The Impact of EFTA Accession

Introduction

On January 1, 1995, the European Union (EU) was enlarged to include Austria, Finland, and Sweden, formerly members of the European Free Trade Association (EFTA). The governments of these countries successfully negotiated with the EU the terms of membership, and their electorates had given their approval in national referenda. A fourth EFTA country, Norway, also negotiated the terms of accession for membership, as it had in 1972 when the United Kingdom, Denmark, and Ireland joined, but the voters once again rejected the proposed accession.

This section discusses the impact of the enlargement to include the three new member states, describes the importance of agriculture in these countries, details the issues faced in the negotiations and their resolution, indicates the implications for agriculture of the accession of three countries, and discusses possible options for two of the members of EFTA, Norway and Switzerland, that have not yet joined the EU.

The EFTA and Agricultural Trade

In July 1956, at a time of intensive negotiations on the future trade relations in post-war Europe, the UK suggested the formation of a free-trade area (FTA) for all the countries of Western Europe. The FTA would have included the six eventual founding members of the European Economic Community, France, Italy, Belgium, West Germany, the Netherlands, and Luxembourg, known as the Six. The Six were not convinced that a mere free-trade area would be satisfactory; such an area did not hold out the promise of the closer political relationships that they sought, particularly between France and West Germany. Moreover, the six distrusted the UK's insistence that such an FTA exclude agriculture (to preserve the benefits of Commonwealth Preferences for their overseas suppliers) and they continued the negotiations that lead to the Rome Treaty.[11]

Several other countries, including Greece, Turkey, and Iceland, were also wary of the notion of a free trade area. But the UK and six other countries, Norway, Austria, Switzerland, Sweden, Portugal, and Denmark (the Outer Seven), pursued the FTA option, leading to the signing of the Stockholm Treaty of 1960 and the formation of the European Free Trade Association (EFTA).

The Stockholm Treaty was heavily influenced by contemporary British trade policy. To avoid any threat to imports of agricultural products from the Commonwealth, the British government argued for the exclusion of these products from the Agreement. The Stockholm Treaty therefore contained an explicit statement that the trade liberalization provisions would not apply to agriculture and to fisheries (Articles 21 and 26). Though the original reasons for this exclusion are no longer relevant, the legacy still remains; EFTA was always an incomplete free-trade area because it omitted these two important sectors of the economy.

Yet some bilateral arrangements made between Denmark and the rest of the EFTA facilitate the export of farm products. The UK also agreed to allow some imports of fish products from EFTA partners, subject to minimum-import prices, in the late 1960's. Some duties on agricultural products were bound in 1966 and market access improved in 1971, but EFTA was never willing or able to tackle the agricultural anomaly.

The result of this hands-off treatment of agriculture was the development of a series of national markets in the EFTA countries behind high border protection and extensive price supports. Trade among the Nordic countries in agricultural products has been lower than might be expected, given their common borders and cultural ties.[12] Trade between these national markets and the former European Community (EC) countries has also been much less than the logic of relative factor endowments would suggest. This situation is likely to change markedly by membership in the EU.

[11] For a discussion of this period see Michael Tracy, *Government and Agriculture in Western Europe, 1880-1988*, Harvester Wheatsheaf, 1990.

[12] Austria and Switzerland, however, both have longer borders with Italy and Germany than with each other. Agricultural trade between Austria and Switzerland is not and may never be extensive.

The decision to exclude agricultural goods was made at the time when a series of bilateral trade pacts developed among the EFTA countries and the EC, following the movement of the UK and Denmark from EFTA to the EC in 1973. Given former EFTA members' reluctance to re-erect trade barriers among former EFTA members, negotiations for a free trade agreement between the former EFTA partners and the EC looked probable, but in agriculture and fisheries the issue did not arise. No new barriers were erected on farm products as no preferences were eroded. Swiss farm exports, for example, were not allowed free access into the UK market under EFTA rules, so they suffered no loss with UK accession to the EC. It was the UK's Commonwealth Preference system, rather than EFTA preferences, that had to adjust most in the area of agricultural trade when the UK joined the EC.

Whether the EC-EFTA bilaterals could have included agriculture is uncertain. The EC had by that time developed the Common Agricultural Policy, which coupled trade liberalization within the EC with a restrictive system for controlling third-country imports. The protectionist face of the CAP toward third countries was not the main problem. Austria, Sweden, Norway, Switzerland, Finland (made a full EFTA member in 1969), Iceland (which joined in 1970), and Portugal all had restrictive regimes for farm trade. The difficult issue would have been trade within the EC-EFTA bloc, rather than with third countries.

EFTA countries could hardly have been expected to have adopted the CAP; the loss of control of rural policy, seen as crucial to national security and social policy in several of these countries, was too much to expect of nonmembers. The full set of regulations governing agricultural marketing, together with a sharing of the financial burden and the need to harmonize prices, would have been too much to impose on the EFTA countries. But without some fairly extensive revision of EFTA policies in this area, intra-European free trade in farm products would have been out of the question.

The ambitious plans laid in 1985 by the EC to "complete the domestic market by the end of 1992" posed a problem for EFTA. The economic case for being inside this large internal market was compelling, yet the political difficulties of membership, in particular the issue of neutrality and the opposition of the Soviet Union, argued for staying outside. As a response to this dilemma the EC developed the notion of a European Economic Area (EEA) which would include both the EC and EFTA, where trade in goods and services could be free and where factors could move without restriction. The talks aimed at establishing an EEA took the same approach on agriculture as in the earlier bilaterals. Rather than open up the question of trade in agricultural products, both the EC and EFTA agreed that it be left off the table. This decision was questioned by Spain, which would have gained from better access into the affluent nations of EFTA for Mediterranean products. But rather than open up the whole "can of worms," participating countries decided to avoid the issue.

Agriculture was, as a result, among the very few sectors that were not already closely integrated between EC and EFTA.[13] A series of preferential quotas was included in the EEA, which only served to highlight the current fragmented nature of the market for many agricultural goods in EFTA.[14] Agriculture plays a small and diminishing part in the EFTA economies. It was politically easy, and feasible from an administrative perspective, to rule all farm trade beyond the scope of the free trade provisions of the EEA.[15]

The long-term economic viability of such a decision was always in doubt. As the impact of integration began to be felt, many imagined potential anomalies that could have called the decision into question. These problems were likely to arise most clearly through developments in the European food industry. Unlike the small size of the farm sector, the food industry of the EFTA countries is one of the largest in the European economy. This industry is undergoing a

[13] Fisheries is another sector where EFTA-EC trade is not subject to common rules.

[14] The quotas allowed limited tariff-free access to a number of fruits and vegetables along with some cheese, processed meats and cut flowers. See USDA/ERS, *Western Europe Agriculture and Trade Report 1992*, p. 82, for details.

[15] This did, however, compromise the position of EFTA and the EEA within the GATT. Article XXIV of GATT states that a free trade area must cover essentially all trade.

process of rapid adjustment, including internal structural change, and closer integration among countries, leading the food industry to increase pressure for the removal of anomalies that prevent these firms from seeking the cheapest source of supply for raw materials in a competitive European food market.[16]

Negotiations for Membership

Whether or not the EEA was a satisfactory solution to the fragmentation of the European agricultural market was never tested. Events in the late 1980's and early 1990's overtook the EEA, as first Austria and then Finland and Sweden announced their intention to apply for membership in the EC, encouraged in particular by the fall of the Berlin Wall and by the weakening of the longstanding neutrality argument against membership. Norway soon followed, leaving the EEA an empty shell.[17] Membership negotiations started in February 1993 with Austria, Finland, and Sweden, and with Norway just 2 months later.

The key principle of any EC enlargement negotiation has been that new members accept the "acquis communautaire," the body of agreed EC law and practice, and that the Community make such changes in the wording of legislation that will incorporate the new members without altering the policy. In practice this principle is breached in two respects:

1) the application of detailed regulations to new members does require fresh interpretation and policy decisions, and
2) the new members bring with them political constraints that must be recognized for the negotiations to succeed.

The first step in the process of enlargement (following an application) is an opinion ("avis") from the Commission that attempts to highlight potential problems for Community policy (and by implication for the applicant). In the cases of Austria, Sweden, Finland, and Norway, the Commission's "avis" was encouraging.[18] The negotiations for entry began with an examination of the "acquis" to highlight those parts of the legislation where change was needed. In this process, the applicants also noted those aspects of the legislation that might prove difficult for their own political process. These latter points were the basis for more detailed negotiations, starting in the summer of 1993. The content of this list of reservations largely determined the ease with which the negotiations were to be completed.

In principle, each application for membership leads to a negotiation between the Commission (on behalf of the Community) and the individual applicant country. In practice, many of the issues are common to each applicant, and there were significant cross-linkages among the different sets of negotiations. This was particularly true for applicants with agricultural issues in the remote and mountainous regions.

Negotiations were concluded in March 1994 and the Accession Treaties were signed in June. In each of the applicant countries, the decision as to whether to accept the negotiated terms was put to a referendum. Agriculture played a major role in the debate on membership in each applicant.

In general, farm groups were strongly opposed in Norway and less adamantly against membership in Finland and Austria. Only Swedish farmers, who had seen supports decline prior to accession, could see any merit in joining the EU, though even there sentiment was mixed. Austrian voters gave EU accession a clear endorsement in June 1994 by a 67-percent majority. This was followed in the fall of 1994 by positive though not overwhelming votes in Finland (57 percent in favor) and Sweden (52 percent in favor) and a fairly narrow negative decision (52 percent against) by the voters in Norway. The agricultural issue was indeed one of the major reasons why Norwegian voters rejected membership, with heavy majorities against the EU in rural areas, in particular in the north.

[16] Under both EFTA and EEA rules, protection is allowed for the agricultural component of processed agricultural goods where the costs differ between countries. This tends to reinforce the isolation of national food firms.

[17] The EEA is now comprised of the EU, Norway, Iceland, and Liechtenstein.

[18] As an example of a negative "avis," the Commission reported on the Turkish application in much more guarded tones and recommended against the start of accession talks.

The speed of the negotiations for EU accession by four of the EFTA countries was possible largely because of the existence of a set of free-trade agreements between those countries and the EC. In most areas of commercial policy, including services, the EEA already obliged the EFTA countries to line up with the EC. Thus the main economic advantage of membership for the EFTA countries was to gain a voice, as full members, in setting rules and regulations for the commercial market in which they were already players.

Agriculture in the EFTA Countries

Agriculture in the EFTA countries operates under conditions notably less favorable than in the much of the rest of the EU. In the Nordic countries, short growing periods lead to low crop yields, and livestock has to be housed inside for much of the year. Transport costs are high, both for inputs purchased by farmers and for products sold on the market. The terrain is often difficult, the size of the local market usually small, and the structure of production (except in southern Sweden) is not conducive to scale economies. In the Alpine areas, altitude and slope combine to make mechanized farming difficult, though the influx of tourists provides a buoyant local market. Some of the main features of the agriculture of these countries are shown in tables 7-9.

The different issues which kept agriculture to the forefront of the negotiations in each country are introduced below.

Austria

Austria, the first EFTA country to apply for membership in the EU, has extensive trade ties with the Union, and rather few trade links with other EFTA countries. Politically and culturally it feels itself to be a part of Western Europe, albeit sharing with its eastern neighbors the experience of Soviet occupation after the war. Austria is a relatively small and affluent country, with a population of 7.8 million and an average income of 22,000 ECU's per head (compared to the EU average of 18,000 ECU's).

Assimilation into the broader EU will pose few problems for Austria. Among the main issues in the membership debate were the fragile Alpine environment, the ability of the Austrian government to continue to pay direct subsidies to small farmers, the competitiveness of the Austrian food processing industry, and the widespread concern about uncontrolled growth of traffic across the mountain passes.

Agriculture in Austria is not a major industry, but is deemed vulnerable to competition from abroad and vital to the health of the tourist sector in the Alpine areas. The farm sector employs about 6 percent of the labor force, but generates only 3 percent of GDP. Protection has come both in the form of price supports, maintained by border controls, and through closely regulated domestic marketing, favoring small local firms and cooperatives. Under the Austrian model of economic policy, the government and farm organizations work closely together to ensure employment in rural areas and to support incomes, resulting in a sector not well structured to face direct competition.

Table 7—Population, GDP, and shares of agriculture in EFTA applicants for EU membership

Country	Population	Agricultural labor force	Share in labor force	GDP	GDP per capita	Share of ag. in GDP
	Million	*1,000*	*Percent*	*Bill. ECU*	*1,000 ECU*	*Percent*
Austria	7.8	208	6.1	170.5	21.9	2.9
Finland	5.0	205	7.0	114.0	22.8	3.0
Norway	4.2	112	5.2	104.8	24.9	3.0
Sweden	8.5	106	1.9	193.2	22.7	1.4
Switzerland	6.7	240	4.1	224.5	33.5	3.2
EC-12	325.3	9,019	6.6	5,900.9	18.1	3.8

Source: *C.A.P. Monitor*. Data are for 1991.

Table 8—Land use characteristics of the EFTA applicants for EU membership

Country	Total land area	Agricultural land	Arable land	Pasture land	Number of farms
	Mill. ha.	*Mill ha.*	*Mill. ha.*	*Mill. ha.*	
Austria	8.4	3.5	1.5	2.0[1]	273,000
Finland	33.8	2.6	2.5	0.1	200,000
Norway	32.4	1.0	0.9	0.1	91,000
Sweden	44.9	3.4	2.9	0.5	95,000
Switzerland	4.1	2.0	0.3	1.7[1]	94,000
EC-12	225.8	127.5	67.3	48.0	6,929,000

[1]Includes alpine pasture.
Source: U.S. Department of Agriculture, Economic Research Service, *Western Europe Agriculture and Trade Report*, December 1992. Figures refer to 1990 or closest available year.

Table 9—Farm structure characteristics of the EFTA applicants for EU membership

Country	Agric. area per farm	Cereal area per farm	Dairy cows per farm	Cattle per farm	Pigs per farm
	Ha.	*Ha.*			
Austria	13.6	2.7	7.1	17.9	25.4
Finland	13.0	6.0	11.0	22.0	128.0
Norway	10.4	11.3[1]	12.0	26.0	82.0
Sweden	29.0	14.0	22.0	36.0[1]	158.0
Switzerland	15.2[1]	4.9	12.5	28.1	69.0
EC-12	16.5	8.2	17.1	33.2	57.6

[1]Includes alpine pasture.
Source: EC Commission. Statistics refer to various years between 1988 and 1990.

Austrian agricultural policy began to change even before the discussion of enlargement. Under a Framework Agreement of 1990, the policy was being oriented toward greater competition in processing and marketing. Set-asides had been introduced for cereals, where surpluses were evident, and farmers were encouraged to switch to oilseeds. The government also instituted a supply restraint program for milk, and paid compensation to farmers who left the sector. Support payments were increased to mountain areas, however, setting up the conflict with EU policy which surfaced in the negotiations.

Austrian agriculture should not be too disadvantaged by membership. Climate and soil are productive in valleys, and yields are high by the EU average. Farms are smaller than the EU average (13.6 hectares, versus 16.5), and livestock per farm is also low. The challenge of EC membership, therefore, includes restructuring the domestic farming and processing industries to compete with larger-scale firms in the EU.

Finland

Finland shared with Austria the experience of living under the shadow of Soviet foreign policy, though it too retained democratic institutions and a market-directed economy. Its trade has been somewhat less completely integrated with the EC, having strong ties to both the former Soviet Union and to other Nordic countries. Finland's dependency on Soviet trade caused severe problems when the USSR broke apart. Nevertheless, Finland is an affluent country with a skilled work force and bountiful natural resources. As such it should also be able to assimilate with little difficulty into the EC market.

Finland has a population of 5 million and a per capita income level of 23,000 ECU's, well above the EU average. The agricultural sector employs about 7 percent of the labor force, and generates 3 percent of GDP. However, only 7.6 percent of the land is used for agriculture, and the population density, at 16 inhabitants per square km, is barely one-tenth that of the EU average. Farms are somewhat smaller than the EU average (13 hectares, versus 16.5 for the EU-12), and livestock herds are also smaller.

Finnish agriculture, in contrast to the manufacturing sector, faces considerable problems arising from the process of membership. Protected for many years by an autarchic policy that all but excluded imports, Finnish farmers had to worry less about foreign competition than about the slowly growing domestic demand and the accumulation of troublesome surpluses. Each year the government would negotiate with farm groups the distribution of the cost of disposing of such surpluses.

The opening of the domestic market to EC imports will most likely be traumatic. Agriculture began a slow reorganization in preparation for the eventual opening of the market, but yields are still low and production costs high. Price levels were frozen and direct payments were given in compensation. A sharp devaluation of the Finnish Markka elevated import prices and somewhat closed the gap between Finnish and EU support levels. Policies were implemented to reduce the agricultural population and consolidate farms. However, Finland still anticipated a long transition in prices toward EU level.

Sweden

Sweden boasts an economy as technically advanced as any in Western Europe, and a society that has prided itself on external neutrality and domestic cohesion. Nevertheless, in Sweden it was widely accepted that closer links with the Union would be helpful in fostering further economic progress. In addition, neutrality has been less of a guiding principle since the fall of the Soviet Union, and even the much-praised domestic social model was felt to need an overhaul. Accession to the EU became a priority by 1991, and Sweden was the first Scandinavian applicant to seek membership.

The population of Sweden, at 8.5 million, makes it the largest of the new members. Per capita income levels are comparable with Finland, and high by EU standards. Swedish agriculture, which accounts for less than 2 percent of the labor force and about 1.4 percent of the GDP, is comprised of small-scale farming in the northern areas, akin to that found in Norway and Finland, and efficient larger-scale farming on the southern plains. The latter areas rival Denmark for productivity and have led to some export surpluses of grain and livestock products from Sweden. As a result, Sweden can expect to be a supplier to other markets in the region.

The changes in the agricultural sector expected as a result of Swedish accession are likely to be less than for the other Nordic countries. Though Sweden historically protected its agriculture at high levels, it undertook a radical reform in 1991; its New Food Policy brought price levels much more in line with those of the EU. The 35-percent reduction in cereal prices over a 3-year period, compensated by hectarage subsidies, was a preview of the policy adopted a year later by the EU. As a result of the reform, farmers in Sweden have not taken such a negative stance on accession as those in Finland or Norway. On the other hand, Sweden was careful to preserve, at least for a time, the stricter health and phytosanitary standards that were adopted in that country.

Norway

The Norwegian population, at 4.2 million, is less than that of the other applicants. Income levels are high, and the existence of considerable reserves of North Sea oil and gas has given the economy a degree of affluence and independence reflected in its relationship with the Union. Agriculture is a minor source of employment (5.2 percent) and income (3 percent), but plays a larger role in the economy of the northern part of the country. The fishing sector and the farming industry have been concerned about the loss of income that might follow the opening of the Norwegian market to imports from the EU. Farms are generally small and produce at high cost. The main areas of population are in the south of the country or on the coast, more easily served by imports than by remote domestic farms.

Perhaps more so than its neighbors, Norwegian agriculture appears justified in fearing competition from other parts of Europe. Policy reform has been slow in Norway, with concern about keeping the remote areas populated, but some decrease in support prices has been achieved, together with an increase in direct payments. Dairy quotas have been cut and the government has recompensed farmers for leaving milk production. However, with small, high-cost farms comprising most of the agricultural structure, the problem of competitiveness may be difficult to solve.

Switzerland

Switzerland is the most affluent of the prospective EU members, with a per capita income of 33,500 ECU, nearly twice the EU average. The population, at 6.7 million, is somewhat less than in Austria. Agriculture in Switzerland employs about 4 percent of the population, and contributes just over 3 percent of GDP. As in Austria, agriculture plays a major role in the tourist industry, both as a provider of food and services and as guardian of the Alpine landscape. Concern in rural areas about the impact of EEA membership led to the rejection of that treaty.

The Swiss have also been taking the first steps toward reform of their agricultural policies. Changes introduced in 1992 reduced the gap somewhat between Swiss and EU agricultural policies and prices. Direct income payments compensated farmers for a reduction in the price supports and were linked to environmental objectives in an attempt to encourage the flow of positive benefits from agriculture to the landscape and hence the tourist and recreation industries.

Agricultural Issues in the Negotiations

From this brief look at the agriculture and agricultural policies of the applicant countries, the range of agricultural issues in the negotiations can be seen to center around four main topics of controversy:

- The harmonization of price levels between the EU and the (usually higher) prices in the applicant countries, the most prominent issue;
- The scope for special policies for farmers in geographically disadvantaged areas;
- The competitiveness of the agricultural processing and food sectors; and
- The question of budget contributions, including the decision as to who should pay any agreed upon subsidies to northern and mountain farmers.

These issues are addressed in turn, although they were often interconnected in the negotiations.

Harmonization of Price Levels

The protection levels in the applicant countries in general exceeded those of the EC. The magnitude of this disparity in protection levels is illustrated in table 10, which shows the Producer Subsidy Equivalent (PSE) for the EFTA countries and the EU for the major commodities. Higher support for grains, milk, and beef exists in Finland and Norway, and for grain-fed livestock products (pigs, poultry, and eggs) in all the EFTA countries, relative to the EU.[19] Membership entailed a significant downward price adjustment with the important exception of Sweden, which had already begun to reduce support.

The Community has been enlarged before, on three separate occasions, giving some precedent for handling the issue of support price differences in agriculture. In each of the three previous EU enlargements, there were price gaps to overcome.

The UK, together with Denmark and Ireland, entered the EC in 1973 with lower price levels for agricultural goods. As exporters of agricultural products, Denmark and Ireland both wished for a speedy transition to full EC prices in order to take advantage of access to the EC market. The UK, by contrast,

[19] Also evident is the generally high level of support for all commodities in Switzerland, an indication of the opposition in rural areas to any closer links with the Union.

Table 10—Levels of farm support in EFTA applicants for EU membership: Producer subsidy equivalent (PSE) levels in 1991

Commodity	Austria	Finland	Sweden	Norway	Switzerland	EC
				Percent		
Wheat	75	84	50	84	84	61
Coarse grains	35	84	57	86	83	55
Sugar, white	77	73	55	0	83	67
Milk	66	76	74	83	85	69
Beef and veal	55	60	51	71	83	54
Pigmeat	33	53	36	51	62	8
Poultry	47	58	35	50	85	18
Eggs	46	40	53	48	82	-3
Sheep	0	80	51	89	79	68
All commodities	52	72	59	77	80	49

Source: OECD PSE tables, 1993.

enjoyed low agricultural prices under a policy particularly attractive to consumers. Though British farmers had the benefit of deficiency payments, the market had been open to imports from the overseas Commonwealth countries, as well as from Ireland and Denmark, without tariffs or levies. Though this policy was to change in 1973, EC membership still implied a sharp rise in support prices together with the adoption of a new support system.

The transition was handled using "accession compensation amounts" (aca's), payments added to or subtracted from levies and subsidies at the border to control the harmonization of price levels. Over time these aca's were phased out until prices were finally harmonized. In addition, "special trade mechanisms" (stm's) in the form of quotas controlled against import surges. These mechanisms were used when Greece joined the EC in 1981 and again for Spain in 1986.[20] In the case of Portugal, an additional twist was added. Portugal was given an additional "pre-transition" period during which the marketing system was to be brought into line with that of the Community.

The defining nature of this "classic" transition method is that border taxes and subsidies be used over an extended period. However, the EFTA countries were acceding to a European Union which had already completed the "Single Market" project, removing internal trade barriers, and was committed by the Maastricht Treaty to an "Economic and Monetary Union." The Commission, negotiating on behalf of the EU, took the view that joining a Post-Maastricht Union precluded the use of border devices to maintain price differences. To keep border posts for the sole purpose of collecting agricultural aca's would be administratively costly; any transition arrangements should be of a budgetary nature.

This policy was not in line with the wishes of three of the applicants. Austria argued for a 7-year transition period for agricultural prices, and Finland wanted as long as 12 years in which to harmonize price levels. Only Sweden, with prices at or even below EU levels, did not ask for a transition period. In the end, the Commission view prevailed, and no transition period was allowed for prices. But in consequence the applicant countries were allowed to maintain more generous non-price subsidies than perhaps would have been possible if there had been a transition period for price harmonization.

The issue of price harmonization was not made easier by 1992 CAP reform. The cereal price level to which the EFTA countries had to move was in effect lowered by 30 percent as a result of CAP reform. Offsetting this, however, was the devaluation of several of the EFTA currencies, relative to the ECU, in the 1992-1994 period, which raised in domestic currency the EU price support levels.

20 In the case of Spain, the concern was to prevent a sudden export surge of agricultural goods from the new member to the existing Community.

Special Programs for Farmers in Disadvantaged Regions

The applicant countries were united by their agricultural sectors' need for additional support to compensate for the locational disadvantages of altitude, slope, short growing season, or remote location. The EU has for many years had a system of compensation for such farmers under the "hill and less-favored area" (LFA) Directive. Payments are made, mainly to livestock enterprises, on a headage basis. Each of the applicants, which had existing policies giving either higher prices or extra payments to their remote and disadvantaged farm regions, calculated that the LFA Directive would not adequately compensate for the loss of these national programs.

Three possible avenues were open:

- Expand the definition of the LFA Directive so that the Nordic and Alpine farms were all fully covered;
- Allow a continuation of the current national policies, at least for a limited period; or
- Devise a new policy at the EU level which would assist the farmers in the remote areas of the new members.

In the end, all three options were extensively discussed. The application of existing LFA payments to the new members was ensured by modifying the definition of eligible farming situations. Moreover, Austria was allowed to choose criteria from among those in use for existing members so as to increase the country's eligibility. About 80 percent of the farming area in Finland has been deemed eligible for LFA grants, along with 50 percent of Swedish farmland and 40 percent of Austrian farms. This program is funded from the budget of the EU (FEOGA), with national co-payments.

National payments under existing programs were also allowed to remain in use, though within some constraints. The "Grundbetrag" payments for small farmers in Austria were authorized for a period of 10 years if adequate payments were not forthcoming from other programs. More significantly, state aids for Nordic farmers can be paid "on a long-term basis" in Finland and Sweden. In addition to these national programs, degressive compensation can be paid from national funds over a 5-year period so long as the compensation is not linked to current production.

The third option (a new EU policy for Nordic agriculture) was ultimately rejected. The Commission was wary of special, higher price levels that would be applied in specific parts of the Union, particularly as these regions were less productive than others. To reward lower yields with higher prices and encourage farming in the areas most remote from markets seemed in contradiction to the EU's desired specialization in an internal market. Direct payments to countries with higher-than-average incomes for domestic political reasons did not appeal to the Commission. The compromise was to allow the new members to continue regional payments, subject to conditions on the means of payment, as described above.

Non-price payments with respect to the adoption of the existing CAP was an issue of importance to applicant countries. The cereal and oilseed farmers in existing EC member states have benefited from compensation payments, paid per hectare on the basis of regional yields, following the price decreases of 1993-1995. From the negotiations' beginning, all participating parties assumed that these payments would form part of the "acquis," and thus would be available to new members. This avoided the political problem of appearing to treat EFTA farmers less generously than those in existing member states, but also built in the notion of an entitlement not tied to compensation for a historical price drop.[21]

Processing Industry and Competitiveness

The lack of competitiveness of the agro-processing industry and of the food sector as a whole was a concern to all four applicants. The Finnish food sector grew up behind protective walls and was commonly thought to be vulnerable to Danish and Swedish competition. The Austrian agro-processing industry was dominated by small-scale enterprises with guaranteed

21 Swedish farmers, for instance, would get the compensation payments for a price drop which had already occurred in 1990 without compensation as a part of the policy change in Sweden.

margins and little competition within the country and feared being swamped by German and Italian processed goods. Norway was concerned that northern processing industries such as dairies and meat-packing plants would be unable to survive without direct government assistance.

The weakness of these sectors was generally recognized; the cure was disputed. The Commission argued that the industries themselves would benefit from lower prices for agricultural raw materials and the structural changes that would come about in the context of a wider market were just what was needed for the survival of these sectors. This view prevailed, and no special provisions were made to continue subsidies for the food sector in the applicant countries. These industries would, however, be eligible for structural funds and would no doubt attract private capital for their investment.

Budget Questions

As is normal in negotiations of this type, the conclusion on the issue of contribution to the budget was left until the last moment. In effect, it acted as a balancing item, with payments to the prospective members (or reduced collection of funds from them) used to compensate for the "losses" in the negotiation process. In effect, the budget discussion allowed several items to be rolled into one: The EU's contribution to the "national" payments for the compensation of farmers for a rapid transition to EU price levels; allowance for the time it would take for new members to be able to use structural and other EU funds; and the EU's take-over of the payments made by the EFTA countries in the name of "cohesion" as part of the EEA agreement, as well as some other payments for "flanking" policies.

An additional budgetary item allowed for an expansion of "agro-environmental" programs in the new members. In effect, the budget deal also allowed a resolution to the underlying issue of who was to pay for the MacSharry compensation payments to which it was agreed the new members' farmers were entitled. Subject to the need in the applicant countries to keep some equity in the budget balance with the EC, the budget agreement solved each of these financial issues without having to argue each item individually.

Terms of Accession for Agriculture

The final terms agreed to by the negotiators can be summarized under eight headings:

1) *Immediate adoption of the policies and prices of the CAP by all members*: The arguments of Austria, Finland, and Norway to the contrary, EU price levels were introduced into the new members with no transition period, meaning that no border taxes or subsidies are required to keep market price levels different by country. The decision was forced by the logic of the "single internal market," which has no provision for maintaining different price levels. This puts the accession of the EFTA countries in sharp contrast to that of previous new members who were allowed transition periods, and sets a strong precedent for future membership negotiations.

2) *Allowance for digressive national aids for a 5-year period to offset the price drops for farmers*: Transition periods for farmers were handled by payment of national subsidies on a digressive basis to farmers. The new members could pay state aids to farmers where price gaps were significant, so long as these aids decreased over the period. The Commission left it up to the new members to submit for approval policies that would meet the relevant criteria of digression and non-interference with trade.

3) *Immediate participation in the budgetary mechanisms, subject to a 4-year schedule of payments to the new members*: The budget issue was sensitive, as the new members were expected to be net contributors and yet could not afford to be seen as such by their voters. In the end, the EU conceded that a budgetary deal was needed to cushion the financial burden of membership. A schedule of payments to new members amounting to 2.6 billion ECU (without Norway) was delivered over a period of 4 years to offset the cost of transitional national subsidies to disadvantaged farmers.[22] The magnitude of the final budget package

[22] The first year's contribution included a notional allowance because the new members most likely would not receive funds from the various structural programs in that year, as a result of normal delays in preparing submissions, processing grants, and disbursing payments.

Table 11—Budgetary compensation to new members for agricultural programs

Country	1995	1996	1997	1998	Total
			Million ECU		
Austria	583	106	71	35	795
Finland	476	163	65	33	737
Sweden	488	432	76	31	1,027
Total	1,547 [1]	701	212	99	2,559

[1]Includes 861 million ECU's to compensate for loss of eligibility for structural funds.
Source: Chapter 15 (Agriculture) in General Secretariat of the European Council (1994).

for agriculture is shown in table 11, with a sharp decline in EU contributions evident after 1996. The deal was clearly necessary to bring the negotiations to an end, but equally clearly signifies the limited commitment of the EU budget to the support of Nordic farmers.[23]

4) *A promise of "rapid action" by the Commission in case of market disruption in the new members*: Though the Commission did not make clear what action it would take (short of price interventions, which are specifically excluded), this part of the agreement has at least the effect of assuring farmers in the new member countries that their situation will be monitored in Brussels.

5) *The authorization of long-term national aids to Nordic farmers, subject to the conditions that they do not distort competition and are not linked to "future" production*: This element of the outcome is the main response to the call for a special program to deal with agriculture in the remote northern regions of the enlarged Union. The specific regions in which such payments would be authorized include those with low population density (less than 10 people per square km), low agricultural usage (less than 10 percent of the total area in agriculture), and little arable land (less than 20 percent of the agricultural land under crops). The area was designed to cover all land above the 62nd parallel, as well as some areas below it. Payments can be tied to hectares used, head of livestock, or past production levels.

The Nordic Agriculture Policy, which emerged from the negotiations, was the product of compromise. The applicants in effect won the right to continue subsidies to agriculture in the northern areas; in turn, the EU was able to insist that these policies not distort competition unduly in the Union. The restriction that the payments not be based on future production is an attempt to reduce the output-increasing aspects of income support. Countries have yet to define the policies that would qualify under this heading. Whether the compromise language produces policies acceptable to the EU remains to be seen.

6) *Authorization of special national aids by Austria in favor of small farmers for a 10-year period*: The Austrian negotiators secured their goal to continue paying a subsidy (the "Grundbetrag") to small farmers, at least for a 10-year period (if payments from other aspects of the policy are not adequate to maintain incomes). This issue was politically sensitive in Austria, and its resolution was considered necessary to make accession acceptable in rural areas.

7) *Modification of the rules for Least Favored Area payments to include more area of the adhering countries*: From the outset of the negotiations, the criteria used in the existing EU for the definition of "least favored" areas were recognized as inadequate to give new members the same benefits. The compromise involved modifying the criteria for payments to farmers embedded in current legislation. In effect, new members were allowed to pick and choose the criteria from the range employed in present member states. Austria, for example, chose a mixture of the French criteria for altitude and slope of land and the German criteria for location and population density. Forty per-

[23] The final budget package also included some adjustments arising from the new members' "cohesion" contributions to EEA financing and to the "flanking" policies under the EEA.

cent of Austrian farmers will qualify for LFA payments under these criteria. For Sweden, the proportion is higher (50-percent eligibility), while in Finland 85 percent of the farmland is covered by the LFA criteria.

8) *Allowing new members to rapidly implement "agro-environmental programs in favor of [their] farmers"*: The new members share with each other a commitment to the environment and a need to demonstrate that commitment in a way visible to the public. This is reinforced in the terms of accession by the commitment of budgetary funds for the implementation of agro-environmental programs. The sums indicated in the agreement include 175 million ECU's for Austria, 135 million ECU's for Finland, and 165 million ECU's for Sweden.

Impact of Membership

New members' concern about massive disruption of the rural economy as a result of membership was understandable and realistic, given the protected nature of agricultural markets in these countries. The concern was not shared in Brussels, where the notion of accession by countries that would buy more EU farm products rather than add to surpluses was encouraged.

In fact, the quantitative impact on European agricultural markets of the accession to the EU of the three new members is unlikely to be great. This is due to three factors:

- The countries themselves are relatively small, both in terms of population and agricultural production, and will not add greatly to the volume of production in the Union.
- The three new members have negotiated the freedom to pay substantial hectarage and headage payments to farmers in remote areas, which will presumably act to keep those farmers from leaving the land idle. Production will no doubt fall over time, with depopulation and extensification, but a major migration is not expected in the short run.
- Production in some areas could actually increase as a result of the opening of markets. Swedish sales to Finland, for instance, could increase. Not all sectors in closed markets are necessarily inefficient. Even Finland could find that some parts of the agricultural sector might develop export markets in addition to competing well with imports from the EU.

The ESIM model was used to see whether this expectation of little change in the overall EU balance was supported by empirical estimation.

Model Results

The quantitative results of the ESIM model, using the same scenarios discussed above, for the EFTA countries show this lack of dramatic change in the market balance as a result of EU membership. The production, demand, and net trade of grains (wheat plus coarse grains) for the EFTA countries are shown in table 12 for the years 1995, 2000, and 2005.

Grains

The results indicate a slower rate of growth of grain production in the new members due to membership. The level of grain output is expected to be 3.1 million tons less by the year 2000 than if these countries had not joined. By the year 2005, this gap could rise to 3.6 million tons. The reduction in prices as a result of the CAP constrains the growth in grain production, but the effect is not felt in the short run. Indeed, in 1995, production was actually higher with membership, the result of an increase in support for grain producers in Sweden, where the combination of higher support prices and generous compensation payments under the CAP led to an expansion of grain output. Grain output for the EFTA-3 is the same for scenarios 1, 2, and 3 because the entry of the EFTA-2 and the CEEC-4 in 2000 does not markedly influence these countries. There is, however, some slight decline in grain output (400,000 tons) in scenario 4, when the CAP is further reformed.[24]

The EFTA-2 are assumed in scenario 2 to join the EU at the turn of the century, which is estimated to drop their grain production by 0.7 million tons in that year

[24] The assumption of further CAP reform influences other commodities more than cereals, where the 1992 reform program is expected to continue.

Table 12—Grain market, EFTA countries

EFTA-3[3]	1989/91	1995	2000	2005	EFTA-2[2]	1989/91	1995	2000	2005
Total grain production		*Million metric tons*					*Million metric tons*		
Base	14.7	12.5	18.9	21.2	Base	2.7	2.6	3.3	3.7
Scenario 1	14.7	14.1	15.8	17.6	Scenario 1	2.7	2.6	3.3	3.7
Scenario 2	14.7	14.1	15.8	17.6	Scenario 2	2.7	2.6	2.6	2.9
Scenario 3	14.7	14.1	15.8	17.6	Scenario 3	2.7	2.6	2.6	2.9
Scenario 4	14.7	14.1	15.4	17.2	Scenario 4	2.7	2.6	2.6	2.8
Domestic demand									
Base	11.3	9.6	10.1	10.2	Base	3.2	2.8	3.1	3.2
Scenario 1	11.3	8.9	11.8	11.4	Scenario 1	3.2	2.8	3.0	3.2
Scenario 2	11.3	8.9	12.5	12.2	Scenario 2	3.2	2.8	3.4	3.4
Scenario 3	11.3	8.9	12.4	12.1	Scenario 3	3.2	2.8	3.4	3.4
Scenario 4	11.3	8.9	12.3	11.9	Scenario 4	3.2	2.8	3.4	3.4
Net trade									
Base	3.4	2.8	8.8	11.1	Base	-0.5	-0.2	0.2	0.5
Scenario 1	3.4	5.2	4.0	6.1	Scenario 1	-0.5	-0.2	0.2	0.5
Scenario 2	3.4	5.2	3.3	5.3	Scenario 2	-0.5	-0.2	-0.8	-0.6
Scenario 3	3.4	5.2	3.4	5.5	Scenario 3	-0.5	-0.2	-0.8	-0.5
Scenario 4	3.4	5.2	3.1	5.3	Scenario 4	-0.5	-0.2	-0.8	-0.6

[1]The EFTA-3 includes Austria, Sweden, and Finland.
[2]The EFTA-2 are Norway and Switzerland.
Source: European Simulation Model

and by 0.8 million tons by the year 2005. These countries are only marginally affected by further CAP reform.

Domestic demand for grain increases in the EFTA-3 with membership, as a result of lower market prices, with the exception of a temporary drop in consumption in 1995 as a result of higher Swedish prices that year. By the year 2000, these three countries consume 1.7 million tons more cereal, a figure which drops to 1.2 million tons of additional cereal use by 2005. The net result of the production and consumption shifts is a net export decrease by the year 2000 of 4.4 million tons from the EFTA-3; the corresponding figure in 2005 is 6.1 million tons, a 5-million ton drop from the projected base case scenario of no membership.

Accession of the EFTA countries appears to relieve to a certain extent the pressure on the cereals market in Western Europe as a whole (EFTA plus EU), though adding to the surplus of the EU. The EFTA-2, if they were to join in the year 2000, would switch from minor exporters of 200,000 tons to importers of about 800,000 tons.

Other Crops and Livestock

The projections of market balance for other crops and for livestock products show that rather little impact can be expected from membership. Sugar production is likely to fall somewhat from the 1993 levels, as negotiated production quotas were based on the previous 5-year average production. The level of sugar quotas on which support prices will be paid is given in table 13. Sugar produced over and above these quotas (often referred to as “C” sugar) can be sold on the world market without subsidy. Sugar consumption will tend to increase as price levels come down. As a result, the EFTA-3 is likely to be roughly self-sufficient in sugar in the years to come.

Oilseed production is modest in the EFTA countries, but appears likely to increase markedly with membership, taking up some of the land released from grain

Table 13—Milk and sugar quotas for new members

Country	Milk			Sugar	
	Deliveries	Direct sales	Reserve	A quota	B quota
			1,000 tons		
Austria	2,205	367	180	316.5	73.9
Finland[1]	2,342	10	200	133.4	13.3
Sweden	3,300	3	175	336.4	33.6

[1]Finland also received a quota for isoglucose (HFCS) of 11,930 tons and a temporary raw sugar input quota of 40,000 tons.

Source: Chapter 15 (Agriculture) in General Secretariat of the European Council (1994).

production. The EFTA-3 could double their production, from 300,000 to 600,000 tons, with accession. This same increase is projected to be maintained through 2005. The quantities produced are still likely to remain small in relation to the EU market as a whole.

Livestock is made more complex by the extensive headage payments to farmers under both pre-existing national policies in the new members and under CAP regulations. The new members negotiated quotas for milk (table 13) which would allow them to continue with current levels of production. The ESIM projections show the level of milk production constant at the quota level for the next few years, as milk production remains a profitable activity under high support prices. The CAP, as reformed in 1992, allows headage payments for cattle and sheep subject to overall limits.

These limits, shown for the new members in table 14, represent historical levels of the herd. The production of beef is, therefore, unlikely to fall, and is projected to rise after membership partly as a result of lower feed costs. Grain-using livestock, particularly pork and poultry, will be affected both by lower feed costs and by increasing competition from the rest of the EU. Pork output is projected to fall marginally after membership but recover by the end of the decade. Poultry production is unlikely to shift greatly as a result of accession.

The impact of EFTA accession on EU budget costs is likely to be rather modest. Budget costs for the EU as a whole rise when accession increases the amount of surpluses that must be exported, or when extra output reduces tariff and levy revenue. Neither impact is likely in the context of the EFTA-3 accession. The sharp decline of market prices in the new members and their replacement by a set of more-or-less decoupled policies will avoid any increased surpluses. The cost will, however, increase with the burden on EU funds of the MacSharry compensation payments to farmers in the new member states, as well as the budget deal to pay for transition policies. These payments add up to a small increase in expenditure on agricultural support, offset by the new members' contributions to the financial resources of the EU.

The impact of the accession of the three new members on agricultural markets is therefore likely to be modest. The significance of this accession lies more in the precedents that the accession may have set for the much more significant enlargement of the Union to the east. The instant adoption of CAP rules and prices, together with flexible use of structural programs and the encouragement of nationally financed compensation payments, gives a new model for the process of accession.

Table 14—Beef and sheep reference quantities

Country	Suckler cows	Male cattle	Ewes
Austria	325,000	423,400	205,651
Finland	55,000	250,000	80,000
Sweden	155,000	250,000	180,000

Source: Chapter 15 (Agriculture) in General Secretariat of the European Council (1994).