close to the target price, the authorities must remove this excess supply from the market by setting an intervention price, usually some 10 to 15 % below the target price (P2).

If the market price falls to P2, the authorities will enter the market and buy the product to support the price. This is the origin of the large stocks of the foodstuffs which are associated with CAP, and is the source of the large budgetary costs of operating system. To get rid of large stocks on world markets, an export subsidy (CD) is required.

Prices for major commodities such as grains, dairy products, beef and veal, and sugar are dependent on the price support system. Other mechanisms, such as subsidies to assist with storage of surpluses, and consumer subsidies paid to encourage domestic consumption of products like butter and skim milk powder, supplement these basic underpinnings of the CAP to strengthen domestic prices. Some items, most often fruits and vegetables, are withdrawn from the market by producer organizations when market prices fall to specified withdrawal prices.

2.3.3 Common Organisation of the agricultural markets (CMOs)

Common market organisations regulate agricultural production and trade in the EU. They aim to achieve the objectives of CAP.

Since the introduction of the common agricultural policy, they have replaced national market organisations. The following products are covered by a common market organisation: cereals, pig-meat, eggs and poultry meat, fruits and vegetables, bananas, wine, milk products, beef and veal, rice, olive oil and table oils, sugar, flowers, dry fodder, processed fruit and vegetables, tobacco, flax and hemp, hops, seeds, sheep meat and goat meat and other agricultural products for which there is no specific market organisation. There are no market organisations for alcohol or potatoes. (European Commission, D-G for Agriculture).

The main tasks of the market organisations include fixing single prices for agricultural products on all European markets, granting aid to producers or operators in the sector, establishing mechanisms to control production and organising trade with non-member countries. It also encourages farmers to form producer organisations.

Classification of the market organisations

There are three types of market organisations. Some organisations involve mechanisms for production premiums and intervention, others use a simple intervention system, some of them merely provide production aid or just provide the products concerned with customs protection.

All the common market organisations involve single farm payments.

1. *COMs with supplementary aid:* apply to durum wheat, protein crops, rice, nuts, energy crops, starch potatoes.

2. *COMs with intervention and production aids*: apply to milk and milk products (from 2005), beef and veal, rice, olive oil, cereals, sheep meat, oils and fats, raisins.

   COMs with intervention: apply to sugar, milk and milk products, wine, pig meat, fresh fruit and vegetables.

   COMs with production aid: apply to flax and hemp, processed products based on fruit and vegetables.

3. *COMs with customs protection*: apply to poultry meat, eggs, live plants and flowers, products for which there is no market organisation.

Products for which there is no common organisation of the market

There are many agricultural products and goods which do not benefit from the mechanisms but may benefit from customs protection, production aid or an extension of the rules relating to the market organisations. For instance, specific assistance is granted for production of silkworms, grain legumes (chickpeas, lentils and vetches) and cotton. Protein crops are supported under the arable crops arrangements. Albumin (ovalbumin and lactalbumin) are covered by the arrangements for exports to third countries. The rules on the market organisations in cereals and in milk products have been extended to certain types of chemically pure isoglucose. (European Commission, D-G for Agriculture).

2.3.4 Financing of Common Agricultural Policy: European Agricultural Guidance and Guarantee Fund (EAGGF)

The CAP is financed from the European Agricultural Guidance and Guarantee Fund (EAGGF), which accounts for a substantial part of the Community budget. The EAGGF was set up in 1962 and separated in two sections in 1964.

Guidance section, one of the structural funds, contributes to the structural reforms in agriculture and the development of rural areas (e.g. investing in new equipment and technology). *Guarantee* section finances expenditure on the agricultural market organisations (e.g. to buy or store surplus and to encourage agricultural exports).

There are two main pillars of agricultural expenditures:

Agricultural expenditures

<u>Pillar 1 (Market and income support):</u>

Market and income support measures are those that most closely identified with the farming. They cover direct payments to farmers and continuing market-related subsidies under the common market organisations such as buying of products into public storage, surplus disposal schemes and export subsidies. Funding for Pillar 1 measures comes from the EAGGF Guarantee section (EC, D-G for Agriculture, “The Common Agricultural Policy- A policy Evolving with the times”, April 2004, p. 4).

<u>Pillar 2 (Rural Development):</u>

Agenda 2000 stated that “rural development” is the second pillar of CAP. Rural development measures aim at encouraging environmental services, providing assistance to difficult farming areas and promoting food quality, higher standards and welfare. The majority of expenditure for rural development measures is funded by the EAGGF

Guarantee section, though a significant part comes from the Guidance section. (EC D-G for Agriculture, "The Common Agricultural Policy- A policy Evolving with the times", April 2004, p.4).

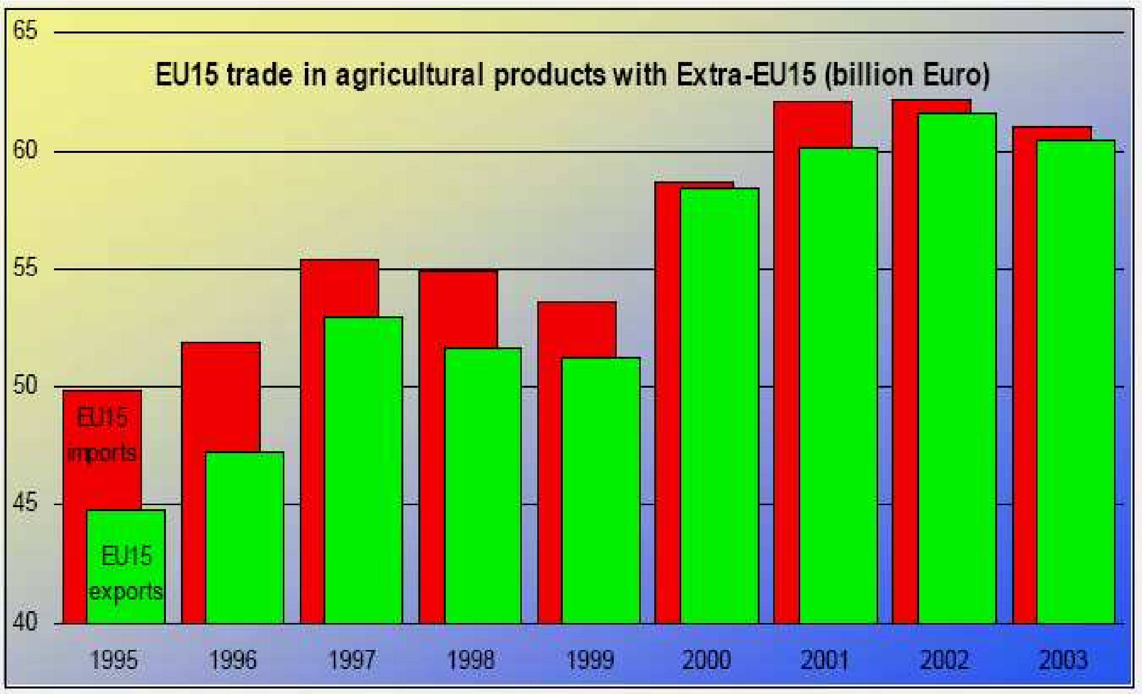
The financial perspectives for 2000-2006 are at the centre of the Agenda 2000 agreement. Under the interinstitutional agreement between the European Parliament, the Council and the European Commission of 6 May 1999, the CAP budget (excluding rural development), will average 38.1 bn € per year for the period 2000-2006. for rural development, the average annual budget available will amount to 4.3 bn €. Finally, 520 mn € is available per year for pre-accession measures in agriculture and rural development i.e. the SAPARD programme (EC General Budget of the European Union for the Financial Year 2004).

2.4 Agricultural trade and its importance

Agriculture has traditionally been the most protected sector in the Community. Since the founding of the Common Agricultural Policy (CAP) in 1959 one of the objectives was to increase productivity. Through the principle 'Community Preference', the internal prices were defended against competitive imports from the world markets. At that time and for all these products, the Union was a net importer. The situation, however, changed in the early 1970s. The prices were set at high level that encouraged production. The initial net importer situation turned into a net exporter situation in the beginning of the 1980s (European Commission D-G for Agriculture, December 2004). Europe became a world leader in the agricultural market. Protective measures and support mechanisms of CAP provided this situation.

Figure 2-4 shows that EU has been a net importer during the 1990s. But this situation seems to turn into a net exporting position for the EU in the future.

Figure 2-2: Agricultural trade with third countries, EU 15



Source: European Commission, D-G Trade, 27 April 2004.

In 2003, EU imports of agricultural products totalled 60.9 billion € (EC, DG Trade, 27 April 2004). Its major imports are tropical products like fruits, coffee, tea, cocoa, spices, as well as oilseeds, and oleaginous fruits. Major suppliers include countries in central and eastern Europe, NAFTA members (Canada, Mexico, USA), Mercosur members (Argentina, Brazil, Paraguay, Uruguay), and the 77 African, Caribbean and Pacific (ACP) countries (EC D-G for Agriculture, 'Common Agricultural Policy Explained', 2004).

Crops and crop products are still the most important single category for imports with a share on total agricultural imports of 42%. There was significant growth for prepared foodstuffs (meat preparation /cereal based food/vegetable preparations, sugar confectionary, beer, wine, spirits, tobacco). Prepared foodstuffs now account for 36%

of total EU15 agricultural imports against 29% in 1995 (EC D-G Trade, 27 April 2004).

The European Union is the second leading exporter. In 2003, the EU's exports of agricultural products reached 60.4 billion € (EC, DG Trade, 27 April 2004). Major exports include wine and spirits, dairy produce, beef, various food preparations, including preparations of cereals and rice. Major export markets are NAFTA, Russia and countries in the Mediterranean region.

More than half of EU exports (53%) are concentrated in the area of prepared foodstuffs and notably in beverages (beer, waters, wine and spirits). Alcoholic beverages (wine, beer and spirits) accounted for 20% of EU exports of agricultural products in 2003 (EC, DG Trade, 27 April 2004).

Export growth has generally been faster in processed products than in primary products. Compared to 1995 the main export growth areas are prepared foodstuffs and vegetable products. Between 1991 and 2000, growth in the exports of processed agricultural products was 71.3% (6.2% annual growth) or 31.4% since 1995 (5.6% annual growth), while for primary products, it was 49.2% (4.5% annual growth) or 26.0% since 1995 (4.7% annual growth) (Eurostat, 2004).

3 INTERNAL FACTORS AFFECTING AGRICULTURAL TRADE LIBERALISATION IN EUROPEAN UNION (CAP REFORM EFFECTS)

In terms of its own objective, the CAP would seem to have had several successes. Firstly, the various agricultural support systems that existed prior to the formation of the European Community (EC) have been liquidated and a common system has been achieved. Secondly, intra-EC free trade in agricultural products has been accomplished through the removal of all intra-EC trade impediments. Thirdly, the EC as a whole has become self sufficient in farm products. Fourthly, it should be mentioned that agriculture has experienced a high rate of technical progress and increased productivity and that the CAP has resulted in stability of EC agricultural markets and in increasing self-supply; these achievements are consistent with the objectives set out in Article 39. Finally, it could be claimed that the CAP has achieved much progress in increasing the size of farm holdings and in reducing the number of farm businesses (A. M. El-Agraa, 1990, p.204). However, problems occurred because of the support policies of European Community.

3.1 Internal factors affecting policy changes in CAP: towards a more liberal policy

Price support system caused many problems and was criticised by trade partners abroad and within the Community. These problems led to some policy changes in the EC. Although CAP threatened to break the Community’s budget, the EC hesitated to take radical steps in the first years of CAP. The Community’s priority was the continuation of CAP based upon its existing principles (Carsten Daugbjerg, 1999, p. 418). However, in 1990s the EC was forced to make reform in agriculture and to reduce the prices of agricultural products. The incentives for significant reforms were budgetary costs of CAP, over-production and costly storing of food surpluses, trade-distorting instruments of CAP, losers of CAP (consumers, taxpayers, third countries) and non-agricultural sectors’ pressure.

3.1.1 Budgetary costs of CAP

The main problem was the increasing *budgetary cost* of the policy.

From the beginning, the share of the budget allocated to the guarantee part of the fund has dominated, accounting for about 95 % of the total EAGGF budget. As a result of the expense of maintaining above world market prices to European consumers, the EAGGF has also dominated the entire budget of the EC. In the beginning of 1980s the guarantee section of the EAGGF was about 64.3 % of the total EEC budget, while guidance was about 3.2%. In the mid-1980s, guarantee actually increased to 65.3% and guidance fell to 2.7%. In 1990, guarantee had fallen to 54.8% and guidance had increased to 3.55. (Lary Neal / Daniel Barbezat, 1998 p.115).

The share of the guidance and guarantee sections of fund on the budget shows that (Table 2-1) nearly 2/3 of the budget went to expenditures on agricultural market organisations, i.e. on support mechanisms. After 1990, the rural development gained importance and its share has increased since 1990.

Table 3-1: Outlay (in mn Ecu) on the European Guidance and Guarantee for Agriculture, 1968-1987

	1968-72	1973-77	1978-82	1983-87
1 Guarantee	10,100	22,800	55,700	99,000
2 Guidance	300	1,000	2,300	3,900
3 EAGGF	10,400	23,800	58,000	102,900
4 Total budget	11,900	30,900	83,500	151,600
1 as a percentage of 3	97	96	96	96
3 as a percentage of 4	88	77	70	68

Source: Willem Molle, 1990.

3.1.2 Over-production and costly storing of food surpluses

Another result of the price system was that, the institutional prices at high levels encouraged production, although there was no significant increase in demand. This led to *over-production* and *costly storing of food surpluses*. The success of increased production has led to food surpluses.

The disposal of surplus involved large budget costs, which were inflated by the negative effect of *export subsidies* on world prices.

The surplus that could not be sold on the world markets and had to be stored in warehouses (large food surpluses were criticised and expressed as butter mountains, wine lakes... at that time).

Through the price system, *large farmers were benefiting much more than small farmers*. So big farmers produced more and earned more money than small farmers. Farmers used herbicides, pesticides, artificial fertilisers in order to increase output. This caused *environmental problems*.

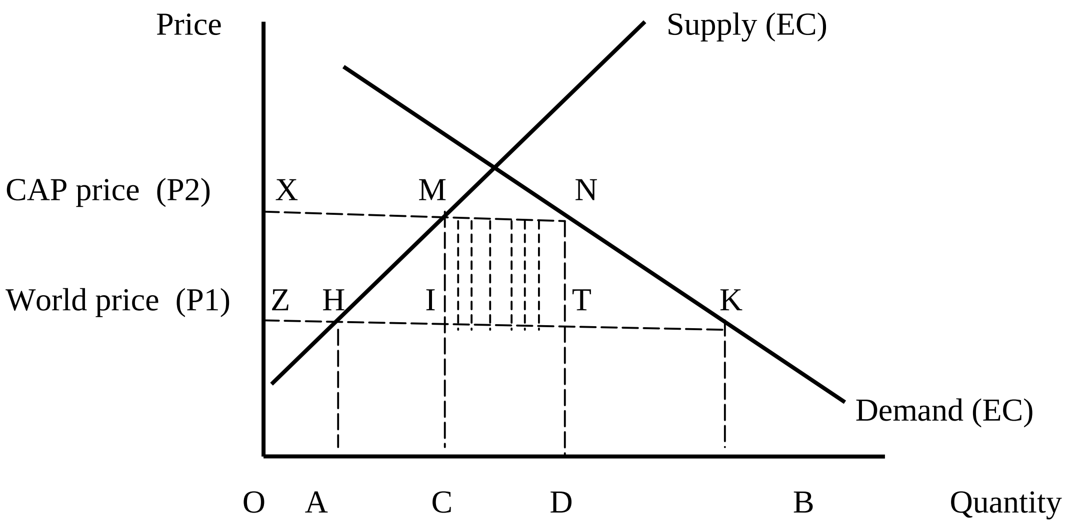
3.1.3 Competitiveness of European Agriculture

Other critic of the CAP was on the *protectionist measures* in European Agriculture. The principle of "Community Preference" encouraged the consumption of EC's agricultural products. Much of the CAP operated through *trade distorting subsidies*. The products imported outside the Community faced levies, so that consumers would prefer Community's production. Export subsidies were required to farmers to bridge the gap between lower world prices and higher Community prices. Quotas, levies, tariffs angered exporters to the EC. Export price supports of CAP distorted world prices.

3.1.4 Losers of CAP: Consumers, Taxpayers, Third Countries

The first group of losers in the EC were the consumers, because they paid more for their products than necessary. The second group incurring welfare losses are the taxpayers. If consumers pay too much for products they needed, taxpayers pay for production nobody really wants. A third group of losers are the third countries. They were facing not only lower export possibilities to the EC, but also lower export possibilities to the EC (Figure 3-1, 3-2), but also lower revenues of their sales to world markets due to dumping by the EC (Willem Molle, 1990, p. 268).

Figure 3-1: Tariff effect

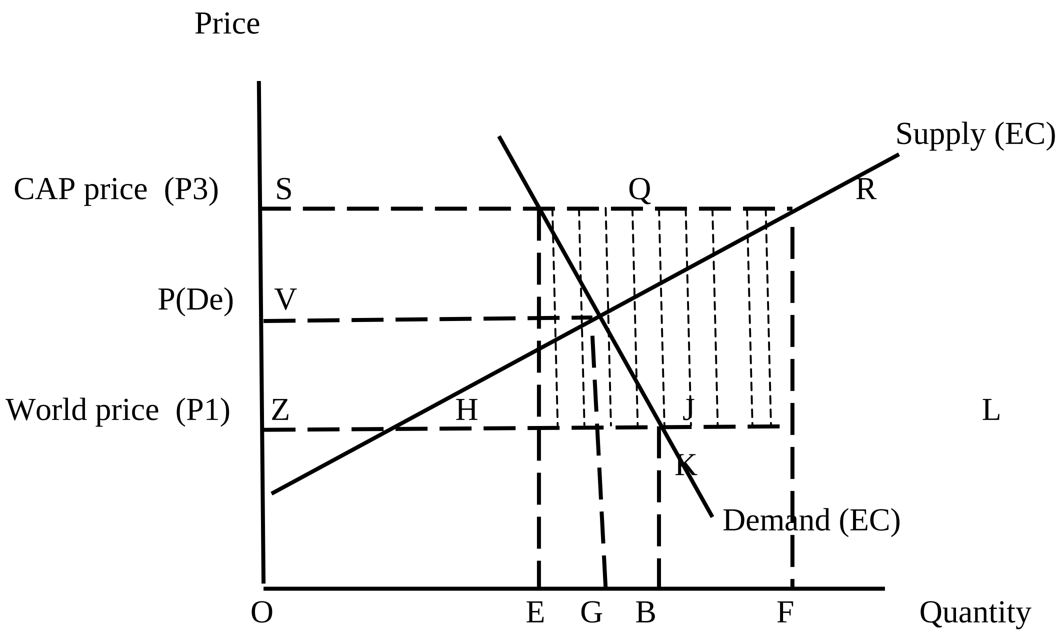


The price on the world market is P1, at which price any quantity can be obtained. In an entirely open economy, domestic production will become OA, domestic demand OB, and a quantity AB will be imported, everything at the price P1. The domestic agricultural production is low in that case, so are consumer prices. Government subsidies do not apply so the taxpayer is not asked a question.

At a guaranteed price P2 (CAP price), domestic production will rise to OC and demand drop to OD. On the quantity imported, CD, European Community imposes an <u>import levy of P2-P1</u> to make prices on the world and EC markets equal. That yields *CD x (P2-P1)* in tariff revenue, the shaded area MNTI of figure 3-1.

The consumer is worse off: he consumes less at higher prices (<u>consumer loss ZXNK</u>, <u>deadweight loss NTK</u>). The farmers' gross return, achieved in one transaction, namely through selling to the intervention authority, will amount to XOCM. The area ZXMH represents an extra producer rent transferred to farmers from consumers (<u>HMI deadweight loss</u>).

Figure 3-2: Export subsidy effect



The price is raised to P (De), which indicates the domestic equilibrium between supply and demand. It can be done without creating surpluses and without involving public budget expenses to be born finally by the taxpayer, albeit at a cost to consumer.

At a price P3 (CAP price), the situation changes, however. Demand will drop to OE entailing an additional loss in consumer surplus as less product becomes available at higher prices. As supply rises to OF, market authorities find themselves compelled to buy a quantity OF-OE at price P3. That quantity has to be sold on the world market, which implies an <u>export subsidy</u> (or restitution in the EC jargon) of the difference between the guaranteed price (or intervention price) P3 and the world market price P1. The amount is QJLR, which will be charged to the taxpayer. The gross return to the farmer, achieved in one transaction through selling of production to the intervention authority, will amount OFRS (figure 3-2).

3.1.5 Non-agricultural sectors' pressure

One result of the price policy was the misallocation of production factors. Agriculture and the industry producing inputs for it were using up resources that could have been better employed elsewhere. Bio-technological industries had difficulties developing, among other reasons because their input prices were too high (sugar, for instance). A considerable area of agricultural land which could have been used for other products (wood for instance, which is in very short supply in the EC) or for nature reserves was tied up in useless production. In some countries, the high product prices led to the further extension of agricultural land at the expense of wood lands (Willem Molle, 1990, p. 268-269).

The large claims agriculture puts on the budget frustrated the development of programmes for the industrial and service sectors (Willem Molle, 1990, p. 269).

Finally, CAP price system resulted in increase in incomes of farmers. This has caused a gap between incomes in agriculture and other sectors of the economy.

These negative effects of the high prices were the reasons why the CAP should be reformed.

3.2 Policy Changes: CAP Reforms

3.2.1 First attempts for CAP reforms

For almost 30 years from its foundation, CAP experienced little change. The first attempt at reform of the CAP was the **Mansholt Plan in 1968**. The plan mentioned that consumption was not increasing as fast as production and the surpluses of products couldn't be disposed of on world markets. In **1972**, structural measures were introduced into the CAP, with the aim of modernising European agriculture. But in the following years, problems persisted; the supply and the demand of agricultural products were not in balance, resulting in ever growing surplus.

The need for changes in the CAP became more important in the **1980s**, because CAP threatened to break Community's budget. In 1984 *dairy quotas* were introduced. Dairy quotas brought spending on dairy sector under control. In 1988, *budgetary stabilisers* came into effect. The aim of the budgetary stabilisers was to reduce the attractiveness of production for intervention by lowering prices when the quantity produce exceeded a threshold, and reducing intervention guarantees.

The stabilisers policy wasn't a fundamental reform of the CAP and didn't attack the underlying problems of CAP. It was a policy to stabilise production and spending. However support through the EAGGF remains proportionate to the quantity produced: this factor caused permanent incentive to greater production (Wyn Grant, 1997, p.75-76). So this policy could not stabilise the production and spending.

3.2.2 1992 Reform (MacSharry Reform)

The reforms undertaken were not so effective that, agricultural spending has kept rising. No reforms have broken that trend. The policy adjustments of the 1970s and the policy reforms of the 1980s were all driven primarily by budgetary crises. The MacSharry

(Agriculture Commissioner) reform in 1992 was also triggered by budgetary problems, but unlike previous reforms this one was also caused by pressure from the GATT Uruguay Round in which particularly the United States launched a serious attack on the CAP.

In fact, MacSharry was against liberalising world agricultural trade, arguing that the whole idea of agricultural liberalisation was based on unreliable academic arguments. EC Commission President Delors supported him by claiming that the abolition of EC export subsidies would destroy the EC agriculture industry (Carsten Daugbjerg, 1999, p. 408, 419).

But the EC's preference was the continuation of CAP based on existing principles. So despite the problems of support policy, no radical changes have been made till GATT Uruguay Round. In 1990, the EC realised that GATT talks could not be completed until the CAP was reformed. For the first time, EC took steps to move agricultural policy in a more liberal direction.

The reform[1] brought changes in the support system. It changed the way in which subsidies were paid to farmers and made radical price cuts. This reform was the first step towards shifting farm support from product to producer. Market price support was replaced by a direct income support scheme.

1992 CAP reform included the reduction of the crops (cereals, oilseeds, protein crops) by 29%. The purpose was to make EU cereals more attractive to the animal feed industry (Jean-Christophe Bureau, 2002, p.16). Compensatory direct income payments were introduced. Basis of agricultural assistance shifted from price supports to direct income

[1] Not all of the countries accepted the reform, but they did not veto it. Voting rules are also important: *In Treaty of Rome*, Agricultural policy decisions can be adopted by the use of qualified majority voting (at least 54 votes until 1996; total 76 votes). According to *Luxembourg Compromise 1966*, Member State could veto a proposal which conflicted with its vital national interest. *Single European Act 1987* extended the use of qualified majority voting to other spheres of Community competence. Luxembourg Compromise was not abandoned so there is an existence of veto opportunity.

supplements. It was paid to big farmers for land set-aside of 15%. Small farmers were exempt from the set aside requirement.

Compensation package agreed to by the Agriculture Council made the reformed CAP more expensive than the unreformed CAP. But by cutting guaranteed prices and taking land out of production, the reform helped reduced the EU's ruinous agricultural surpluses. At the same time, farmers did not experience the drops in income predicted by their leaders; on the contrary, farm incomes across the board rose steadily in the following years (Desmond Dinan, 1999, p. 344).

3.2.3 Agenda 2000

The radical changes in CAP started with 1992 reform, was deepened and extended through the Agenda 2000 reform.

The reform of 1992 was generally regarded as successful, with positive effects on European agriculture. However, developments in the following years – international trends, the enlargement towards Central and Eastern Europe, the preparation of the single currency causing budgetary constraints, the increasing competitiveness of products from third countries and a new round of World Trade Organisation negotiations – forced further adaptation of the CAP, a new reform. Agenda 2000 was a step in this direction.

The Agenda 2000 agreement reached at the Berlin European Council in 1999 shapes the CAP until 2006. The agricultural budget will be restricted to an average of € 38 billion annually for market policy and € 4.3 billion for rural development measures (EC General Budget of the European Union for the Financial Year 2004).

Agenda 2000 reforms focus on increasing the competitive position of European agriculture on the world market. This meant further reducing support prices for cereals and beef from the year 2000 onwards and milk from 2005.

Direct payments to producers have been organised in a different way compared with 1992. Part of the direct payments for beef and dairy will take the form of a national financial envelope from the EAGGF budget which Member States can distribute, thus allowing them to target specific national or regional priorities. Each Member State will be able to allocate resources freely, subject to certain Community criteria designed to prevent distortions of competition.

Rural development measures concern in particular support for structural adjustment of the farming sector (investment in agricultural holdings, establishment of young farmers, training, early retirement), support for farming in less favoured areas, remuneration for agri-environmental activities, support for investments in processing and marketing facilities, for forestry and for measures promoting the adaptation of rural areas insofar as these are related to farming activities and to their conversion. The policy brings together for the first time all the measures related to the development of the countryside which were funded by the EAGGF and is to accompany and complement the proposed reforms in market and price policy.

Moreover, there will be increased emphasis in the new CAP on food safety and environmental concerns. The guiding principles of this policy are those of decentralisation of responsibilities - thus strengthening subsidiarity and partnership - and flexibility of programming based on a 'menu' of actions to be targeted and implemented according to Member States' specific needs. As a coherent package of measures it has three main objectives:

- To create a stronger agricultural and forestry sector, the latter recognised for the first time as an integral part of the rural development policy;
- To improve the competitiveness of rural areas;
- To maintain the environment and preserve Europe's rural heritage.

Furthermore, the Agenda 2000 agreement gives Member States the opportunity to modulate direct payments (modulation) made to farmers under the CAP based on criteria that can include the workforce on the holding, the overall prosperity of the holding or the total amounts of payments granted under support schemes (European Commission, D-G for Agriculture, Agenda 2000 the CAP reform – A policy for the future).

3.2.4 June 2003 reform

Today, the rules of Agenda 2000 still apply, but the Council of Ministers decided in June 2003 on a new CAP reform. New CAP will be more geared towards the interests of consumers and taxpayers, while giving EU farmers the freedom to produce what market wants.

This new reform completely changes the way the EU supports its farm sector.

<u>The elements of the new reform:</u>

- Introduction of *single farm payment*: this payment is independent from production. It is linked to the respect of environmental, food safety, animal and plant health and animal welfare standards (*cross compliance*).

  The amount of the payment will be calculated on the basis of the direct subsidies farmers received in a reference period (2000 to 2002). The aim of the single payment is to allow farmers to become more market-oriented.

  Single Farm Payment will enter into force in 2005. If a member state needs a transition period, the state can apply single farm payment from 2007 at the latest.

- A *strengthened rural development policy* with more EU money, new measures to promote the environment, quality and animal welfare and to help farmers to meet EU production standards starting in 2005. This will be achieved via *modulation* – that means a transfer of funds from direct payments to rural development.

- *Financial discipline mechanism* has been agreed in order to ensure that the farm budget is fixed until 2013.

Link between subsidies and production will make EU farmers more competitive and market oriented, providing the income stability. This reform will also strengthen the EU's negotiating hand in the WTO trade talks. Because EU has made efforts to redirect its farm policy towards more transparent and non trade-distorting instruments. (European Commission, D-G for Agriculture, September 2003).

3.2.5 Continuation of CAP reforms in 2004

The 2004 reforms concern "Mediterranean products" and sugar.

Luxembourg Council on 26 June 2003 invited the Commission to make reform of the common market organisations for olive oil, tobacco, cotton and hops that would be based on the principles of the June CAP reform.

The largest part of support for the three sectors is decoupled, based on historical references for the 2000-2002 period, and is integrated into the legal framework of the single farm payment.

The reform of agricultural aid for cotton, tobacco , hops and olive oil and table olives was negotiated together and included in the same Regulation (Council Regulation (EC) No 864/2004**)** in what was know as the "Mediterranean package". All these products were subsequently included (April 2004) in the comprehensive reform of the common agricultural policy (CAP) of June 2003, with the approval of the move from direct aid (aid paid by hectare, unit of output or livestock unit) to a system of single farm payments .

Cotton, tobacco and olive oil are grown in certain regions whose development is lagging behind. The reform aims to safeguard production in those regions by according priority to farmers' incomes rather than to providing aid for production. Coupled aid is to be provided for tobacco and cotton to permit adjustment to the new arrangements. Coupled aid may be paid for hops to take account of particular market situations or structural situations within a region.

The current reform affecting "Mediterranean products" is based on the Commission communication to the Council and to the European Parliament "Accomplishing a sustainable agricultural model for Europe through the reformed CAP - the tobacco, olive oil, cotton and sugar sectors ". The common main aim as regards tobacco, olive and cotton growing is to support sustainable development in the sector, achieved by reorienting the support to reward healthy, high-quality products and practices, and developing alternative sources of income and economic activity.

The Commission has also proposed a radical reform of the sugar CMO. This reform includes a restructuring of the sector to reduce sugar exports and export refunds by removing intervention and capping Community production of sugar and its domestic price. The reform also provides for decoupled aid (separated from production) to sugar beet producers

3.2.6 Changes of supports in agricultural products

Arable crops

The arable crops sector covers cereals, oilseeds crops and protein crops. The sector production accounts for 11% of the value of the EU production. It accounts about 42% of EAGGF expenditure and uses 40% of the EU Usable Agricultural Area.

The main innovation of Agenda 2000 reform for the cereals is the reduction of the intervention price by 15% in two stages starting in the 2000/2001, bringing it down from

€ 119.19/t to € 101.31/t. Direct payments fixed on per hectare basis will be increased in two annual steps from € 54/t to € 63/t in the marketing year 2001/2002. The increase represents 50% compensation for the overall price cut (Regulation (EC) No 1251/99).

In the case of oilseeds and linseed, direct payments per hectare will be reduced in three annual steps so that they are the same as the cereals payment i.e. be € 63/t in 2002/2003.

Protein crops will receive a premium of € 9.5/t on top of the basic direct payment, bringing in one step total aid to € 72.5/t as from 2000/2001.

The minimum price of potato starch is cut by 15% over two years (2000/2001 and 2001/2002), with the aid rate being raised to EUR 110.54/t (equivalent to 75% of the EUR/t intervention price cut). The minimum price for potatoes intended for the manufacture of potato starch will be set at EUR 194.05/t for 2000/2001 marketing year and EUR 178.31/t for 2001/2002 marketing year onwards. The aid rate is matched by lower production quotas so as ensure budget neutrality. Under these conditions, Member States which have a quota greater than 100 000 tonnes will see a reduction in their quotas of 2.81% in the marketing year 2000/2001 and of 5.74% in the 2001/2002 marketing year. Member States which have quota less than 100 000 tonnes will see a reduction of 1.41% and 2.87% in the respective years.

Rice

A first reform of the rice market organisation was undertaken in 1995 (Regulation (EC) No 3072/95). Intervention price for rice was set at € 298.35/t for the 1999/2000 and subsequent marketing years. A national base area was established for each producing Member State, together with a more than proportional penalty in case of overrun.

Dairy sector

Milk production is the most important agricultural activity in the EU, representing 18% of the total value of production. The reform of the dairy sector is delayed until 2005/2006.

The Regulation (EC) No 1255/99 introduces a 15% reduction for butter and skimmed milk powder in three equal steps, starting from the marketing year 2005/2006. The milk quota regime will be extended and will stay in force until 2007/2008.

In Member States (besides Italy, Greece, Spain, Ireland and Northern Ireland) quotas will be increased by 1.5% in three steps over three years in parallel with the price reductions starting in 2005.

Beef and veal

Beef and veal sector is the second biggest contributor to the value of agricultural production with a share of 10% at EU level (after dairy).

Agenda 2000 reform introduces a 20% reduction of the current market support price from € 2780/t to € 2224/t in three equal steps (Regulation (EC) No 1254/99).

Direct payments to farmers take the form of special premiums for male animals, suckler cow premiums, slaughter premiums. Special premiums for male animals would be € 210 per head for bulls and € 150 for steers in 2002 (onwards). Suckler cow premium is € 200 in 2002 (onwards). Slaughter premium amounts to € 80 for bulls, steers, dairy cows, suckler cows and heifers, and € 50 for calves in 2002 (onwards).

Sheep meat and Goat meat

Regulation (EC) No 2529/2001 establishes the common organisation of the market in sheep meat and goat meat. The products concerned are lambs, sheep and goats, edible offal and fats. In case of significant change in prices on the market, appropriate measures may be taken. In the event of an outbreak of an animal disease, exceptional measures may be taken to support the market.

Wine

In terms of production, consumption and trade, the EU wine sector plays a significant role on a global scale. EU vineyards currently account for 45% of the world’s production area and some 60% of volume, whilst EU consumers account for almost 60% of world-wide consumption.

EC Regulation No 1493/99 maintains the principle of a prohibition until 2010 on the planting of vine varieties.

Community support will take two forms. Firstly, compensation for loss of revenue resulting from implementation of the plans (no compensation where old and new vines coexist for a maximum of three years). Secondly, there will be a Community contribution to the actual costs of the restructuring and conversion. The Community contribution will not exceed 50% of these costs (75% in Objective 1 regions).

An aid scheme has been introduced to assist producers with the private storage of table wine, grape must, concentrated grape must and rectified concentrated grape must.

Olive Oil and Table oils

The common organisation of the markets in olive oil and table olives has been reformed, moving from direct aids to producers to a new system of single decoupled aid (single payment). At least 60% of all production aid paid during the 2000-2002 reference period (100% for holdings of less than 0.3 hectares) will be transferred to the single payment scheme. The remaining funding (a maximum therefore of 40%) will become an area aid for the upkeep of olive groves of environmental or social value. The new system will come into force for the 2005/2006 marketing year. The current support scheme, which provides for production aid of EUR 1322.5/tonne, will remain applicable until 1 November 2005 (Council Regulation (EC) No 865/2004**).**

Tobacco

Council Regulation (EC) No 864/2004 of 29 April 2004 amending Regulation (EC) No 1782/2003 establishing common rules for direct support schemes under the common agricultural policy and establishing certain support schemes for farmers.

The common organisation of the market in raw tobacco has been fundamentally changed in order to switch over completely to the single-farm-payment system by means of decoupling (separating aid from production) within four years, starting in 2006. Decoupling will apply in full from 2010, but Member States may opt for a four-year transitional period starting in 2006. During that period, at least 40% of direct aid for tobacco under the old system will be allocated to single farm payments.

From 2010, 50% of aid for the tobacco sector will be used to establish a financial allocation for restructuring tobacco-growing areas. The reform will apply from 1 January 2006.

Cotton

Extensive changes have been made to the aid arrangements for cotton, with a partial move to a system of single farm payments. The move is only partial in that 35% of aid will continue to be provided in the form of an area payment (direct aid), with the remaining 65% being provided as a single farm payment.

(Council Regulation (EC) No 864/2004 of 29 April 2004 amending Regulation (EC) No 1782/2003**)**

Hops

From 1 January 2005 (end of transitional period: 31 December 2005) European Union aid for hops will switch over to the decoupled system (aid granted independently of production) and to the single farm payment. Nevertheless, each Member State may grant a maximum of 25% of aid to the sector as additional aid for farmers and/or approved producer organisations.

3.3 CAP Reform effects on reducing protection

From 1962 to 1992, the CAP relied on a managed market system that relied on import restrictions so as to maintain internal market prices above a pre-determined administrative price; intervention buying to guarantee that every quantity produced would be sold at least at a pre-determined price; subsidies to export or to destroy excess supply that would have caused the internal price to fall below this administrative price (Jean-Christophe Bureau, 2002, p.13). The problems arisen from the CAP system led to some policy changes.

Before 1990s, CAP used the most trade-distorting instrument “market price support”. 1992 MacSharry reform reduced the market price support for cereals and beef and replaced the income loss through direct payments linked to historical production levels. This reform was the first step towards shifting farm support from product to producer.

As shown in the Figure 2-1, CAP was operating mostly through trade distorting instruments before 1992 reform. 90.7% of CAP funding went to refunds and intervention. The rest of 9.3% of funding was less trade-distorting that went to direct payments. 1992 CAP reforms changed this situation. The share of refunds and intervention fell to 36.9% and the share of direct payments increased to 50%.

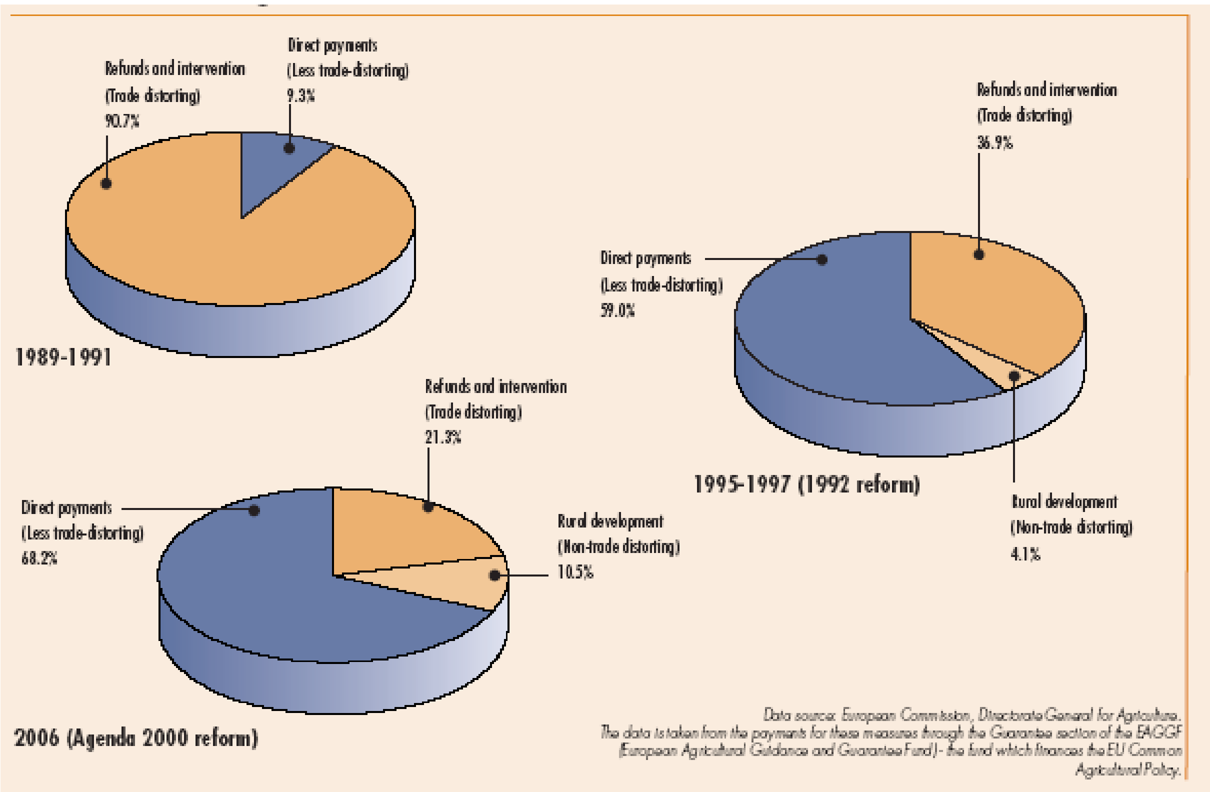
However, with this reform, for the first time, EU took steps to move agricultural policy in a more liberal direction. But access conditions for third country suppliers have not improved.

Agenda 2000 is the continuation of MacSharry reforms. It was put into place to be prepared for an enlarged EU.

Agenda 2000 lowered market price support and direct payments are organised in a different way compared with 1992: The reductions in intervention prices were compensated with direct payments. This means that the reforms change the structure of the agricultural support, but not a change in the level of support.

When compare to 1992 CAP reforms, with Agenda 2000, total market support (including export subsidies) has fallen progressively from 91% of total support pre-1992, and will reach a low of 21% by 2006; export refunds now represent only 12% of CAP expenditure, compared with 25% in 1992 (EC D-G for Agriculture, 2001).

Figure 3-3: Share in CAP funding for the various measures



Source: European Commission D-G for Agriculture, 2001.

The share of funding for rural development has increased. Member states have to respect environmental measures and food safety. Focus on quality is increased. This reinforces the EU's position in WTO.

But despite these developments, Agenda 2000 is still focused on product support. However, product support is decreased when compared with MacSharry reforms.

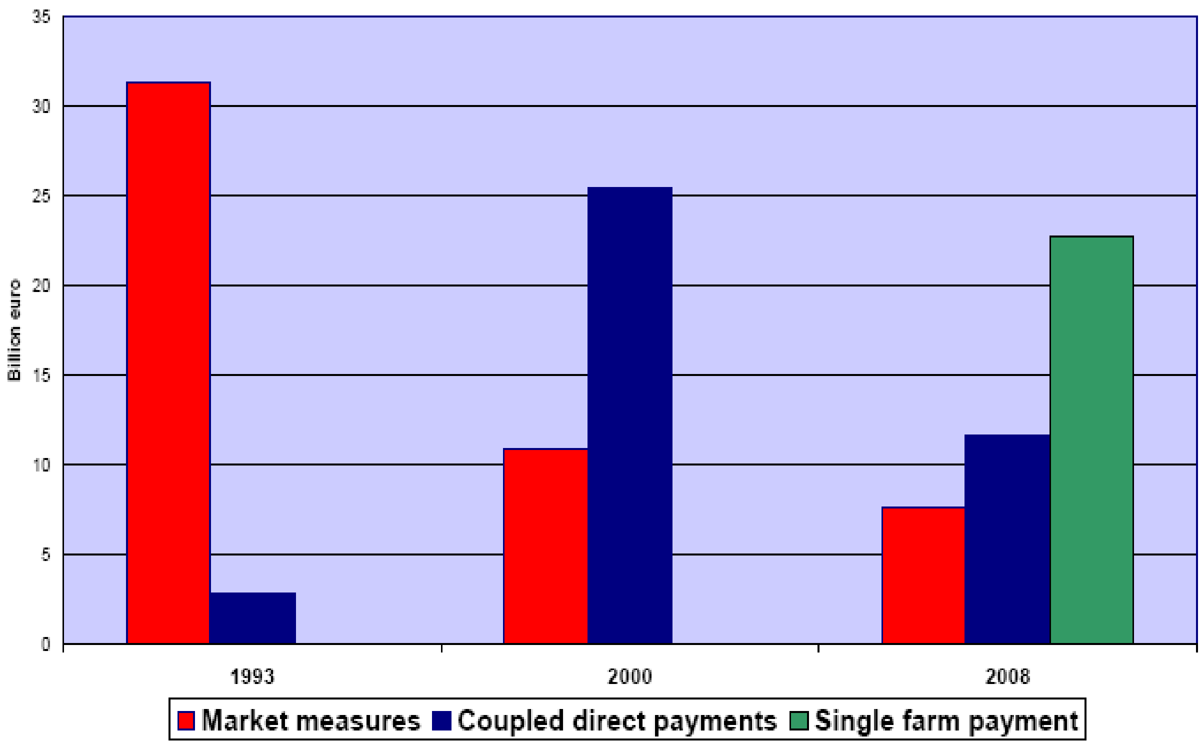
Fundamental Reform of June 2003 made the CAP more trade friendly and acceptable among its trade partners.

The way the money is spent is different in 2003 CAP reform. The most important objectives of support will be for food safety, care of the environment, animal welfare and rural development. This European Farm Model is called Multifunctionality. The aim is to make CAP more trade friendly and fully compatible with WTO obligations.

Centrepiece of the June 2003 reform is Single Payment Scheme. To receive single payment, farmers must keep the land in good agricultural and environmental condition. The farmers have the freedom to produce what the market wants.

2003 CAP reforms break the link between support payments and production. These new payments are decoupled and little trade distorting.

Figure 3-4: Support to EU-15 farmers in billion €



Source: European Commission, Directorate-General for Agriculture: "Agricultural Trade and its Importance", December 2004.

**market measures: price support measures*

According to OECD, increased decoupling will reduce distortions to international trade and help boost farm incomes. The step towards the decoupling of support to farmers so that the payments they receive are less dependent on what they produce (OECD, 2004, p. 43).

With the reforms in recent years, support to EU farmers is moved from the most trade distorting amber box into blue box and finally into the green box[2] (Figure 2-2), i.e. support has moved from the most trade distorting programmes into the less trade distorting instruments.

However, single farm payments based on historical entitlements remains linked to farm size. So larger and richer farmers will benefit more than the smaller ones from the support. This can lead to income disparities (OECD, 2004, p. 44).

To conclude, European Union had to take some protective measures at the beginning. Whenever the problems of support emerge, EU has not made necessary structural reforms. Instead EU has adhered to make temporary adjustments in CAP. So level of agricultural support has not decreased to desired level.

Now, European Union has been still criticised of being highly protectionist in agriculture.

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[2] Under the WTO, policies that distorted trade were divided into three boxes: Amber box (red box), Blue Box, Green box. (*For further information, see Part 4, pages 41-45).*

4 EXTERNAL FACTORS AFFECTING AGRICULTURAL TRADE LIBERALISATION: GATT/WTO INFLUENCES

The early 1990s was an extremely important period for trade liberalisation in Europe because the completion of the single market in the EU, was achieved and the Uruguay Round Agreement under the General Agreement of Tariffs and Trade was signed.

Agricultural trade was not subject to the liberalisation in the GATT negotiations before Uruguay Round (1986-1994). The negotiations started at the time, when protectionism was high in the world. With the Uruguay Round the first steps were taken towards liberalisation. Following the Uruguay Round, GATT transformed into the World Trade Organisation.

For the first time, member governments were committed to reduce agricultural export subsidies and trade-distorting domestic support. They have agreed to prohibit subsidies that exceed negotiated limits for specific products.

A particular feature of agriculture is that it has a specific agreement, the Agreement on Agriculture. The Uruguay Round Agreement on Agriculture (URAA) came into force on 1 January 1995. The agreement set up a framework of rules and started reductions in protection and trade-distorting support. It was to be implemented over a six-year period (from 1995 to 2000) for developed countries; 10 years (1995-2004) for developing countries.

4.1 Uruguay Round Agreement on Agriculture and its consequences for CAP

The Uruguay Round Agreement on Agriculture established a new regime for agricultural trade under 3 aspects: domestic support, market access and export subsidies. Table 3-1 shows the commitments of the developed and developing countries.

Table 4-1: Key aspects of WTO

Numerical targets for cutting subsidies and trade protection

The reductions in agricultural subsidies and protection agreed in the Uruguay Round

	Developed countries 6 years: 1995-2000	Developing countries 10 years: 1995-2004
Market access		
average cut for all agricultural products	**-36%**	**-24%**
minimum cut per product	-15%	-10%
Domestic support		
cuts in total ("AMS") support for the sector	**-20%**	**-13%**
Export subsidies		
Value of subsidies (outlays)	**-36%**	**-24%**
subsidized quantities	**-21%**	**-14%**

Notes: Least-developed countries do not have to reduce tariffs or subsidies. The base level for tariff cuts was the bound rate before 1 January 1995; or, for unbound tariffs, the actual rate charged in September 1986 when the Uruguay Round began.
Only the figures for cutting export subsidies appear in the agreement. The other figures were targets used to calculate countries' legally binding "schedules" of commitments. Each country's specific commitments vary according to the outcome of negotiations. As a result of those negotiations, several developing countries chose to set fixed bound tariff ceilings that do not decline over the years.

Source: WTO, 2003.

4.1.1 Market Access

The main elements of market access are the level of the tariffs, the existence of tariff peaks and tariff escalation and the existence of quotas.

Market access provisions required the converting of non-tariff measures such as quotas, variable import levies, voluntary export restraints into tariffs through tariffication. Tariffs are more transparent than other forms of protection (J. Of W. T. Vol. 36, No: 6).

Developed countries were to lower their agricultural duties by 36% in 6 stages over a six-year period in relation to their level in the 1986-88 reference period. The developing countries were to cut their duties by 24% over a ten-year period. The least developed countries are not required to reduce them.

The market access rules of the WTO Agreement on Agriculture which came into force in 1995 did not improve market access conditions for developing countries. The reason for that was the conversion of non-tariff barriers into tariffs and tariff quotas established high maximum tariff levels in the developed countries ("dirty tariffication"). Developed countries, including the EU, have been accused of artificially increasing their protection through this process, by basing their calculations on inflated world prices.

Tariffs

Uruguay Round resulted in conversion of the EU's variable import levies into tariff with an obligation to reduce them by 36% over a six-year period. The EU has continued to reduce its tariffs since the Uruguay Round.

EU reports that tariff for agriculture is 10% (European Commission, Directorate-General for Agriculture, 2003). But estimates of the EU average agricultural tariff range between 10% and 40%. There are three main reasons for this broad range of estimate. First, most studies rely on the bound tariffs, i.e. the tariffs the EU applies under the most favored nation (MFN) clause. The data are readily available, since this is the official list of tariffs submitted to the WTO. However, half of the value of agricultural imports in the EU enter under preferential agreements or tariff rate quotas, at a much lower tariff than the bound tariff (agreement with the PECOs, Lome/Cotonou, System of generalized preference, etc.). Second, the EU tariff structure is very complex, with a large number of specific tariffs (i.e. in Euros per tonne, liter, head, etc.). In order to construct useful indicators, one needs to convert them into ad valorem (i.e. percentage tariffs). Not only this introduces a bias in the appreciation of the overall effect of the tariff (a specific tariff affects low unit value commodities more than high quality products), but the price used for the conversion has, in practice, a considerable impact on the value of the ad valorem equivalent Third, there are several ways to construct an average tariffs. Using a simple arithmetic mean, or using a trade weighted average lead to different results, because of the large quantities of commodities such as coffee or soybeans, that are imported with very low tariffs (Jean Christophe Bureau, 2002, p. 52).

Despite Uruguay Round commitments, the developing country market access to European Union markets was restricted.

First reason was dirty tariffication. For example, the prices in the EU were established (intervention price plus 10%) for the purposes of conversion into tariff equivalents in order to achieve higher initial tariffs (Marita Wiggerthale, 2004 Heinrich Böll). An important factor is the fact that rates of protection during the selected base period (1986-88) were very high for many products in the European Union (Table 3-2).

Table 4-2: Tariff equivalents, bound and applied tariffs

	Period	Common Wheat	Coarse Grains	Beef	Pork	Poultry	Dairy	Sugar
1 Tariff equivalents (reference period)	1986-88	103.0	133.0	83.0	40.0	51.0	177.0	234.0
2 Uruguay MFN bound tariffs	1995	155.6	134.4	125.0	51.7	44.5	288.5	297.0
3 Applied (out-of-quota) tariffs	1995	34.8	99.2	80.9	40.3	16.3	147.5	n.a
4 Applied (in-quota) tariffs	1995	n.a	45.7	20.0	13.3	8.1	33.2	n.a
5 Applied (out-of-quota) tariffs	2000	55.5	78.1	36.8	19.2	12.7	103.8	248.1

n.a: not available

Source: Patrick A. Messerlin, 2001.

For example, the specific duty on wheat was estimated to be equivalent to an ad valorem tariff (i.e. percentage tariffs) of 155.6%, whereas the ad valorem equivalent tariff for the years 1986-88 was estimated to be 103%, that is, it was a "dirty tariffication" amounting to more than 52% (Patrick A. Messerlin, 2001, p. 302-306).

Tariffication exercise also witnessed a protectionist trend in the beef sector. The ad valorem tariff equivalent for beef is estimated to be 125%, showing a dirty tariffication of 42%.

The same trend is seen in dairy and sugar sectors. The average ad valorem equivalents for dairy products are estimated at 288.5% and for sugar at 297%, revealing a huge dirty tariffication of 111.5% in dairy and 63% in sugar.

Secondly, reduction commitments applied to 'bound' rates, the legally binding ceilings agreed to in the URAA, rather than 'applied' rates. Applied rates are what countries actually charge on imports. Many countries' applied rates are much lower than their bound rates, making reduction commitments on the bound rates largely irrelevant (Table 2-6). The differential between applied and bound rates also allows countries to adjust their rates according to market conditions while staying within commitments, just the kind of variability the URAA was supposed to eliminate (Beierle, C. Thomas, 2002, p. 1095).

Thirdly, average tariff reduction facilitated the avoidance of full tariff reduction of 36% for sensitive products. With few exceptions the EU applied three categories of tariff reductions (20%, 36%, 100%) with 20% reductions applied to “sensitive” products such as sugar, milk powder, olive oil, wine, many fruit and vegetable varieties, and semi-processed products.

Finally, the market access in developed countries is defended by a safety valve incorporated into the URAA. The Special Agricultural Safeguard allows countries to protect designated products from flood of imported goods by raising tariff levels on an emergency basis. The safeguard is triggered when imports fall below a certain price rise above a particular quantity. Of the 38 WTO members that have reserved the right to use the safeguard, European Union is a larger user. During the implementation period, European Union accounted for 57% of all value-based actions (Beierle, C. Thomas, 2002, p. 1095).

The Special safeguard clause creates as significant protection in addition to tariffs in the EU. For example, the special safeguard for butter and sugar, for example, could be invoked almost everytime the EU wanted it during the 6 years following the Uruguay Round. The trigger price for butter was set at 2,483 Euro per ton, while the EU itself had estimated (in the tariffication process) that the relevant world market price for tariff calculations was 943 Euro per ton. For white sugar, the threshold price was set at 531 Euros per ton, compared to the 193 Euro per ton used for tariffication. The EU invoked the special safeguard on the basis of prices for chicken carcasses, for processed preparations, and for sugar and molasses in 2000. The clause was invoked on the basis of volumes for 15 types of fruits, on a temporary basis (Jean-Christophe Bureau, 2002, p. 53).

Tariff Rate Quotas (TRQs)

Since the Uruguay Round, there are no quotas applied in agricultural trade. Now tariff rate quotas (TRQs) exist. Tariff rate quotas don’t limit trade. They provide for imports at a favourable tariff up to a given limit. Beyond these limits imports are unlimited, although they are subject to higher tariffs.

Two types of tariff quotas were introduced as part of the tariffication process. First, tariff quotas had to be set up to establish minimum access opportunities where there had been no significant imports in the base period. The sizes of the quotas were to increase from 3% of the 1986-1988 base period domestic consumption in 1995 to 5% at the end of the implementation period. In-quota tariff rates were required to be “low or minimal”. Second, tariff quotas were constituted to maintain current access opportunities, where the process of tariffication would otherwise have resulted in a deterioration of market access conditions. In this second case, tariff quotas had to be equal to quantities imported during the base period. Both quota volumes and in-quota tariff rates are specified in the countries’ schedules of commitments.

For a number of products the EU opened up Tariff Rate Quotas (TRQs) in order to meet the obligations of current access. When traditional imports did not represent a sufficient percentage of domestic consumption, TRQs were also opened so as to meet minimum access commitments (Table 3-3).

Table 4-3: Number of tariff quotas applied by European Union, by product group

Products	Current access (tonnes)	Minimum access (tonnes)
Live bovines	194.000 (heads)	
Beef	151.050	20.000
Pork		75.600
Sheep and goats	319.875	
Poultry		29.000
Eggs		208.000
Butter	76.667	90.000
Skim milk powder		69.000
Cheese	15.250	104.000
Cassava, sweet potatoes	6.857.390	
Bananas	2.000.000	
Citrus	45.000	
Maize-sorghum	2.300.000	500.000
Wheat		300.000
Sugar	1.565.000	
Bran	475.000	
Mushrooms	62.660	

Source: Jean-Christophe Bureau, 2002.

The six Members with the highest number of tariff quotas are located in Europe. European Union ranks fourth with 87 quotas (Norway ranks first with 232 quotas, followed by Poland with 109, Iceland 90). The distribution of tariff quotas by EU, by product group is as follows:

Table 4-4: Number of tariff quotas by European Union, by product group

Cereals	**Oilseeds**	**Sugar**	**Dairy**	**Meat**	**Eggs**	**Beverages**	**Fruit & veg.**	**Tobacco**	**Fibres**	**Coffee, etc.**	**Other**	**ALL**
15	-	3	12	28	3	1	25	-	-	-	-	**87**

Source: WTO, 2000.

TRQs are managed by the European Commission on a fully transparent basis and are handled either on a “first come first served” basis (20 TRQs out of 87) or on the basis of licences (44 TRQs) or on historic imports (22 TRQs). Third countries have only used around 67% of the TRQ each year (EC, D-G for Agriculture, 13 February 2003).

Tariff peaks

The percentage of total agricultural tariff lines subjected to tariff peaks is around 10%, covering a limited number of farm products such as beef and lamb sectors, dairy products and sugar. (EC D-G Trade, 13 February 2003). In addition, it is important to underline that the majority of developing countries are not subject to these peaks in the Community market due to their preferential access (Generalised System of Preferences, Everything but Arms, Cotonou Agreement with Africa, Caribbean and Pacific countries, Mediterranean agreements etc).

Tariff escalation

This is a real problem for development, because tariff escalation in agricultural processed products encourages developing countries to export their raw commodities without adding any value. This is particularly the case for least developed countries. It is therefore very difficult to exploit the dynamics of industrialisation and development that accompany the processing of agricultural commodities. The EU is not a great user of tariff escalation, i.e. does not have a tariff structure (EC D-G Trade, 13 February 2003).

4.1.2 Export subsidies

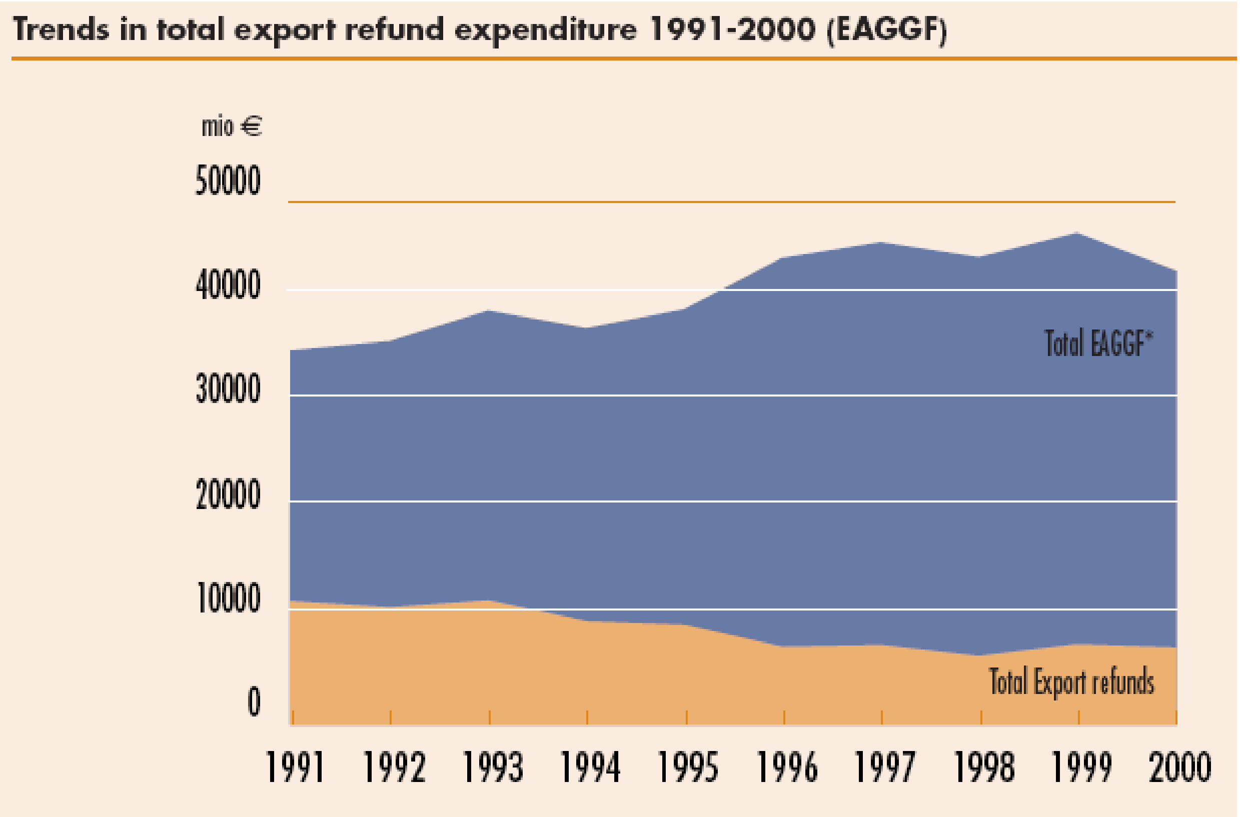
Export subsidies include direct government or producer subsidies on exports, transportation, and freight; marketing; and the sale or disposal of government stocks below domestic prices. They are the most important trade-distorting agricultural policies due to their direct effect on world commodity prices.

Subsidies result in lower world prices and are damaging to foreign producers. When used as an instrument to stabilize domestic market prices, they increase price instability on the world market. Most economist also point out that an export subsidy is a relatively inefficient way to support farm income, since a large share of the money spent by consumers disappear in deadweight losses and in subsidies to foreign consumers. More generally, it makes little sense to deteriorate your own terms of trade by subsidizing exports (Jean C. Bureau, 2002, p. 27).

Developed countries were to cut outlays for exports subsidies by 36% and quantities of subsidised exports by 21% over a six-year period. Developing countries were to cut export subsidy outlays by 24% and quantities of subsidised exports by 14% over ten years. The least developed countries are not required to reduce export subsidies or quantities of subsidised goods.

25 WTO members (accounting the EU as one) can grant export subsidies as a result of the URAA. European Union is the largest user of export subsidies, accounting for more than 90% of global expenditures (Beierle, C. Thomas, 2002, p. 1096).

Figure 4-1: Evolution of export subsidies, 1991-2000



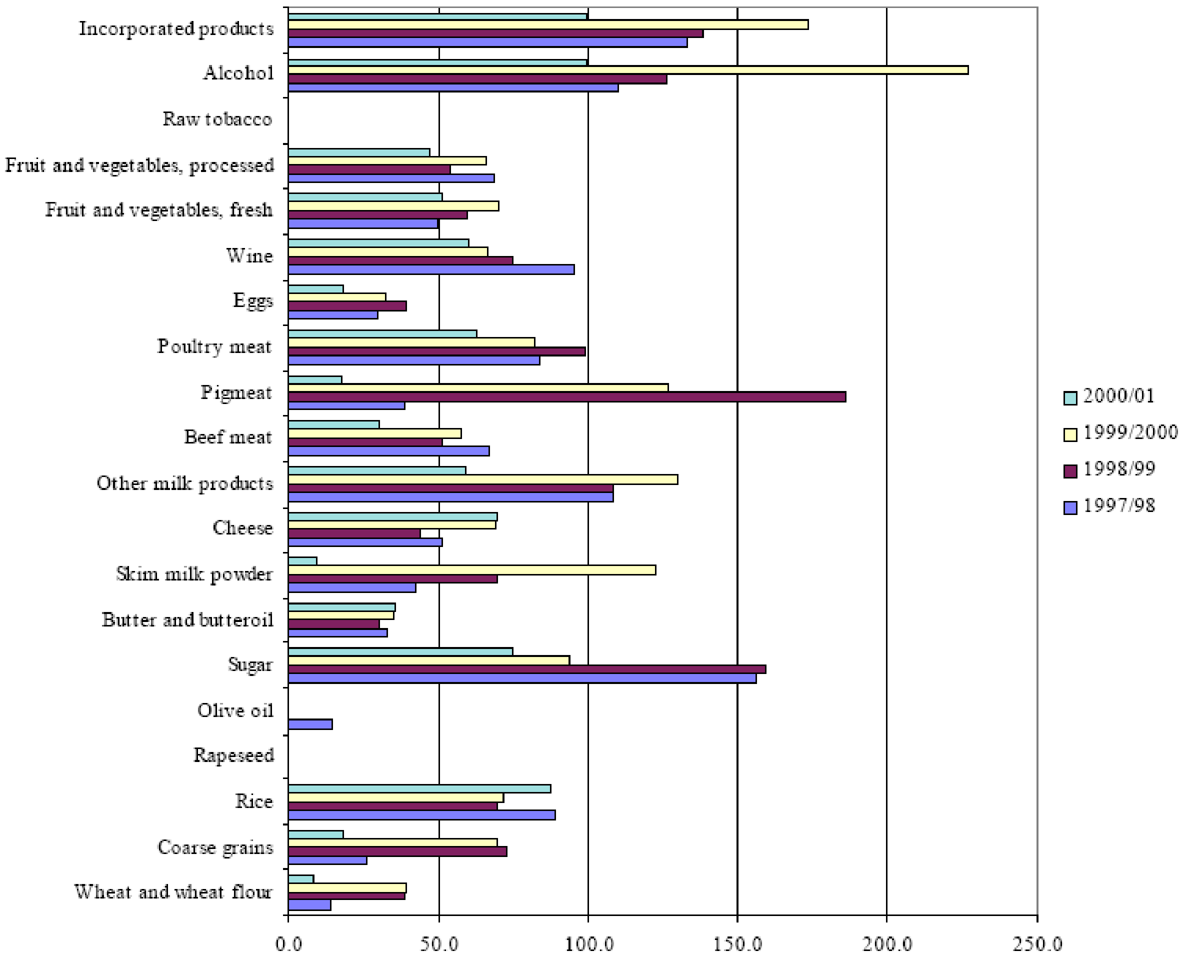
Source: EC D-G for Agriculture, 2001.

In the period 1995-1999, the EU used less than 60% of the financial possibilities allowed by the URAA. Between 1995 and 2000 on average $6.2 billion of export subsidies were provided, mainly by the EU. The EU budgetary expenditure on export refunds has fallen from 29.5% of the value of exports in 1991, to 7.5% in 2001. Figure 3-1 shows the decline in the export refunds from 1991-2000 and also the decreasing trend of burden of export refunds in the EU budget.

In the marketing year 2001-02, the Commission notified an allocation of € 2.6 billion to export subsidies (down from € 5.6 billion 1999-00), principally on milk and milk products (37%), sugar (19%), and beef meat (15%).

The EU has benefited from high world prices in the late 1990s, then from the depreciation of the Euro. This has limited the effect of the constraints on export subsidies, at least in value (Jean-Christophe Bureau, 2002, p. 51).

Figure 4-2: EU export subsidies, Utilization of final commitments, Outlay % of final commitment



Source: OECD, 2003.

Figure 3-2 shows the export subsidies notified to the WTO, which hit the binding ceilings in some cases, like coarse grains, skim milk powder, other milk products, pigmeat and alcohol in the period 1997-2000. But this comparison is irrelevant, as subsidized exports in the years before 2000/01 were not subject to lower constraints for the year (OECD, S. Tangermann, 2003, p. 74).

According to OECD (2003), there has been little substantial policy reform on export subsidies in EU. The 1980s were a peak time for export subsidisation and both the volume of and the outlays for export subsidies in the base period years of 1986-90 were historically high. The European Union benefited greatly from the agreement to use a 1986-90 baseline because it received credit for substantial cuts in export subsidies following 1992 reforms of CAP – before the URAA was finalised.

4.1.3 Domestic Support

However, lower trade barriers alone may not be sufficient for developing countries to benefit. In many developing countries, agriculture has suffered not only from trade barriers and subsidies, but has also been neglected by domestic support policies (FAO, 2003, p. 4).

Domestic support measures are the aid granted to agricultural production that are not export subsidies. Governments provide internal support to their producers in many ways. Some of these policies have significant consequences beyond a country's borders. Such policies can impose costs on other countries and world markets by encouraging overproduction or inducing production of specific commodities.

Under the WTO, policies that distorted trade were divided into three boxes: Amber box (red box), Blue Box, Green box.

Amber box (red box) programmes are regarded as the most trade distorting and are the only form of domestic support subject to the reduction commitments. They are those whose payments to farmers are directly linked to prices or quantities, such as market price supports, input subsidies and direct per-unit payments.

34 WTO members have commitments to reduce their trade-distorting domestic supports in the amber box (i.e to reduce the "total aggregate measurement of support" or AMS). Members without these commitments have to keep within 5% of the value of production (i.e. the "de minimis" level) — 10% in the case of developing countries.

Green box programmes are regarded as minimally trade distorting and are not disciplined under the URAA. Green box policies have two main categories. First are programmes that provide decoupled payments to farmers. Second are programmes that pursue a variety of policy goals laid out in the URAA, such as environmental protection, research and disaster relief. To qualify for the green box, these programmes must be publicly funded and and must not involve price support. They must be "non– or minimally trade distorting". "Green box" subsidies are therefore allowed without limits, provided they comply with relevant criteria. They also include environmental protection and regional development programmes.

Blue box policies, like green box policies, are exempt from disciplines but are acknowledged as trade distorting. Like the amber box, this box includes support policies linked to prices and quantities, but here they are accompanied by offsetting policies that limit production. The creation of the blue box was a last-minute compromise in the Uruguay Round that allowed the European Union to continue compensatory payments under the 1992 CAP reforms. Blue box was created in the reforms of 1992 when the arable crop premium and the headage premiums were introduced (European Agriculture, D-G for Agriculture: "Agricultural trade and its importance", December 2004).

For developed countries, commitment for the domestic support is a reduction of the amber box spending by 20% from levels existing during the 1986-88 base period in 6 equal annual instalments. Developing countries are required to make reductions of 13% over ten years. Least developed countries are not obliged to make any reductions but must bind their levels of support.

Domestic support level is measured by an Aggregate Measurement of Support (AMS) defined within the URAA.

GATT Uruguay Round Agreement on Agriculture resulted in reduction of EU' domestic support with an obligation to cut the AMS by 20%. The EU's declared level of domestic support has fallen well short of its AMS (Aggregate Measurement of Support) constraint, largely because its area and headage payments have been declared as blue box expenditure (Table-3-5 and Table 3-6).

Table 4-5: The EU's Green, Blue and Amber Box Declarations

Million ecu/€	1995/96	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02
AMS Commitment	78,672.00	76,369.00	74,067.00	71,765.00	69,463.00	67,159.00	67,159.00
AMS Declared	50,026.00	51,009.00	50,194.00	46,683.00	47,885.70	43,654.00	39,281.30
Blue Box	20,845.50	21,520.80	20,442.80	20,503.50	19,792.10	22,222.70	23,725.90
Green Box	18,779.20	22,130.30	18,166.80	19,168.00	19,930.50	21,844.50	20,661.20
Total Support	89,650.70	94,660.10	88,803.60	86,354.50	87,608.30	87,721.20	83,668.40
% AMS in Total Support	55.80	53.89	56.52	54.06	54.66	49.76	46.95

Source: EU submissions to the WTO, Alan Swinbank, 2005.

Table 4-6: EU Aggregate Measures of Support, notifications to the WTO and ceilings (million euros),
marketing year 1999/2000 (June 2002 notifications)

Category		EU notification	Ceiling
Green box measures		19930.5	none
Blue box measures			
including	Arable crops	15128	none
including	Beef	2930	none
including	Sheep, goats	1734	
Amber box		47886	69463
including	AMS arable crops	7205	
including	AMS sugar	5758	
including	AMS olive oil	2070	
including	AMS dairy	5814	
including	AMS beef	13089	

Source: Jean-Christophe Bureau, 2002.

There are discussions on further criteria to help distinguish the blue box from the amber box and to invalidate the argument on 'box-shifting'. The developing countries propose, that it would be more useful, if the amber and blue boxes were combined under the category of 'trade-distorting support' with the green box maintained under the category of 'non-trade-distorting support' (Marita Wiggerthale, 2004, p. 12).

The blue box represents 23% of the total domestic support granted from 1995 to 1998. If the blue box subsidies had been included in the AMS definition in 1995-96, the European Union would have already been dangerously to its AMS commitments; by 10 to 5 percent (Patrick, A. Messerlin, 2001, p. 93).

OECD indicator of support: Producer Support Estimate

Outside the WTO notification, the most widely used indicator to measure support to agriculture is the Producer Support Estimate (PSE) and Total Support Estimate (TSE) developed by the OECD. The Total Support Estimate (TSE) is an indicator of support to the agricultural sector and the Producer Support Estimate (PSE) is an indicator of support to agricultural producers arising from agricultural policy. The PSE includes transfers from market price support (MPS) and transfers from budgetary payments classified according to implementation criteria.

In the 1986-88 period total support to agriculture in OECD countries amounted to € 278 bn, In 2002, total support increased and stood at € 329 bn. The large share of it (€ 240 bn) was support going directly to farmers (PSE) (OECD, 2005, p. 13). This amount of producer support means that 31 % of a farmer's revenue comes from government support in the world's richest countries (Table 3-7).

Table 4-7: Producer Support Estimate, European Union

	1986-88	1990	1995	1999	2000	2001	2002	2003
European Union								
EUR mn	92 308	80,946	96,779	107,173	93,338	93,061	96,989	104,474
Percentage PSE	41	33	36	39	33	32	34	36
OECD								
EUR mn	220 776	197,307	204,439	256,083	263,649	245,094	240,279	227,268
Percentage PSE	37	32	31	35	32	29	31	30

Source: OECD 2005.

In 2003, government support to farmers (PSE) in OECD countries was € 227 bn, accounting 30% of farm income.

In European Union, producer support going to EU farmers was € 104 bn in 2003, accounting 36% of farm income (Table 3-8).

Table 4-8: Composition of Producer Support Estimate in European Union

	1986-88	2002-04	2002	2003	2004p
Producer Support Estimate (PSE)	92,308	100,576	96,989	104,474	100,264
Market Price Support (MPS)	80,175	55,166	54,478	57,088	53,932
Payments	12,133	45,410	42,511	47,386	46,332

p: proviosonal

Source: OECD, 2005.

The PSE decreased from 41 to 36% of agricultural receipts between the beginning and the end of the period. In real terms, unit PSE stayed 10% above the OECD-wide average. Real PSE dropped by more than 30% because of a 20% boost in output volume and a nearly 45% drop in unit PSE.

According to OECD's report about CAP 2003 reform, although the composition of the support is modified, there is not any change in the level of support. As shown in the Table 3-8, payments more than doubled, while market price support was halved.

According to the OECD, the producer support estimate (PSE) for the EU remains very high, particularly for beef and veal, wheat and other grains, sugar, milk, and sheepmeat; eggs benefit the least (Table 3-9).

Table 4-9: Main indicators of support by commodity, 1986-02

	1986-88	2000-02	2000	2001	2002[a]
Wheat					
PSE (€ million)	7,879	9,757	9,950	9,243	10,078
Percentage PSE	51	46	46	46	46
Maize					
PSE (€ million)	2,928	2,616	3,038	2,812	1,997
Percentage PSE	53	35	41	37	28
Other grains					
PSE (€ million)	5,238	6,110	6,014	6,199	6,116
Percentage PSE	56	51	50	51	52
Rice					
PSE (€ million)	395	269	136	349	321
Percentage PSE	57	31	17	40	37
Oilseeds					
PSE (€ million)	2,828	1,884	2,157	1,806	1,689
Percentage PSE	59	35	39	34	31
Sugar					
PSE (€ million)	2,883	2,357	2,614	2,008	2,449
Percentage PSE	60	48	50	44	49
Milk					
PSE (€ million)	19,002	17,523	16,335	17,088	19,147
Percentage PSE	57	44	42	41	48
Beef and veal					
PSE (€ million)	11,956	21,047	17,720	20,108	25,313
Percentage PSE	55	73	66	73	79
Sheepmeat					
PSE (€ million)	3,616	3,050	3,507	3,333	2,312
Percentage PSE	70	46	53	49	38
Pigmeat					
PSE (€ million)	2,839	6,201	5,933	5,884	6,786
Percentage PSE	16	24	25	20	26
Poultry					
PSE (€ million)	1,770	3,432	3,295	3,535	3,466
Percentage PSE	24	37	37	35	38
Eggs					
PSE (€ million)	644	230	244	124	323
Percentage PSE	13	4	4	2	6
Other commodities					
PSE (€ million)	24,740	25,791	25,205	25,474	26,694
Percentage PSE	29	22	22	21	22
All commodities					
PSE (€ million)	86,718	100,266	96,146	97,963	106,689
Percentage PSE	40	35	34	34	36

a Provisional

Source: OECD (2003), *Agricultural Policies in OECD Countries: Monitoring and Evaluation 2003*, Paris.

4.2 The Negotiations from 2000 to Now: Doha and beyond

Uruguay Round Agreement was the first phase of the reform towards agricultural liberalisation. Despite the achievements of the Uruguay Round, trade in agricultural goods remained highly distorted. Article 20 of the Agriculture Agreement committed members to start negotiations on continuing the reform at the end of 1999 (or beginning of 2000). Those negotiations began using Article 20 as their basis.

The negotiations began under Article 20 of the Agreement on Agriculture in March 2000. The direction of the reform was clearly set out in the Article 20: “substantial progressive reductions in support and protection resulting in fundamental reform. The first phase began in early 2000 and ended in March 2001. In these meetings, member governments submitted proposals about market access, export subsidies, domestic support, special and differential treatment and non-trade concerns. The second phase began in 2001 and ended in 2002. In this phase, the meetings were by topic, and included more technical details (WTO, “where we are now”, 2003).

Negotiations on further agricultural reform began in 2000, are mandated under the Doha Declaration signed in November 2001. The November 2001 Doha Ministerial Declaration sets a new mandate by making the objectives more explicit, building on the work carried out so far, and setting deadlines. The negotiations were difficult because of the wide range of views and interests among member governments. They aim to contribute to further liberalisation of agricultural trade. This will benefit those countries which can compete on quality and price rather than on the size of their subsidies. That is particularly the case for many developing countries whose economies depend on an increasingly diverse range of primary and processed agricultural products, exported to an increasing variety of markets, including to other developing countries (WTO, “where we are now”, 2003).

4.2.1 Fifth WTO Ministerial Conference in Cancun (September 2003) and EU's position

In the Cancun Ministerial Conference, G21 countries[3], the LDC group, the Africa-Caribbean-Pacific (ACP) countries and the African Union (AU), representing in all nearly 90 WTO member countries took part.

The negotiations were held in five groups: agriculture, development, non-agricultural product market access, the Singapore issues (competition, investment, trade facilitation and transparency in government procurements) and other points.

The countries' ministers and experts tried to make their positions closer. Nevertheless, a consensus could not be achieved at Cancun.

Blockages between the developing countries and the EU continued, with on the one hand the EU stuck in its request for the opening of negotiations on all four Singapore issues and on the other the developing countries that did not really want to open these negotiations and in no case wished to address all the questions.

Agriculture has been the focus of tensions. Indeed, although discussions broke down because of a dispute concerning the Singapore questions, the refusal of the developing countries to address new issues was directly linked to the fact that the Draft Statement of 13 September contained no significant progress in agriculture for these countries.

The Draft Statement proved to be catastrophic for millions of farmers, in developing in particular. In case of "domestic support", the developing countries requested more liberalisation (abolition of the blue box, limiting of the green box) while the developed countries considered that the undertakings were too substantial. So the measures

[3] The G21 consists of South Africa, Argentina, Bolivia, Brazil, Chile, China, Colombia, Costa Rica, Cuba, Egypt, El Salvador, Ecuador, Guatemala, India, Mexico, Pakistan, Paraguay, Peru, the Philippines, Thailand and Venezuela.

concerning domestic support did not satisfy any of the member countries. For the developing countries, the text about "market access" takes up the concept of 'special products' again, but plans a decrease in customs tariffs on these products, while the great majority of these countries requested on the contrary not to be subjected to any undertaking on special products, including the possibility of increasing tariffs when they are too low.

The paragraph on "export subsidies" was very similar to the text of the EU-USA proposal. It plans the end of export subsidies for products that interest developing countries, the reduction of the other export subsidies and a reduction in export credit. However, the developing countries, and especially those belonging to G21, want more, and in particular the total removal of export subsidies (Anne Chetaille, Karine Tavernier, September 2003).

Finally, a consensus could not be achieved at Cancun. The Conference had failed. Reactions were rapid at the conference centre. Developed country delegates were vexed and those of the developing countries were also disappointed (Anne Chetaille, Karine Tavernier, September 2003).

4.2.2 WTO Doha Development Agenda 31 July 2004 Framework and EU's position

The 147 Members of the World Trade Organisation (WTO) unanimously agreed 31 July 2004 on a framework for modalities how to liberalise farm trade within the context of the Doha Development Agenda (DDA). The framework agreement will deliver a much bigger farm trade liberalisation step compared to the Uruguay Round. It will bring a substantial cut in trade-distorting agriculture subsidies, the elimination of trade distorting export practices, and a significant opening of agriculture markets closer. All developing countries will benefit from special treatment, allowing them to liberalise less over a longer period. The 50 poorest countries in the world do not have to undertake any commitments.

Cutting trade distorting agricultural support

The framework locks in the recent reforms of the EU's Common Agricultural Policy (CAP). They will not be called into question. The agreement also ensures that other developed countries, will have to undertake reforms. This will be achieved by a combination of disciplines of the different forms of support.

- Overall levels of the most trade distorting domestic support will have to be substantially reduced.
- A down payment of 20% of this reduction will be made in year 1 of the implementation period. This is a bigger cut than the reductions made following the Uruguay Round over six years.
- Big subsidisers will make the deepest cuts.
- Blue box support cannot exceed 5% of agricultural production, no further reduction is foreseen.
- The non-trade distorting green box remains untouched.
- The de minimis-loophole will be reduced.

Ending trade distorting export practices

- EU export subsidies, export credits, credit guarantees and insurance programmes with repayment periods beyond 180 days will be eliminated by an end date to be agreed.
- Export credits, credit guarantees and insurance programmes with repayment periods below 180 days will be subject to strict disciplines regarding subsidies and any other trade-distorting elements.

- Trade distorting practices with respect to export State Trading Enterprises will also be eliminated.
- Genuine food aid for people in need will obviously continue. However, for food aid which is being abused for commercial displacement concrete disciplines will be imposed. The question of providing food aid only in grant form will be addressed in the negotiations.

<u>Opening agriculture markets</u>

The deal will substantially improve market access. Farm tariffs will be cut according to a single, tiered approach: the higher the tariff, the higher the tariff cut will be. However, the agreement caters for the EU’s concern to address sensitive products. Countries can self select an appropriate number of sensitive products which will can be treated in a more lenient way. As compensation, tariff rate quotas have to be opened in order to ensure better market access.

<u>A special, better deal for developing countries</u>

All developing countries will benefit from a special and differential treatment across the board via:

- Longer implementation periods for all commitments.
- Lower tariff and subsidy cuts.
- Special treatment on market opening for so-called special products to address food security, livelihood and rural development concerns.
- Fullest liberalisation of trade with tropical products.
- Addressing the erosion of trade preferences.

Least developed countries do not have to undertake any commitments to reduce tariffs or farm support. In addition, developed countries and those developing countries in a position do so should provide duty-free and quota-free market access for products from

LDCs. The EU has already unilaterally implemented such a measure with its "Everything But Arms" initiative.

To summarise, European Union benefited greatly from the agreement to use a 1986-90 baseline, when the protectionism was high. It provided extra protection margin in all GATT aspects. Although EU carried out all Uruguay Round commitments, the protectionism remained still high.

5 AGRICULTURAL TRADE LIBERALISATION BETWEEN EUROPEAN UNION AND DEVELOPING COUNTRIES

Global agricultural trade has grown tenfold over the past decades from € 45 billion in 1965 to € 450 billion in 2000 (Morrison, Jamie & Murphy, Sophia, 2004, p. 4).

The share of developing countries' agricultural exports in their overall exports fell from nearly 50% at the beginning of the 1960s by more than 5% by 2000. Developing countries will become significant net importers, with a trade deficit of almost US $ 35 billion by 2030 (FAO, p. 234-236).

Of the 142 WTO members in July 2001, four-fifths are developing countries. Agriculture plays a dominant role in most of the economies of the developing countries, so they should benefit from the liberalisation of trade. Participation of developing countries and in particular the least developed countries, in the international trading system should therefore be promoted.

The 1994 Uruguay Round had a direct impact on EU agriculture. Since the Round, the EU has opened up its market to imports of agricultural products from third countries.

The EU has respected the commitments adopted in 1995 both to reduce the level of tariff as well as to reduce the level of domestic and export support afforded to agricultural products. In addition, the EU has concluded a number of bilateral free trade agreements as well as preferential trade arrangements, which have substantially benefited third countries and in particular developing countries.

EU is by far the largest market for the exports of agricultural products from developing countries. This is in large part a result of its trade preferences, which include the EU

Generalised System of Preferences, the EU/ACP agreements, and other bilateral arrangements.

5.1 Generalised System of Preferences (GSP)

Generalised System of Preferences provides better access of agricultural products from developing countries to the European market. This scheme was initiated by the EU in 1971, and then adopted by other countries.

The present regulation governing **the EC GSP-scheme** entered into force in 1 January 2002 and will cover the period until the end of 2005 (after its extension for an extra year). A total of 142 developing countries benefit from the General System of Preferences. Current GSP provides an additional 5% tariff reduction for countries who meet additional environmental and labour conditions.

The GSP regime is based on only two product categories: sensitive and non-sensitive. While non-sensitive products continue to enjoy duty-free access to the Community's market, all other products will benefit from a uniform flat rate reduction of 3.5% points ad valorem duties and 30% for specific duties. However, the new regulation also contains a 'stand-still' clause assuring that the preferential treatment provided under the previous regulation continues to apply where it is more favourable (EC, 2003, p. 156).

5.2 ACP-EU Lomé Cotonou Agreement

A cornerstone of the EU's relations with the Third World is the Lomé Convention, to which 66 countries in Africa, the Caribbean and the Pacific (the ACP states) now belong. The Convention provides trade cooperation with the ACP states, who are able to export almost all their products to the EU free of duty. In later years, the Lomé Convention operated under a waiver from the GATT/WTO principle of non-discrimination that expired in 2000. In 2000, a major reform of the relations between the EU and ACP took place with the Cotonou agreement, to which 77 ACP countries took part. The new agreement is designed to run for 20 years, and includes and 13.5 billion euros budget for the first five years.

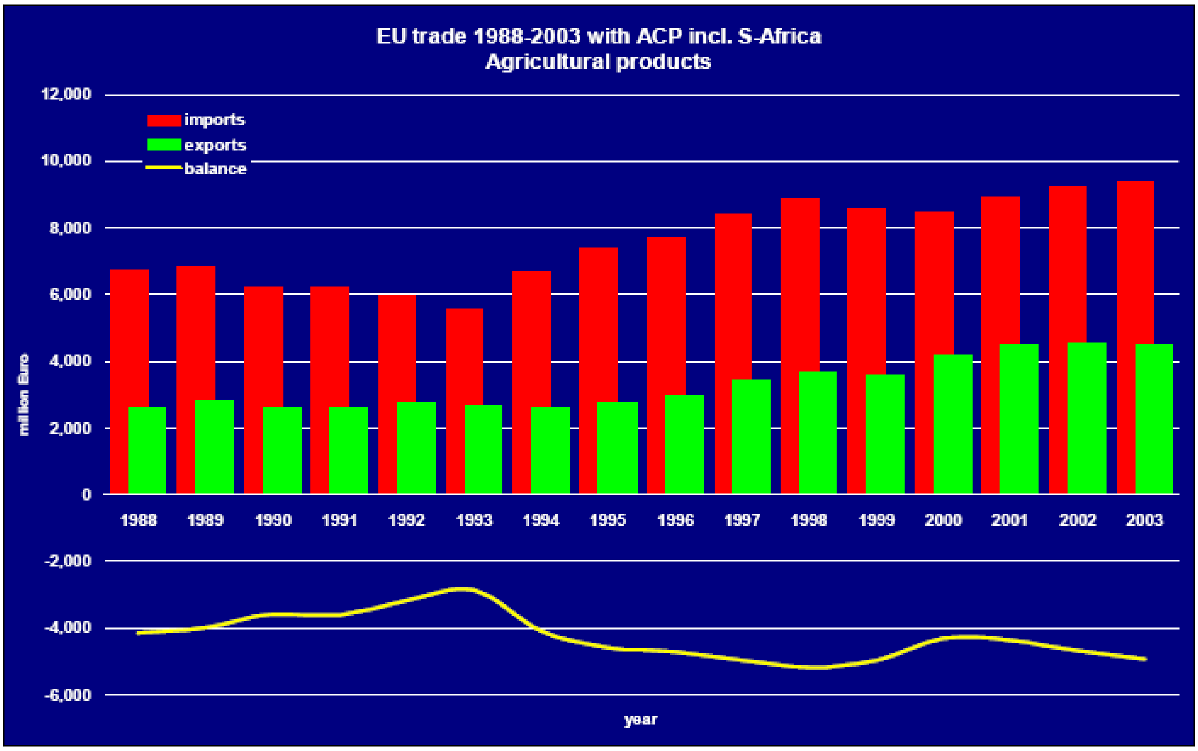
Under the Cotonou Agreement, the all ACP non reciprocal tariff preferences will be maintained until the end of 2007. Then, a set of reciprocal Economic Partnership Agreement (EPAs) will normally replace them, following negotiations that began in 2002. These free trade agreements will be WTO-compatible, would cover “essentially all trade” and will include provisions for cooperation and support in areas other than trade (structural adjustment, etc.). ACP countries are invited to sign as groups or individually, building on their own regional integration schemes. Not all ACP countries will have to open their markets to EU products after 2008 (Jean-Christophe Bureau, 2002, p. 58).

Open to Trade for ACPs

EU agricultural imports from ACP are relatively stable over the last 6 years at a level of somewhat less than 9 Bill €. The growth rate of the agricultural EU imports is relatively small (3.1 %) and lower than the growth rate for all import from ACP (5.8%). Consequently the share of agriculture imports declined from 26 % to 21 % over the period 1995-2003.

EU exports to ACP increased last years and represent about half of EU imports from ACP (Figure 4-1). The growth rate of the agricultural EU exports (6 %) is however larger than the growth rate of all EU exports to ACP (5.4%). The agricultural EU export share represents 10% of all EU exports. The level of trade varies considerably between ACP countries: Nigeria, Ivory Coast, Angola, Botswana and Cameroon are the most important exporters to EU.

Figure 5-1: EU agricultural trade with ACP



Source: European Commission, D-G Trade, November 2004.

The main agricultural EU imports from ACP are concentrated on few raw products: by declining order: cacao, fish, coffee, tobacco, fruits, sugar and tea; from ACP Caribbean: sugar, banana, fish and rice; and from ACP Pacific: palm oil, sugar and coffee. These figures illustrate perfectly the reality of much of ACP which remains commodity dependent.

The main EU Exports to ACP are concentrated on cereals, dairy, food preparation and livestock.

5.3 Everything but Arms Agreement

The agricultural sector plays a dominant role in the economies of the least developed countries. It accounts for a large share of gross domestic product (GDP) ranging from 30 to 60 percent in about two thirds of these countries.

The European Union has opened its markets to the Least Developed Countries (LDCs) with the adoption of Everything But Arms Initiative. The EBA Agreement came into force in March 2001, and ensures unrestricted access (quota and tariff free) for all products (except arms and ammunition) from the LDCs to the EC market is provided. For a transitional period up to 2008/09 the three most sensitive agricultural products – rice, sugar and bananas – are exempted from immediate liberalisation.

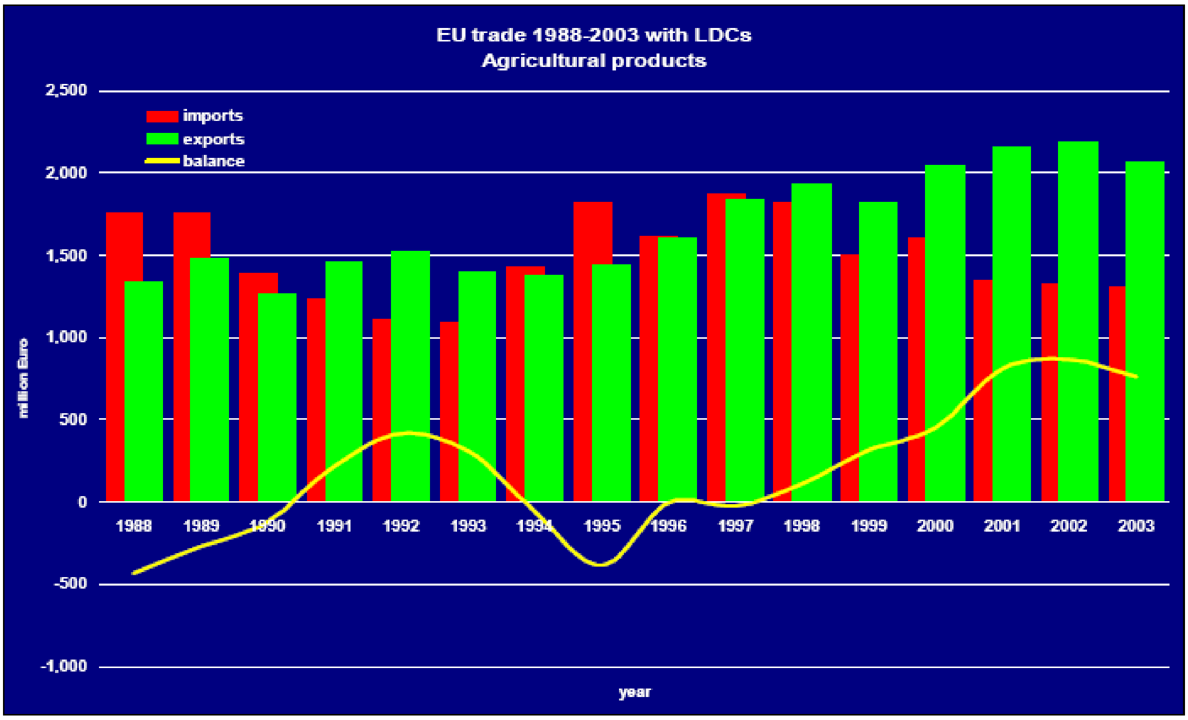
United States criticises the EU because of its protective policies and argues that the EBA agreement is not subject to WTO discipline, is unilateral in nature and imposes strict rules of origin requirements (USDA Foreign Agricultural Services).

<u>Open to trade for Least Developed Countries (LDCs)</u>

Where agriculture is often the largest sector of the economy, the share of agricultural exports declined from more than 65% in the early 1960s to less than 15% by 2000. The low shares for developing countries are a reflection of protectionist policies in OECD countries. The agricultural trade deficit of the group of LDCs is expected to widen further and will increase overall by a factor of four over the next 30 years.

The EU’s overall trade balance with LDCs became slightly negative in favour of the LDCs during the period 1988-2003. The figure 4-2 shows the decline of agricultural imports from LDCs.

Figure 5-2: EU agricultural trade with Least Developing Countries



Source: European Commission, D-G Trade, November 2004.

Share of agricultural EU imports from LDCs declined from 25% to 11% over the period 1995-2003. In that period, the EU exports to LDCs steadily increased and arrived at € 2 billion. This represents 18% of all EU total exports. LDCs' exports to EU declined in that period and stayed below € 1.5 billion.

The main EU imports from LDCs are concentrated on few raw products: mainly tropical products, cotton, fruits & vegetables and sugar. The main EU exports to LDCs are concentrated on cereals, dairy, livestock and food preparation

5.4 Free Trade Agreements (FTAs)

European Union has concluded Free Trade Agreements with a number of developing countries (Mexico, South Africa, Mediterranean countries). For agricultural production, the general aim of free trade is subject to numerous exceptions, and any advanced concessions are strictly defined for single products and countries. In all agreements, the pattern of product coverage of liberalised imports into the EU reflects the degree of EU domestic protection (Table 4-1). Here, three general rules apply:

- High domestic protection leads to a low willingness for tariff reduction, as this could undermine high domestic prices.
- High domestic protection supplemented by risks of internal surpluses leads to additional restrictions on imports by not extending TRQs.
- Existing remarkable surpluses increase EU interest in improving its access to the markets of the contracting partner.

Table 5-1: EU strategic (sensitive) agricultural products

High domestic protection	**High domestic protection with remarkable surpluses**
Bovine animals and beef	Meat
Domestic swine	
Poultry	
Dairy	Dairy
Cereals	Cereals
Sugar	Sugar
Some fruits and vegetables[7]	
Olive oil	
Citrus fruit and grapes	
Flowers	
Rice	

Source: European Centre for Development Policy Management 2004.

5.4.1 The Euro-Mediterranean (MEDA) Agreements

Since the first Euro-Mediterranean Conference in November 1995, the EU and twelve Mediterranean countries have been engaged in negotiating Association Agreement. The overall objective is to form, by 2010, one Euro-Mediterranean free trade area from the separate agreements in place. To date, bilateral Association Agreements have been concluded with seven trade partners: Tunisia (1995), Israel (1995), Morocco (1996), Jordan (1997), the Palestinian (1997), Algeria (2001) and Lebanon (2002).

The MED agreements aim at establishing a WTO compatible free trade area for all products, with a transitional period of up to twelve years.

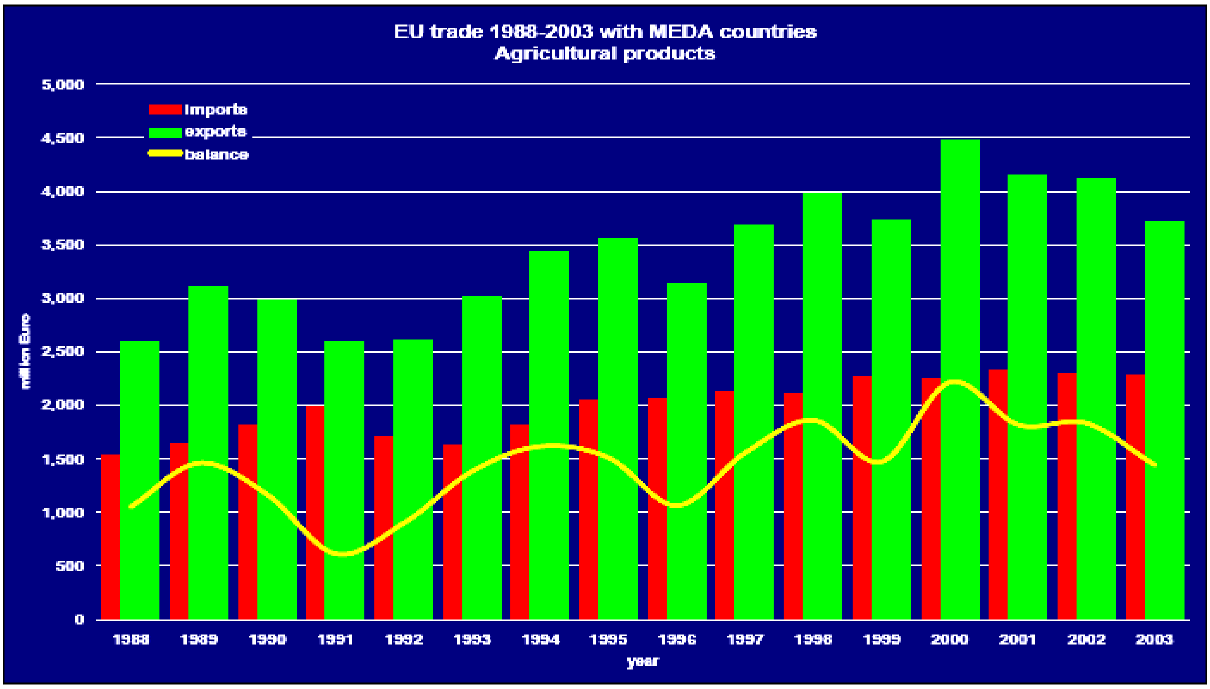
Tariff reductions granted by the EU refer mainly to goatmeat, sheepmeat and to some fruits and vegetables. Tariff reductions granted by the MED countries concern live animals and meat, dairy products and some fruits and vegetables.

Tariff rate quotas are the key instrument to achieve preferences for MED countries. The most important quotas refer to some of the strategic products such as citrus fruits, tomatoes, apples, olive oil and wine. Some quotas are subject to seasonal constraints. For certain products, reference quantities are defined instead of TRQs. (Rudloff, B. and J. Simons, 2004).

<u>Open to Trade to Mediterranean Countries</u>

The agricultural trade balance has traditionally been in favour of the EU (Figure 4-3). Over the last 15 years (1988 – 2003), EU imports from these countries have ranged rather stably between € 1,5 million and € 2,5 million, while exports have been characterised by a more erratic trend, fluctuating between € 2,5 million and € 4,5 million.

Figure 5-3: EU agricultural trade with MEDA Countries



Source: European Commission, D-G Trade, December 2004.

Trade between the EU and MEDA is mainly concentrated on raw products. Fruits and vegetables account for approximately 50% of MEDA exports to the EU (34% and 15% respectively). Tomatoes, courgettes and citrus fruits are the most important exports falling within this category. The EU primarily exports cereals (20%), followed by dairy products (15%), sugar and sugar confectionery (11.1%), preparations of fruits and vegetables (5.9%), beverages, spirits and vinegar (6.2%).

5.4.2 Agreements with South Africa and Mexico

The agreements with South Africa and Mexico are characterised by the assumption of a general liberalisation within a predetermined period of time. For most agricultural products, tariff elimination is not achieved immediately but according to tariff reduction schedules.

The EU-South Africa Agreement

The EU and South Africa concluded their Trade, Development and Cooperation Agreement (TDCA) in 1999. Table 4-2 shows the exceptions from trade liberalisation.

Table 5-2: Exceptions from trade liberalisation between the EU and South Africa

Main products excluded from liberalised import into the EU	Main products excluded from liberalised import into South Africa
beef / sugar / some dairy (powdered milk products) / sweet corn / maize and maize products / rice and rice products / starches / some cut flowers / some fresh fruits (certain citrus, apples, pears grapes, bananas) / prepared tomatoes / some prepared fruits and fruit juices / some wines / vermouth / ethyl alcohol	beef, swine, goats, sheep / sugar / some dairy (butter and other fats and oils derived from milk: dairy spreads, cheese and curd, ice cream) / sweet corn / maize and maize products / barley and barley products / wheat and wheat products (incl. wheat starches) / chocolate

Source: European Centre for Development Policy Management 2004.

Tariff rate quota concessions are implemented for some of the products that are excluded from the overall liberalisation process (Table 4-3).

Table 5-3: Tariff rate quotas conceded by the EU and South Africa

Main TRQs (quota/year) conceded for imports into the EU	Main TRQs (quota/year) conceded for imports into South Africa
cut flowers (1,600 t, half duty) / strawberries (250 t, half duty) / several canned fruits (60,000 t, half duty) / several fruit juices (5,700 t, half duty / some wines (32 million litres, duty free)	cheese and curd (5,000 t, half duty)

Source: European Centre for Development Policy Management 2004.

The EU-Mexico Global Agreement

The EU and Mexico signed their Economic Partnership, Political Coordination and Cooperation Agreement, also known as the "Global Agreement" in 1997. Trade liberalisation was established by Decision 2/2000 of EU-Mexico Joint Council that entered into force on 1st July 2000. (Rudloff, B. and J. Simons, 2004).

The Global Agreement sets out a transition period of ten years for the implementation of all liberalisation commitments. Products whose denomination is protected within the EU are excluded from trade liberalisation. This pertains especially to cheese and wine Table 4-4 lists the main products that are excluded from liberalisation.

Table 5-4: Exceptions from trade liberalisation between the EU and Mexico

Main products excluded from liberalised import into the EU	Main products excluded from liberalised import into Mexico
bovine animals, beef, swine, poultry / dairy / eggs / honey / cut flowers / some fruits and vegetables (e.g. olives for the production of oil, sweet corn, asparagus, peas, beans, apples, pears, strawberries, grapes, bananas) / cereals except buckwheat / sugar / some juices (tomatoes, citrus fruits, pineapple, apple, pear) / vermouth / ethyl alcohol / vinegar	bovine animal, beef, swine poultry / dairy / eggs / potatoes / bananas / cereals except buckwheat / roasted coffee / some oil and fats (palm oil, cobra oil, animal fats or oil) / sugar / cocoa / grape juice and grape most / rum

Source: European Centre for Development Policy Management 2004.

The Agreement contains tariff quotas for certain agricultural products that are not subject to full liberalization, as well as review clauses for further liberalisation. The Decision contains provisions for co-operation in the field of customs, standards and technical regulations, Sanitary and Phytosanitary (SPS) measures, and for the opening of public procurement markets. To this purpose a number of Special Committees at expert level was established.

Tariff rate quotas (Table 4-5) are conceded by the EU for imports originating in Mexico.

Table 5-5: Tarif rate quotas conceded by the EU and Mexico

Main TRQs (quota/year) conceded for imports into the EU	Main TRQs (quota/year) conceded for imports into Mexico
eggs (1,500 t, half duty) / honey (30,000 t, half duty) / cut flowers (1,500 t, duty free) / aspargus (600 t, duty free; 1,000 t prepared, half duty) / peas (500 t, half duty) / cane molasses (275,000 t, duty free) / prepared tropical fruit (1,500 t, duty free) / juices (orange 1,000 t, half duty; 30,000 t, 25% duty; 2,500 t pineapple juice, half duty)	no TRQs conceded

Source: European Centre for Development Policy Management 2004.

5.4.3 The EU-Chile Association Agreement

The latest free trade agreement concluded by the EU to date is the one signed with Chile in November 2002. The Association Agreement defines a transition period of maximum ten years for trade liberalisation of agricultural commodities and processed agricultural products. Regarding tariff concessions, there are four tariff elimination schedules in which the EU completely eliminates duties with transitional periods of zero, four, seven and ten years. In addition, duties are partially liberalised in four other product schemes (Art. 71). On the Chilean side, liberalisation takes place in three schedules of zero, five and ten years, in which tariffs for the respective products are phased out completely. Besides TRQs, Chile has not committed to any further partial liberalisation schedules. (Rudloff, B. and J. Simons, 2004).

As in the Global Agreement, products whose denomination is protected within the EU are excluded from trade liberalisation. This is especially valid for cheese and wine. Table 4-6 lists other main products that are excluded from liberalisation.

Table 5-6: Exceptions from trade liberalisation between the EU and Chile

Main products excluded from liberalised import into the EU	Main products excluded from liberalised import into Chile
beef, swine, sheep and goats, poultry / dairy / eggs / some fruits and vegetables (e.g. beans, mushrooms of the genus agaricus, olives for the production of oil, sweet corn, manjoc) / cereals and the corresponding products of the milling industry / sugar / vermouth / ethyl alcohol / vinegar	dairy / leguminous vegetables / sweet corn / wheat and meslin flour, wheat groats and pellets of cereals / vegetable oil and margarine / sugar

Source: European Centre for Development Policy Management 2004.

Main tariff rate quotas for products excluded from liberalisation are listed in Table 4-7.

Table 5-7: Tariff rate quotas conceded by the EU and Chile

Main TRQs (quota/year) conceded for imports into the EU	Main TRQs (quota/year) conceded for imports into Chile
beef (1,000 t, duty free) / meat of swine and prepared food (3,500 t, duty free) / meat of sheep (2,000 t, duty free) / meat of poultry and prepared food (7,250 t, duty free) / cheese and curd 1,500 t, duty free) / worked cereal grains (1,000 t duty free) / prepared mushrooms (500 t, duty free)	cheese and curd (1,500 t duty free) / olive oil (3,000 t per year, duty free)

Source: European Centre for Development Policy Management 2004.

5.4.4 Negotiations with Mercosur[4]

A cooperative agreement was signed in 1995 between the EU and the four South American states of the Mercosur. Proposals for liberalizing agricultural trade, a condition for Mercosur to sign an agreement, has so far met strong oppositions from some members. As part as a regional negotiation, the EU has offered to dismantle tariffs over 10 years on around 2.2 billion euros of agricultural exports from Mercosur countries.

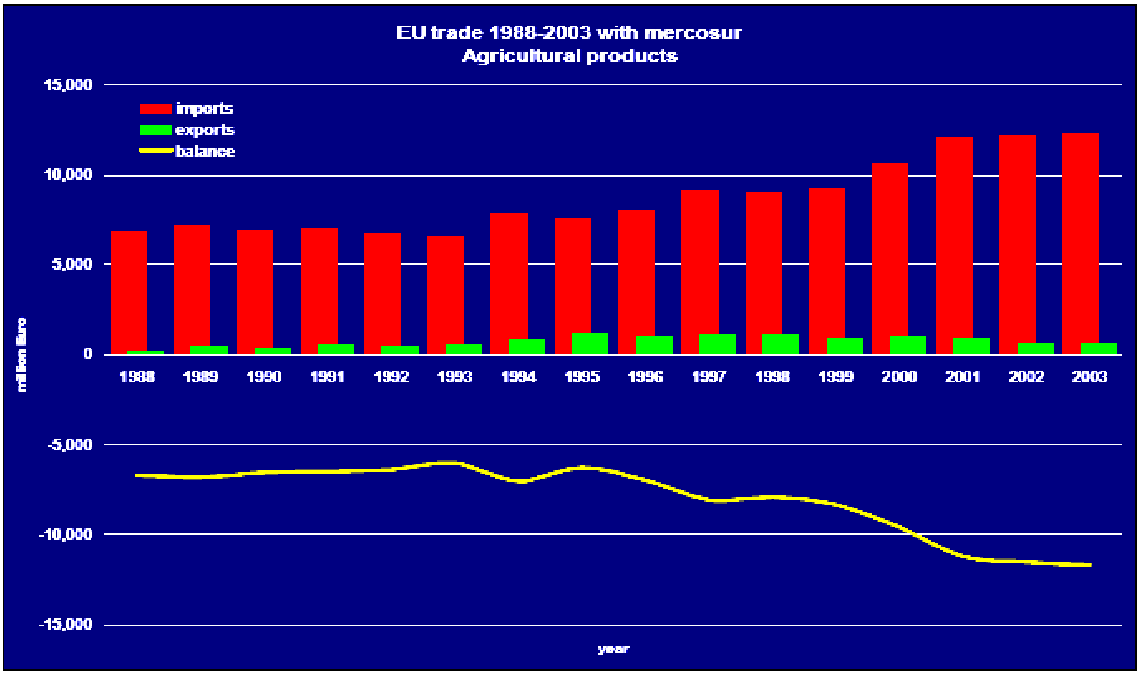
[4] Mercosur was created by Argentina, Brazil, Uruguay and Paraguay in March 1991.

However, for sensitive products, the EU offers to adopt TRQs (beef, sugar, dairy and cereals), a proposal which has so far met little enthusiasm from Mercosur countries. Mercosur countries have proposed a progressive elimination of tariffs on a significant share of imports. However, Mercosur countries insist that a larger access to EU markets on commodities such as beef and sugar is crucial for an agreement.

Open to Trade for Mercosur

Agricultural goods account for over 50% of all EU's imports from the region, while only 4% of EU's exports to Mercosur are in the agricultural sector. It is surprising that the EU's agricultural trade balance with Mercosur has, over the years, steadily been negative (Figure 4-4). Imports of agricultural products from Mercosur have constantly been increasing since 1988, passing from approximately € 6,5 million in 1988 to € 12,279 million in 2003. By contrast, after a period of moderate increase over the 1988-1995 period, EU's agricultural exports to the region have constantly been declining since 1995.

Figure 5-4: EU agricultural trade with Mercosur



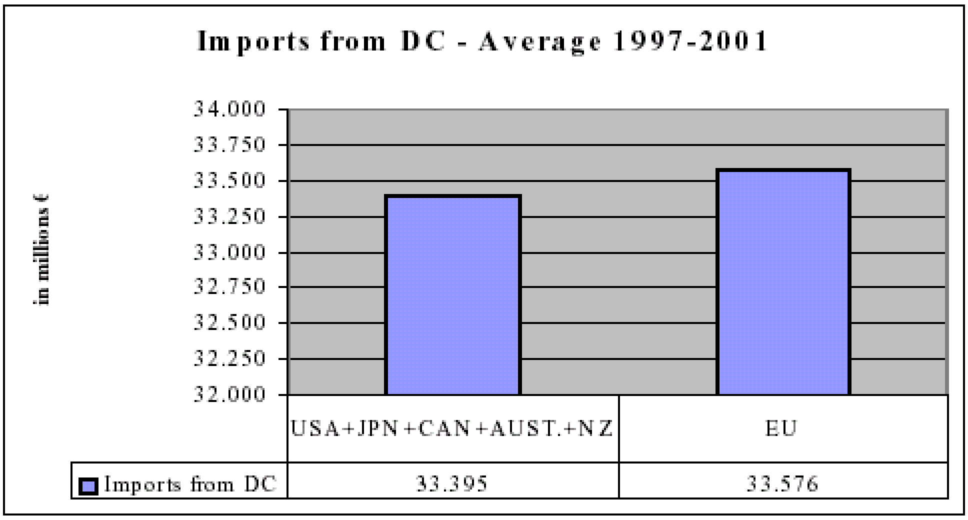
Source: European Commission, D-G Trade, December 2004.

Brazil is the most important trading partner among Mercosur. The most important EU's agricultural imports from Mercosur include oilseeds and oils, which account for 53% of all agricultural imports, livestock (14%), tropical products (8%) and fruits and vegetables (7%). Wines and spirits are the main agricultural products exported by the EU to Mercosur. Alone, they account for 23% of all EU's agricultural exports to the region. They are followed by cereals (19%), food preparations (14%), olive oil (7%) and fruits and vegetables (5%).

5.5 Evaluation of Market Access for Developing Countries

EU is one of the world's biggest open markets to imports of farm products from developing countries. As a largest importer of agricultural products from the developing world (Figure 4-5) total agricultural imports amount to 33 billion € (as much as the US, Japan, Canada, Australia and New Zealand taken together) while the agricultural exports to the same countries total 22 billion € (Dr. Franz Fischler, Agra-Europe Outlook 2002 Conference, London, 21 March 2002).

Figure 5-5: EU agricultural imports from DC – Average 1997-2001



Key: DC = Developing countries; USA = United States of America; JPN =Japan; CAN = Canada; AUST = Australia; NZ = New Zealand

Source: EC D-G for Agriculture, " A policy evolving with the times", April 2004.

However, some facts show that the EU has not opened its market fully to developing countries despite trade agreements with them.

Europe’s share in total agricultural exports from the developing countries declined from 30.5% in 1990 to 28.5% in 1994 and thereafter stayed at that level (Marita Wiggerthale, 2004, p.6).

The developing country market access was restricted. Trade in agricultural products is far from being completely liberalised. The EU and its trading partners retain many tariff barriers concerning market access. So the agricultural parts of EU Free Trade Agreements (FTAs) contend with the conflict of trade liberalisation on the one hand and national interests to limit market access on the other hand.

The analysis of the different EU Free Trade Agreements (FTAs) shows that the EU excludes important products from the targeted free trade. The EU's domestic protection and support pattern for certain agricultural products can be identified as a key factor determining these exceptions. For those products that are excluded from liberalisation, the EU grants important concessions by admitting market access within the limits of TRQs.

In fact, Dr. Franz Fischler (Member of the European Commission responsible for Agriculture, Rural Development and Fisheries) claimed that fully liberalisation of European markets for developing countries, and abolishing all tariffs and subsidies, would help the most competitive among them and wipe out the export possibilities of the weaker (F. Fischler, 26 August 2003).

F. Fischler stated in his speech in Agra Europe Outlook Conference in March 2004 that, “Making trade free for all will not make it fair for all” (F. Fischler, 2 March 2004). In this respect, trade must be good regulated in the favour of developing countries too. All developing countries should not be treated the same for tariff reduction and export subsidy reduction, as it would only help the most competitive amongst them. So he rejects full agri-trade liberalisation for developing countries.

Adjustments to market access for developing countries

Adjustments have been adopted to encourage the export of processed products and to take account of the accession to the EU of the new Member States .

Importers may be asked to produce an import licence and to pay an import levy. If the Community market is severely disturbed, the Commission has the power to take safeguard measures.

- **Import licences** are issued by the competent authorities of the Member States after a security has been lodged. The security is returned to the importer only after he demonstrates that he has fulfilled his obligations.

- **A single levy system** on entry into the European Union has been introduced for most products to ensure that import prices are not less than those in the Community. Some products are simply subject to the rates laid down in the common customs tariff while others are exempt. There are also mixed systems. Taxes having an effect equivalent to customs duties and quantitative restrictions on imports or measures having an equivalent effect are prohibited in trade with non-member countries.

  As a result of the EU's international commitments in the World Trade Organisation (WTO) or its relations with non-member countries or groups of countries, the import of certain products may be subject to quotas or preferential tariffs may be granted on imports. Imported products are partially or completely exempted from all customs duties. Tariff quotas which fix the quantity of products subject to exceptional arrangements may be granted using the first come/first served method, simultaneous examination, traditional operators/new operators or other non-discriminatory methods.

- **Safeguard measures** going as far as the suspension of imports may be taken if there is a danger that the Community market will be seriously disturbed by imports or, in certain cases, exports. The Council, acting by a majority on a proposal from the Commission and after consulting Parliament lays down general rules on the safeguard measures which the Member States may take. The Commission fixes these measures on its own initiative or at the request of the Member States.

Importance of food safety

The clear food safety rules necessary for trade are established at the EU level. Guidelines to explain the EU's import requirements for animals and animal products have been produced by the European Commission's Food and Veterinary Office (FVO) as part of efforts to facilitate safe food trade with third countries.

To ensure that imported products live up to EU food safety standards, imports are only allowed from "listed" countries and establishments. This means that their compliance with EU food safety rules has been checked and they appear on a list managed by the European Commission on behalf of the EU Member States. The EU imports from 100 countries around the world. A large country like Brazil has 473 listed establishments while smaller countries often also have a significant number of establishments approved for trade with the EU. For example, Ghana has 67 establishments listed for fishery products (EC, D-G for Agriculture).

6 ENLARGEMENT EFFECT ON AGRICULTURAL TRADE LIBERALISATION

The challenge of enlargement for European agriculture is the problem whether enlargement will shift European Union to a more or less liberal European agriculture. To eliminate the problems, the way, in which the new member states have shaped their agricultural support and their liberalization process, must be analysed.

This enlargement process is the largest enlargement and the most challenging event for the European Union since its establishment. The first wave of accession, which includes ten countries (Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovak Republic and Slovenia), took place in May 2004. The second group is supposed to take place in 2007, which will include Bulgaria and Romania.

Europe as a whole will gain from an assured political stability and security, as well as from the expansion of the internal EU market from 380 to 454 million people. This larger market will also offer new and important opportunities for the development of European agriculture and of the EU's common agricultural policy (CAP). The new member countries have different economic and social policies. But they have relatively large agricultural potentials. So enlargement means also contribution of Accession Countries to the agricultural potential of the European Union.

Moreover, the Union's position on the international arena and world markets will be strengthened.

This enlargement is important not only because of the number of the countries being considered for accession or of the expansion of single market, but also because of the significant economic and political changes these nations have faced since 1989. After the end of the Communist regime in Central and Eastern Europe, the countries of this region have been moving toward becoming members of the European Union.

6.1 Agriculture in EU-25

6.1.1 New Shape of European Agriculture

The new Member States form a highly diversified and heterogeneous group. They have large agricultural potential.

The new Member States added about 38 million ha of Utilised Agricultural Area to the 130 million ha of the current Member States, representing an increase of 30 % (Table 5-1). This increase in total agricultural area in the EU-25 shows the production potential of new member states. Nearly half of the increase results from Poland with an UAA of 18,2 million ha.

Share of agricultural employment in the new member states is 21%, compared to only 4.3% of the active work force in the EU-15. After enlargement, a further 4 million farmers are added to the existing 7 million farmers (Table 5-1). The share of the total work force employed in agriculture is particularly high in Poland.

Table 6-1: Agriculture in EU-25

	UAA (ha)	Gross Value Added of Agriculture (mn €)	Share of Agriculture in Country's GDP (%)	Agricultural Employment	Food expenditure (% of total country's expenditure) 1998
new MS	38.312.300	11.934	4,6	3.776.100	
EU-15	131.619.000	167.197	2,0	6.767.000	17,4
EU-25	169.931.300	179.131		10.543.100	

Source: European Commission, D-G for Agriculture, Country Reports, 2002.

The contribution of agriculture to the economies of Central and Eastern Europe is relatively more important than in most current Member States of the EU. For example in 2000 agriculture in the CEECs produced 4.6% of the Gross Domestic Product (GDP), compared to 2% in the EU-15. Gross Value Added (GVA) of agriculture will increase by

6% with the new member states. A large part of income is spent on food in new member states varying from 18 to 45%. The expanding for EU-15 to EU-25 will result in increasing the share of food expenditure in total expenditure and also increasing the importance of food safety.

These numbers confirm that the new Member States have a large agricultural production potential. The new shape of European agriculture shows that the enlarged EU will be more agricultural than the EU-15.

6.1.2 Importance of Agriculture in new Member states

The new member states have more agricultural potential than the EU-15, particularly Hungary and Poland.

Polish agriculture has many aspects of a self-sufficient economy, with very small and fragmented farms, high rural employment and low productivity and product quality standards. In terms of population with 38 million people and area with a size of 31.000.000 ha, Poland is the largest country of the new Member States and the fifth biggest in EU-25.

The contribution of agriculture to total GDP fell at 6.0% in 1996 compared with 12.9% in 1989 (EC report, 1998). In the process of restructuring and economic development, the share of agriculture in GDP declined to 2.9% in 2000. The agricultural labour force held a 26.7% share of the total employment in 1998. In 2000, only 18.8 % of total civilian employment work in agriculture, fishery and forestry. Of a total area of 31 millions ha, Utilized Agricultural Area (UAA) represents 18.2 million ha or 58.3 % of the total. This is a relatively high share compared with EU Member States (EU-15 average is 40.6 %). This share also represents half of the total UAA of new member sates (CEECs-10).

Four fifths of agricultural land was not put into collective farms during socialist time and therefore did not need to be privatised. The remaining 20 % were owned by the state. Now, more than 90% of the agricultural land is owned privately, of which 83% by individual farms.

Hungary has an area of 9,300,000 ha. From the total area, Utilised Agricultural Area (UAA) represents 5,854,000 ha or 62.9% of the total. About 227,000 persons work in agriculture, fishery and forestry corresponding to 6% of total civilian employment. GDP of Hungary is about € 117 billion. Gross Value Added of agriculture is about € 1,913 million and accounts 3.9% of GDP. The Per capita GDP of € 11,700 is at about only 52% of the EU-15 average.

In Hungary, over 60% of agricultural land was in the co-operative and around 30% in the state-farm sector. There are two big farm sectors: individual farms utilise 43% of the total area of Hungary and 41% is utilised by corporate farms.

6.1.3 Applying the Common Agricultural Policy in the new Member States

In general, the new Member States will apply the agricultural elements of the acquis communautaire (body of EU legislation) from 1 May 2004. But some of the CAP's mechanisms will not apply immediately. This is partly because the new Member States and farmers need time to establish and adopt to the necessary administrative procedures, and partly because the continuing disparities in farms prices, structures and food industries mean that immediate implementation of the CAP as a whole could still provoke sudden changes. (EC D-G for Agriculture, "Enlargement and Agriculture", April 2004, p.7).

Direct Payments:

Direct payments would be introduced in the new member states equivalent to a level of 25% in 2004, 30% in 2005 and 35% in 2006 of the present system. In a second step after 2006, direct payments would be increased by percentage steps in such a way as to ensure that the new member states reach in 2013 the support level then applicable (EC Commission, successfully integrating into CAP).

Single Area Payment Scheme (SAPS):

The new single farm payment poses a problem for the new Member States as it is not possible to calculate payment entitlements for their farmers on the basis of the same historical reference period as used in the EU-15 (2000-2002). For this reason the EU offered the new Member States the option of operating a simplified system of direct payments – the Single Area Payment Scheme (SAPS).

SAPS involves payment of a uniform amount per hectare of agricultural land. The level of the per hectare payment shall be calculated by dividing the national financial envelope by the utilised agricultural area. As is the case with the single farm payment, farmers in the new Member States that apply the SAPS system have no obligation to produce, but they must keep the land in good agricultural and environmental condition.

SAPS is an option for three years (which can be extended for two years). Then the new Member States must opt for the scheme in force in the EU at the time.

Financial discipline and modulation:

As regards the mechanisms of *financial discipline and modulation*, the proposals foresee that these should not be applicable to the new Member States until their level of direct payments reaches the applicable level of direct payments in the EU.

Rural development measures:

In order to tackle structural problems in the rural areas of the new Member States, the Copenhagen Summit in 2002 agreed an enhanced rural development strategy worth € 5.1 billion for the years 2004-06. (Brussels / Copenhagen 13 December 2002, "Enlargement and Agriculture: summit adopts fair and tailor-made package which benefits farmers in accession countries"). In addition, approximately € 2 billion of structural funds resources (EAGGF Guidance Fund) is also allocated to rural development measures. A wide range of rural development measures will be co-financed at a maximum rate of 80% (85% for agri-environment and animal welfare measures) by the EU (Enlargement and Agriculture). This will provide support for the following measures:
_ early retirement schemes for farmers;
_ support for less favoured areas or areas with environmental restrictions;
_ agri-environmental programmes;
_ afforestation of agricultural land;
_ specific measures for semi-subsistence farms;
_ setting up of producer groups;
_ technical assistance.

Additional rural development measures (Investment in agricultural holdings, aid for young farmers, training, other forestry measures, improvement of processing and marketing, adaptation and development of rural areas, land improvement and reparcelling, farm relief and management services, marketing of quality agricultural products, renovation of rural villages, diversification of agricultural activities, agricultural water resources management, development of agricultural infrastructure, tourism/crafts, environmental protection, restoring agricultural production potential, financial engineering, land registers and quality control structures) will also be financed by the Structural Funds (European Agriculture Guidance and Guarantee Fund (EAGGF) Guidance Section).

Food Safety Standard

Obligations of EU membership will apply immediately unless transitional measures have been agreed. The principle example of this is the upholding of food safety standards. This is such an important issue for EU consumers and for the EU's export markets that standards can not be lowered.

Production Limitation

The limits of production to apply for each new member state were established according to common principles and based on recent reference periods, taking into account special production circumstances.

Production limitation is in the form of:

♦ Production quotas	for milk, sugar, isoglucose, potato starch, tobacco
♦ Base areas & reference yields	for some arable crops
♦ Maximum guaranteed quantities	for some other products
♦ Maximum guaranteed areas	for some other products
♦ Ceilings on premiums	in the livestock sector

Financial assistance to new countries

In June 1999, the European Union Council of Ministers adopted a Regulation (Council Regulation (EC) No 1268/1999) enabling the Community assist in the restructuring of the farm sectors of the candidate countries in the run-up to accession. The funds available amount to € 520 million annually (at 1999 value) until 2006. Sapard (Special accession programme for agriculture and rural development) funding aims both to contribute to the implementation by the countries of the acquis communautaire in the area of the CAP and rural development. Poland receives the highest amount of SAPARD fund (€ 171.6 million) and Hungary receives € 38.2 million.

6.2 Evolution of agricultural trade liberalisation process in new member states (Country case: Poland, Hungary)

6.2.1 Agricultural transformation from planned economy to market economy

GATT Uruguay Round negotiations and European Union accession process played great role in liberalisation of agricultural trade in Poland and Hungary.

Since the beginning of the 1990s, Poland and Hungary have undergone a deep transformation from a centrally planned economy to a market economy open to international competition.

In Poland, market mechanisms were introduced six months earlier in the agricultural sector than in the rest of the economy. Poland took the ‘shock therapy’ approach in the beginning of transformation. In this period of transformation agricultural support, including border protection, was reduced, the market was opened to foreign competition and farmers became were taxed rather than subsidized. Most of the administrative limitations to procurement and marketing of agricultural products had already been phased out by 1st August 1989. The second stage of price liberalisation took place in January 1990. Following this first “shock therapy”, structural reforms have been continued to restructure and privatise state-owned enterprises, create a legal framework for business operations based on market mechanisms, and develop capital markets. Increased openness of the market to international trade and investment has been a major element of Poland’s transformation process (Paul G. Hare, 2001, p. 21).

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In Hungary, the state owned most land and capital, with production and processing coordinated through central planning, and consumption distorted by subsidies under Communism.

In contrast to Poland, Hungary has taken a more gradualist approach to agricultural reforms. Hungary reduced the level of protection and support (TSE) gradually, from 32% in the end of 1980s to a very low level (9%) in 1996-97. Later the level of agricultural support increased as a result of the adjustment of the national agricultural policies to a CAP-like policy (Jerzy Wilkin, 2002, p.9).

In fact, general liberalization over the past decade has been combined with the two countries' step-by-step integration into the EU. In 1992, European Union signed Europe Agreements, based on Article 238 of the EC Treaty with each of the Central and East European Countries. The decisive step towards the current enlargement was taken by the Copenhagen European Council meeting in June 1993 which decided that the countries shall become the members of the Union as soon as they are able to assume the obligations of membership by satisfying the economic and political conditions required.

Poland and Hungary, after the market liberalization in the early nineties had a relatively low protection for the agricultural sector. Since then, the expected membership in the EU and internal pressure by farmers lead to a progressing adaption of CAP rules and, among the two countries (and Czech Republic too), in Poland to an increase in protection (Jörg-Volker Schrader, 2000, p. 18).

6.2.2 Liberalization of trade in agricultural products between EU and the new member states

In the socialist era, CEECs were seriously constrained in terms of market access to the EU. They faced high tariffs, quantitative restrictions and a wide range of contingent protection measures. At that time, CEECs ranked at the bottom of the pyramid of trade preferences granted by the EU to various groups of countries. The liberalisation of East-West trade began in 1988 (when the EU concluded a trade and co-operation agreement with Hungary), but the major change came in 1991: the »Europe Agreements» promoted Hungary and Poland to the top of the pyramid of trade preferences. But trade in agricultural and food products is only partly covered by the agreements.

In 2000, the EU concluded bilateral agreements with all 10 central and eastern European candidate countries on further liberalization in agricultural trade. The agreements should be seen in the overall context of the accession process and represent a major step – for the EU as well as for each of the candidate countries - in preparing for an enlarged single market.

Poland

The agreement with Poland (Council Regulation (EC) No 2851/2000), which entered into force on 1 January 2001, involved the liberalization of a wide range of products, either fully or within tariff quotas. For some products – in particular pigmeat, poultry, cheese, apples, wheat and butter – the parties also undertook to grant no refunds for exports to each other's territory (the 'double zero' approach: reciprocal elimination of export refunds and import duties in certain sectors). A further round of negotiations (now referred to as 'double profit') launched in December 2001 for the 'double zero' approach being agreed in other sectors such as other cereals, dairy products, beef and sheepmeat, together with improvements to the existing trade concessions. Several technical consultations on trade mechanisms, in particular tariff quota management and import licensing, have been held with the Polish authorities since the entry into force of the 2001 agreement to liberalize trade.

The trade of agricultural products has a share of 8.0 % of total exports and 6.7 % of total imports in 2000 in Poland. The agricultural trade in total and with the EU-15 in particular has an increasing tendency in the last decade (Table 5-2). Due to the financial crisis in Russia the trade especially with the eastwards laying neighbours suffered. Total imports have more than doubled (times 2.2) between 1992 and 2000, while exports increased only 1.8 times. Promising is especially the increasing export of processed agricultural products in total, which improved times 3.8 between 1992 and 2000. Also in the trade with EU-15 the trade in the years between 1992 and 2000 tends to import more raw products (times 2.4) and to export more processed products (times 2.7). (EC D-G for Agriculture, 2002).

Table 6-2: Poland’s agricultural trade with EU-15 (million €)

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2000/ 1992
Exports	940	881	941	989	981	1076	1107	1081	1272	1.4
Imports	890	1100	1129	1219	1563	1653	1764	1647	1923	2.2
Balance	50	-219	-188	-230	-582	-577	-657	-566	-651	

Source: Eurostat. 2002.

Despite this integration, the trade balance of Polish Agro-food trade worsened similar to the development of total trade. In 2000 the balance of agricultural trade amounted to a deficit of 770 Mill. EUR. The main deficit was created in trade with the EU-15 both for processed as well as for raw products. Statistics show a positive balance in trade with the CEECs and the FSU (Former Soviet Union), especially in the area of processed commodities.

Hungary

The agreement with Hungary (Council Regulation (EC) No 1727/2000,), which entered into force on 1 July 2000, involved the liberalization of a wide range of products, either fully or within tariff quotas. For some products – in particular pigmeat, poultry meat and cheese – the parties also undertook to grant no refunds for exports to each other’s territory (the ‘double zero’ approach: reciprocal elimination of export refunds and import duties in certain sectors).

A further round of negotiations was concluded between negotiators in April 2002. This further agreement (now referred to as ‘double profit’) is applicable from 1 July 2002. It enhances the existing agricultural trade preferences between the parties and promotes the abolition or reduction of import duties either within tariff quotas or for unlimited quantities in sectors such as cereals, dairy, beef and sheepmeat. This further agreement also includes a commitment by the parties to remove export refunds for certain sectors. Trade concessions on wine under a new wine and spirits agreement have been in force since 1 January 2001.

Of the acceding countries, only Hungary is a net exporter of total agricultural products to the EU (Table 5-3). But both Hungary and Poland are net exporters of specific commodities to the EU live animals (mostly cattle), meat and meat products, dairy products, and fruits and vegetables. Hungary is a net exporter of grain to the EU, whereas Poland imports grain. Both are net importers of feeds and processed foods.

Hungary is the largest agricultural exporter of the ten new member states. Only Hungary has a positive trade balance.

The trade of agricultural products account for 8.0 % of total exports and 3.4 % of total imports in 2000. Agricultural trade in total, and with the EU-15 in particular, increased over the last decade. While imports from the EU-15 have doubled, exports increased only slightly (1.2 times) between 1992 and 2000, the agricultural trade balance was still at a level of € 1.27 Bn in the year 2000.

Table 6-3: Hungary’s agricultural trade with EU-15 (million €)

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2000/ 1992
Exports	953	843	984	966	998	1014	1028	1083	1141	1.2
Imports	283	396	520	428	375	418	449	431	566	2.0
Balance	670	447	464	538	623	596	579	652	575	

Source: Eurostat, 2002.

6.3 Agricultural trade regime under WTO aspects (Poland, Hungary)

After enlargement, additional problems could arise for the CAP stemming from the obligations, the European Union and the new member states have assumed within the GATT/WTO framework. To eliminate the problems, the European Union must look at the way in which the new member states have structured their commitments.

Hungary and Poland belonged to GATT during the Uruguay Round (UR) negotiations. They generally succeeded in binding their commitments on import tariffs, market access, and export subsidies at relatively high levels.

6.3.1 Domestic support

Main Support Policies in Hungary and Poland

Market price support forms the main element of support in Hungary. It accounted in 1998 for one-third and in 1999 for half of total support.

Market price support is based on a system of guaranteed prices in the case of crops. If market prices are below the guaranteed prices the state purchases limited quantities of wheat (bread-wheat) and maize. Prices for milk, pig meat and beef are supported by a guarantee and guidance price system. Subsidies are paid to processors who pay prices above the guidance price to farmers or to farmers in case the price they receive is below the guidance price. In addition price premiums are paid for high quality production of milk, pig meat and beef.

Poland sees agricultural support as a key element of its policy to promote rural areas of the country, and envisages full participation in the Common Agricultural Policy (CAP) of the EU upon accession.

Since 2001 market and price policies, particularly for cereals and for pork meat, have been characterised by a high level of interventions.

The majority of agriculture-related budgetary expenditures in Poland is absorbed by the Agricultural Social Security Fund (KRUS), whose share in the years 1998 – 2001 approximated 80 %. The remaining agricultural budget devoted to rural development, agricultural market measures and institutions varied between € 706 million in 1999 and € 1,188 million in 2001 (EC D-G for Agriculture, "Country Report" 2002).

WTO commitments of Hungary and Poland

Hungary and Poland are well within their AMS WTO obligations.

Table 6-4: Total Aggregate Measurement of Support (AMS) commitments by Hungary and Poland, 1995-99

		1995	1996	1997	1998	1999
HUNGARY (Ft Million)	Total AMS commitment level	40851	39443	38034	36625	35217
	Current AMS level	20949	-	-	-	-
POLAND (US $ Million)	Total AMS commitment level	4022	3883	3745	3606	3457
	Current AMS level	254.5	226.5	295.8	300.6	-

Source: WTO, 2000.

Hungary has used its domestic support commitments to an even smaller extent, as shown in Table 3-1. In 1995, Hungary had a current AMS far above its commitments.

Poland's commitments on domestic support are expressed in $ and therefore shielded against the devaluation of the zloty. Total Aggregate Measurement of Support (AMS) was limited to 3.4 bn $ by the year 1999. Current levels of domestic support are much lower than the commitments.

In contrast to EU, both countries' current AMS levels are below their commitments (Table 5-4).

Producer Support Estimate of the Countries

Hungary has reduced the level of protection and support gradually to 13% in 1995. Later the level of agricultural support increased as a result of the adjustment of their national agricultural policies to a CAP-like policy (Jerzy Wilkin, 2002, p. 9).

In Poland, Agriculture was heavily supported under the old system. From the transformation these levels declined dramatically, but since that time the overall picture has been one of increasing protection levels.

PSE-calculations show that at the beginning of the transformation process in 1989-90, Poland intended to build up a very liberal market economy with low support levels. The result was that overall support to agriculture in the period 1989-1991 was generally negligible. Since then Poland reinforced the border measures and equivalent price support systems mainly due to increasing competition problems caused by structural deficiencies particularly in the food processing industries. Support to farmers as measured by PSE has increased from 16% in 1991-93 to 27% in 1999. The PSE decreased in 2003 to 8%, compared to pre-transformation levels in 1986-88 of 11%.

Table 6-5: OECD, Producer Support Estimate, Hungary and Poland

	1986-88	1990	1995	1999	2000	2001	2002	2003
European Union								
EUR mn	92 308	80,946	96,779	107,173	93,338	93,061	96,989	104,474
Percentage PSE	41	33	36	39	33	32	34	36
Hungary (1)								
EUR mn	716	1,443	592	1,107	1,131	1,297	1,986	1,492
Percentage PSE	16	23	13	24	22	22	33	28
Poland (1)								
EUR mn	1 180	-872	2,256	3,348	1,729	2,556	2,844	1,084
Percentage PSE	11	-18	16	27	12	15	19	8
OECD								
EUR mn	220 776	197,307	204,439	256,083	263,649	245,094	240,279	227,268
Percentage PSE	37	32	31	35	32	29	31	30

(1) For Hungary and Poland: The figure in the first column refers to 1991-93
and 2002-2004 is replaced by 2001-2003.

Source: OECD, PSE/CSE database 2005.

Both countries' PSE levels are below the EU-15 and OECD average (Table 5-5). A comparison of the PSE of the two countries and the EU show that the support of agricultural producers in the EU has been more stable and higher than in Poland and Hungary, though the farmers in the new member states would enjoy substantial support in the European Union.

6.3.2 Market access

Tariffs

In Hungary, imports are regulated by ad-valorem (percentage of price) tariffs and tariff rate quotas. In the period 1997 to 2000 Hungary lowered its MFN tariff rates for most agro-food products in accordance with the Uruguay Round Agreement in Agriculture (URAA).

Prior to the Uruguay Round, Hungary applied relatively low tariffs on agricultural products, and quantitative restrictions served as a main protective tool against imports. In accordance with the WTO Agreement on Agriculture, these measures were completely abolished as of 1 January 1995 with a parallel increase in tariff protection. Though agricultural tariffs have not been high in international comparison even after the tariffication of Quota Rates.

The commitments of Poland on market access consist of two elements, the provisions on minimum market access and the new tariff rates resulting from the process of tariffication. The base for calculation is the period 1986 to 1989 when Poland's trade was still state managed and controlled.

Due to the non-market nature of the Polish economy in the base period, Poland carried out the tariffication process in a different manner than the majority of GATT members. Sensitivity of the markets for individual products and the level of tariff rates in the EU was adopted as a basis for tariffication. In relation to all tariff items recognised as sensitive, Poland was guaranteed the right to apply Special Safeguard Provisions (SSG). These provisions allow for introduction, in the implementing period, additional customs duties in the event of excessive quantitative growth or decline in import prices.

Poland and Hungary’s membership in the EU and the adoption of the EU external tariff will affect significantly the level of import tariffs.

In the area of market access, the central issue is the harmonization of tariffs among the EU-15 and the accession countries. Given the GATT/WTO requirement that the (trade weighted) average of tariffs should not rise in the process of enlarging the EU (OECD, S. Tangermann, p. 72).

Applied tariff protection of agricultural products will decrease or increase depending on the product (Table 5-6).

Table 6-6: GATT Tariff Binding: final bound rates
Ad valorem equivalent, EU = 100

GATT TARIFF BINDING:final bound rates
ad valorem equivalent, EU = 100

	Wheat	*White sugar*	*Potatoes*	*Beef*	*Pork*	*Poultry*	*Butter*	*Milk powder*	*Cheese*
EU-15	100	100	100	100	100	100	100	100	100
Poland	148	103	1113	169	162	292	83	159	216
Hungary	59	49	365	70	111	150	83	80	91

Source: EC Directorate General for Agriculture 1995.

Hungary has lower level of protection than EU-15. High protection is seen in pork, poultry and potatoes sectors. Higher tariffs in Poland are on products like tobacco, most alcoholic beverages, apples, certain types of potatoes, certain meat products, black tea, etc. These sectors will be challenged after the accession only the by the competition from the enlarged domestic market, but from the lower protection against third countries.

Polish import tariffs are lower than the EU external tariffs on cereals, milk products, bananas, some fruits etc. And Hungary's border protection is low in wheat and other cereals, sugar, beef and dairy products.

In these sectors, the border protection of the enlarged market might be more favourable in relation to third markets after the accession in some agricultural products.

<u>Tariff Rate Quotas (TRQs)</u>

Hungary opened preferential tariff quotas for more than 100 products in order to provide appropriate market access opportunities.

Hungary has 70 tariff rate quotas (Table 5-5). Tariff quotas apply to a wide range of imports mainly to fruits and vegetables, meat and coffees.

Table 6-7: Number of tariff quotas by Hungary and Poland, by product group

	Hungary	Poland
Cereals	7	12
Oilseeds	4	4
Sugar	2	2
Dairy	4	8
Meat	8	14
Eggs	1	3
Beverages	4	5
Fruit & veg.	33	37
Tobacco	1	1
Fibres	-	3
Coffee, etc.	6	11
Other	-	9
ALL	70	109

Source: WTO, 2000.

Due to increase of import tariffs for some agricultural and food products in the second half of 1995 and the next years, and according to UR agreement commitments, Poland had to introduce "First come, first served" import quotas with access conditions not worse than those before December 1993. Quotas, according to commitments, are either constant or yearly progressively increasing. Many of these quotas have been consistently and substantially underutilized. Poland has also applied bilateral tariff quotas on agricultural imports from regional trading partners.

Poland ranks second with 109 tariff rate quotas after Norway in Europe. In 1997 most used were the quotas for: meat and edible offal of poultry, egg yolks dried, natural honey, tomatoes fresh (from 1April to 31 May), some kinds of spices, vegetable saps and extracts, some types of tobacco and gelatine. During 1997 there was no in-quota imports of: milk and cream concentrated or containing added sugar or other sweetening matter, egg yolks fresh, eggs dried, cut flowers, cider apples, strawberries, rye flour, flour and other products of potatoes, beet seeds, hop cones, edible oil, potatoes prepared or preserved, flavoured sugar syrups, wine, denatured spirits, egg albumin dried, dextrins. (EC, D-G for Agriculture, 1998, p. 89-91).

6.3.3 Export subsidies

In Hungary, in the field of agriculture, subsidies until the 1990s were heavily concentrated on exports. Though in the process of economic transformation the real value of agricultural export subsidies decreased to one third of its previous level, the seriously erroneous base period data on the product coverage and value of export support presented at the Uruguay Round negotiations and the resulting schedule of commitments led to a situation which required corrective action.

Before 1997 expenditure on export subsidies was about twice the level of Hungary's URAA Commitment and covered 149 products as against 16 specified in the WTO schedule. Against this background the Hungarian government applied for a waiver.

According to the waiver obtained in 1997 from the General Council after lengthy consultations, Hungary has been provided with a transition period until 2002 to gradually adjust its support programmes to the limits of its schedule.

The Ministry of Agriculture estimates that it was using two-thirds of the export subsidies allowed for under the WTO waiver in 1999.

The Polish schedule of concessions to WTO includes export subsidy commitments for 17 groups of agricultural products, but in fact up to 1997 subsidies were imposed only for sugar.

Export subsidies apply, including on sugar, potato starch and, in 1999, on pig carcasses. Subsidies totalled US$13.9 million in 1998. Poland's WTO agricultural commitments permit it to extend export subsidies to additional products, such as animal products, meat, fruit, vegetables, rapeseed, and rapeseed oil (WTO).

Table 6-8: Agricultural export subsidies in the URAA base period (1986-90) relative to exports and agricultural output (Hungary, Poland)

Country	Export subsidy outlay US $ mill.	Agricultural exports US $ mill.	Agricultural output US $ mill.	Exports/ output (%)	Exp.subsidy outlay/ exports (%)	output (%)
European Union	11282.52	36460.00	148629.31	24.5	30.9	7.6
Hungary	421.29	1670.91	4687.00	35.7	25.2	9.0
Poland	783.60	1345.52	7141.61	18.8	58.2	11.0

Source: OECD 2003.

After enlargement, additional problems could arise like, larger surpluses can be expected. To eliminate the effect of larger export subsidies, the European Union must look at the way in which the new member states have structured their export subsidy commitments (OECD, S. Tangermann, p. 75).

Poland suggested large export subsidies during the base period, amounting to about 58% of the base period exports. Hungary, on the other hand, notified only a relatively low expenditure on export subsidies during the base period, equivalent to no more than 25% of export value (Table 5-8).

6.4 Enlargement as a challenge for European Union (Poland, Hungary)

Enlargement will create the world's largest trading bloc. Thus, for commercial, as well as for general economic and political reasons, what happens between the existing EU and its Eastern neighbors will be of concern to everyone.

The new member states will apply all the EU bilateral trade agreements, the common external tariff and the EU trade defence measures.

As they acceded to the European Union on May 1, 2004, the trade policy regime of the new member states is going to change.

6.4.1 Applying the Free Trade Agreements (FTAs)

Enlargement is important for the third countries to see how the new member states alter their existing trading patterns and agreements.

The European Commission has expressed its views on the subject of free trade agreements entered into by new member countries and third countries, taking into account legal and political aspects with particular regard to the relevant provisions of the Europe Agreements and the WTO.

According to the European Commission, it is important that new member countries avoid entering into obligations with third countries which may later on become obstacles with regard to EU accession. With respect to trade agreements between new member countries and third countries, the preferences granted should not be more favourable than the preferences granted by the Union to those countries. Prior to the moment of accession when such agreements would have to be cancelled in order for the new member country to assume the obligations of the common commercial policy, discrepancies would have to be eliminated to ensure that the process of accession takes place smoothly (European Parliament, 1999, p. 15).

The new Member States will have to bring their external economic policies gradually in line with the EU's. This means that they must extend preferential treatment to third countries in accordance with the EU's international agreements (bilateral free trade agreements, the future Lomé convention) and the generalized system of preferences. In the future, it is equally likely that the new countries will have to take on further moves towards trade liberalisation within the framework of the WTO. By doing so and through a gradual integration of the new Member States into the EU, they will contribute to the expansion of the trade.

6.4.2 Discharging the WTO obligations

The new member states are successful in binding their WTO commitments. It seems that the new member states will take further moves towards trade liberalization within the framework of the WTO.

As the European Union stands for free trade in line with its commitments to the WTO and for economic dynamism, enlargement can prove a catalyst in the process of further trade liberalisation.

The new member states can cause difficulties for the EU to respect WTO commitments. However, the issue seems to be a problem mainly in the area of <u>export subsidies</u>. After enlargement, additional problems could arise where the market situation in the countries is such that larger surpluses can be expected. Indeed, the WTO commitments of the new member states in terms of quantities that can be exported with subsidies are limited. When facing EU-15 prices and payments, their contribution to EU-25 production will be significantly larger. Simulations show that the main problems raised by export subsidies commitments for the EU-25 would result from the pigmeat sector, followed by the grain and the beef sector (Jean-Christophe Bureau, 2002, p. 63). But generally, it is assumed that the new member states are successful in binding their export subsidy commitments, so enlargement would not cause any problem from the European Union perspective.

In the case of domestic support, both the European Union and the new member states are below their AMS commitments. However, EU was only able to meet its Uruguay Round commitment to reduce domestic support because its direct payments were classified in the blue box. If the blue box were abolished, an enlarged EU could run into difficulty in meeting this commitment (Susan S. Nello, 2002, p. 28).

In the field of market access, the new member states will apply the common external tariff of European Union.

Under WTO rules, a country has a right to claim compensation for lost or more limited market access if it loses preferential access or faces higher tariff rates as a consequence of its trading partners joining a customs union (Natalija Kazlauskiene, 2003, p. 10). Compensation is only applicable to third parties which are WTO members (Article XXIV:6 GATT). Countries not members of WTO can not request compensation under WTO procedures.

For instance, no compensation can be asked in the case of the termination of preferential agreements between new member states and the third countries, as the tariffs applied under preferential trade are not the MFN bound tariffs.

6.5 Turkey’s Agricultural Trade Liberalisation Process as a Candidate Country

The Helsinki European Council meeting in December 1999 concluded that: *"Turkey is a candidate State destined to join the Union on the basis of the same criteria as applied to the other candidate States. Building on the existing European Strategy, Turkey, like other candidate States, will benefit from a pre-accession strategy to stimulate and support its reforms."*

As a candidate country, liberalization of trade in agriculture is expected to become top priority in Turkey. Apart from bilateral concessional trade agreements and WTO commitments, Turkey will also begin negotiations with European Union on October 3, 2005. The steps towards membership will provide full liberalization of agricultural trade with European Union.

6.5.1 Agricultural Sector in Turkey and Main Problems

Agricultural sector bears an important role in the Turkish economy. After World War 2, there has been significant change in the agricultural sector in Turkey. Especially in 1950s, the sector became mechanised and more technology-driven. In that period, utilised agricultural area (UAA) and production increased by 60% and 69% respectively. (Şevket Pamuk, p.263-264). In 1960s and 1970s, there has not been an important change. In 1977, the world prices in agriculture decreased. Agricultural sector in Turkey witnessed a slowdown since 1978. After 1980s, the priority of development was given to industrialisation and agriculture fell in second place. But the importance of agriculture can not be ignored.

Despite of its decreasing share in the economy, agriculture is still a large contributor to GDP, employment, food industry and to trade. In the first years of Foundation of Turkish

Republic (1920s), the share of agriculture in GDP was 40%. The share fell to 36% in 1970s, and to 25% in 1980. The share was 16% in 1990 and decreased again to 13,5% in 2000. But still the share of agriculture in GDP is higher in Turkey than that of in developed countries. (tarim.gov.tr)

In the latest years the labour force in the agricultural sector decreased, which now represents 33.2% of the whole labour force, equivalent to some 6.7 mn people in 2002. Nevertheless, agriculture is the most important provider of employment in the Turkish economy.

Turkey has a total agricultural area of 39 million hectares. Subsistence and semi-subsistence farming is an important characteristic of Turkish agriculture, which is similar to the situation in regions in the EU-25 as well as in Bulgaria and Romania. This type of farms is characterised by very low productivity, high hidden unemployment and low competitiveness. These farms, however, are crucial for providing income security and livelihood to the majority of the rural population in Turkey.

Subsistence and semi- subsistence farms are difficult to reach with traditional market and price policies, because they only market a minor part of their production with a very limited regional scope.

Within the last 45 years, governments in Turkey, displayed a great concern in introducing enough modern technology into agriculture. Among the other technologies, agricultural mechanisation is generall the most visible and easily recognized of technological changes observed in the rural areas of Turkey as in the other developing countries. One of the main structural characteristics and problems of Turkish agriculture is that, agricultural holdings mainly consists of considerably small-scale ones. These structural characteristics create difficulties in application of technologies, in specific agricultural mechanisation.

There are about 4 million farms in Turkey, where 68 % of farm holdings has a size smaller than 5 ha. Over 90 % of the farms and over 60 % of total land fell into the 0-20 ha size group. The farm structure is very fragmented. In Turkey average farm size was 5.9 ha, while in the European Union it is 19 ha (European Commission, Country Report “Turkey”, 2003).

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Income is also low. Inequalities of income between urban and rural residents--and among segments of the farm population--have created social tensions and contributed to emigration from rural to urban areas. The Kurdish insurgency in eastern Turkey has added to problems in some rural areas.

In Turkey, quality agricultural land is a limited resource. To increase and sustain agricultural production, and to achieve the greatest benefit from this as goods reach the market, the use of contemporary technological and scientific advances should be expanded and continually reviewed (http://www.khgm.gov.tr/aboutgdrs.htm).

As for water resources, Turkey is considered to have general water management problems. Accordingly the improvement of water efficiency for arid or semi-arid regions has long been a priority. The best example is the South-eastern Anatolia Project (GAP), is the largest and most comprehensive enterprise ever undertaken in Turkey. GAP is a combination of several sub-projects which include the construction of 22 high dams and 19 hydro-power plants. The ongoing implementation of this project shows that it will have a major impact not only on agricultural production, but also on industry, construction services, employment, and per capita income (http://www.mfa.gov.tr).

6.5.2 Agricultural Trade Liberalisation in Turkey

Liberalization of trade in Turkey dates back to early 1980’s. Prior to 1980, the imports of agricultural commodities were highly restricted. Agricultural commodities allowed to be imported only by state economic enterprises (SEEs). Import tariffs, complemented by administered prices in some cases used to provide support for domestic production. A ban on imports of livestock has been applied for sanitary purposes. Prior to 1980, restrictions in the form of licensing and registration requirements widely applied on export of agricultural products and inputs. Export levies were applied on relatively high-value products to raise revenue and to regulate domestic supplies. Subsidies also existed to promote exports. Since 1980, many licenses and monopolies have been eliminated, and export duties reduced or replaced by special fund taxes. Export subsidisation continued for a number of products (Cagatay, S., C. Saunders and R. Amor, 2001, p. 3).

6.5.2.1 Main Support Policies

In the last decade Turkey has become a part of three agreements which were expected to shape the future of the agricultural policy instruments and developments. The first agreement was the Uruguay Round of the GATT which Turkey took part in the negotiations and signed the resulting Agreement in April 1994. The second one was the Customs Union (CU) agreement with the EU in 1995. Lastly, Turkey has signed a stand-by agreement with International Monetary Fund (IMF) in December 1999 (Cagatay, S., C. Saunders and R. Amor, 2001, p. 4).

With IMF Agreement Turkey committed to phase out production-oriented agricultural support and to replace it by income support payments during the 2001-2004 period. The Turkish Government has developed the Agricultural Reform Implementation Project (ARIP) to pursue the aim of this Agreement. The project particularly aims a restructuring in government institutions and encouragement of sectoral investment, with emphasis on harmonisation of Turkey's regulations and procedures in preparation for European Union accession. According to ARIP:

1. In 2000 a pilot programme of income support payments has started in four selected regions.

2. Simultaneously with the application of income support payments programme, price supports and input subsidies would be phased out.

3. In the longer run, most agricultural state enterprises would be privatised. The Agricultural Sales Co-operatives Unions would be restructured.

Current Support Policies:

Direct Income Support (DIS) Program:

In 2001, the direct income support (DIS) Program was introduced by the Government of Turkey, aiming to compensate partially farmers for the negative impact on their income of subsidy reduction. The direct income support is intended to provide the farmers safety net as a result of the elimination of the current mechanisms of support. The DIS is not contingent on input use or output production decisions of the farmer, and hence it is decoupled. Currently, the payments are moderately targeted. The farmers are eligible to receive a fixed amount of payment up to 50 hectares of cultivated land.

DIS reduced the cost of agricultural transfers (subsidies and DIS) by over 2.3 percent of GDP, contributing a third to the success in reaching the Government of Turkey target of a 6.5 percent primary budget surplus (World Bank, 9 March 2004).

By 2002, the input subsidies were cut (especially fertilizer and credit). By the end of 2002, the reform program reduced the fiscal outlays on agricultural subsidies by about US $5.5 billion to US $0.6 billion. This represents a savings of over 2.7 percent of GDP (World Bank, 9 March 2004).

Farmer Transition

Farmer Transition helps farmers make the transition to alternative activities as the governmental supports are reduced. The objective of this component is to cover the cost of converting from previously highly supported crops. Currently the most serious problems are with hazelnut and tobacco. As a result of high support prices, there has been a large expansion of cropping area for these crops, with significant amounts of surplus production and stock accumulation. Under the reform program, the artificially high prices of these products have declined significantly, and it is expected that many of these farmers in areas which have good alternatives will want to stop producing them. This component provides grants to qualified hazelnut and tobacco farmers to cover the average cost of buying inputs for alternatives, and preparing and tending fields in the transition period; and to hazelnut farmers to cover the uprooting costs.

Privatization of the related state economic enterprises and restructuring of the sales cooperatives:

The state procurement activities were decreased together with the privatization of the related state economic enterprises and restructuring of the sales cooperatives.

Progress in reducing the intervention purchases of the Turkish (State) Grain Board (TMO) has been significant, and the cost of intervention purchases by the hazelnut ASCU (Fiskobirlik) has fallen, but less progress has been made in the sugar, tea, and tobacco markets (World Bank, 9 March 2004).

The governments had a dominant role in the agricultural sales cooperatives. The major sales co-ops are in the purchase and processing of cotton, hazelnuts, sunflower and olives. Until the enactment of the new Agricultural Sales Cooperative and Agricultural Sales Cooperative Union Law in June 2000, cooperatives were mainly channels for implementation of government programs rather than member-owned cooperatives. Funded by government, the cooperatives were put under the supervision and direct control of the Ministry of Industry and Trade. Restructuring Board of co-ops has been trying to make them independent and responsible for their own finances, management and operations (Erol H. Çakmak, 2003, p. 8).

6.5.2.2 Turkey’s Commitments under GATT/WTO

Turkey has been striving to improve and increase the competitiveness of its agricultural sector on the basis of the UR Agreement. With this Agreement Turkey has committed itself to comply with certain general rules on agricultural support and protection. In addition, like all member countries Turkey made specific commitments in the areas of market access, export competition and domestic support. Turkey’s commitments under the WTO is summarized below accordingly with these areas.

6.5.2.2.1 Market access

As a developing country Turkey had to reduce its applied tariffs by 24 percent on average until the year 2004.

One problem for the tariffication is that, Turkey has changed the product definitions during the liberalisation process. This was the problem for tariffication because, the definitons of agricultural products were not the same with past periods (Prof. Dr. Fatma Doğruel, 1998, p. 34-35).

However, before the Uruguay Round, Turkey has reduced the tariffs in agricultural products during the liberalisation process. For this reason, Turkey did not need to adjust its tariffs because of its WTO commitments.

6.5.2.2.2 Export subsidies

According to the Uruguay Round Agreement on Agriculture all existing export subsidies had to be bound based on historical export subsidies of the years 1986-88, and as a developing country Turkey had to reduce its export subsidies by 24 percent (outlays) and 14 percent (quantities) until 2004 (which is 36 percent (outlays) and 21 percent (quantities) by the year 2000 for developed countries). Turkey had bound export subsidies for 44 products/product groups but Turkey was below the bound limits for most products and close to the limit (quantity or budget) for a few products only. The total amount of the final (2005) bound for export subsidies is about US$95 million in 2005 and this is less than 4 percent of Turkey's agricultural exports and less than 0.25 percent of the value of agricultural production in 1994 (FAO, 1997). In addition, in 1996 Turkey reduced the coverage of export subsidies to a group of five products (potatoes, tomatoes, onions, citrus fruit and apples). These numbers show that export subsidies in Turkey do not have the same importance as means to get rid of structural surplus in agriculture as they have in major industrialized countries (Cagatay, S., C. Saunders and R. Amor, 2001, p. 4).

6.5.2.2.3 Domestic Support

<u>WTO nottification</u>

According to the AoA all domestic support policies which are not in one of the categories exempted from reduction commitments had to be bound at the level of 1986/88 or 1986. As a developing country Turkey had to reduce its aggregate measure of support (AMS) by 13 1/3 percent (which is 20 percent for developed countries) during the implementation period.

Turkey has bound *de minimis* support for all products. This means that domestic product specific support policies applied by Turkey are not allowed to exceed 10 percent of the production value of the product concerned and that nonproduct specific support policies are not allowed to exceed 10 percent of the value of agricultural production. Turkey's commitments in the area of domestic support is still open to discussions. This is basically based on the way Turkey has calculated its product based AMS. The product based support in Turkey was calculated by using the method equivalent measure of support (EMS) instead of AMS. According to FAO (1997) Turkey easily meets the *de minimis* provision for individual products (so doesn't have to reduce domestic support) as long as the EMS calculations are done according to the methodology applied to the base period. However, for the calculations of EMS in the base year Turkey did not report any product specific support other than market price support (except intervention buying) and these other product specific support measures are not included in the EMS. Therefore, whenever such policies do exist (for example product specific premiums and credit subsidies) it should be calculated whether they are *de minimis* or not.

Furthermore, in the area of nonproduct specific support Turkey did not report any policies which would be subject to reduction commitments if they exceeded the *de minimis* level. For example, input subsidies are an important means of agricultural policy in Turkey. Turkey basing upon "Measures Exempt from Reduction Commitment - Special and Differential Treatment (which are exempt from reduction commitments in the case of developing countries)" declared the eligibility of these subsidies to be included in the exemption category. However, it is not clear whether these subsidies are for low income farmers as stated in the above statement. Similarly, credit subsidies are not reported in Turkey's calculation of the base level of domestic support and in Turkey's notifications by basing upon the developing country exemption of "... investment subsidies which are generally available to agriculture..." (AoA Art. 6:2). According to FAO (1997) it is not clear to what extent these subsidies are eligible for exemption. This is because only part of these subsidies is for investments, the other part being granted for inputs like fertilizer and seed. Credit subsidies granted for inputs, however, are not investment subsidies and should therefore be below *de minimis.* FAO (1997) shows that Turkey would have exceeded its *de minimis* commitment for example in 1995 and 1996 if it had calculated an AMS by considering the factors above (Cagatay, S., C. Saunders and R. Amor, 2001, p. 4-6).

Producer Support Estimate

According to the OECD estimate the support for agriculture in Turkey is lower on a per-ha and a per-capita basis than in the EU and in the OECD countries on average. However, agricultural policies in Turkey absorb a significant higher share of the GDP as compared to the OECD average (Table 5-9).

Support is largely paid by consumers through taxation. After the middle of 1980's, the transfers to producers mostly occurred from consumers through support purchases for major crops backed by high tariffs. The transfers to producers from the taxpayers did not reach relatively high levels, but were accompanied by huge financial costs. Most of the direct transfers from the state, i.e. deficiency payments, were not budgeted and the funds of the state banks were utilized without paying back in due time. Another channel increasing the financial costs of support purchases cropped up through the related state economic enterprises (SEEs) and Agricultural Sales Cooperatives Unions (ASCUs). SEEs responsible for implementing agricultural policies (TMO for grains, Tekel for tobacco, TurkSeker for sugar, Caykur for tea) had to borrow at market rates and eventually had to either write them off as 'duty loses' or receive capital injections (Erol H. Çakmak and Haluk Kasnakoğlu, 2002, p. 2).

Table 6-9: Indicators of Agricultural Support in Turkey, comparison with EU and OECD average

	1986-1988	2000	2001	2002
PSE per hectare of agricultural land (EUR)				
Turkey	67	183	63	161
EU	644	697	711	775
OECD	167	204	196	193
PSE in %				
Turkey	15%	21%	10%	23%
EU	40%	34%	34%	36%
OECD	38%	32%	31%	31%
TSE per capita (EUR)				
Turkey	55	169	88	120
EU	296	288	299	323
OECD	270	311	303	300
TSE as % of GDP				
Turkey	3.6	5.3	3.6	4.1
EU	2.7	1.3	1.3	1.3
OECD	2.3	1.3	1.2	1.2

Source: OECD 2002.

Market price support accounts for three quarters of this PSE, and the remaining quarter is largely input subsidies (Table 5-10).

Table 6-10: Producer Support Estimate (Real 2001 Prices – TL Billion)

	1998	1999	2000	2001
PRODUCER SUPPORT ESTIMATE (PSE)	**9,467,519**	**7,567,047**	**6,559,971**	**2,764,989**
Market Price Support (MPS)	7,609,620	5,626,934	5,478,683	1,909,348
of which MPS commodities	4,882,082	3,577,990	3,455,037	1,201,294
Payments based on output	110,695	264,939	307,651	557,997
Payments based on area planted / animal numbers	0	0	0	0
Payments based on historical entitlements	0	0	0	83,640
Payments based on input use	1,747,204	1,675,174	773,638	214,004
Percentage PSE	**26.46%**	**24.44%**	**21.43%**	**10.29%**

Source: OECD 2001.

Table 5-11 shows the main PSE indicators by commodity. Overall, the reduction in support is in line with the reduced market intervention during the 2000-2001 period and lower levels of deficiency payments. Before the introduction of agricultural reforms, almost 70 percent of the aggregate PSE was accounted for by the crop component, while the livestock sector garnered about one-third. Since 1999, the support to the crop component decreased by over 3.1 quadrillion TL (US $2.5 billion), with the grains sector absorbing about two thirds of this reduction. The sugar sector absorbed about 20 percent of the reduction. Support to the livestock sector dropped by about 1.7%; proportionally less than in the crops sector. Hence, the relative importance of support to animal production has increased, to over 40 percent of the aggregate PSE.

Table 6-11: Main PSE Indicators by Commodity (Billion Real 2001 TL)

		1998	1999	2000	2001
Wheat	PSE (TL.bn)	1,575,871	1,254,393	588	-157,257
	Percentage PSE	42	42	21	-6
	NAC	1.72	1.72	1.27	0.94
Maize	PSE (TL.bn)	183,722	141,555	101,055	20,068
	Percentage PSE	45	39	32	7
	NAC	1.82	1.64	1.47	1.08
Other Grains	PSE (TL.bn)	702,282	525,792	260,128	44,218
	Percentage PSE	55	48	27	5
	NAC	2.22	1.92	1.37	1.05
Oilseeds	PSE (TL.bn)	134,300	156,795	114,545	71,992
	Percentage PSE	35	41	42	27
	NAC	1.54	1.69	1.72	1.37
Sugar	PSE (TL.bn)	1,078,794	860,893	564,918	184,181
	Percentage PSE	65	70	56	30
	NAC	2.86	3.33	2.27	1.43
Other Crops	PSE (TL.bn)	3,113,186	1,809,413	2,704,841	1,479,235
	Percentage PSE	13	9	13	8
	NAC	1.15	1.10	1.15	1.09
Livestock	PSE (TL.bn)	2,679,365	2,828,209	2,226,693	1,122,553
	Percentage PSE	42	42	44	25
	NAC	1.72	1.72	1.79	1.33
Total	PSE (TL.bn)	9,467,519	7,567,050	6,559,971	2,764,990
	Percentage PSE	25	23	21	10
	NAC	1.33	1.30	1.27	1.11

Source: OECD, Worldbank, 2004.

**NAC:Nominal Assistance Coefficient. The NAC is simply the ratio of total farm revenue including all direct subsidies reflected in the PSE relative to the underlying value of farm output at border prices without other output and input-based subsidies.*

6.5.3 Agricultural Trade Liberalisation between Turkey and European Union

6.5.3.1 Agricultural Trade between Turkey and European Union

Turkey's major trade partner of agricultural products is the EU-15, with 4.3% of exports. The market share of the EU-15 in Turkey's agricultural imports is 24.7%.

Turkey has a trade surplus with the EU-15 in the field of agriculture mainly due to exports of edible fruits & nuts, preparations of fruit and vegetables as well as tobacco and tobacco products. In 2001 Turkey expanded significantly its exports by 14.1% to € 1.93 bn (Table 5-12). Imports from the EU reached € 0.73 bn that is 23.8% less than in 2000 due to the devaluation of the Turkish Lira (*EC D-G for Agriculture, 'Country Report', 2003).*

In 2003, overall agricultural trade between Turkey and the EU saw a small increase. Turkey's exports to the EU-15 grew from €1,995 million in 2002 to €2,036 million, while its imports from the Community increased from €965 million in 2002 to €1,027 million. EU-15 imports were again dominated by fruit and nuts (though these were down again on the previous year), followed by vegetable and fruit preparations. Key areas of EU-15 exports were tobacco, cereals and animal and vegetable fats (European Comission, Regular Report, 2004, chp. 7).

Table 6-12: Agricultural trade with European Union (1000 Euro)

	1999	2000	2001
EXPORT	1,806,497	1,682,807	1,931,442
IMPORT	718,039	916,488	734,925
Balance	1,088,458	766,319	1,196,517

Source: European Commission D-G for Agriculture, 'Country Report', 2003.

A number of complaints have been received from EU companies concerning technical barriers to trade and infringements of the Customs Union or Association Agreement. A ban on imports of livestock and meat products remained in place. The ban on certain energy drinks had been lifted by the adoption of a new communiqué in March 2004 (EC, “2004 Regular Report on Turkey’s Progress towards Accession”, 2004).

6.5.3.2 Customs Union Agreement

Turkey and the EU signed a Customs Union (CU) Agreement in 1995. The agreement excluded agricultural sectors initially but confirmed the possibility of eventual agricultural integration in the course of time (2001). The CU agreement became effective at the beginning of 1996.

Customs Union Agreement proposed in the field of agriculture:

1. Adoption of Common External Tariff (CET) of the EU by Turkey on imports from the third regions.

2. Turkey is obligated to provide preferential access to its markets to all countries to which the EU grants preferential access. These countries include: Central and Eastern European countries (CEEC) with whom the EU has association agreement, EFTA countries, Mediterranean countries that are covered by the Mediterranean Policy of the EU and African and Pacific countries included in the Lome Convention.

3. There will be no restrictions on tariffs imposed by Turkey on imports of agricultural products.

4. The agreement proposes no restrictions on export subsidies to third countries or export subsidies in agricultural products to any country.

EU Preferences Granted for Agricultural Products Originating from Turkey

The EU granted tariff preferences for agricultural products originating from Turkey and at various stages these preferences have been extended. Since 1987 almost all *ad valorem* tariffs have been abolished and in some cases reduced rates were granted also for specific duties. The preferences granted by the EU for Turkey can be grouped under four categories based on the import regime applied by the EU to agricultural imports originating from Turkey.

These groups are as follows (Cagatay, S., C. Saunders and R. Amor, 2001, p. 6-7**)**:

1. Products for which no most favoured nation (MFN) import barriers exist (MFN tariff = 0; no minimum import price).
2. Products with a MFN tariff and/or a minimum import price, no preference for Turkey.
3. Products with a MFN tariff and/or an minimum import price, partial preference for Turkey (for example a reduced MFN tariff rate).
4. Products with a MFN tariff and/or an minimum import price, no import barrier for Turkey (tariff= 0 and no minimum import price).

9 percent of Turkey’s agricultural exports are in category 1, where preferential treatment was technically impossible. This group consists mainly of products of guts, bladders, stomachs, oilseeds and oleaginous fruit, cotton and wool. Approximately 20 percent of Turkey's agricultural exports to the EU are in category 2 which are subject to a tariff (and, in some cases, a minimum import price) at MFN conditions. Hazelnut, grapes and melons are in this group. Around 71 percent of agricultural exports (categories 3 and 4) are under preferential conditions (being about 11 percent in category 3 and 60 percent in category 4).

Category 3 consists mainly of olive oil (with a minimal reduction of the specific MFN duty) and various fruit and vegetables subject to MFN minimum import prices but not to the MFN *ad valorem* duty. The most important product groups in category 4 are preparations of vegetables and fruits, and vegetables. Therefore around 70 percent of Turkey’s agricultural exports enter the EU market tariff free and without any other restrictive border measure. Again around 70 percent are subject to preferential conditions. However, high specific duties for almost all "core-products" of the Common Agricultural Policy (CAP) like cereals and cereal products, sugar and sugar products, dairy, meat and live animals and for some other products of importance for Turkey like olive oil still exists.

Turkey's Preferences Granted for Agricultural Products Originating from the EU

Turkey has granted only very few preferences for agricultural imports originating from the EU and most of these preferences are relatively insignificant (FAO, 1997). Significant preferences are limited to fish and other marine animals, some alcoholic beverages and pectic substances. Some more highly processed products are covered by a special import regime for processed agricultural products. These are the so called "Non-Annex II Products". Import tariffs for these products reflect, in addition to the protection granted to the processing industry, the protection granted for the incorporated agricultural raw products. Non-Annex II products are protected by a fixed "industrial" component of the tariff and an “agricultural” component that is charged based on the contents of certain "basic agricultural products" and the (agricultural) tariffs charged on these basic products. Basic products for this purpose are dairy products, cereals and sugar.

The agricultural component charged on trade of Non-Annex II products is exempted from the CU. If preferences are granted for basic agricultural products, these preferences must be taken into account if an agricultural component is calculated to be charged on any Non-Annex II product traded between Turkey and the EU. A second group of processed agricultural products are considered as being industrial products and are therefore fully included in the CU.

Completing the customs union between EU and Turkey so as to cover the agricultural products would imply the abolition of all border measures and the adoption of EU external tariff applied to third countries by the EU. As a result, agricultural prices of products for which border measures still exist would come much closer in the EU and Turkey, with remaining differences due to quality and transportation/marketing costs. But this will also require that agricultural price policy be harmonized between the parties (Sübidey Togan, Ahmet Bayener, and John Nash, p. 6).

6.5.3.3 Adaptation of Turkish Agricultural Sector to Common Agricultural Policy

When we compare the European Union agriculture with the Turkish one, we see significant differences in the fields of productivity, sizes of enterprises in the fields of productivity, organisation of producers, technology usage, animal health and phytosanitary conditions. Therefore, agricultural sector will be the hardest and the most problematic area to be harmonised with the Common Agricultural Policy of the European Union.

One of the committees that will manage the relations between Turkey and the European Union is the “Agricultural and Fisheries Sub-Committee” which carries on necessary studies for the implementation of the national programme for the harmonisation with the Common Agricultural policy. Besides this, a reform and restructuring programme has been prepared both for a great challenge in the Turkish agriculture and to harmonise Turkish agricultural policy with the CAP. This programme contains:

- Direct support system has been initiated and continuing in co-operation with the World Bank. The activities have been continuing for “Farmers Registration System” as well.
- A draft law on Agricultural Producers Union will be enacted by the Parliament soon.

- One of the most substantial problems in Turkish agricultural sector is the small sized and fragmented agricultural holdings. Changes have been realised in the Heritage Law in order to optimise these holdings. Besides, activities for land consolidation are in progress.
- A project for “alternative crops” such as tobacco, hazelnut and sugar beet has been prepared in order to prevent the surplus of supply in production and to avoid unevaluated stocks as well as to increase the production of the imported commodities.
- Draft Agricultural Insurance Law has been prepared, which will protect farmers from natural calamities such as draught, frost, hail and fire.
- Moreover, a new “Soil Law” has been prepared aiming to prevent the wrong and out of target utilisation of the agricultural land.

The agricultural sector has been the subject of Ankara Agreement that established an Association Between the European Economic Community and Turkey (Signed at Ankara, 1 September 1963).

Article 11 of the Agreement covers agriculture and trade in agricultural products:

1. The Association shall likewise extend to agriculture and trade in agricultural products, in accordance with special rules which shall take into account the common agricultural policy of the Community.

2. "Agricultural produces" means the products listed in Annex II to the Treaty establishing the Community, as at present supplemented in accordance with Article 38 (3) of that Treaty.” (Ankara Agreement, available at http://www.mfa.gov.tr).

On January 1st 1996 the Customs Union between the European Union and Turkey came into effect, thereby creating the closest economic and political relationship between the EU and Turkey. Agricultural trade is excluded from the Customs Union. Article 24 of Decision 1/95 lays down the principle that the parties are committed to move towards the free circulation of agricultural products.

The Association Agreement between the Community and Turkey and the Additional Protocol of 1970 set out the fundamental objectives of the Association, which include establishing a customs union in three successive stages. One of the aims of both this Agreement and Decision No 1/95 on implementing the final stage of the customs union is to achieve free movement of agricultural products between the Community and Turkey.

Despite the commitments which it entered into under the Ankara Agreement and the Customs Union Decision with a view to achieving free movement of agricultural products with the Community, Turkey has not achieved this objective and has made little progress towards bringing its agricultural policy into line with the common agricultural policy.
(Accession Partnership: http://europa.eu.int/scadplus/leg/en/lvb/e04113.htm)

At its meeting in Luxembourg in December 1997, the European Council decided that the Accession Partnership would be the key feature of the enhanced pre-accession strategy, mobilising all forms of assistance to the candidate countries within a single framework. The purpose of the Accession Partnership is to set out in a single framework the priority areas for further work identified in the Commission's 2002 Regular Report on the progress made by Turkey towards accession, the financial means available to help Turkey implement these priorities and the conditions which will apply to that assistance. The priorities in the Accession Partnership are divided into two groups - short and medium term. Those under the short term have been selected on the basis that it is realistic to expect that Turkey can fulfil them in 2003/2004. The priorities listed under the medium term are expected to take more than one year to complete although work should be taken forward substantially in 2003/2004.

The priorities in Agriculture are as follows:

SHORT TERM

- Complete the establishment of animal identification systems, which are a key element of the Integrated Administration and Control System. Also begin preparatory work on other elements such as the land parcel identification systems.

- Prepare a strategy for the introduction of the EC rural development policy and the forestry strategy.

- Adopt a veterinary framework law and acquis harmonised secondary legislation; strengthen the human, technical and information resources of the relevant administrative, scientific, testing and inspection bodies; ensure enforcement of legislation; step up animal disease eradication efforts, contingency planning and monitoring capacity.

- Identify sites for the development and operation of an EC-compatible system of Border Inspection Posts with third countries.

- Adopt a programme for transposition of the veterinary and phytosanitary acquis; strengthen the administrative, scientific and technical structures enabling the efficient and effective implementation of the acquis on plant protection, in particular laboratory testing; strengthen inspection arrangements both of the domestic production as imports of plants and plant products, as well as in food-processing establishments.

MEDIUM TERM

- Complete the establishment of the Integrated Administration and Control System.
- Set up the administrative structures required for the implementation of EC rural development policy and the forestry strategy.

- Adopt the legal basis, administrative structures and implementation mechanisms for the establishment of common market organisations and effective monitoring of agricultural markets.

- Submit a plan and timetable for upgrading the system of Border Inspection Posts third countries in line with the acquis.

- Re-organise and strengthen the food safety and control system and upgrade its human, technical and financial resources to ensure that EC food safety standards are complied with.

- Establish an up-grading plan with timetables to modernise food-processing establishments to meet EC hygiene and public health standards, and further establishment of testing and diagnostic facilities
(http://ekutup.dpt.gov.tr/ab/kob/2003i.pdf).

In parallel with the priorities of the Accession Partnership Document, the National Program adopted by the Turkish government on March 19th, 2001 contains the legislative, institutional and administrative reforms and human and budgetary resources, Turkey intends to deploy in the above-mentioned issues.

Meanwhile, the internal efforts of harmonisation are being carried out by the relevant public organisations and institutions through the co-ordination of the Secretariat General for EU Affairs. In order to speed up the harmonisation work on the main issues listed in the National Program, “working groups” are established in the following areas: veterinary issues, phytosanitary issues, food control, land registration, animal identification system, fisheries administrative structures and rural development.

To sum up, Turkey will begin negotiations with European Union on October 3, 2005. Agriculture will be a difficult issue in the negotiations.

CONCLUSION

The Common Agricultural Policy (CAP) was the first and has still been the major common policy in European Union. It has helped EU integration and served as an experimental field for the functioning of a economic as well as political union.

When the Common Agricultural Policy was founded, the major aim was to increase productivity. Starting from 1960s, CAP and its objectives have undergone radical changes. In the future, Common Agricultural Policy will be shaped by trade liberalisation in the world and the last enlargement process in the EU.

In the first years of its foundation, European Union had to take some protective measures to increase agricultural production. Much of the CAP operated through trade distorting measures at that time. As the system created problems inside and outside the EU, new reforms became necessary.

The first reforms after foundation of CAP made little changes. It helped in reducing the budgetary costs of agricultural support policy and balancing the supply and demand of agricultural products.

Recent reforms after GATT Uruguay Round were different, in that, the aims of the reforms would not be driven by only internal problems, but also by external problems. Protectionist support measures were reduced to make CAP more trade friendly and acceptable among EU’s trade partners, and fully compatible with GATT/WTO obligations.

The way the money is spent is different in the last CAP reforms (Agenda 2000 and 2003 CAP reform). The most important objectives of support will be for food safety, care of the environment, animal welfare and rural development in the future.

GATT Uruguay Round Agreement on Agriculture (URAA) was a turning point in CAP history that European Union has tried to reduce trade distorting support measures and shape its reforms towards a more liberal policy regarding its URAA commitments.

European Union is one of the world's biggest open markets to imports of farm products from developing countries. Nevertheless, trade in agricultural products is far from being completely liberalised. Despite Uruguay Round commitments on "domestic support, market access and export subsidies", the developing country market access to European Union markets was restricted. It is because, European Union like other developed countries, benefited greatly from the agreement to use a 1986-90 baseline, when the protectionism was high. It provided extra protection margin in all GATT aspects. So protectionism in European agriculture remained high, although EU carried out all Uruguay Round commitments.

The EU and its trading partners retain many tariff barriers concerning market access. So the agricultural parts of EU Free Trade Agreements (FTAs) contend with the conflict of trade liberalisation on the one hand and national interests to limit market access on the other hand.

The analysis of the different EU Free Trade Agreements (FTAs) shows that the EU excludes important products from the targeted free trade. The EU's domestic protection and support pattern for certain agricultural products can be identified as a key factor determining these exceptions.

Another important issue in the future of Common Agricultural Policy is the enlargement process. The problem is whether enlargement will shift the European agriculture to a more or less liberal direction.

Since the beginning of the 1990s, the new member states' agricultural policies have undergone a major transformation. They made liberal steps in agriculture. EU accession and the GATT Uruguay Round were the most powerful liberalizing forces. In fact, general liberalization over the past decade has been combined with the new countries' step-by-step integration into the EU.

The new member states' agricultural policies became less protectionist than the European Union's. They were successful in binding their GATT/WTO commitments.

As, the new member states apply all the EU bilateral trade agreements, the common external tariff and the EU trade defence measures, there will not be any problem for the third countries. However, the issue seems to be a problem mainly in the area of export subsidies. After enlargement, additional problems could arise where the market situation in the countries is such that larger surpluses can be expected.

In the case of domestic support, both the European Union and the new member states are below their AMS commitments. However, EU was only able to meet its Uruguay Round commitment to reduce domestic support because its direct payments were classified in the blue box. If the blue box were abolished, an enlarged EU could run into difficulty in meeting this commitment. The blue box represents 23% of the total domestic support granted from 1995 to 1998. If the blue box subsidies had been included in the AMS definition in 1995-96, the European Union would have already been dangerously to its AMS commitments; by 10 to 5 percent

As a candidate country, liberalization of trade in agriculture is an important issue in Turkey too. The steps towards membership will provide full liberalization of agricultural trade with European Union.

In the last decade Turkey has become a part of three agreements which were expected to shape the future of the agricultural policy instruments and developments. The first agreement was the Uruguay Round of the GATT which Turkey took part in the negotiations and signed the resulting Agreement in April 1994. The second one was the

Customs Union agreement with the EU in 1995. Lastly, Turkey has signed a stand-by agreement with International Monetary Fund (IMF) in December 1999.

Due to the agreements, Turkey has changed its agricultural support policies. Production-oriented agricultural support was phased out and it was replaced by income support payments. The state procurement activities were decreased together with the privatization of the related state economic enterprises and restructuring of the sales cooperatives. Furthermore, Farmer Transition helps farmers make the transition to alternative activities as the governmental supports are reduced.

With the new support policies, Turkey's agricultural support policy became more harmonized with the European Union's and more compatible with WTO commitments.

Turkey will begin negotiations with European Union on October 3, 2005. Agriculture will be a difficult issue in the negotiations. At this point, no certain claim can be foreseen regarding contribution of each side.

In the future the new member states will take further moves towards trade liberalization within the framework of the WTO. As the European Union stands for free trade in line with its commitments to the WTO and for economic dynamism, enlargement can prove a catalyst in the process of further trade liberalisation.

However, it seems that European agriculture can not survive without protection. In the future, EU can take steps to change the support policy with mostly external forces, i.e. WTO negotiations. But again, CAP would seem more liberal than before, but the level of support can remain the same.

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