Approved for Release: 2018/08/22 C06296175

Directorate of
Intelligence

~~Confidential~~
[redacted] (b)(3)

EC Agricultural Policy: Impact of German Unification and East European Reforms [redacted] (b)(3)

An Intelligence Assessment

[redacted] (b)(3)

[redacted] (b)(3)

~~Confidential~~

EUR 90-10025
August 1990

Copy 412

Warning Notice — Intelligence Sources or Methods Involved (WNINTEL)

National Security Information — Unauthorized Disclosure Subject to Criminal Sanctions

Dissemination Control Abbreviations		
	NOFORN (NF)	Not releasable to foreign nationals
	NOCONTRACT (NC)	Not releasable to contractors or contractor/consultants
	PROPIN (PR)	Caution—proprietary information involved
	ORCON (OC)	Dissemination and extraction of information controlled by originator
	REL...	This information has been authorized for release to...
	WN	WNINTEL—Intelligence sources or methods involved

A microfiche copy of this document is available from OIR/DLB [redacted] printed copies from CPAS/IMC [redacted] or secure 3-37108; or AIM request to userid CPASIMC). Regular receipt of DI reports can be arranged through CPAS/IMC.

[redacted]

(b)(3)
(b)(3)
(b)(3)

All material on this page is Unclassified.

Directorate of
Intelligence

~~Confidential~~
[redacted] (b)(3)

EC Agricultural Policy: Impact of German Unification and East European Reforms [redacted] (b)(3)

An Intelligence Assessment

This paper was prepared by [redacted] (b)(3)
[redacted] Office of European (b)(3)
Analysis. Comments and queries are welcome and may be directed to the Chief, Issues and Applications Division, [redacted] (b)(3)

Reverse Blank

~~Confidential~~
EUR 90-10025
August 1990

EC Agricultural Policy: Impact of German Unification and East European Reforms [redacted]

(b)(3)

Key Judgments

Information available as of 9 August 1990 was used in this report.

German unification and the revitalization of East European agriculture will gradually build pressures on the European Community to reform the protectionist Common Agricultural Policy (CAP), which has been the focal point of the sharpest US–West European trade disputes. The CAP—a system of tariffs and subsidies to protect EC farmers from outside competition—is already an expensive proposition for the EC. Although the Community can sustain the system for several more years and will try to avoid major concessions to the United States in the ongoing Uruguay Round talks, the potential transformation of Eastern Europe into an agricultural powerhouse by the mid-1990s is likely to force further burdensome increases in EC subsidy payments. Under such circumstances, budget constraints almost certainly would force the EC to contemplate sweeping CAP reforms. We believe the EC would opt to couple such measures with managed trade arrangements that would continue to limit the access of competitive US farm products. [redacted] (b)(3)

In our view, the EC can deal with the immediate challenge of absorbing East Germany into the Community without making fundamental changes to the CAP. The concern of most Europeans to anchor Germany firmly in the Community is likely to lead to generous EC decisions in expanding dairy and grain quotas to include East German production. Even so, after unification occurs, the former German Democratic Republic will be unlikely to burden unduly CAP finances in the next year or so because increased demand for food in eastern Germany is expected to outstrip any rise in its agricultural output. Revenues from sales of surplus EC food stocks to the east will probably be enough to offset the costs of buying any excess eastern dairy and grain output. [redacted] (b)(3)

With the CAP currently under little budgetary pressure, politics—particularly in Germany—will govern the EC reaction to the US push to cut agricultural subsidies, especially those on exports. The current political climate, however, does not bode well for significant EC trade concessions in the GATT Uruguay Round that is to be concluded by the end of 1990. The Kohl government, for example, is facing a national election in December and is loath to antagonize the crucial farm vote. [redacted] (b)(3)

By the late 1990s, however, strong gains in East European agriculture may well make CAP costs increasingly intolerable to the EC member states. Some leading European agricultural experts anticipate a 20-percent increase in the farm output of the eastern half of Germany over the next decade. If this happens, CAP spending will have to rise to buy up mounting

(b)(3)

surpluses in such commodities as grain. Likely gains in agricultural productivity from economic reforms elsewhere in Eastern Europe will turn the region from a net importer of agricultural goods to a net exporter by the end of the decade. This development probably will add to the CAP's budget woes by pushing down global food prices and forcing the EC to increase export subsidies—if permissible under GATT rules—in order to maintain market share. These mounting costs, coupled with reduced influence of the farm lobby as the number of West European farmers declines, will probably make the EC more amenable to US arguments for a reduction in agricultural subsidies. [redacted] (b)(3)

Movement to reduce CAP subsidies later in the decade will not necessarily make agricultural trade issues significantly less difficult for US-EC relations. Member-state demands for some continued protection of agriculture might lead the Community to contemplate other managed trade policies troublesome to the United States. We believe the influential Germans may push for market-sharing arrangements that could limit access of US agricultural products to the Community. Soybeans and nongrain feedstuffs are obvious targets, although we believe the EC—fearing US retaliation—would not support measures directly limiting US exports. Rather, the Community might cloak protection for its farmers by claiming it is helping to reform East European countries and might indirectly reduce US exports by granting East European products preferential access to the EC market. [redacted] (b)(3)

(b)(3)

Contents

(b)(3)

 (b)(3)

How the CAP Works

The EC's Common Agricultural Policy was created in the early 1960s, at a time when one worker in five in the Community was a farmer. Reflecting the political as well as economic significance of agriculture, the EC's original members—France, West Germany, Italy, the Netherlands, Belgium, and Luxembourg—set the following ambitious and sometimes contradictory goals for the CAP: to increase agricultural productivity, stabilize markets, ensure a fair standard of living for farmers, guarantee regular supplies of food, and ensure reasonable prices for consumers. [redacted]

Of the three general principles governing the operation of the CAP, Community preference affects third countries the most. Through the imposition of fixed import duties on some farm goods and variable levies on others such as wheat and corn, it protects Community farmers from outside competition. The variable levies come into play when world market prices fall below the minimum import price, or threshold price, set by the EC. Should EC prices go below the world price, which rarely happens, the Community would use an export levy to keep products inside the Community. [redacted]

Common pricing—which requires the price of an agricultural commodity to be the same throughout the Community—is the primary CAP internal support mechanism and is similar to the support price in the United States. Every spring the Council of Ministers of Agriculture from the member states sets prices for all the commodities on the basis of proposals from the EC Commission. According to the third principle, common financing, the EC pays for the CAP out of its own Community-wide revenues, which come primarily from customs duties and a share of member state value-added tax collections. [redacted] (b)(3)

The EC's agricultural support program, as applied, is one of the most generous in the world. A recent OECD assessment estimated that CAP expenditures in the early 1980s amounted to over 40 percent of the value of production, more than 20 percentage points above the US level. The generosity of the programs has been necessitated in large part by the inefficiency of the EC farm sector, a phenomenon caused primarily by the small scale of production. The average size of an EC farm in the mid-1980s was 9 hectares—14 hectares if Spain and Portugal are excluded—at a time when the average US farm was 175 hectares. [redacted] (b)(3)
(b)(3)

(b)(3)

(b)(3)

EC Agricultural Policy: Impact of German Unification and East European Reforms [redacted] (b)(3)

Introduction

The EC's Common Agricultural Policy (CAP)—the Community's most protectionist program—reflects the political, economic, and social importance of agriculture to the EC member states (see inset, opposite). It was the first and, until the 1992 Single Market Program, the only truly "common" policy implemented by the member states. The CAP, which claims roughly 55 percent of the EC budget or $30 billion, bolsters farm income with guaranteed support prices and protects Community farmers from outside competition through fixed import duties on some farm goods and variable levies on others. Since the establishment of the CAP, the EC has changed from a net food importer to a major agricultural exporter, cutting dramatically the access of the United States and other food exporters to the EC market. Ballooning EC export subsidies have helped move mounting food surpluses out of Community storage and into world markets. This has heightened the competition US farmers face in third-country markets. [redacted]

We expect the East European countries'[1] transitions to market economies to pose two challenges to the CAP:

- The immediate problem will be accommodating East Germany's agriculture under Community production quotas as German economic unity proceeds.
- Over the medium term, a surge in agricultural output from other East European countries—viewed as likely by many experts—will increase pressure on the EC to improve market access for East European foodstuffs and may lower world agricultural prices enough to push CAP subsidies up to prohibitive levels. [redacted]

[1] In this paper, we consider East Germany and the rest of Eastern Europe separately. [redacted]

German Unification: Limited Near-Term Impact on Agriculture

Over the next year or two, we expect German unification to provide more opportunities than problems for Western farmers. The demand in eastern Germany for more varied and better quality food products almost certainly will grow with economic recovery, but the region has little capacity to respond quickly to the expected increase in demand:

- East Germany's grain harvest will approach record levels this year, but the region probably cannot become self-sufficient in grain, at least in the near term.
- More important, the US Embassy reports the German Democratic Republic cannot currently produce adequate quantities of high-value products such as fresh fruits and vegetables that East German consumers desire.

(b)(3)

Even if the short-term measures designed to shield GDR farmers from intense Western competition had worked, the GDR's $1.2 billion deficit in agricultural trade—already one of the highest in Eastern Europe—almost certainly would have widened (see inset, page 2). Embassy reporting indicates that West German agricultural exports to the GDR climbed 80 percent in the first quarter of 1990 while GDR farm exports increased only 7 percent. [redacted] (b)(3)

The likelihood that East Germany will remain a net agricultural importer in the near term should ease its absorption into the CAP, especially in the important dairy and grain sectors. These two sectors, along with meat and oilseeds, account for the bulk of CAP spending, according to Embassy reporting (see figure 1). To keep spending on surplus output in check, the (b)(3)

(b)(3)

East German Agriculture After German Economic and Monetary Union

Bonn and East Berlin have agreed on a variety of transitional support programs to protect the teetering East German agricultural industry. East German consumer demands are being met by West German firms with the result that the marketing of East German products has almost completely broken down. Bitter farm protests have occurred across eastern Germany prompting East Berlin to announce an emergency aid package for its farm sector. The primary support system is:

- ***Financial.*** *East German authorities have implemented a cash compensation program. This is intended to assist East German farmers in adapting to the introduction of the EC pricing system and boost the liquidity of all East German farms. East Berlin allocated $500 million for this aim in July. As of 1 July, East Berlin is buying all agricultural raw materials at EC intervention prices to cushion the impact of rapid adjustment of producer prices; East Berlin plans to buy up the entire grain harvest. East Berlin will also provide subsidies to reduce output—modeled on the West German acreage reduction system.* [redacted]
- ***EC Access.*** *Effective 1 August, East Germany became a de facto CAP member, and East German agricultural products are permitted to move freely, without levies or border duties into all EC countries. Because these products must meet EC quality and health requirements—few do—most exports will be limited until food-processing plants are upgraded. Instead, GDR farms will ship their products to West Germany for processing, and then export.* [redacted] (b)(3)

Unification will also force German leaders to address the thorny issue of land ownership. The East German agricultural sector is dominated by roughly 4,000 farm collectives that were forcibly collectivized on the Soviet model in the late 1950s. West German agricultural interests favor reprivatization, in hopes that dismantling the collectives would diminish the competitive threat, but farm specialists in eastern Germany want to avoid unnecessarily fragmenting the GDR farm sector. Compensation payments to West German citizens having title to large tracts of GDR territory expropriated by the Communists will almost certainly be part of the solution, although the legal issues will not be fully settled for some time. (b)(3)
[redacted] (b)(3)

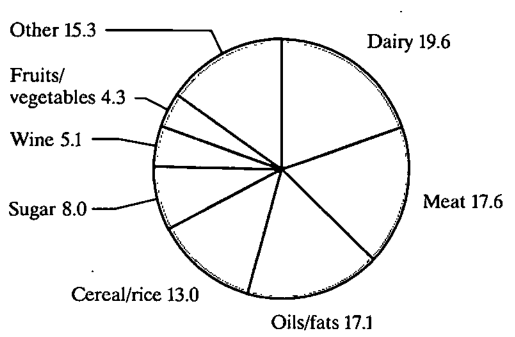
EC instituted dairy quotas and measures to stabilize grain production in 1984 and 1988, respectively. The Community must decide how much to raise the existing production limits to take account of the GDR's entry. [redacted] (b)(3)

We expect the EC to be fairly generous in making these decisions, in part to avoid antagonizing Bonn at a time when most Europeans want to "anchor" Germany firmly in the Community:

- With Western Europe's famous butter and cheese mountains now virtually eliminated, the EC probably will decide that it can raise the milk quota to accommodate most eastern German milk production—an estimated 8 percent of present EC production. Press reports indicate West German Agriculture Minister Kiechle expects that perhaps 75 percent of existing East German milk production could be included in the EC quota.
- Similarly, the EC probably will expand the grain quota—which, if breached, automatically reduces the following year's prices—by 4 to 6 percent because the GDR at present is a large net grain importer. Nonetheless, we believe the Community is

Figure 1
European Community: 1989 CAP Budget, by Product

Percent



Unclassified 327612 8-90

unlikely to agree to any German demands to suspend rules mandating an automatic 3-percent cut in price supports if the new production limits are breached.

The EC probably will be able to offset the costs of buying up eastern German dairy and grain output through expanded sales to the region of Community surplus products, such as fruit, vegetables, and wine; Dutch vegetable sales have already soared. [redacted]

With German unity imposing limited near-term costs on the CAP, the EC is unlikely to alter significantly its position on agriculture in the GATT Uruguay Round talks. EC Agriculture Commissioner MacSharry's recent proposal to cut farm support and protection by 30 percent over 10 years is a minimalist position that is far from meeting US demands on agricultural reform. The Community believes it has made a major concession by accepting partial "tariffication"—an idea advanced by Washington whereby nontariff barriers such as import quotas are converted into tariffs and then reduced—and apparently hopes that a delay in serious talks until at least September will prompt concessions from GATT members concerned about meeting the December deadline for concluding the Uruguay Round negotiations. Moreover, political considerations will constrain the EC's scope to negotiate in the next few months. With an all-German election set for early December, the Kohl government is loath to antagonize the crucial farm vote by making sweeping concessions, although we believe he will be more flexible after the vote. Although the EC is unlikely to accept US proposals for rapid liberalization of agricultural trade and elimination of subsidies, we believe the Community still places a high value on successful completion of the GATT talks. Thus, when the Uruguay Round enters the homestretch, EC leaders will, in our judgment, give the talks the high-level attention necessary to strike bargains on contentious issues. [redacted]

(b)(3)

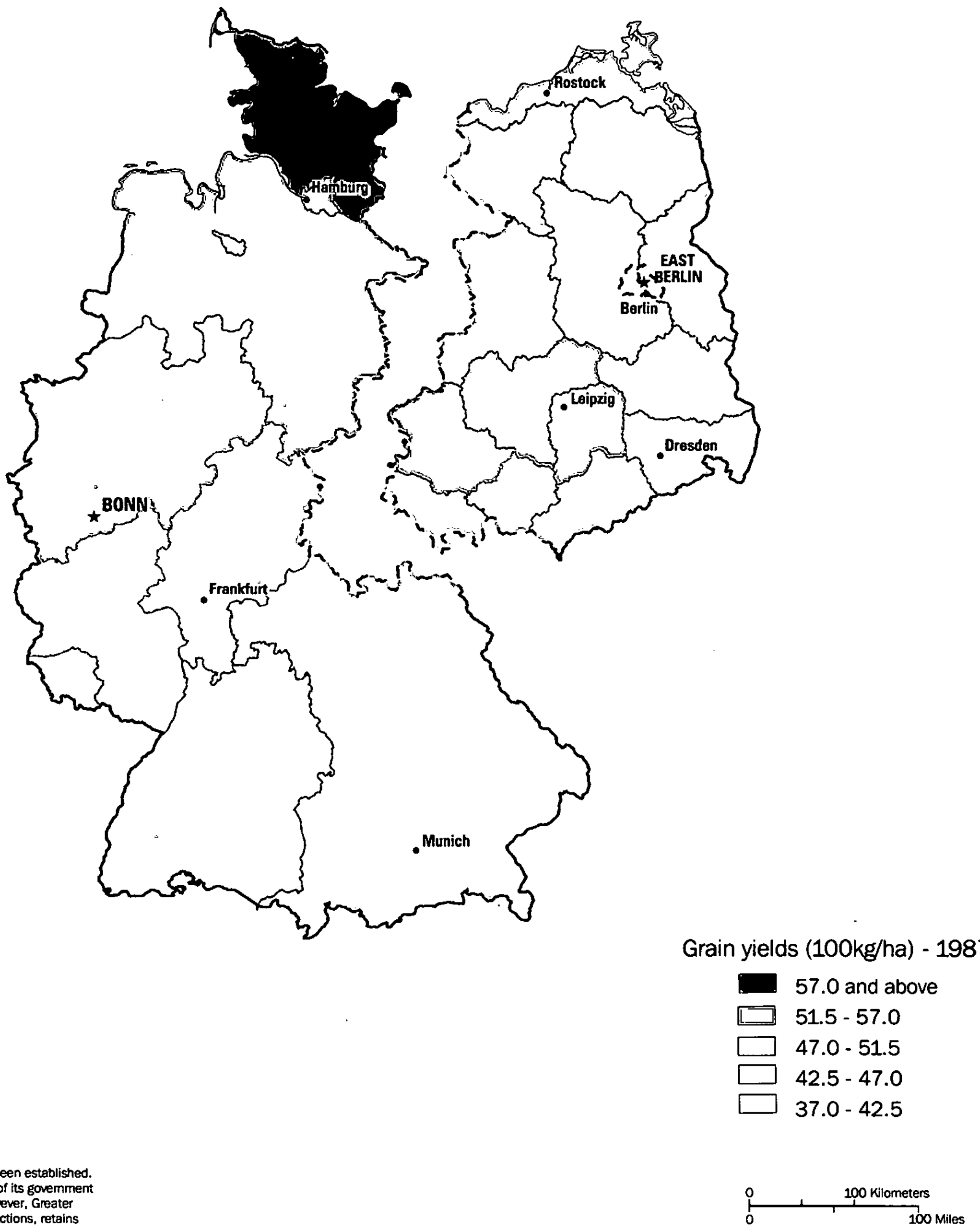
The Medium-Term Impact: Competitive Challenge Likely

By the mid-1990s, agriculture in eastern Germany could pose a major competitive challenge to farmers in western Germany. West German agricultural specialists note that parts of the GDR were once considered the "granary of Germany" and that some of its land is still potentially the most productive in Germany (see figure 2). Soil around Leipzig, for example, scores close to 100 on a West German 100-point scale that assesses soil on the basis of type, fertility, and crop yields. The GDR region also enjoys better climatic conditions. Even more important, the economies of scale made possible by eastern Germany's large farm cooperatives confer significant potential advantages (see table 1). Many of the collectives' component farms are likely to be reprivatized, but we expect farms in eastern Germany to remain much larger than those in the west—and become more efficient, once the farm sector sheds up to half its current work force. [redacted]

(b)(3) (b)(3)

Economic reforms and modernization accompanying unification will allow farmers in the east to exploit these advantages. Market-determined prices will strengthen incentives for the production of goods that eastern Germany produces most efficiently. Eastern German farmers will be able to apply Western know-how to improve yields on their superior land; at

Figure 2
Grain Yields in the Germanys, by Administrative Division



Final borders of Germany have not been established. East Germany has located the seat of its government in the Eastern Sector of Berlin. However, Greater Berlin, including all four occupied sections, retains its Four-Power juridical status.

Unclassified

719334 (801076) 7-90

Table 1
West and East German Agricultural Sectors: A Snapshot [a]

	West Germany	East Germany
Size		
Hectares *(million)*	12.0	6.0
Farms	685,000	4,000
Employment *(million)*	1.5	0.9
Average farm size *(hectares)*	17	1,500
Grain production *(million tons)*		
Wheat	12.0	4.0
Barley	8.4	4.2
Rye	1.6	2.2
Yields *(100 kilograms per hectare)*		
Grains	50.6	45.6
Winter wheat	60.0	54.2
Barley	49.9	47.1
Potatoes	332.0	272.7
Sugar beets	507.1	350.2
Producer prices		
Wheat	36.6 (DM)	66.5 (OM)
Feed barley	33.15	60.3
Rapeseed	89.0	149.0
Potatoes	26.0	48.67
Milk	69.35	163.03

[a] Data is from 1987.

This table is Unclassified.

present, crop yields are roughly 20 percent below West German levels. Moreover, investments in transportation, storage, and distribution systems will remove bottlenecks that currently limit production and raise costs in the GDR farm sector. [redacted] (b)(3)

Analysis by *Agra Europe,* a leading European journal on agricultural issues, projects increases in current GDR production of 20 to 30 percent within a few years as a result of such reforms, with the greatest gains in grain, meat, and milk output. Embassy reporting, however, indicates that some East German officials are less optimistic; they believe that the emphasis being placed on the environment may limit yield increases—or take land out of production—and dampen eastern German agriculture's competitiveness. [redacted] (b)(3)

The Kohl government is committed to aiding farmers in eastern Germany even though enhanced competition for agriculture in the west may result, according to Embassy reporting.[2] West German Agricultural Minister Kiechle is focusing on rationalization of agricultural production and conversion to environmentally sound practices. For example, the Agricultural Ministry in Bonn is likely to urge the GDR to pursue "extensification"—substituting less potent natural fertilizers for the chemical fertilizers used under the Honecker regime's intensive agricultural strategy. In addition, Bonn agreed initially to channel DM 4 billion ($2.4 billion) in 1990 and DM 7 billion ($4.2 billion) in 1991 to the east for structural improvements and environmental upgrading, and has since upped its financial commitment. Bonn also dropped all restrictions and quotas on GDR farm products, according to Embassy reporting, so that raw materials can be shipped to West Germany for further processing. The bulk of this production will be exported—mainly to the USSR and Eastern Europe with EC export subsidies. [redacted] (b)(3)

If, as we expect, Bonn's help permits eastern Germany's agricultural output eventually to outstrip its demand for food, a surge in CAP spending by the mid-to-late 1990s is probable. Surpluses in commodities such as grain would accumulate, forcing the EC to spend vast sums to subsidize exports—if still permitted under post–Uruguay Round GATT rules—or to store the excess.[3] The size of the increase in CAP outlays will depend on world agricultural prices and the health of EC economies. A decline in world food

[2] Regional farm associations in West Germany are pitching in as well. The Bavarian Farmers' Association is organizing seminars and providing information to GDR farmers, including assistance to the newly organized Saxon farmers' association. [redacted] (b)(3)

[3] The USDA estimates that merely bringing East German yields up, and feed use levels down, to West German levels would make approximately 3-4 million tons of wheat and barley available for export each year. We estimate this would result in a $300-450 million increase in CAP spending. (U)

prices boosts subsidies the EC must provide to make its exports competitive and makes the high EC support prices more untenable in the face of rising production surpluses. European economic health influences CAP spending because under a February 1988 agreement increases in outlays are restricted to 74 percent of the Community's GNP growth rate.

East European Farmers: Eyeing the EC Market

A similar, if less rapid, transformation of other East European countries into substantial agricultural exporters would add to the pressure on the CAP, even if the EC does not open its doors to Eastern agricultural produce (see inset, page 7). The region has the potential to become an agricultural powerhouse. Poland and Czechoslovakia have abundant pastureland and meadowland that is ideal for animal husbandry, especially dairying, and orchard production, according to the USDA. Hungary, Romania, Yugoslavia, and Bulgaria already are relatively important food exporters and have broad, fertile land conducive to grain and oilseed crops. These, in turn, can support intensive hog and poultry feeding complexes.

But such a transformation is not certain. While it is relatively easy to project consumption levels, production levels depend heavily on policy choices that have not yet been made and require financing that has not yet been secured. We have devised three scenarios to portray the range of possible outcomes. In all cases, we have assumed that no country in the region becomes a member of the EC by the late 1990s:

- *The status quo* scenario. We assume yields will remain at their 1989 levels and that each country's acreage under cultivation will be in line with the trend established over the last decade. In Poland, for example, the land devoted to agriculture climbed by 7 percent during the 1980s; in Czechoslovakia, Hungary, and Romania, however, the percentage declined as marginal land was taken out of production.

- *The enhanced productivity* scenario, which we consider the most likely case. This scenario takes account of the impact that land reforms,[4] better access to agrochemicals and machinery, and upgraded distribution systems are likely to have on yields. In it, we assume that the East Europeans are able to cut the existing gap between their yields and those of EC members in half, with land under cultivation increasing at the trend rate from the 1980-89 period. The biggest gains would come in Bulgaria, Poland, and Romania. (b)(3)

- *Increased productivity and land use* scenario. This final scenario posits that both productivity and land under cultivation rise. We have assumed that each country's agricultural acreage in the year 2000 equals its past high or the trend value, if that turns out to be larger. Admittedly, development priorities of East European regimes may argue against an expansion in agricultural land use. Indeed, marginal land cultivated during the first decades of Communist rule, when many regimes strove for self-sufficiency, probably would not be returned to farming in an efficiency-oriented market economy. Moreover, environmental damage sustained in once-fertile farm regions may limit various countries' abilities to boost agricultural production (see inset, page 8). (b)(3)

(b)(3)

The differential impact on trade of these three scenarios is most evident in the grain sector. Whereas Eastern Europe remains a substantial net importer in the status quo scenario, the region becomes a significant exporter in the other two (see figure 3). At the end of the decade, enhanced productivity alone would turn the region into a net exporter of nearly 14 million metric tons of grain, with Romania exporting the bulk of the total. With enhanced productivity and more land under cultivation, the region would be a net

[4] Land reforms are already occurring in some countries: Romania has distributed about 27 percent of its agricultural area to the peasantry, and Sofia has promised 30 hectares to any Bulgarian who will cultivate the land. (U)

East European Food Exports: Knocking on the EC's Door

East European countries view agriculture as an important sector of their economies and will emphasize it in their reform programs. It accounts for about 20 percent of the region's GNP and employs nearly 22 percent of the labor force. This compares with 2.3 percent of GDP and 8 percent of the labor force for the EC. Moreover, exports of food and raw agricultural products have been both a major earner of hard currency on Western markets and important in barter trade with the USSR to acquire energy and raw materials.

The East Europeans are pressing for increased access to the EC market—particularly in the meat, dairy, and grain sectors—in order to earn badly needed hard currency to modernize their economies. A Hungarian economic official, for example, has expressed concerns over EC protectionist tendencies, arguing that the EC needs to open its agricultural markets and abandon its agricultural subsidies if it is serious about aiding the East. The EC has always been a key market for East European agricultural goods, taking about a third of the region's agricultural exports. In fact, Eastern Europe is a net exporter of foodstuffs to the Community despite protectionist EC policies, such as quotas on East European beef that were imposed in 1974. (b)(3)

The EC probably realizes that it will have to make concessions to the region in agriculture or face the anomaly of supporting liberalizing economic reforms in the East European countries while still protecting the EC's own highly managed agricultural system. In our view, the EC is likely to grant the East Europeans "controlled access" to its agriculture market—potential East European food exports are in sensitive EC sectors—working out new voluntary-restraint-type agreements with the individual East European countries or expanding old ones. These would most likely be in the meat and dairy sectors, along with some grains. It already has increased the beef quotas granted to Hungary, Romania, Poland, and Yugoslavia, and suspended import levies for sheep and goat meat for all the East European countries except Romania. (b)(3) (b)(3)

exporter of over 27 million metric tons of grain. Romania would again be the biggest producer by far, followed by Hungary and Poland.

The scenarios have a less wide-ranging impact on other agricultural sectors:

- Output of livestock products, such as meat, milk, and eggs, is likely to increase 14 percent if the productivity gap with Western Europe is halved, according to our analysis. The rise could reach 24 percent if farmers increase their herds in response to profits under a market system. Bulgaria, Poland, and Romania will share the largest increases in output.

- The region's output of oilseeds is likely to increase 10 percent over the next decade under the enhanced productivity scenario. Import needs will decline although Eastern Europe will remain a net importer of this product. (b)(3)

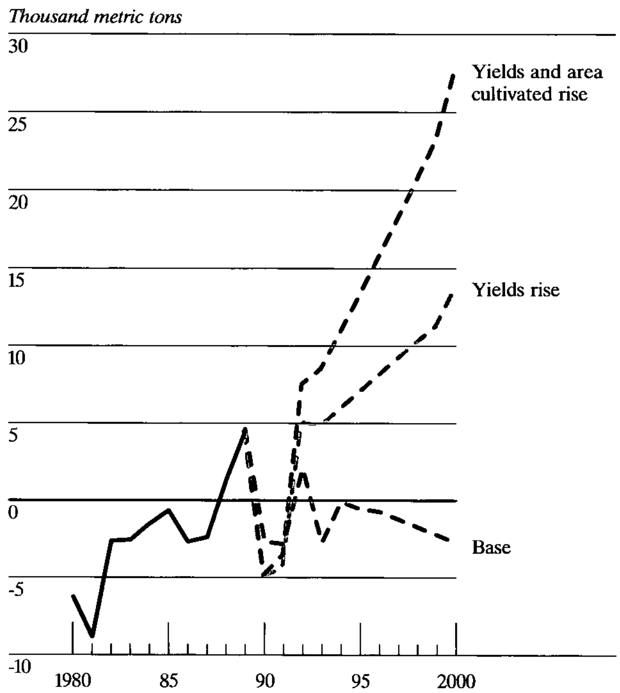
- Vegetable and fruit production is likely to expand only modestly over the medium term. The productivity-enhancing measures we assume for grain cultivation—more use of agrochemicals and machinery—are less appropriate for these crops. Production in this sector is highly labor intensive, and most agricultural experts do not foresee significant increases in this type of effort by the large cooperative farms expected to dominate Eastern Europe's agriculture. (b)(3)

Environmental Degradation in Eastern Europe

Pollution of agricultural lands and water may limit the ability of Eastern Europe to increase food production. Even if it does not, US and EC concerns about health risks and food quality probably will constrain export opportunities:

- *According to Czechoslovak press reports, dairy and livestock products as well as sugar and vegetables contain high concentrations of nitrates because of inappropriate use of fertilizer.*
- *East German journalists allege that overproduction of liquid manure at one state enterprise has released large concentrations of ammonia and nitrate gasses into the atmosphere and ground water, poisoning wells, rivers, and farmland within a 10-mile radius. An entire forest was destroyed and the area now resembles "Afghanistan," according to locals.*
- *Military reporting indicates ground water in Romania remains relatively uncontaminated in the Banat region. Surface water is highly contaminated, however, with bacteria, agricultural chemicals, and heavy metals.*
- *Bulgarians have frequently voiced concerns about the concentration of radioactive materials in the food supply, especially in the aftermath of the Chernobyl' disaster.* [redacted]

Figure 3
East Europe: Agricultural Trade Balance[a]



[a] Data for 1980-89 are based on historical data, those for 1990-2000 are baseline and scenarios.

[redacted] 327613 8-90 (b)(3)

(b)(3)

The magnitude of Eastern Europe's competitive challenge to West European agriculture also will depend on the development of East European trade with the USSR. For the foreseeable future, the region will continue to obtain most of its energy and raw material imports from the Soviet Union, partially in exchange for food and agricultural products. Many East European officials fear that, at least for the next several years, the region's terms of trade with the USSR may well deteriorate, as more and more of their trade is put on a hard currency basis at world prices, according to Embassy reporting. If these concerns prove true, the volume of Eastern Europe's exportable surplus in agriculture going to the USSR almost certainly will not diminish and may well increase. This, in turn, may well limit the increase in East European food exports to the world market. [redacted] (b)(3)

Quantifying the effects of expanded East European production on CAP spending is extremely difficult. Should our most optimistic projections prove correct, the region's net exports would surpass present EC net exports and equal approximately 5 percent of current world grain production. Such a large increase in food exports almost certainly would put downward pressure on world prices, but the price decline could be

Table 2
Eastern Europe: Supply and Demand of Wheat and Coarse Grains

	Area Harvested *(million hectares)*	Yield *(metric tons per hectare)*	Production *(million metric tons)*	Net Imports *(million metric tons)*
1979/80	29.0	3.14	91.1	14.7
1980/81	29.0	3.35	97.2	11.5
1981/82	28.8	3.31	95.3	8.2
1982/83	28.8	3.70	106.6	3.9
1983/84	28.9	3.54	102.3	2.4
1984/85	29.0	3.96	114.8	−0.6
1985/86	28.7	3.56	102.2	4.6
1986/87	29.1	3.86	112.3	2.4
1987/88	28.5	3.61	102.9	4.3
1988/89	29.1	3.59	104.5	3.0
1989/90	29.2	3.73	108.9	4.7

This table is Unclassified.

either mitigated or deepened by weather-related production changes elsewhere, such as a drought-induced shortfall in grains. In any case, EC CAP costs would rise in response to falling world prices. USDA estimates, for example, suggest that—in the reverse case—a 1 Ecu ($1.20) increase in the US export price of wheat results in a nearly $120 million decline in EC export subsidies. [redacted]

Agricultural Surpluses: Sowing the Seeds of CAP Reform

The concerns of the German Government, which is among the most determined defenders of the CAP, are likely to guide the EC's handling of growing European agricultural surpluses. Bonn's traditional protectionist stance on agriculture has been influenced by a mix of political, social, historical, and economic factors, including the homage paid to small family farms as an integral part of West German rural society. At least half of West German payments to farmers are social security payments designed to limit pressures on them to leave farming, even if they are no longer competitive, according to Embassy reporting. These policies have been followed by German governments through the years; indeed, German agricultural trade has been tightly controlled since Bismarck's chancellorship over a century ago. [redacted]

(b)(3)

We expect Bonn to respond more constructively to the pressures for CAP reform likely to emerge during the latter half of the 1990s.[5] The impact of unification on Germany's complicated balance of regional power, even more than economic forces, is likely to be decisive in changing Bonn's hardline agricultural policy. At present, West German agricultural policy is shaped by the politically influential south—Bavarians have held the Agriculture Ministry for over 20 years—rather than the more efficient north, according to Embassy reporting. The development of more efficient farmers in eastern Germany will eventually dilute Bavaria's influence on agricultural policy and probably tip the balance in favor of greater market liberalization. Assuming that northern Germany shares in the economic boom unification is expected to bring, northern farmers are likely to find common cause with their eastern counterparts and be more supportive of a more market-oriented agriculture regime. [redacted] (b)(3)

Other Community members are also likely to view more favorably fundamental reforms of the CAP—tougher production quotas and virtual elimination of subsidized export prices—by the end of the decade. Paris, a frequent hardline supporter of subsidies, already is indicating that it believes French grains are competitive in a free market and occasionally espouses making the CAP more market oriented, according to Embassy reporting. Other factors will probably work to weaken political support for subsidization of agriculture in Europe: (b)(3)

- Concerns over the environmental damage from agricultural overproduction are likely to grow in coming years, pushing the EC to implement reforms that would reduce its agricultural surpluses.

[5] German policymakers will probably also feel pressure for CAP reform from consumers in eastern Germany. While polls consistently show that West Germans are prepared to pay high prices for agricultural products, the reaction of East Germans to the sharply higher food prices that accompanied German economic union clearly shows that they are not. Since income levels in eastern Germany probably will lag those in the west for some time, German leaders will almost certainly encounter pressure to accept reforms that lower food prices in order to ease the burden in the east. [redacted]

(b)(3)

- Demographic trends—especially the expected retirement during the next decade of the majority of farmers in both Germany and France—will reduce the farm lobby's political influence.

- Over time, the EC-92 program of deregulation is likely to help liberalize the agricultural sector. Stronger competition and investment in the European food industry may well build demand for more specialized agricultural products and divert resources away from traditional agricultural goods that currently are in surplus. Cheaper East European products in these traditional areas might, in turn, find a larger EC market.

Nonetheless, the EC will remain committed to some residual protection for agriculture. Over the next several years, as the scope of Eastern Europe's challenge to CAP and world agricultural trade becomes clearer, we expect to see discussion of options ranging from retargeting subsidy policies to market-sharing arrangements. Some aspects of this debate may move Community agricultural policy closer to US preferences:

- Some agricultural lobbyists have advocated "greater regionalization" of the CAP. This idea, which is opposed by many Europeans as a step away from a "common agricultural policy," would grant national governments more latitude in providing aid. Even though Bonn is likely to stop short of embracing regionalization as a concept, we believe it will boost direct subsidies—perhaps in the form of regional aid—to German farmers.

- Alternatively, the Commission and member states might opt to substitute direct income supports to farmers for price supports. This would bring European agricultural policy more in line with US farm policy, but the EC has staunchly resisted this approach because it believes that income supports would create production distortions of their own in the agricultural market and weaken countries' abilities to correct the imbalances.

At least one option that may appeal to the highly influential Germans could pose a major obstacle to US exports to Western Europe, however. More specifically, Bonn may be increasingly attracted to the idea of a global market-sharing arrangement in which the European market would be closed to non-European farmers in exchange for ending the dumping of surplus EC food on the world market. This policy has been primarily advocated by farmers in southern Germany. Conservative leaders in the north have begun to back it, too. Proposals to limit the access of US agricultural products to the Community—particularly soybeans and nongrain feedstuffs—could receive increasingly serious attention. (b)(3)

Although we believe the EC would be reluctant to push openly for direct limits on US agricultural products out of fear of retaliation, the Community is likely indirectly to limit US access to its agriculture market by granting greater access to East European producers of lower priced products. Some Europeans are beginning to believe that, if the EC market must be opened, they would rather have the East Europeans the beneficiaries than US farmers, according to Embassy reports. Association agreements that are likely to be negotiated between the EC and East European countries in the next year probably will be the vehicles for setting up such a market-sharing regime. (b)(3)

(b)(3)

~~Confidential~~

~~Confidential~~

Approved for Release: 2018/08/22 C06296175