

EU enlargement in agriculture and the WTO process

Rozšíření EU v agrárním sektoru a WTO

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Abstract: Inclusion of the countries in Central Europe (CECs) in the Common Agricultural Policy (CAP) of the European Union raises a large number of issues, not the least in the context of the accession negotiations among the current EU member states and the newcomers. However, in the process of enlargement, negotiations will also be necessary with other countries. This is because both the EU and the accession candidates have commitments in the WTO and inclusion of the CECs in the CAP may affect the nature of these commitments, as well as the ability of the enlarged Union to honour them. The paper deals with the fundamental problems in connection with presented themes.

Key words: EU Enlargement, agriculture, Common Agricultural Policy, GATT/WTO, supports

Abstrakt: Začlenění zemí střední Evropy (ZSE) do programu Společné zemědělské politiky (SZP) Evropské unie přináší velké množství složitých otázek v kontextu vyjednávání vstupních podmínek mezi členskými zeměmi EU a kandidátskými zeměmi. V průběhu rozšiřování bude nutné jednat také s dalšími zeměmi. Tato nutnost vyplývá ze závazků jak EU, tak kandidátských zemí vůči Světové obchodní organizaci (WTO) a rozšíření SZP na ZSE může ovlivnit povahu těchto závazků, stejně jako schopnost rozšířené EU se s těmito závazky vyrovnat. Příspěvek pojednává o základních otázkách souvisejících s uvedenou problematikou.

Klíčová slova: rozšíření EU, zemědělství, Společná zemědělská politika, GATT/WTO, podpory

INTRODUCTION

If the enlarged EU found it difficult to live up to the obligations on agriculture which it will have in the WTO, it might have implications for the way in which the CAP can develop in future.

In discussing these issues, one starts best by considering the way in which the current WTO commitments in agriculture (or the commitments that may result from the ongoing negotiations under the Doha Development Agenda) of the EU-15 and the individual accession countries will be merged into one joint set of commitments for the enlarged Union. On this basis, some of the more relevant issues in the three broad areas of rules under the Uruguay Round Agreement on Agriculture (URAA), i.e. market access, export competition and domestic support, can be considered in turn.¹

DEFINING THE WTO COMMITMENTS IN AGRICULTURE OF THE ENLARGED UNION

In terms of WTO law, the European Union is a customs union, as defined in the GATT Article XXIV. This GATT

provision sets the rules to be honoured by customs unions, including the requirement that their formation, and enlargement has to be notified to, and accepted by, the GATT/WTO. It is interesting that the European Economic Community (and hence the customs union under the EU) has never been formally approved by the GATT.² This has not, however, prevented the EU from becoming a member of the newly born WTO, and it is generally considered that the status of the EU as a legal customs union is essentially approved in practice. In any case, as on earlier occasions of the Union enlargement, accession by the CECs to the EU will trigger a WTO process of verifying the consistency of policies in the enlarged Union with the earlier WTO commitments of its constituent parts.

Of particular relevance is the criterion that countries participating in a customs union have to guarantee that their trade barriers vis-à-vis third countries “shall not be higher or more restrictive than the general incidence of duties and regulations of commerce applicable in the constituent territories prior to the formation of such union” (Article XXIV: 5(a)). The “old” GATT was not

¹ In this short paper, only some of the more relevant issues can be discussed. A fuller treatment was provided in an earlier paper (Tangermann 2000).

² See Srinivasan (1996), p. 3; see also WTO (1995), p. 11.

very precise in defining how the “general incidence of duties and regulations [...] prior to the formation” should be measured and compared to the situation after the formation or enlargement of a customs union. The new Understanding on the Interpretation of Article XXIV agreed in the Uruguay Round, however, operationalised one dimension of this criterion by requiring that the import-weighted average of all tariffs applied should not rise. Whether the use of a trade-weighted average of tariffs makes economic sense, can well be questioned, but that is not relevant here.

While the rule regarding tariff average relates to tariffs applied, another requirement is that countries should not, in the process of acceding to a customs union, raise tariffs beyond their bound levels. Where this happens, compensation should be offered to the exporting countries concerned. However, in assessing the need for compensation, “due account shall be taken of the compensation already afforded by the reduction brought about in the corresponding duty of the other constituents of the union” (GATT Art. XXIV: 6). This provision, not much clarified in the WTO Understanding, does not precisely specify that a (weighted) tariff average should be used to assess whether the reductions in some countries outweigh the increases in others, but in practice the assessment may come close to this. Where it is found that reductions in some of the new member countries are not sufficient to maintain the average level of tariffs, the customs union is expected to offer compensation on other tariff lines.

While these rules provide guidance on how to look at tariffs of an enlarged customs union, neither the “old” GATT Article XXIV nor the WTO Understanding on the Interpretation of Article XXIV contain provisions for how to deal with the new types of commitment established under the URAA, such as minimum and current access, domestic support and export subsidies. It is not necessarily clear how rules that were essentially designed for dealing with tariffs can be applied to these other commitments, and different potential options come to mind. However, there is the precedent of the EU Northern enlargement in 1995. In that case, the domestic support commitments of the constituent members of the enlarged customs union were simply aggregated, and the minimum/current access commitments and those regarding export subsidies were also added up, though bilateral trade between the original EU and the new member countries were netted out.³ It appears likely that the same procedures will also be applied in the WTO when it comes to Eastern enlargement.

How precisely the commitments of the individual constituents of a new or enlarged customs union are compared and aggregated is, to some extent, a matter of negotiation. Such negotiations usually take place after the formation or enlargement of the customs union, in the

framework of a Working Party established in the WTO for that purpose. It is for that Working Party to make first judgements on whether all the relevant GATT/WTO rules are respected.

Assuming that these WTO rules and procedures define reasonably well how the commitments in agriculture of the enlarged Union will look like, the central question then is whether inclusion of the accession candidates in the CAP, as it may look like at the time when enlargement takes place, will be consistent with these commitments. Where it appears that this may not be the case, two options exist. Either the CAP is adjusted prior to enlargement or in the process of negotiating the enlargement of the customs union in the WTO; or the enlarged Union offers compensation to the third countries affected. Such compensation could in principle come in many different forms. However, again based on experience gained during the Northern enlargement, the most typical solution is to offer tariff-reduced access to the EU market, in the form of country-specific tariff rate quotas, to the exporting third countries negatively affected. However, this option may only work (and did during the Northern enlargement) where access conditions deteriorate. It is more difficult to see how it could be applied to any potential difficulties in the areas of export subsidies and domestic support. It may therefore be safer to assume that in these two areas, compensation is less of an option than policy adjustment in the EU.

MARKET ACCESS

In the area of market access, the central issue is the harmonization of tariffs among the EU-15 and the accession countries. Under the EU practice of requiring accession countries to accept the *acquis communautaire*, tariff harmonization in the process of EU enlargement is not done by setting tariffs at the average of tariffs in the EU-15 and those in the accession countries, but that the accession countries have to adopt the tariffs applied in the EU at the time. In some cases this may lead to tariff increases, in other to tariff reductions in the newcomer countries. Given the GATT/WTO requirement that the (trade weighted) average of tariffs should not rise in the process of enlarging a customs union, it is a matter of calculating, for each individual tariff line, the outcome of all these tariff changes. In order to get a first impression of what may be the outcome of this, it is useful to take a look at comparative tariff levels in the EU-15 and the accession countries for major agricultural products. When doing this, an issue is whether it should be tariffs applied or tariff bindings which are used for this purpose. Under the WTO rules, it is clear that the before-after comparison of tariffs has to be done on the basis of tariffs applied. However, in the EU-15, there is hardly any

³ One can assume that the netting out of past bilateral trade will be happily accepted by the members of an enlarged customs union when dealing with tariff rate quotas, while in the case of export subsidy commitments the interest may be in an unadjusted sum of commitments. However, in the case of Northern enlargement, the netting out of bilateral trade flows was done symmetrically.

difference between bindings and tariffs applied in the area of agricultural products, and the same tends to hold increasingly true for the CECs. Hence a comparison of tariff bindings between the EU-15 and the CECs is a reasonable approach for this purpose.

When looking at tariff bindings for agricultural products in the CECs, it is immediately clear that they differ significantly from country to country. Where these bindings originated in the Uruguay Round, this reflects the specific treatment that the CECs were granted when it came to tariffication in the Uruguay Round.⁴ Industrialized market economies were expected to base the conversion of their past non-tariff barriers into bound tariffs on tariff equivalents, to be calculated from the gap between domestic and world prices during the base period. The CECs, however, were allowed to adopt tariff bindings essentially unrelated to base period conditions. In this regard, their treatment was similar to that of developing countries which could offer “ceiling bindings”, i.e. tariffs unrelated to past policies. The individual CECs have dealt rather differently with this option. Consider, as examples, two countries in Central Europe, Hungary and Poland.

Hungary generally bound ad valorem tariffs, at a level significantly above that applied at the time (see Tangermann 2000). For a large set of products, Hungary committed itself to reducing these tariffs during the six year

implementation period of the Agreement, by the 36 per cent required as the average rate of tariff reduction. Poland, on the other hand, bound its tariffs very much in line with those established by the EU. More specifically, for many core products, Poland bound ad valorem duties, limited to a maximum or minimum specific duty as the case may be, such that this specific duty is largely equivalent to that bound by the EC. Indeed, Poland made use of the option to bind specific duties in a foreign currency, in this case in ECU. As in Hungary, the bound tariffs were generally significantly above tariff rates applied at the time (i.e. in 1994). Not only were Poland’s bound rates set similar to those of the EU, rates of reduction over the implementation period followed those of the EU as well, i.e. in most cases 36 per cent, though for the more “sensitive” products, reduction rates were no more (but also no less) than 20 per cent, as in the EU.

The result of these highly variable approaches to setting tariffs is not only that there is a considerable divergence of tariffs between the individual CECs, but also that in some CECs and for some products, the tariffs bound in agriculture are significantly below the respective tariff bindings in the EU (see Figure 1). On accession to the Union, when tariff harmonization takes place, there may be a relatively large number of cases in which the tariff for a given product after enlargement (which will be

EU tariff bindings 2000 = 100

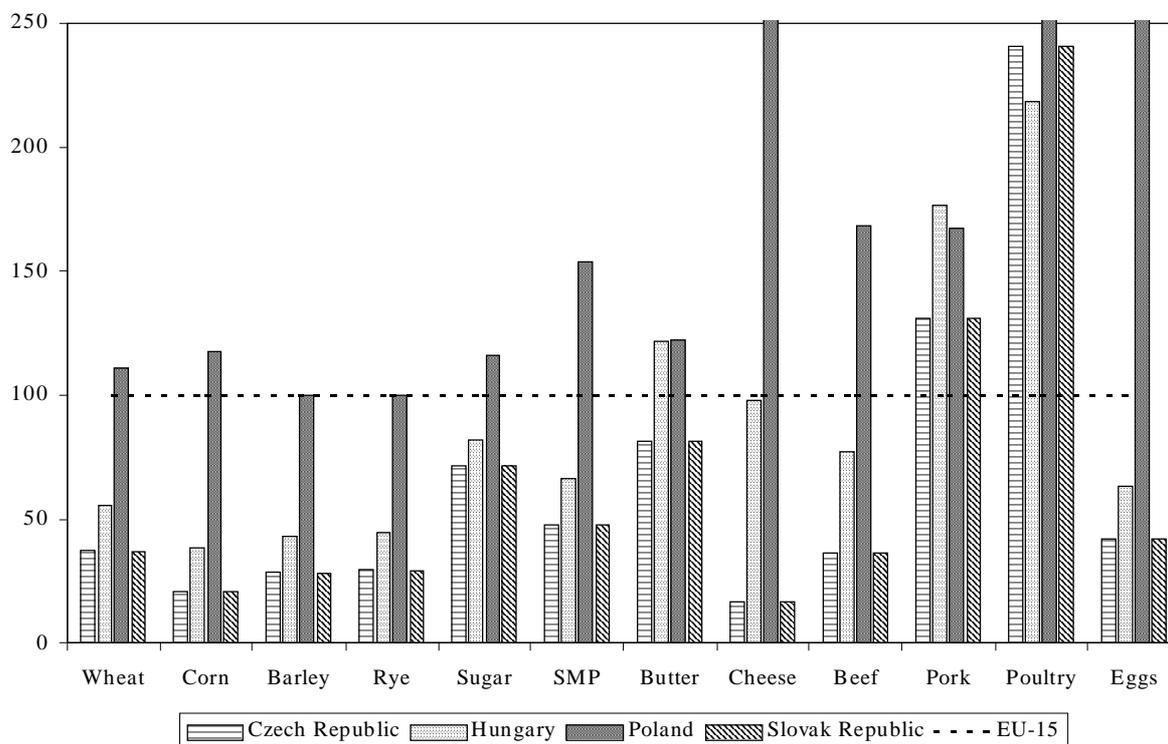


Figure 1. Final tariff bindings of selected CEC relative to tariff bindings in the EU (EU bindings = 100)

Sources: Twesten (1998) and sources given there

⁴ Some countries in Central Europe were already GATT members when the URAA was negotiated (Czech Republic, Hungary, Poland, Romania, Slovak Republic). These countries have accepted Schedules of quantitative policy commitments during the Uruguay Round, like all other founding Members of the WTO.

the EU-15 tariff) will be considerably higher than the average of tariff rates for the EU-15 and the CECs. In all these cases, the enlarged Union may have to engage in negotiations with exporting countries, and may be expected to provide compensation. In some cases, such compensation could possibly come in the form of lower post-enlargement tariff averages for other products of export interest to the third country concerned, but these cases may not be frequent. It will, therefore, be more likely that the exporting countries may ask the EU to provide reduced-tariff quotas for the same product for which the average tariff was increased during enlargement.

EXPORT COMPETITION

The new commitments on export subsidies agreed in the Uruguay Round have often been considered to be the most constraining element of the URAA for some countries, in particular the EU. At the same time, the EU

is the entity that holds the single largest “rights” to agricultural export subsidies in the WTO, and actually grants around 90 per cent of all agricultural export subsidies notified to the WTO in recent years (Tangermann 2002). It is for these reasons above all that the continued compliance by the EU with its export subsidy commitments after enlargement is likely to be watched with particular attention by the EU’s trading partners.

The extent to which the WTO constraints on export subsidies may be an issue for the EU is obvious when one compares the EU’s subsidised exports with its final commitments on export subsidisation, i.e. the commitments applicable in 2000/01 and the following years. This comparison is irrelevant in legal terms, as subsidised exports in the years before 2000/01 were of course not subject to the (lower) constraints for the final year. However, for an assessment of the scope of the EU’s agricultural policies this comparison is useful, as any consistent excess of past subsidised exports over the final commitments may signal a potential need for policy adjustment.

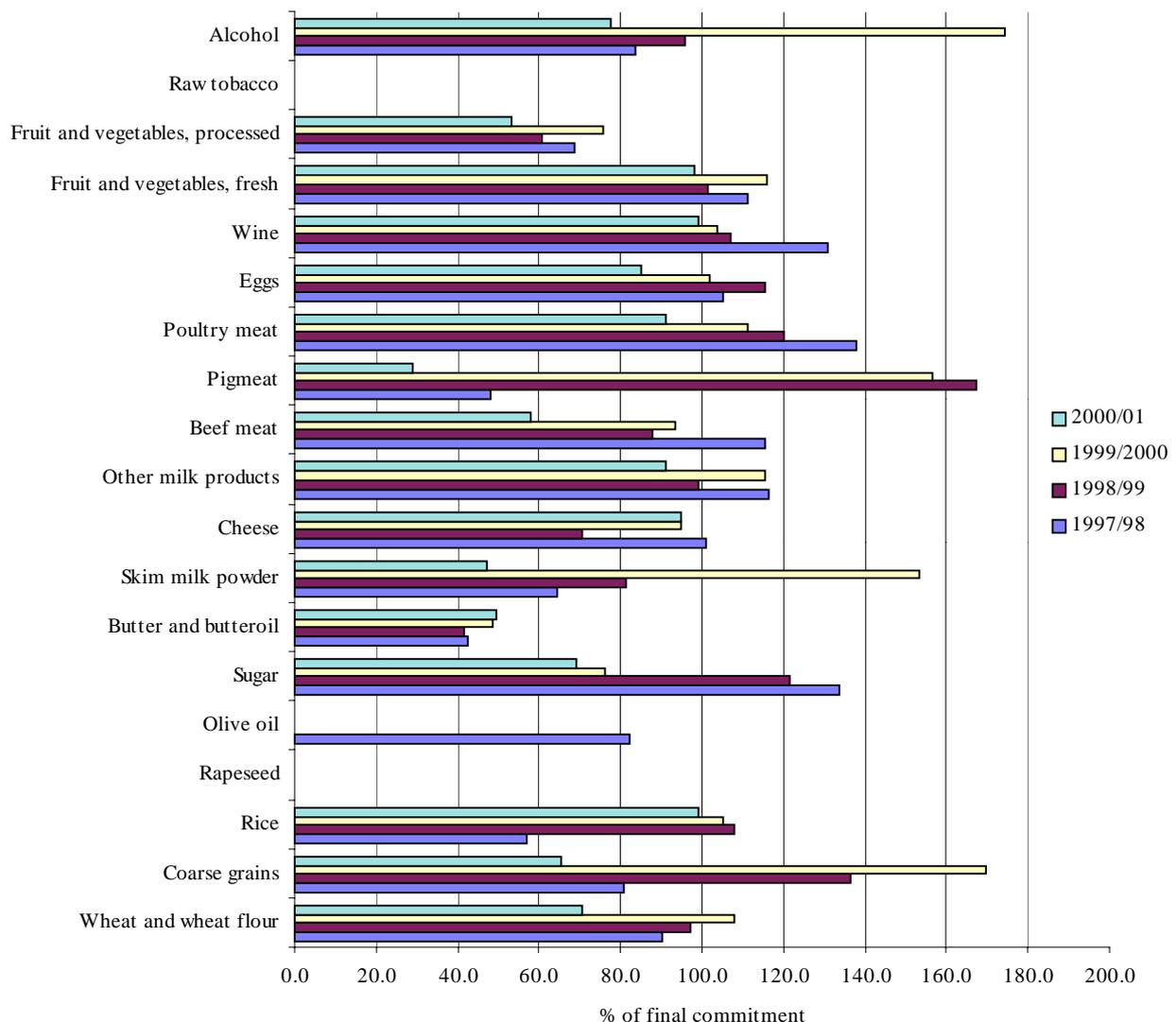


Figure 2. EU export subsidies: Utilization of final commitments, quantities

Source: EU notifications to the WTO

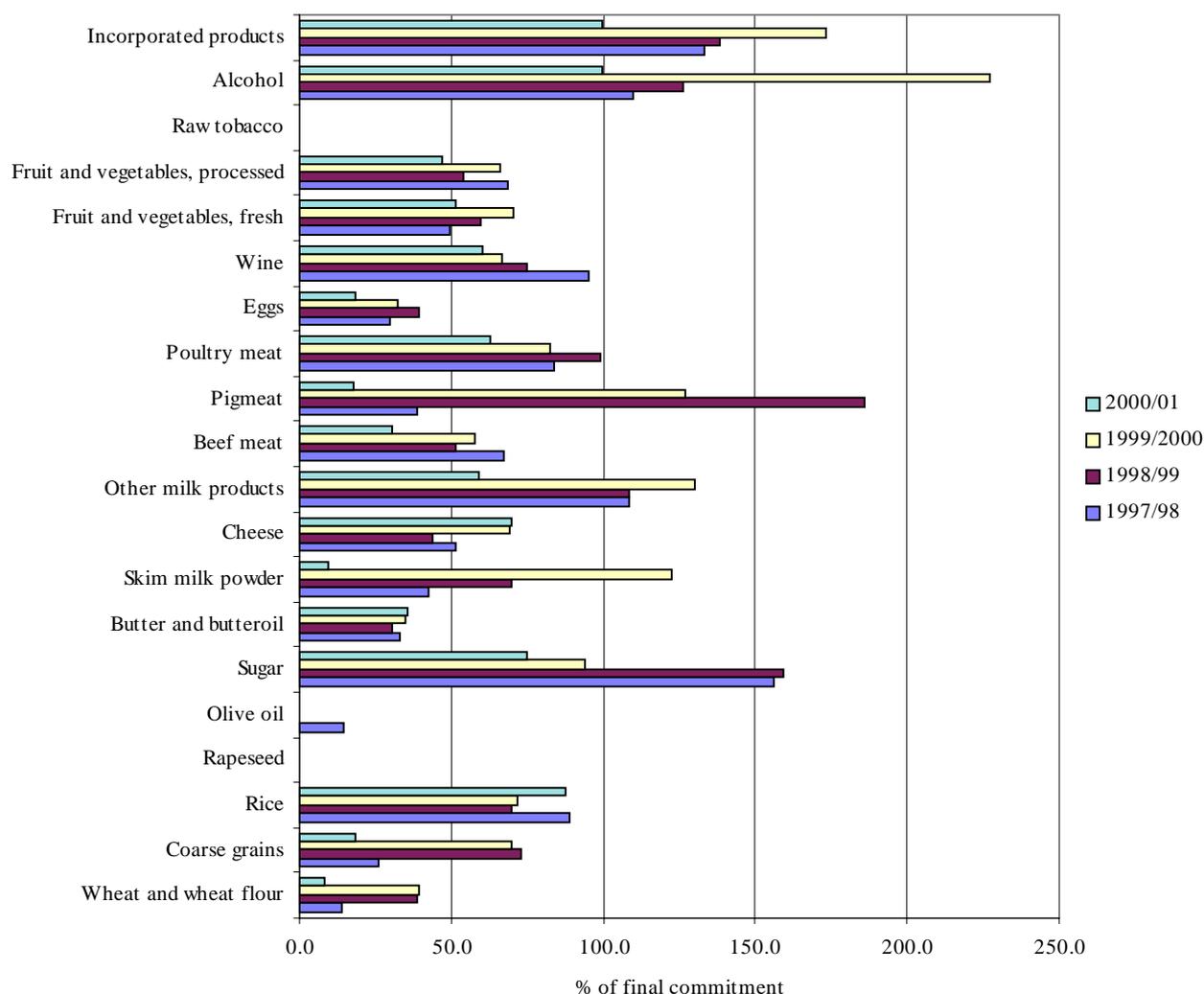


Figure 3. EU export subsidies: Utilization of final commitments, Outlay

Source: EU notifications to the WTO

As shown in Figure 2, there are several products for which the quantities of the EU subsidised exports were above the final commitment in some of the most recent years (though of course not in 2000/01). This tendency was particularly pronounced for coarse grains, “other milk products”, pork and poultry meat, wine and processed fruit/vegetables. As far as outlays on export subsidies are concerned, Figure 3 shows sugar, pork, alcohol and processed foods (“incorporated products”) which were cases in point.

After enlargement, additional problems could arise where the market situation in the accession countries is such that larger surpluses can be expected. On the other hand, the new member countries also bring scope for larger subsidised exports, where they have non-zero commitments on export subsidies in the WTO. The extent to which this may ease or aggravate the situation in the EU can be assessed only on the basis of a detailed product-by-product analysis, including the expected effect of inclusion in the CAP on the future market balance in the CECs. Such an analysis is beyond the scope of this paper.

However, some rough impressions can already be gained by taking a look at the way in which the CECs have structured their export subsidy commitments. Some CECs had a tendency to bind rather high export subsidies, based on the argument that they had granted ample subsidies during the base period. For example, the Czech and Slovak Republics submitted export subsidy data suggesting that their outlays amounted to some 77 per cent of actual export value during the base period, while the comparable percentage for the EU was no more than around 30 per cent. Poland, too, suggested large export subsidies during the base period, amounting to about 58 per cent of 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 per cent of export value (see Table 1).

Moreover, the product composition of the export subsidy commitments in CECs differs markedly from that in the EU. In Figure 4, the aggregate of the final quantity commitments of the EU-15 and those CECs that have non-zero commitments on export subsidies are shown as a

Table 1. CEC agricultural export subsidies in the URAA base period (1986–1990) relative to exports and agricultural output

Country	Export subsidy outlay mill. US \$	Agricultural exports mill. US \$	Agricultural output mill. US \$	Exports/ output (%)	Exp. subsidy outlay/ exports (%)	output (%)
European Union	11 282.52	36 460.00	148 629.31	24.5	30.9	7.6
Czech Republic	346.31	669.24*	5 416.20	n.a.	77.2*	6.4
Poland	783.60	1 345.52	7 141.61	18.8	58.2	11.0
Hungary	421.29	1 670.91	4 687.00	35.7	25.2	9.0

Source: Twesten (1998) and sources given there

Notes: * Aggregate for Czech and Slovak Republics

percentage of the commitments of the EU-15.⁵ The graph therefore shows the extent to which commitments in the enlarged EU are likely to exceed those of the EU-15 if the same approach to establishing these commitments after enlargement is adopted in the WTO as was done in the

case of Northern enlargement, except for the netting-out of bilateral trade between the EU-15 and CECs, which has not been done for this rough analysis. As can be seen, the CECs bring considerable scope for export subsidisation in some products for which the EU has already ex-

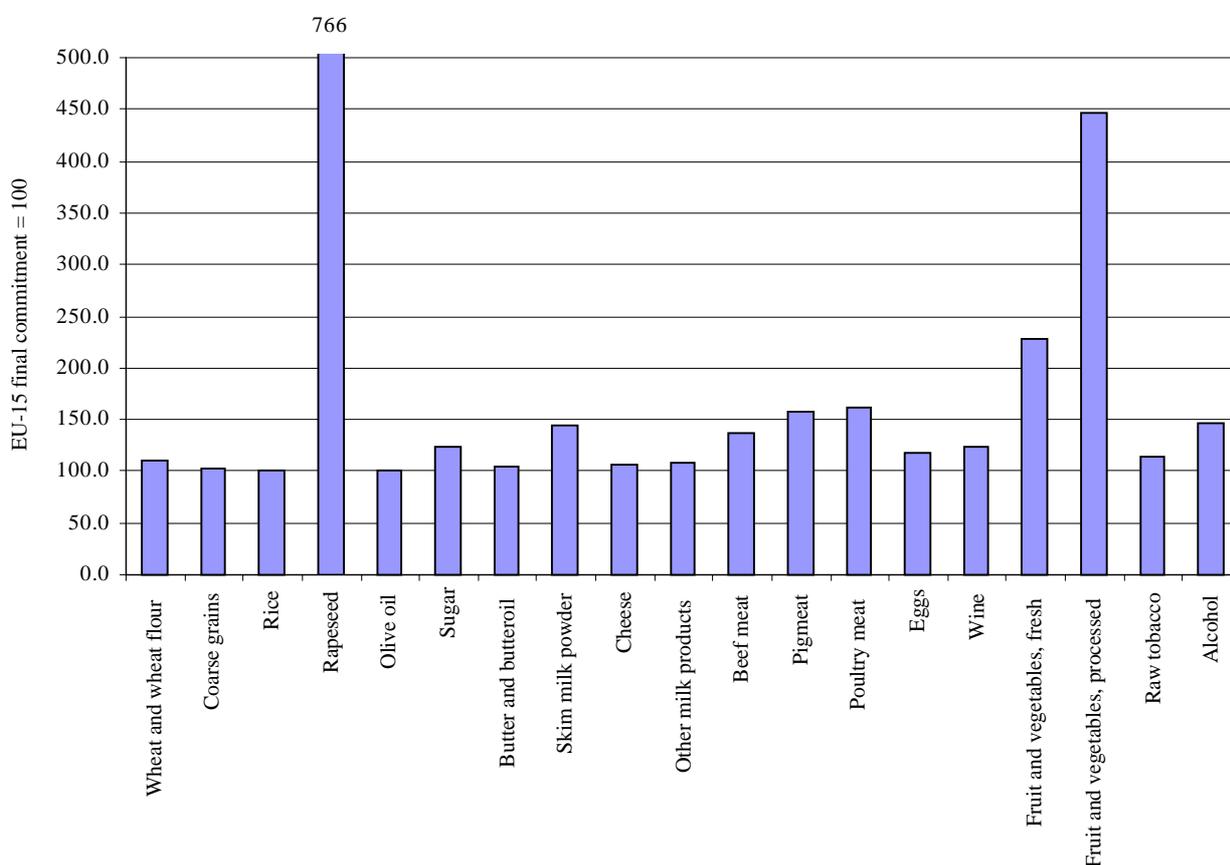


Figure 4. Export subsidy commitments: Aggregate of EU-15 and CEC commitments on quantities, in per cent of EU-15 final commitments

Source: WTO Schedules of the EU and the CEC. Note: The CEC included are those with non-zero export subsidy commitments, i.e. Bulgaria, Czech Republic, Hungary, Poland, Romania and Slovak Republic

⁵ The commodity definition of the export subsidy commitments in some CEC differs from that of the EU, and it is therefore not completely clear how the aggregation of their commitments with those of the EU will be done in the WTO. For example, in some cases poultry meat and eggs are in the same category in individual CECs, while the EU has separate commitments for poultry meat and eggs. For the aggregation shown in Figure 4, the respective commitments for the CECs have been somewhat arbitrarily split up into the EU categories. On the other hand, some CECs exhibit more disaggregated product categories, which have been added up here to be aggregated with the respective commitments of the EU.

hibited a high degree of utilization of its final commitments in the past, e.g. pork, poultry meat and processed fruit/vegetables.

Of course the extent to which the export subsidy commitments of an enlarged EU may turn out to be binding will also depend on the future of the CAP. For example, in its proposals for the mid-term review of the CAP, the European Commission has suggested that the intervention price for cereals should be reduced by another five per cent, and that intervention for rye should be eliminated. This improves the prospects for the EU cereal prices to be in line with world market prices, and hence may make it possible for the EU to export cereals without export subsidies in the future. After all, even with the current EU intervention prices there is a good chance that the EU can export, in coming years, considerable quantities of cereals without export subsidies (OECD 2002). At the same time, the lower cereal prices are in the EU, the better the chances are that larger shares of cereal-based livestock products, i.e. pigmeat, poultry meat and eggs, can also be exported without export subsidies.

DOMESTIC SUPPORT

Finally, the commitments regarding domestic support are more difficult to assess, not least because of the very specific way in which the aggregate level of support is calculated for WTO purposes. In this area, too, the individual CECs have adopted widely differing approaches when setting their commitments. Particularly interesting is the case of Poland, which started by calculating the percentage share of the Aggregate Measure of Support (AMS) in production values for each product category in the 1986–90 base period. A hypothetical AMS for each product in 1992 was then estimated by applying its 1986–90 AMS share to the actual 1992 value of production. The

sum for all products was then converted into US dollars, and was used as the base for AMS bindings during the implementation period, where commitments are specified in US dollars as well. By using a foreign currency to specify the commitment, the erosion effect which future Zloty inflation might otherwise have had, was avoided. Slovenia, too, has specified its domestic support commitments in foreign currency (i.e. ECU). The remaining CECs, on the other hand, bound their domestic support in domestic currencies.

In the past, the EU has not had any problems meeting its commitments on domestic support. As shown in Figure 5, this is largely due to the fact that a significant share of its domestic support could be notified under the blue box. Moreover, the EU has also made ample use of the green box.

Some CECs have used their domestic support commitments to an even smaller extent, as shown in Figure 6. On the other hand, in some years Slovenia has already come close to its commitment level. In 1998, Hungary had a current AMS far above its commitment, but proposed that this should be seen in the context of the URAA provision regarding “the influence of excessive rates of inflation” (URAA, Article 18:4).

Assuming again that the commitment of the enlarged EU will be established by adding up the domestic support commitments of the EU-15 with those of the CECs, it is interesting to look at the extent to which the aggregate of the EU-15 and CECs have utilised their collective commitments in the past. This is shown in Figure 7 (although only selected CECs are included in the analysis). On this basis, it appears that there was still some slack in the aggregate domestic support commitment. However, this impression is not really conclusive, as in the past CECs could not, of course, apply the full arsenal of policy instruments under the CAP.

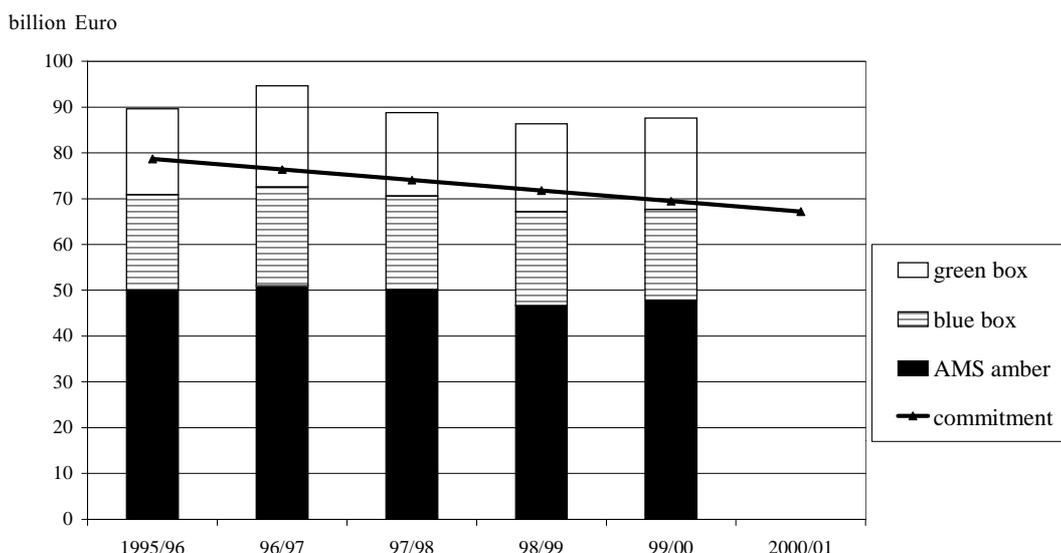


Figure 5. Domestic support and WTO commitment: EU-15

Sources: EU notification to the WTO

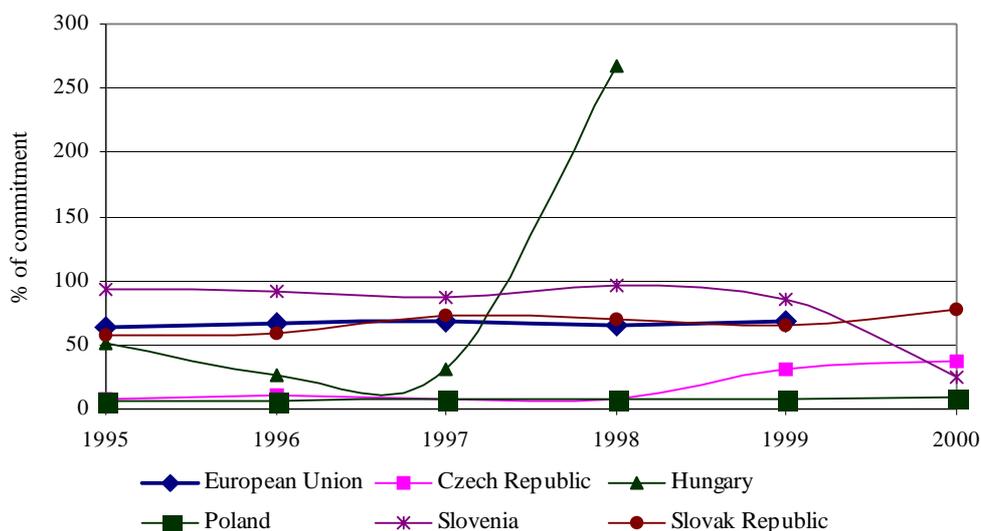


Figure 6. Utilization of Domestic Support Commitment: EU-15 and Selected CECs

Sources: Country notifications to the WTO

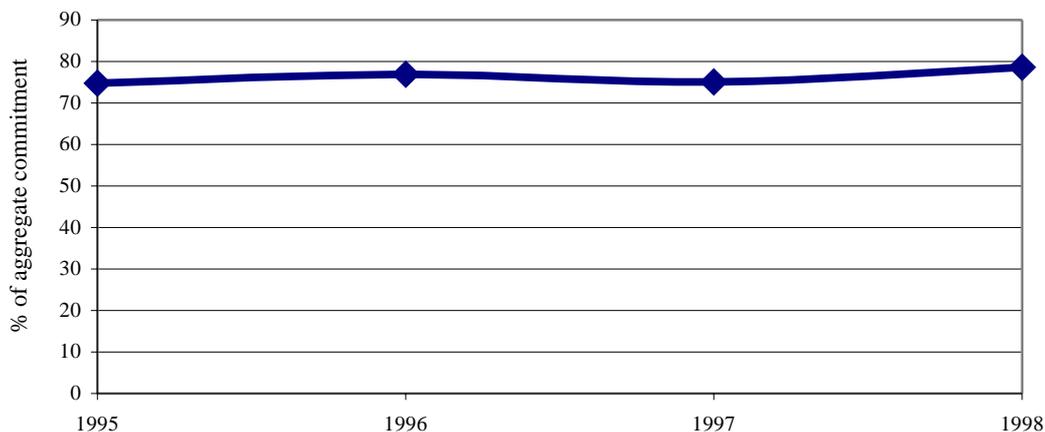


Figure 7. Utilization of Domestic Support Commitment: Aggregate of EU-15 and Selected CECs

Sources: Country notifications to the WTO

Note: CEC included are Czech Republic, Hungary, Poland, Slovenia, Slovak Republic and Estonia

On the other hand, in this case it will be particularly important to consider the way in which the CAP will be applied to the accession countries, above all regarding the extension of the direct payments under the CAP to the new member countries. Moreover, it will be decisive how the CAP may change in the future, and how this may interact with the ongoing WTO negotiations on agriculture under the Doha Development Agenda. In its proposals for the mid-term review of the CAP, the European Commission has suggested that (nearly) all direct payments should be fully decoupled from production. This may open up the possibility of placing these payments in the green box, and could therefore potentially guard against any re-definition of the blue box in the WTO negotiations. If this were the case, it may well turn out that the enlarged EU might not face major difficulties in meeting future commitments on domestic support.

CONCLUSIONS

Based on this rough analysis, it appears that the enlargement of the EU may not face major difficulties when it comes to meeting the WTO commitments on agriculture in the areas of domestic support and export subsidies, although in the latter case some individual product categories (e.g. processed foods) may require attention. On the other hand, harmonization of tariffs in the new member countries with those in the EU may cause some concern, as tariff bindings on certain products in some of the CECs are significantly below those of the EU. In these cases, the EU's trading partners with export interests in the products concerned are likely to expect compensation, to be negotiated with the EU. Based on the experience gained in the process of Northern enlargement, the EU may be expected to open up extra quotas

for market access at reduced tariffs. It will be interesting to see how this may affect market balance in the EU for the products concerned, and whether this could exert additional pressure for adjustments to the CAP in these product sectors.

Another interesting issue will be the way in which the timing of such compensation negotiations may be scheduled in relation to the ongoing WTO negotiations on agriculture. Moreover, the general outcome of these negotiations under the Doha Development Agenda may set new parameters for the future of the CAP, at a time when the first countries from Central Europe may already have joined the EU. All this will also be affected by the outcome of the decision process on the mid-term review of the CAP. The complexity of the interplay between these different processes is considerable, and the countries involved, as well as analysts, will follow these developments with much interest.

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