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Some Economic Effects of EC Agricultural Trade Preferences for Central Europe

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Abstract

Beginning in 1988, the EC began to grant trade preferences to countries in Central Europe, first by including these countries in its GSP, later by concluding Association Agreements. Agricultural products figure prominently in the preferential arrangements. The paper describes the nature of these preferences, discusses issues involved in analyzing their economic implications, and provides preliminary quantitative estimates of the benefits accruing to the countries in Central Europe.

I. Introduction

Closer economic integration between the European Community and Central Europe is an important instrument in EC foreign policy towards the countries of the former Eastern Bloc. Trade preferences are central to this process. As agriculture is one of the potentially competitive sectors in the economies of Central Europe, preferential access to EC agricultural markets has right from the beginning played an important role in the debate about the emerging new economic relations between Western and Central Europe.

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Farmers in the EC have been full of fears about increasing competition from the east, and some traumatic (though limited) difficulties on EC agricultural markets resulting from growing shipments from the former GDR and Central Europe in 1990 have led to strong opposition against more significant agricultural concessions for Central Europe. As one the consequences, negotiations with the CSFR, Hungary and Poland about Association Agreements have been rather difficult when it came to agricultural trade preferences. Yet, in these Agreements the EC has made agricultural concessions of a nature which goes significantly beyond earlier preferential arrangements.

This paper looks into some of the economic effects which may result from the agricultural trade preferences which the EC has granted to Central Europe. It concentrates on the three countries in Central Europe with whom the EC has, so far, concluded Association Agreements. In the following section, the design of EC agricultural trade preferences for Central Europe is briefly outlined. In section III, some of the issues involved in assessing the effects of such trade preferences are discussed. Section IV presents some preliminary results of attempts at estimating the value of preference margins resulting from the existing arrangements.

II. The Design of EC Agricultural Trade Preferences for Central Europe

When the process of transformation started in Central and Eastern Europe, the European Community responded promptly, in a serious attempt at providing political and economic support. Indeed, the European Community appreciated the eminent political significance of developments among its eastern neighbors, and it was prepared to accept a good share of responsibility for paving the way *back to Europe* for the states in Central and Eastern Europe. Consequently, the EC was right from the beginning active in pursuing various measures of support to countries in Central and Eastern Europe ⟨Guth, [1992]⟩. As early as July 1989 (after the Paris Summit) the Commission of the EC accepted the mandate given to it by the community of Western states to coordinate help of the 24 OECD countries (G-24) for Central and Eastern Europe. Shortly later the EC started its own support actions under the PHARE programme, which provides aid for economic restructuring, and also opened up credit facilities of various types.

Moreover, the EC started early to extend trade preferences to Central and Eastern Europe. Beginning in 1988, trade preferences for Central Europe were in fact rapidly broadened, both with respect to the type of preferences granted and the recipient countries. In this process, the typical progression regarding the type of preferential treatment extended by the EC was, first, to eliminate quantitative restrictions against imports from Central Europe which had remained from the times of non-GATT treatment of COMECON members, Second, the EC began to include individual countries in Central Europe in its Generalized System of Preferences (GSP), and to add some products of particular export interest to countries in Central Europe to the GSP list. At a third stage, more elaborate measures were agreed in Trade and Cooperation Agreements. The fourth, and for the time being last stage was reached when the EC entered into Association Agreements (*Europe Agreements*) with countries in Central Europe. As the preambles of these Europe Agreements explicitly say, association is supposed to pave the way towards the logically final stage, *i.e.*, membership in the European Community, at some not yet determined point in the future.

Selectivity has always a feature of the Community's approach to preferential trading arrangements ⟨Hine [1985]; Matthews [1991]; Tovias [1990]⟩. It is therefore no wonder that the EC has been deliberately selective in the way it extended trade preferences to Central and Eastern Europe. As a result, the extent to which countries in Central and Eastern Europe have access to EC markets now differs widely from case to case ⟨Langhammer [1992b]⟩. At the top of the hierarchy are the CSFR, Hungary and Poland after they initialed, in December 1991, Association Agreements with the EC. The trade provisions of these agreements have been put in force on March 1, 1992. At the next highest step on the ladder of preferential treatment are Bulgaria and Rumania which are still in the process of negotiating Association Agreements with the EC. At a lower step come the three Baltic states which have been included in the Community's GSP scheme since February 1992. At the lowest level are the states of the former Soviet Union, which do not benefit from tariff preferences but can lean on the Trade and Cooperation agreements concluded with the Soviet Union in 1989 and 1990.

In spite of the current diversity of treatment by the EC among the countries of Central and Eastern Europe, there is an emerging trend towards more uniformity. The Association Agreements which are now being negotiated with Bulgaria and Rumania may look rather similar to the first round of Europe Agreements ⟨Guth [1992]⟩. Moreover, there is now occasional talk of possibly entering into negotiations about Association Agreements with the Baltic states as well. In other words, until the (probably not so near) time when the European Community is enlarged to the East, the Europe Agreements may be the basic model of how relations between the EC and its eastern neighbours are shaped.

It would certainly be wrong to assess the Europe Agreements solely from the perspective of their economic implications, let alone their consequences for agricultural trade. These agreements attempt to lay a new foundation for the totality of relations between the EC and its eastern neighbours, and they embrace areas as wide and important as political coordination and cultural exchange. Yet, for the countries in Central Europe the expected economic benefits have eminent importance, and among these economic benefits, improved access to the Community's agricultural markets is considered essential.

Agricultural trade preferences as granted by the EC in the Europe Agreements come in six major forms.[1]

Type a: For some agricultural products, variable levies are reduced by one half, for maximum quotas which increase over time. This category includes meat of geese, ducks and pigs, as well as sausages and potato starch.

Type b: For a small number of products, tariffs are reduced, without quantitative restrictions. Products falling in this category are mainly game meat and specific types of fruit and vegetables.

Type c: For a number of products, variable levies are progressively reduced, by 20% in the first year, 40% in the second year, and 60% in later years. Levy reductions are limited to given quantities, which tough increase over time. This type of regulation applies to certain types

1 Council Decisions of 25/2/1992: 92/228/EEC, Official Journal L 114/1 (Poland); 92/229/EEC, L 115/1 (CSFR); 92/230/EEC, L 116/1 (Hungary).

of beef, pork and poultry meat, some dairy products, eggs and a limited number of cereals and cereal products.

Type d: For selected fruit and vegetable products and tobacco, tariffs are progressively reduced for quotas which increase from year to year.

Type e: For selected processed foods, the fixed tariffs, as well as the variable levy elements on the raw products contained in these foods, are progressively reduced for limited quantities which increase by 10% per year.

Type f: For a given quantity of live bovine animals for fattening, variable levies are reduced by 75%, and this preferential quota is not reduced even if other third countries (which also benefit from a levy reduction of this type) have to cut back their preferential exports in times when the EC feels it has a reduced import requirement.

Preferences of *types a* and *b* essentially extend the equivalent preferential treatment which the products concerned have already enjoyed under the GSP.[2] Preferential treatment of *type f* also extends (and consolidates, as far as the unreduced quota is concerned) similar regulations which existed earlier. As a matter of fact, these *preferences* for live bovine animals for fattening are of a somewhat dubious value as licences for preferential quotas are issued primarily to importers in the EC, with the likely result that quota rents resulting from levy reduction flow to companies in the EC, rather than to the Central European countries.[3]

The preferential quotas for beef and sheep meat falling under preference *type c* can be reduced if the EC grants aid for equivalent shipments from the three Central European countries to the former Soviet Union.

This rather complex structure of different types of agricultural preferences has been carefully designed by the EC, in a difficult process of negotiations, such that it essentially reflects the degree of political and economic

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2 Indeed, some products for which the EC had granted preferences under the GSP are no longer included in the Europe Agreement. Since the CSFR, Hungary and Poland no longer have access to GSP preferences, their benefits have deteriorated rather than improved as far as these products are concerned. The number of these products is relatively large, but export revenue affected is comparatively small.

3 For this reason, preferences of *type f* have not been included in the estimates of preference margins presented below.

sensitivity of the various agricultural products concerned. As a general rule, the EC has been relatively generous where agricultural exports from the three Central European countries do not seriously compete with domestic agricultural production in the EC, but it has strictly limited the quantities enjoying preferential treatment for products in which the EC already has a surplus and/or where politically important groups of EC producers are concerned (*e.g.*, French beef producers). Indeed, with the exception of some rather *exotic* products (preferences of *type b*), all agricultural preferences are constrained by quotas. In other words, contrary to the treatment of industrial products (excluding textiles and coal, iron, steel), where bilateral free trade (gradually to be introduced during an adjustment period) was agreed, agricultural trade between Central Europe and the EC will continue to be regulated by rather strict interventions.[4]

Unfortunately, from the perspective of the three Central European countries, the *sensitive* agricultural products in the EC also tend to be those products where improved market access would be of particular interest to Central Europe. Accordingly, negotiations between the EC and the three Central European countries were rather difficult, and at some stages close to breakdown, in the area of agricultural preferences. Indeed, had it not been for the dramatic political events in the Soviet Union in summer 1991, the EC might have found it even more difficult to make significant concessions in the negotiations, and the results might have been even more disappointing for the CSFR, Hungary and Poland.

On the other hand it must not be overlooked that the nature of agricultural preferences granted to the three Central European countries by the EC goes much beyond preferences which any other third countries enjoy in agricultural trade with the Community (with the possible exception of beef and sugar preferences for some ACP countries under the Lomé arrangements). After all, in the Europe Agreements the EC has made some concessions concerning the core of its agricultural trading regime, *i.e.*, the variable levies.

The extent to which the Europe Agreements provide improved access to the Community's agricultural markets is certainly less than the three Cen-

4 For an overall assessment of the economic arrangements in the Europe Agreements, see Langhammer [1992a] and Kuschel [1992].

tral European countries would have liked. Yet, the economic value of these preferences may still be significant. Whether this is indeed the case, is a matter of quantitative assessment. Some preliminary estimates will be presented below, after a short discussion of some issues involved making such estimates.

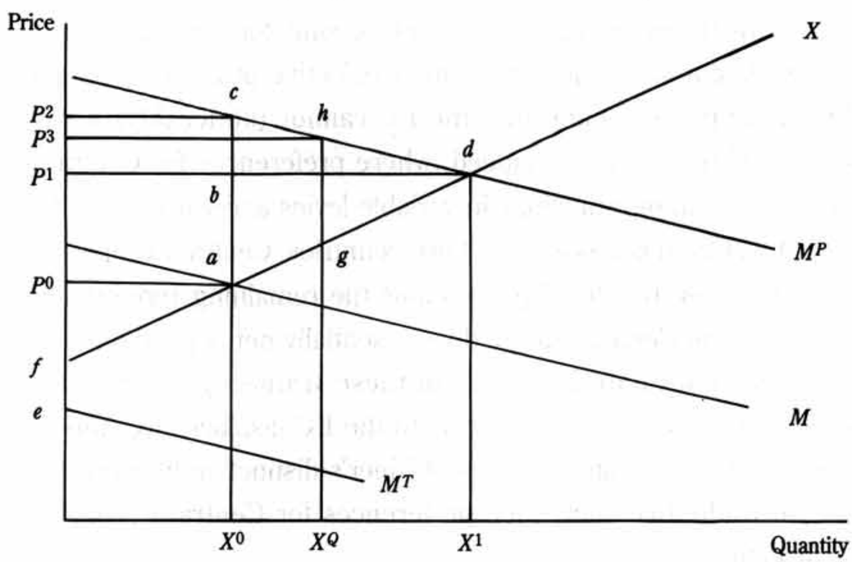
III. Some Issues in Analyzing the Economic Effects of Agricultural Trade Preferences for Central Europe

Trade preferences can have many types of economic effects, in the recipient country, the donor country and in the of the world. As far as welfare effects are concerned, there has been much debate about whether or not trade preferences (or customs unions) tend to increase world welfare. Also, the welfare effect on the country granting preferences (the donor) is not unambiguous, and in many cases the donor loses. However, there is agreement among economists that non-preferred third countries tend to lose under most conditions, and that the country receiving trade preferences (the recipient) gains in essentially all cases.[5] Indeed, the economic gain to the recipient is the most obvious reason for establishing trade preferences. The donor country would not necessarily expect to reap economic benefits, but aims at political advantages (or simply yields to political pressure), and third countries' interests are anyhow often disregarded in the process of negotiating preferential arrangements.

However, are the economic gains to recipients really large? Of course this must depend on the circumstances of the case concerned. In the standard static partial equilibrium framework, the most important factors determining the magnitude of the recipient's gains from trade preferences are the size of the preference margin, the price elasticities of import demand (in the donor country) and export supply (from the recipient country). In Figure 1, M is the pre-preference import demand of the EC, *i.e.*, the EC import demand curve faced by Central Europe before it received preferences from the EC. M^P is the demand for imports from Central Europe after the EC established trade preferences. In other words, the margin of preference

5 See the survey article by Pomfret [1986].

Figure 1
Market Effects of Trade Preferences



granted to Central Europe is the vertical distance between these two lines ($ac = P^0P^2$). Central Europe's export supply is illustrated by X. In the absence of quotas, preferential treatment results in an expansion of Central Europe's exports from X^0 to X^1, the price at which Central Europe's exports sell on the EC market drops from P^2 to P^1, and the price received by Central Europe increases from P^0 to P^1.

How much of the preference margin (P^0P^2) results in a price gain to Central Europe (P^0P^1), depends on the extent to which the price received on the EC market drops as a result of increased deliveries to the EC, and this in turn depends on the price elasticities of import demand and export supply. Hence, in an empirical estimate one has to make (notoriously difficult) assumptions about these elasticities.[6] For most of the agricultural preferences granted to Central Europe by the EC, one can assume that EC demand for imports from Central Europe is fairly elastic, for two main rea-

6 For an analysis of EC trade preferences for Hungary where such elasticities are assumed, see Tovias and Laird [1991].

sons. First, the volume of imports from Central Europe is small relative to the total EC market for the products concerned (with some exceptions), and agricultural products are relatively homogeneous so that imports from central Europe *disappear* in the large EC market, rather than depressing the price in a small specific market segment. Second, for most agricultural products the EC pursues a policy of rather effective price support, such that additional imports coming into the EC cannot (noticeably) depress the domestic EC market price. Indeed, where preferences for Central Europe come in the form of reductions in variable levies and where the EC continues to import from non-preferred third countries, Central Europe is likely to receive the given threshold price minus the remaining (preferential) levy, and that price to Central Europe does essentially not depend on the volume of imports from Central Europe. In these (rather frequent) cases, any increase in Central Europe's exports to the EC displaces EC imports from the rest of the world, and in terms of Viner's distinction between trade creation and trade diversion, such preferences for Central Europe are fully trade diverting.

Where these conditions hold, EC demand for imports from Central Europe can be assumed to be infinitely elastic. The preference margin is then fully reflected in a price gain to Central Europe. In the preliminary estimates presented below, this assumption is made throughout. In reality, EC demand for imports from Central Europe may not in all cases be infinitely elastic, and actual price gains may therefore be somewhat less than calculated here. However, as shown in the appendix, even if EC import demand is not fully elastic, the extent to which price gains are overestimated here is relatively small for most plausible elasticity constellations, possibly in the order of magnitude of 20%.

Another factor limiting the price drop on the EC market for most agricultural products is the quantitative restriction on the volume of preferential exports. In Figure 1, a quota X^{Q} on preferential exports keeps the price received in the EC at P^{3}. Indeed, fears that expanding imports from Central Europe might depress market prices in the EC are the main reason for setting these quotas.

In public statements about the economic effects of trade preferences granted to Central Europe, it is common to refer to the gains in foreign exchange revenue which might accrue to Central Europe. Important as foreign exchange earnings *per se* might be for Central Europe, it would be wrong to confuse them with gains in economic well being. After all, shipping more exports to the EC is not costless to Central Europe. The additional quantities exported, as a result of preferences, to the EC have to be either produced or foregone in domestic consumption, and in both cases this involves economic costs. Alternatively, additional exports to the EC can mean less exports to other countries and therefore less foreign exchange earnings from other sources. In any case the welfare gain resulting from EC preferences is less than the increase in revenues from exports to the EC.

In Figure 1, with an expansion of exports to X^1 and an increase of the price earned to P^1, Central Europe's export revenues will increase by the price gain on the original volume of exports (area P^0P^1 *ba*) because the area below the supply curve (X^0X^1 *da*) represents the cost of expanding exports to the EC. As a matter of fact, in quantitative terms the welfare gain to Central Europe is not much larger than the price gain on the original volume of exports.[7] Again, if the expansion of preferential exports is constrained by quotas, the difference between the welfare gain and the price gain is even smaller.

On the other hand, it is not even certain that the total potential price gain resulting from preferences actually accrues to Central Europe. Only two of the various relevant factors shall be mentioned here. First, where existing tariffs or levies are prohibitive, not all of their reduction results in a price gain for the exporting country. In Figure 1, if the protection of the EC market is so high that the original import demand of the EC is M^T, that part of the levy reduction which is equivalent to the distance to the distance between points *e* and *f* does not result in a price gain for Central Europe. In these cases one would expect pre-preference exports from Central Europe to the EC to be zero, and a calculation of the price gain based on the volume of pre-preference exports would anyhow not show any gain. However, market conditions keep changing, and it may well be that a given levy was not prohibitive in the base period, but would be prohibitive in the period when preferences begin to work. In particular, EC variable levies are essentially

7 For example, for a price gain of 20 per cent and a supply elasticity of 1, the welfare gain is only 10 per cent larger than the price gain on the original quantity. See appendix.

prohibitive against any imports if there is a surplus on the EC market such that the domestic EC price falls below the threshold price. If an EC market for a given product turns into a surplus situation after preferences have been granted, it would be wrong to assume that all of the preferential levy reduction results in a price gain to the preferred exporter.[8]

Second, where quantitative restrictions effectively constrain the volume of preferential exports to the EC, there is a quota rent. In Figure 1, with quota at X^Q, the quota rent per unit is equivalent to the distance between points *g* and *h*. In such cases there is the issue of who eventually collects that rent. In particular, does it accrue to agents in Central Europe, or does it flow to enterprises in the EC? If some or all of the quota rent flows to companies in the EC it would be wrong to assume that all of the theoretical price gain results in a welfare benefit to Central Europe.

The actual distribution of quota rents will depend on the procedure chosen for allocating licences. The approach adopted by the EC is such that not only exporting companies from Central Europe, but also domestic companies in the EC can apply for licences.[9] This would suggest that indeed not all quota rents flow to Central Europe.[10] Moreover, in some cases exporting companies from Central Europe may well be joint ventures with companies from the EC, and in such cases even more of the quota rent may end up in the EC, rather than adding to economic welfare in Central Europe.

It is extremely difficult to obtain empirical information on the actual procedures used for allocating preferential quotas and on their results. Hence for the time being we are unable to say which companies from which coun-

8 A different way of conceptualizing this situation is to note that the EC import demand curve becomes completely inelastic at the point where the EC market turns into a surplus. In principle this can also happen as a result of increased exports from Central Europe to the EC, if these exports taken together with domestic EC supply just happen to make the EC switch from a deficit to a surplus situation. In a special situation like that the assumption suggested above that the EC import demand curve tends to be rather elastic no longer holds.

9 This is true for quotas under both GSP and the Association Agreements.

10 As mentioned above, in the case of live bovine animals for fattening the relevant EC regulation even says that EC agricultural producers and their associations shall have priority in receiving licences. In this case it is unlikely that any quota rent accrues to agents in Central Europe.

tries have received which licences.[11] Indeed, where constrained preferential exports have come from more than one country in Central Europe (as for example in the case of pork loins and ducks) we cannot even say which Central European country has received which share in the total quota.[12]

As a related matter, even if exporting companies attracting quota rents are fully owned by agents in Central Europe such that welfare gains indeed accrue to Central Europe, it is not at all certain, indeed it is rather unlikely, that most of the preferential benefits flow to agricultural producers in Central Europe. It is more likely that rents will effectively be attracted by intermediaries, which for the time being are often still state agencies.[13]

Finally, there is the issue of safeguards which the EC can invoke in case exports from Central Europe cause serious difficulties on EC markets. Safeguard measures not only restrict market access when they are invoked, they also cause uncertainty for exporters simply because of their existence. The extent to which this reduces the value of trade preferences, though, is difficult to assess in quantitative terms.

IV. Some Preliminary Estimates of Benefits for Central Europe

With all the comments made in the preceding section, it is clear that any attempt at estimating the economic effects of EC preferential trading arrangements with Central Europe is a risky exercise. Moreover, in addition to the conceptual and empirical difficulties involved in making the appropri-

11 About the only information we have so far is that in some case the total amount of licence applications was far above the available quota, which suggests that quota rents were significant in these cases. For example, for frozen pork loins under GSP, licence applications from Central Europe were 17 times the available quota in the first quarter of 1990 and increased to 130 times to quota in the third quarter of 1990. On aggregate in 1990, only 15 per cent of quantities for which licences had been requested were actually shipped, and these shipments were three times the preferential quota ⟨Overberg [1992]⟩.

12 Global quotas for all eligible countries have existed under GSP. Under the Association Agreements, quotas are set by country of origin.

13 According to EC rules companies applying for licences have to prove that they have been in the trade for at least twelve months. For the time being this rule tends to favour established state enterprises.

ate assumptions, it is technically difficult to deal with the enormous number of products included in the arrangements to collect the relevant data, and to take appropriate account of the sometimes rather complex nature of the specific rules for each category of preferences.[14]

In a first, still preliminary attempt at providing a feel for orders of magnitude we have concentrated on estimating preference margins. The total value of the preference margin for each individual product has been calculated as the quantity exported to the EC times the difference between MFN levies (plus other duties) and preferential levies (plus other preferential duties). Taking the full difference between MFN rates and preferential rates as the preference margin per unit means that implicitly we have assumed given prices in the EC, *i.e.*, an infinitely elastic EC demand for imports from Central Europe.

As far as export quantities from Central Europe are concerned, different assumptions have been made for two different categories of products. For products where preferential treatment is not contained to given quotas (preferential treatment of *type b*), actual export quantities of 1990 have been used.[15] This is certainly not problematic as far as estimates of preference margins for 1990 are concerned. In later years, Central Europe's exports of

14 For example, EC import rules (MFN) for some processed foods provide for an *ad valorem* tariff plus a variably levy element for the raw products contained. In some cases, though, the *ad valorem* tariff is limited to a maximum specific tariff. Preferential arrangements, too, provide for a (reduced) *ad valorem* tariff, limited to a (reduced) maximum specific tariff, and for a (reduced) additional tariff to cover the raw material content. For calculating the preference margin in a case like that, it is necessary, among others, to determine whether the unconstrained ad valorem tariffs or the maximum specific tariffs apply, for both MFN and preferred imports, and to consider the appropriate tariff rates jointly with the raw material elements, before the net revenue to a MFN exporter and a Central European exporter can be estimated. Also, the variable elements on raw material contents have to be calculated from the variable levies on the basic raw products and from input coefficients ⟨Overberg [1992]⟩

15 1991 data have not yet been available to us in machine readable form at the time of making these estimates. The statistical source used for trade quantities and values is Eurostat, *Monthly EEC External Trade* (Combined Nomenclature), CD-ROMs. Tariff and variable levy information has been taken from a magnetic tape provided by the German customs service.

these products to the EC may expand, as a result of both supply elasticity and productivity gains. Hence for this category the total value of the preference margin may be underestimated.

For products where quotas constrain preferential access to the EC, the results presented here have been calculated under the assumption that quotas are always filled. In other words, for these products we have estimated the maximum potential benefit, which may not always be reached. On the other hand it appears likely that quota exports will be filled in most cases, simply because there would otherwise not have been much reason for the EC to insist on setting these quotas.

Prices used actual unit values from 1990. Variable levies are averages of those applicable in the second half of 1990 and the first quarter of 1991.[16]

A first fact to note is that the overall importance of agricultural exports to the EC differs significantly among the three Central European countries with whom the EC concluded Association Agreements. While the share of agricultural products in total exports to the EC is one quarter for Hungary and one fifth for Poland, it is only 8% in the case of the CSFR ⟨see Graph 1⟩. Preferences agreed in the Association Agreements cover only some part of all agricultural exports to the EC. Based on 1990 trade values, the value share of agricultural products with preferential treatment under the Europe Agreements differs between 45% (Poland) and 66% (Hungary) of all agricultural exports to the EC ⟨Graph 1⟩.

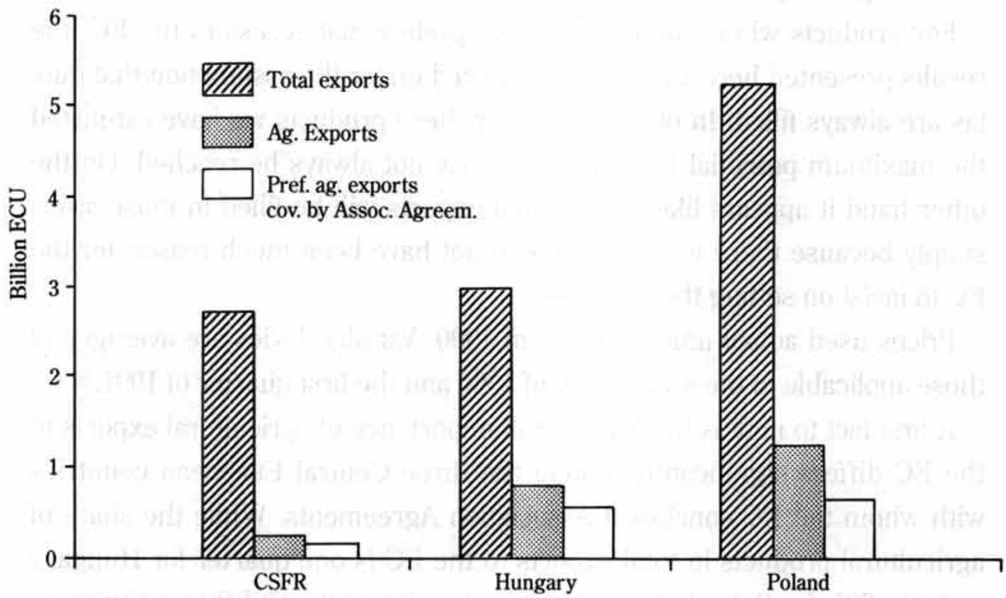
For the time being, the total value of preference margins for agricultural exports to the EC is a relatively small share of total agricultural exports. In 1992 it is no more than 3.2% of the total (1990) value of all agricultural exports to the EC for Poland, 4.5% for Hungary, and 5.4% for the CSFR ⟨Graph 2.⟩[17] Of course, percentages are higher if preference margins are presented as a share of the export value of only those agricultural products which benefit from preferences under the Association Agreements ⟨Graph 2⟩.

16 For important product groups, variable levies in this base period were well in line with average levies over the last six or seven years.

17 For the first two months of 1992, GSP preferences applied, while from March on preferences under the Association Agreements became effective, under the interim agreements. The estimates for 1992 presented here are the sums of the effects of these two different arrangements in 1992.

Graph 1

Central Europe's Exports to the European Community, 1990



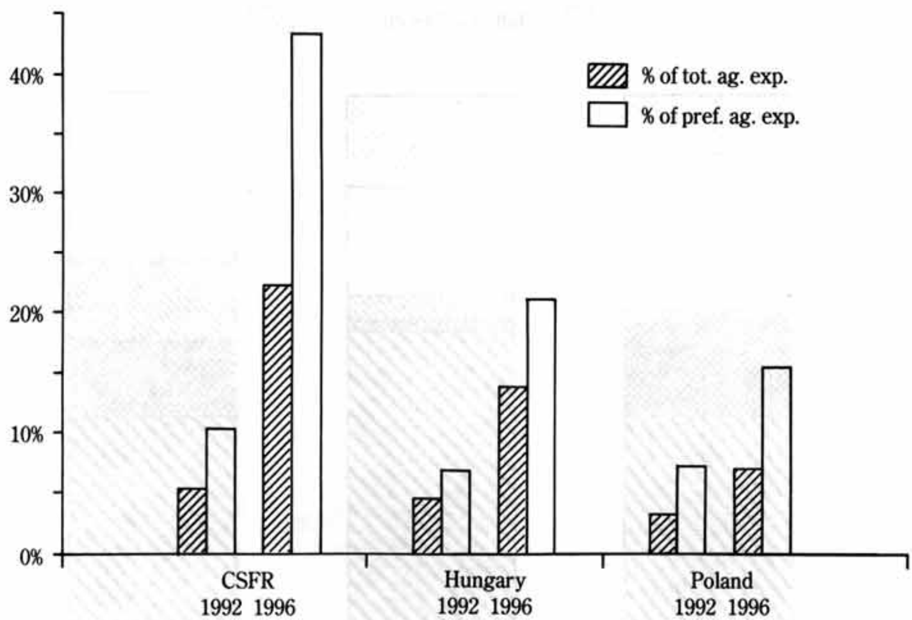
Moreover, with the annual increases in both the volume of preferential quotas and the size of levy and tariff reductions agreed in the Association Agreements, the value of preference margins will grow over time. In 1996, the total value of preference margins may have reached 7% of total 1990 agricultural exports to the EC for Poland, 14% for Hungary, and 22% for the CSFR[18] ⟨Graph 2⟩. Again, in relation to the 1990 export value of only preferentially treated products percentages are much higher.[19]

As far as the product composition of preference margins (as estimated for

18 1996 values for the "CSFR" could be interpreted as the aggregate of values for the Czech and Slovak Republics if (a) the creation of these two separate states does not fundamentally change the volumes of their aggregate trade with the EC, and (b) preferences in the current Association Agreement with the CSFR are proportionately divided among the two states.

19 In the case of the CSFR, one reason why percentages in relation to the 1990 export value of products covered by Association preferences are so high is that the CSFR was not yet included in the GSP in 1990, so that the value of its exports of the products concerned was still rather low.

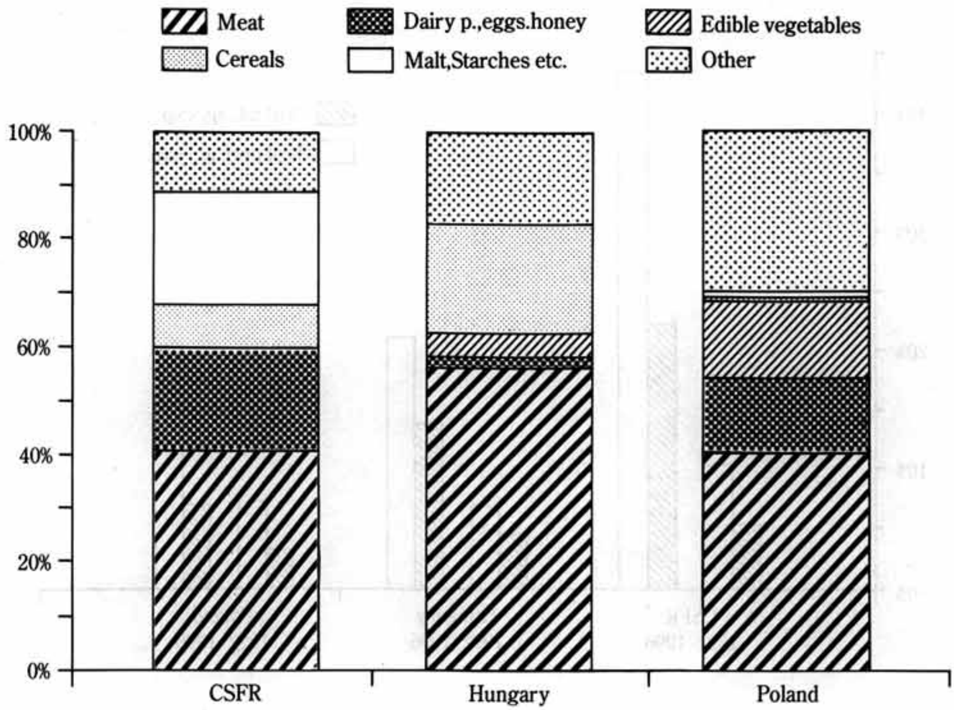
Graph 2
Preference Margin in Relation to 1990 Agricultural Exports



1996) is concerned, meat has the highest share in all of the three Central European countries ⟨Graph 3⟩. Another important product category for the CSFR and Poland is that of dairy products, eggs and honey, while cereals are particularly important for Hungary, milling products for the CSFR, and vegetables for Poland.

Another interesting aspect is the relative importance of the various types of preferential treatment in EC agricultural trade with the three associated countries in Central Europe. That type of preferential arrangement which goes deepest to the core of EC agricultural protection and which therefore was most difficult to agree in the negotiations, *i.e.*, progressively increasing levy reductions on progressively increasing quotas (*type c,* see above page 155), is indeed of particular and growing importance to all three Central European countries ⟨Graph 4⟩. Preferential arrangements which existed already under the GSP (*types a* and *b*) will remain important for Hungary and Poland[20], and progressive reductions of tariffs on increasing quotas of

Graph 3
Share of Major Product Groups in Total Preference Margin, 1996



fruit, vegetables and tobacco (*type d*) will become significant for these two countries[21]. Benefits from concessions on processed foods (*type e*) are small relative to the overall value of preference margins.

As argued above, the value of the preference margin is relatively close to the welfare gain accruing to an exporting country as a result of trade preferences. The (preliminary) estimates of aggregate preference margins presented here may therefore be indicative of the size of benefits which the Central European countries may derive from agricultural trade preferences granted by the EC. A completely different measure is the increase in export revenues resulting from preferential treatment. With completely elastic

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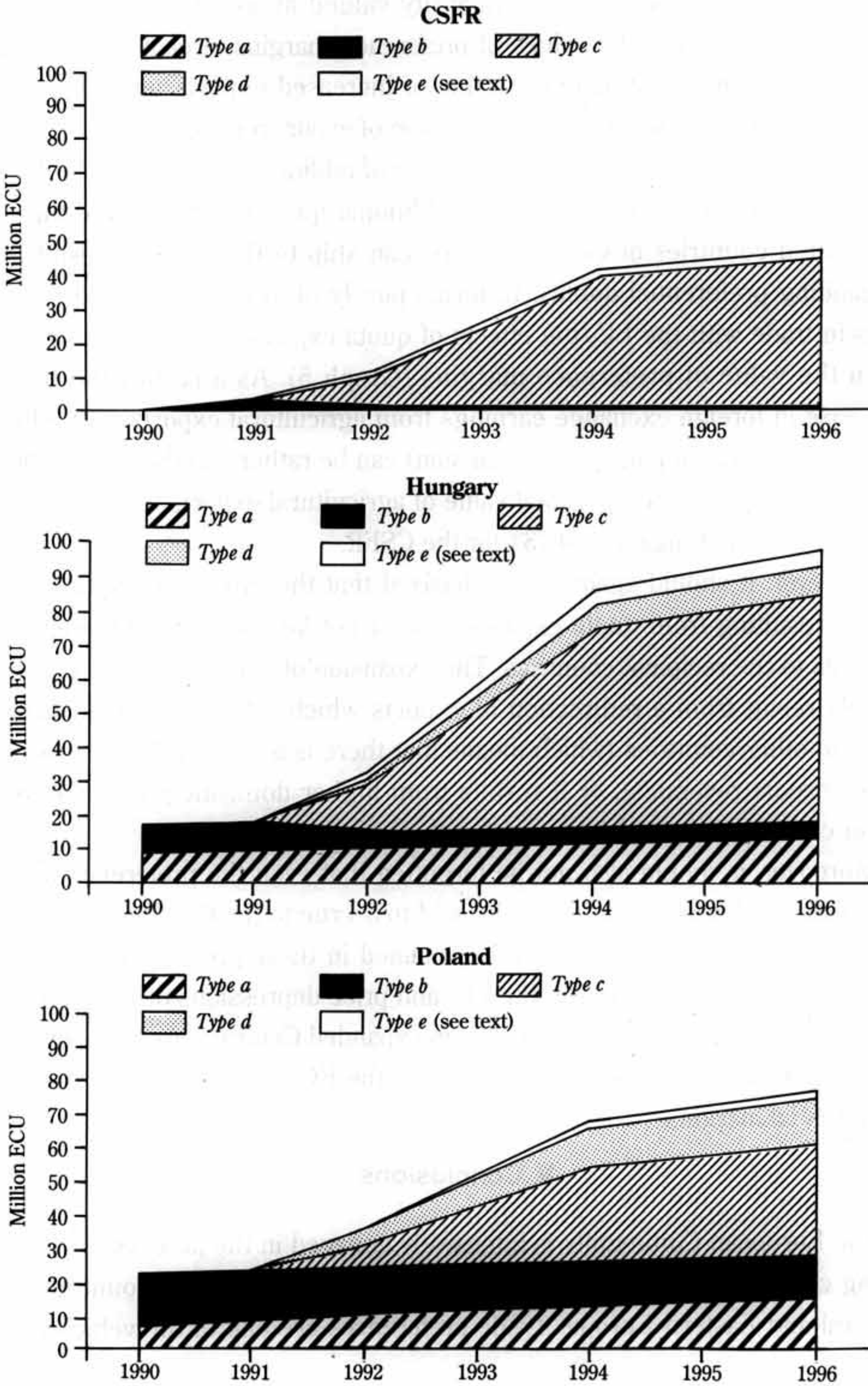
20 If quantities shipped under these arrangements should increase over time (rather than remain at their 1990 volumes as assumed in the calculations), these types of preferences could gain in importance.

21 Preferences of *type d* have not been extended to the CSFR.

Graph 4
Preference Margin by Type of Preferential Treatment



import demand, the increase in export revenues is identical to the sum of (a) the value of preference margins on total exports to the donor country, and (b) the increase in export quantity valued at world market prices. Hence, in addition to the values of preference margins already presented, one would want to estimate the value of increased exports under preferences in order to assess the total expansion of export revenue.

As a first step in estimating the volume of additional exports to the EC, we have calculated the value of the additional quantities which the three associated countries of Central Europe can ship to the EC as a result of expanding preferential quotas. In terms purely of foreign exchange earnings in trade with the EC, the effects of quota expansion are much higher than the value of preference margins ⟨Graph 5⟩. As a result, the total increase in foreign exchange earnings from agricultural exports to the EC (preference margin plus quota expansion) can be rather significant by 1996, as much as 19% of the 1990 total value of agricultural exports to the EC for Poland, 44% for Hungary, and 73% for the CSFR.

However, it should again be emphasized that the growth in export revenues resulting from quota expansion must not be confused with welfare benefits to the recipient countries. The expansion of exports to the EC may simply result from a redirection of exports which otherwise would have gone to other countries (which means that there is a corresponding loss in other export revenues), or it results from higher domestic production or lower consumption (which means that there are domestic costs).

Moreover, it should also not be forgotten that even the preference margins estimated here cannot safely be said to accrue to the Central European countries. Parts of the quota rents contained in these preference margins may well flow to companies in the EC, and price depressions of EC agricultural markets, as possibly resulting from expanded Central European export or from increasing domestic production in the EC, may reduce the size of preferential margins.

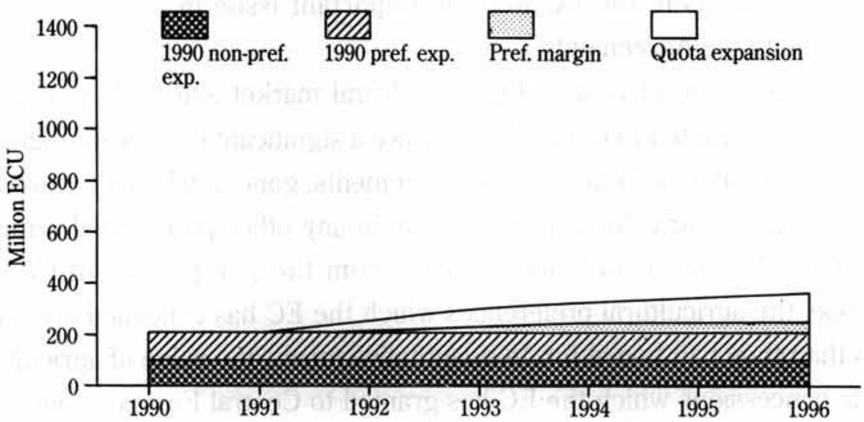
V. Conclusions

The European Community is intensively engaged in the process of developing closer and deeper economic and political links with the countries of Central and Eastern Europe. Trade preferences are one of the vehicles in

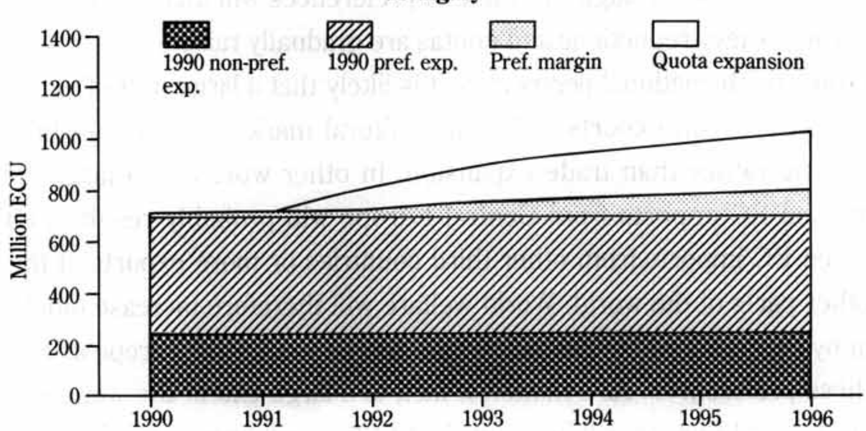
Graph 5

Value of Agricultural Exports to the EC

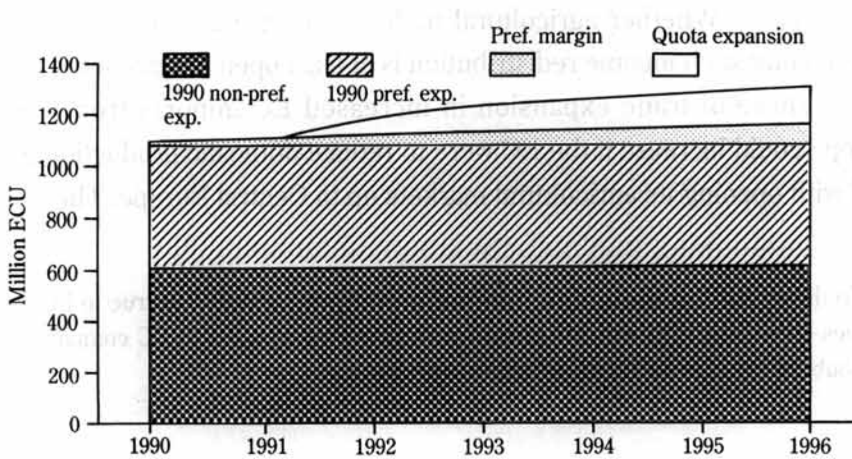
CSFR



Hungary



Poland



this process. In the Association Agreements which the EC has concluded with the CSFR, Hungary and Poland, trade preferences figure prominently. For the three Central European countries, improvements of access to agricultural markets in the EC were an important issue in the negotiations which led to the Agreements.

From the point of view of EC agricultural market and trade policy, the preferences granted to Central Europe are a significant concession. After all the Community has, in the Europe Agreements, gone much further towards opening up its agricultural markets than in any other preferential arrangement the EC had concluded before. From the perspective of Central Europe, the agricultural preferences which the EC has conceded are much less than they had hoped for. In quantitative terms, the value of agricultural trade concessions which the EC has granted to Central Europe is not more than a few percentage points of their export earnings from agricultural trade with the EC, though the value of preferences will increase in the coming years as levy reductions and quotas are gradually raised.

From an international perspective it is likely that a large part of increased Central European exports to EC agricultural markets will result in trade diversion, rather than trade expansion. In other words, to a large extent increased EC imports from Central Europe will probably result in either reduced EC imports from other third countries or more exports of the EC to other parts of the world. World welfare will therefore increase much less than by the welfare benefits which may accrue to Central Europe as a result of these preferences. As a matter of fact, to a large extent the welfare benefits to Central Europe will be equivalent to reduced levy and tariff revenues in the EC, *i.e.*, income will be redistributed from EC taxpayers towards Central Europe.[22] Whether agricultural trade is a particularly efficient vehicle for effecting such income redistribution is at least open to questioning.

The share of trade expansion in increased EC imports from Central Europe could increase if the EC were to reduce domestic production in parallel with opening its agricultural markets up to Central Europe. The EC has

22 To the extent that quota rents contained in preference margins accrue to EC companies (see above), income is redistributed from EC taxpayers to EC companies. It is doubtful whether such redistribution is desirable.

embarked on a fundamental reform of its Common Agricultural Policy, and it may also have to reduce its level of agricultural protection as a result of a GATT agreement (if and when such an agreement is reached). For Central Europe, a reduction of EC agricultural protection will improve access to markets which so far have not been included in preferential arrangements. On the other hand, where preferences exist, it will mean reduced preference margins and therefore lower benefits. The balance of these gains and losses is not easily assessed. In any case, agricultural policy reforms in the EC may allow the growing agricultural exports of Central Europe to result in trade expansion rather than trade diversion. To the extent that this happens, an increasing share of the welfare benefits to Central Europe will take the form of higher world welfare, rather than income redistribution from the EC to Central Europe.

Appendix

In the conceptual framework presented above in Figure 1, let the elasticity of EC demand for imports from Central Europe be Central Europe EM and the elasticity of export supply be EX. The tariff equivalent before preferences is t and the preferential change in the tariff rate (*i.e.*, the percentage preference margin) is dt. The rate of change in the price received for exports from Central Europe, dP/P, is then

$$dP/P = [(EM/EX)/(1 - EM/EX)] * [dt/(1+t)]. \tag{A. 1}$$

Assuming an infinitely elastic EC demand for imports from Central Europe then overestimates this relative price change by the factor $(1 - EX/EM)$. For example, with an actual elasticity of export supply of 1 and an elasticity of export demand of –5, the assumption of an infinitely elastic demand for imports overestimates the price gain by 20%.

In the same framework, the ratio between the welfare gain and the price gain on the original volume of exports is $1{+}0.5 * EX * dP/P$.

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