Conclusions

It is important to recognize that this analysis was completed in 1994 without adjusting U.S. policies to the 1996 Farm Act and without anticipating the high world prices that resulted from the 1996 supply/demand situation. While these phenomena have not been taken into account in the short run, the results presented are likely to accurately reflect the most likely outcomes for the EU after the year 2000.

It is clear from the model results that the CAP, in its current form, will have to be reformed or modified significantly if it is to meet its GATT commitments and/or if it is to be enlarged to include the Central and Eastern European countries. The EU Commission, in its Agenda 2000, recognized this and called for further reform of the CAP through reductions in intervention prices of beef, grains, and dairy (similar to scenario 4 analyzed for this report). Regardless of what scenario is used—standing pat with present policies, lowering prices, or slowing technological growth—the CAP appears destined for reform once again, whether to meet its GATT commitments or to absorb the CEEC's.

The traditional EU reaction to short-term phenomena in agriculture is to devise short-term policies that create more long-term problems, a likely outcome of the problem of agriculture in EU enlargement to the east. However, the EU must take into account its future relations with its trading partners in the World Trade Organization (WTO) and the political and economic viability that the EU needs so desperately.

Recent declarations[27] by Guy Legras, Director General of the EU's Agricultural Directorate, indicate that the Commission is resigned to reforming the CAP not only to accommodate the east but to comply with the new GATT rules that will exert pressure on the CAP in the year 2000, if not before. Director General Legras also indicated that the change in U.S. farm policy played a role in pushing the EU to the realization that it will have to move to world prices.

The German Farm Ministry revealed the same conclusions in the press[28] but with more emphasis on the need to accommodate eastern countries. The political desire of the Germans to incorporate the Visegrad-4 countries stems from the historical fact that a stable middle Europe is essential to German peace and prosperity. A stable middle Europe also augurs well for a politically stable and economically prosperous European continent. In addition, the Germans and other EU member states want to meet stringent fiscal requirements that would allow them to enter into the EU's single currency in 1999. Qualifying for membership in the single currency will require an imposition of tight fiscal policies, which are likely to rein in spending on the CAP.[29]

The absorption of the three EFTA countries into the CAP has been a relatively painless affair for all countries in spite of political and structural obstacles, but it was done with much anticipation and with countries that were economically and legally prepared for membership. The ease with which Austria, Finland, and Sweden joined the EU contrasts sharply with the agricultural "land mines" that face the entry of the Czech Republic, Hungary, Poland, and Slovakia. Nevertheless, the precedents set by the incorporation of the EFTA countries in 1995 represent the most likely conditions under which the CEEC's will join the EU.

The results of this analysis indicate that there would be high budgetary costs incurred by the EU if the CEEC-4 were allowed to enter under the current CAP and the threat posed to farmers in the west by farmers in the east of Europe. However, there are potentially high financial and political costs if the CEEC's are not absorbed into the EU in a way that is consistent with international agreements and the mutual interests of west and east Europe.

The financial costs of enlarging the EU to absorb the Visegrad-4 are calculable under various scenarios, but the incalculable political costs of not including the CEEC's in the EU are potentially more critical to a relatively stable, prosperous, and peaceful Europe than any other issue of the day. This is not to say that there are no political costs to be incurred by absorbing the Visegrad-4 because of reforms that must be made

[27] *Agra Europe*, June 21, 1995.
[28] *Financial Times*, London, July 1, 1996.
[29] *Financial Times*, London, July 24, 1996.

to the CAP or because of increased competition from the east.

While the principal source of concern is the budgetary cost to the EU of absorbing the CEEC-4, specific agricultural sectors will be at risk in the current EU. Grains and oilseeds do not present a problem while livestock products from the Visegrad-4 clearly pose a threat to the EU according to ESIM results. While many unknowns surround this conclusion, including the ability of eastern European farmers to meet quality standards demanded by law and EU consumers, model results indicate that Central Europe will benefit more from exporting livestock products (principally pigmeat) than any other sector. Lower labor costs in the CEEC's will reinforce this tendency.

Various solutions to the dilemma that the EU faces for enlargement include not requiring the CEEC's to set aside land, which would allow the EU to forgo the costs of compensation payments. This would solve the budget issue but then would raise the issue of set-aside in the western EU. A likely outcome is the lowering of CAP intervention prices, which both helps on the budget side and could allow EU countries to export grains without subsidy. The possibility of using world prices as the guide to production decisions exists among many others, which helps explain the conundra facing EU policymakers as they tackle the enlargement issue in various institutional, political, and budgetary contexts.

Likely Conclusions for U.S. Agricultural Trade

What does all of this mean for U.S. agriculture? In a sense, the United States may be looking at an enlarged EU that will adjust its agricultural policies to a great extent as the United States would like to have seen at the last GATT negotiations, the Uruguay Round. U.S. agriculture is likely to gain world market share in exports as the EU lowers its prices to confront the GATT limitations and its own budgetary constraints. U.S. agricultural exports of bulk commodities to the rest of the world will most likely increase because of EU enlargement.

A more market-oriented and enlarged EU would seem to bestow distinct political and market advantages to U.S. agriculture because of the 1996 Farm Act. U.S. farmers will rely more heavily on world prices for their incomes as direct payments are gradually phased out. EU policy will also be more reliant on world markets, which should give the United States an opening to compete with the EU. U.S. agriculture is generally acknowledged to have a comparative advantage in bulk commodity trade, and will be able to exploit that advantage and export more where the EU is not able to supply future demand. Prices would be higher than they would be if the EU had not enlarged; quantities traded by U.S. agriculture would be higher for the same reason.

The EU does appear to have a comparative advantage in the production of high-value products (HVP). With lower prices in the EU as cited in scenario 4, the EU could become more competitive without subsidies in HVP trade. However, this advantage would be tempered somewhat by the increased intra-EU trade in the EU-19 with HVP's moving from west to east (with the likely exception of meats, where the direction is reversed). An increase in intra-EU trade of HVP's could remove some EU trade from the world market, allowing U.S. food companies to enter new markets.