

THE INTEGRATION OF FINNISH AGRICULTURE TO THE CAP

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Summary:

Agriculture was very strongly opposed to the integration into the EU. The profitability of agriculture was feared to fall considerably, if only the normal forms of support of the EU were available for Finland. The Accession Treaty includes the right to pay long-term nordic support for about half of the cultivated area. However, Southern Finland may be left without adequate support, and the future of especially cereal production is still very uncertain.

The market price level has dropped by about 40 % as a result of the membership. In the very beginning of the year the prices fell even more than was expected. Gradually the prices have become established at the estimated levels, i.e. the average level in the EU. In some cases domestic demand and supply have a greater impact on the market prices than competition from other EU countries.

According to estimates, farmers' incomes are going to decrease considerably. The support is not adequate to keep the incomes at the earlier level, which was the objective in the support calculations. However, it is still too early to evaluate the real income development. Production has not yet reacted to the changes in the prices in any way.

Consumer prices have decreased by about 8 %, even if the expected decrease was about 10 %.

Anotace:

Zemědělství silně odporovalo proti vstupu do Evropské Unie. Byly obavy, že při běžných formách podpory, která by Evropská Unie Finsku poskytla, dojde ke značnému poklesu výnosnosti zemědělství. Smlouva o vstupu do Unie obsahuje právo financovat dlouhodobou severskou podporu pro asi polovinu z obdělávané plochy. Přesto může jižní Finsko zůstat bez adekvátní podpory, a budoucnost zejména obilné produkce je dosud velmi nejistá.

Úroveň tržních cen poklesla o asi 40 % v důsledku členství. Na počátku roku poklesly ceny dokonce ještě více než se čekalo. Postupně se ceny ustálily na odhadnuté úrovni, t.j. průměrné úrovni v Evropské Unii. Domácí poptávka a nabídka měla v některých případech větší vliv na tržní ceny než konkurence jiných zemí Evropské Unie.

Podle odhadů se příjmy zemědělců značně sníží. Podpora není natolik přiměřená, aby udržela příjmy na dřívější úrovni, což bylo cílem při podpůrných výpočtech. Přesto je dosud příliš brzo na zhodnocení skutečného vývoje příjmu. Výroba ještě vůbec nezareagovala na změny v cenách. Spotřebitelské ceny se snížily asi o 8 % dokonce i když očekávaný pokles byl okolo 10 %.

Key words:

Accession treaty, integration, transitional period, support

Klíčová slova

Smlouva o vstupu do Unie, integrace, přechodné období, podpora.

1. Introduction

The present European Union is founded on economic considerations. In the beginning it was a customs union, but gradually it has become a uniform economic area, which aims at a political union of the member states. It can only be guessed what it will become in the long run. Some people may aim at the United States of Europe. Consequently, joining the EU was a decision with far-reaching consequences for Finland. In this paper we shall concentrate on economic considerations and leave the political issues to others.

Political changes in the Soviet Union and Eastern Europe made it possible for Finland to join the European Union in the beginning of 1995. The political decision on the membership was made in 1991, the negotiations with the EU were started soon after this, and they were completed in the beginning of March, 1994. The negotiations can be considered to have proceeded quite rapidly, partly as a result of the earlier EEA agreement and the free trade agreement with the EEC made already in the 1970s.

From the economic point of view the problems related to the membership were the greatest for agriculture. Other sectors of the economy had already adapted themselves to the free competition within the EFTA and EEC. Instead, agriculture had remained protected against foreign competition. Due to the border controls the price level had become considerably higher than in the EU. The market price level fell by about 40 % as the Accession Treaty came into force and all border controls were abolished.

The high price level can partly be explained through the unfavourable natural conditions. Finland is located far in the north, where the growing season is short and temperatures relatively low, which in turn result in small yields. The average yields of the two most important cereals, oats and barley, are 3.5 tons/ha. Thus the production costs of fodder cereals are high, which is reflected in the costs of livestock production.

Finland has protected its agriculture very efficiently. Border controls were practically insuperable due to the high duties and import levies and import quotas. Finnish agricultural

policy was fully independent, and international pressures had hardly any impact on it. However, closed economy has both advantages and disadvantages. In the short run the sector itself may benefit from the situation, but the lack of competition may lead to various kinds of market disturbances. The production structure of the sector may become distorted, which may result in increased costs. Farmers do not necessarily benefit from the border controls as much as they think, but the prices of production inputs may rise along with the prices. Other parts of the sector take their share of the benefits. Border controls may also lead to inefficient use of resources, which results in welfare losses to the whole society.

Closed economy has partly been the reason for the high production costs in agriculture. The necessary structural improvement was neglected, and the problems were dealt with through price support. Membership in the European Union makes it now necessary to deal with the problems that have been neglected so far.

2. EU negotiations

The negotiations on the integration were started in February 1992 after the Government had made the decision to apply for the membership in the EU. The next stage was the reply of the EU to the application, i.e. the so-called avis, which was completed in October 1992, and in which the EU Commission examined how well prepared Finland was to start the negotiations. The view of the Commission was that there were no obstacles to starting the negotiations. It also noted that the most serious difficulties would be related to the integration of agriculture, because the Finnish producer price level was considerably higher than the price level in the EU. The Commission considered that it was possible to find satisfactory solutions to the problems.

In the early part of 1993 a survey of Finnish legislation and the legislation of the EU was conducted by comparing these to each other and noting the points where Finnish legislation would have to be revised to make it uniform with the legislation of the EU. In this connection both Finland and the EU brought up issues that required unification or negotiations.

In September 1993 Finland left the so-called position paper to the EU Commission, stating the demands of Finland for the part of agriculture, among other things.

The negotiations were conducted simultaneously with all four applicant countries, Finland, Sweden, Norway, and Austria, and the EU left a joint negotiation tender to all applicants in December, 1993. The negotiations were continued after the turn of the year, and they became

more and more intensive towards the end of February. The final settlement was reached March 1, 1994.

After this the negotiation outcome was submitted to national inspection and referendum. In the national referendum in October 1994 57 % of those who voted were in favour of the ratification of the Accession Treaty. The Parliament passed the final ratification of the Treaty in December 1994, and since all member states of the EU approved and ratified the Treaty, it came into force in the beginning of 1995.

Accession Treaty

The objective of Finland was to reach an agreement that would make it possible to continue agricultural production in its earlier extent. Central factors were the cultivated area entitled to CAP reform support, sugar quota, milk quota, and the bull premium and suckler cow premium related to beef production. In these respects the agreement is satisfactory.

The cereal area entitled to CAP reform support is 1.6 mill. ha. Cereal area has been smaller than this in the past few years because of set-aside. The total cultivated area is 2.5 mill. ha. The rest is under hay, pasture, other crops, etc. Towards the end of the negotiations there was some dispute on the sugar quota, because it does not quite meet the production objectives of Finland.

The milk quota is 2,342 mill. kg, which is based on the production of 1992. Farmers who have made contracts to reduce production for a certain period of time may resume production, and for this purpose there is the so-called SLOM quota (bonus quota) of 200,000 tons. In meat production the quotas (bull and suckler cow premiums and ewe quota) correspond to the earlier production quantities.

A further important negotiation objective was to include the whole country to the LFA support, and to be able to pay more support than normally stipulated for EU states. For the part of the LFA support the requirement was not quite fulfilled, but the LFA mountain support (ECU 121.5, FIM 900/ha) is paid for 85 % of the arable land area.

Finland wanted that the whole country would be covered by a special nordic support. This objective was not reached in full, either, but the national nordic support may be paid north of the 62nd parallel and in adjacent areas, as well as in the whole country in case of serious difficulties.

The Treaty includes an extensive environmental support package. The EU pays FIM 840 mill. environmental support and Finland pays half of the support of environmental programmes.

Finland hoped for a long transitional period for the adjustment to the price level of the EU. This was not granted, and Finland had to shift to the EU price level immediately upon accession. The EU participates in the costs of the transitional period by altogether FIM 2.9 bill.

3. How is Finland going to adjust?

In principle the Accession Treaty guarantees that Finnish agriculture can continue as before by means of the quotas and the CAP reform support. However, it does not guarantee that the economic preconditions for agriculture will be good enough to make it possible to continue production. This was a major concern for agriculture during the whole negotiation process. It is obvious that the decrease in the market prices by 40 % affects the profitability considerably, even if there are some cost savings, too. It is possible that farmers' incomes will drop dramatically. Consequently, the Accession Treaty includes both arrangements for the transitional period and stipulations on long-term support.

3.1. Arrangements for the transitional period

Finland shifted directly to the common EU market area in the beginning of 1995. All obstacles to imports were abolished, which resulted in a decrease in all market prices (producer prices) to a level that is close to the average level in the EU.

The decrease in the value of stocks caused some problems. In order to prevent possible market disturbances before the accession, the Treaty included a stipulation that guaranteed farmers and entrepreneurs a compensation for the decrease in the value of stocks and for other costs caused by the system. All sales stocks were compensated for through a single payment according to the situation of January 1, 1995. For this purpose farms had to make an inventory of their stocks.

There are costs related to the earlier system in livestock production also after the integration. These are compensated for through a degressive additional price for livestock products and special crops. The additional support must be abolished completely by the end of 1999.

During the transitional period it is possible for Finland to promote structural development without the restrictions structural development by means of EU support is normally subject to. The stipulations of the investment support of the EU restrict the investments to land improvements and repairs because of overproduction. According to the Accession Treaty e.g.

expanding production at the farm level is allowed during the transitional period, provided that the production capacity of the whole country does not grow. In general the size of enterprises is much too small in Finland, and increasing this is important for improving the competitiveness. A transitional period of 5 - 7 years has been reserved for the structural change.

3.2. National support measures

The national support package is central for the adjustment of agriculture to the EU. It was decided on in connection with the membership negotiations, and the principles for the level of support and the regional distribution were agreed on at the same time.

The Accession Treaty of Finland determines the principles and conditions that the national support arrangements must be based on. Production may not be increased by means of support, and the amount of support may not exceed the total level of support prior to the accession. The support can be paid only on the basis of hectares and livestock units. The support is differentiated by region and it is degressive.

The support package has been prepared so that it provides the necessary preconditions for domestic agricultural and horticultural production. It is subject to the restriction that the support may not exceed the limits set by the state economy.

Calculation of the support

The national support package is prepared so that, using the quantities of 1993, agricultural income stays at the level of 1993 until the end of the transitional period, when the changes in the producer prices and prices of production inputs are taken into account. The calculation in question is a total calculation concerning agriculture as a whole, and it involves several assumptions concerning the development of prices. The development of productivity has also been taken into account.

Table 1. The total calculation of agriculture and horticulture in current prices of 1993 and in EU prices, FIM million.

| | 1993 level | EU level | Change |
|--------------------------|------------|----------|----------|
| Crop production | 6166.9 | 2928.8 | |
| Livestock production | 13819.1 | 8490.9 | |
| Horticultural production | 2025.0 | 1070.3 | |
| Total | 22011.0 | 12489.9 | -9521.1 |
| Support | 4265.0 | 0.0 | |
| Total return | 26276.0 | 12489.9 | -13786.1 |
| Costs | 20342.3 | 15281.6 | -5060.7 |
| Entrepreneurial income | 5933.7 | -2791.7 | -8725.4 |

Price forecasts were decisive in estimating the effects of the integration, because the calculations of the support were based on these forecasts. The prices of crop products have been derived from the administrative prices of the market year 1995/96 of the EU. In the calculation it has been assumed that the intervention price of the EU would determine the price level of fodder cereals, and the prices of wheat and rye could be 10 and 20 % higher than the intervention price. The future EU prices of livestock products have for the most part been determined on the basis of the realised development in market prices rather than administrative prices. The price forecasts are based on the average producer prices in Germany and Denmark in 1992, which the CAP reform is expected to lower by 15 - 20 %. The market prices have been converted to Finnish markka using the commercial exchange rate, and the administrative prices using the green rate. The commercial exchange rate of ECU used was FIM 6.30 and the green rate FIM 7.60.

The value of crop production and horticultural production was estimated to fall about 50 %. In livestock production the drop in the market prices was expected to be slightly smaller (about 39 %). Thus the sales return in market prices was expected to fall from FIM 22.0 bill. to 12.5 bill. Price policy support (FIM 4.3 bill.) may not be paid in its earlier form, and it was abolished. Consequently, the total return was calculated to fall altogether FIM 13.8 bill.

There are some cost savings as the prices of fodder and purchased seeds decrease and the taxes on fodder and fertilizers as well as the hidden sales tax are abolished (the share of agriculture in the export cost charges is abolished).

In livestock production the most significant savings result from the decrease in the price of fodder by 40 %. The price level of fertilizers was expected to fall by 25 % as a result of the abolition of the taxes on fertilizers. The seed cost decreases considerably as the price of cereals

falls. The abolition of the marketing charges of agriculture lowers the need for support by about FIM 0.5 bill.

Finland shifted to the value added tax system in the beginning of 1995, and the hidden sales tax included in the production inputs of agriculture was removed (FIM 1.1 - 1.3 bill., depending on the calculation method).

The decrease in the fixed costs as a result of rationalisation and other factors has also been taken into account. The need for adaptation at the farm level is taken into account in the farm models, and farms will have to deal with this through rational structural development.

Need for support

The calculation presented in Table 1 shows that, in order to maintain the income level, the need for support is FIM 11.4 bill. in the first year and FIM 8.7 bill. in the sixth year. The support consists of the share of the EU and national support paid by Finland itself. The national support system includes the following forms of support:

- environmental support to the agriculture of the EU
- long-term nordic support
- national special support to Southern Finland
- degressive support for the transitional period
- transportation support

The environmental support to the agriculture of the EU is part of the total support package of agriculture, and combining it with the other support systems has been considered important. Environmental support systems have objectives related both to the environment and to securing the income level of farmers. The support is mainly paid on the basis of the arable land area to farmers who commit themselves to taking measures that reduce the load of agriculture to the environment. Farmers have to make environmental management contracts, which restrict the use of fertilizers and pesticides. The support is intended to be the highest in Southern Finland, i.e. in the area of the most intensive agriculture.

The area of the long-term nordic support covers the area north of the 62nd parallel and adjacent areas with comparable conditions. The support is paid on the basis of the number of livestock and hectares, and in the northernmost areas as price support according to production quantities. Because the support may not be tied to future production, regional maximum amounts

have been set for the support on the basis of the number of animals and hectares. This makes structural change possible, because the support is not necessarily distributed on the basis of individual farms.

The support to the livestock and special crop production in the whole Southern Finland is based on the clause on the "remaining serious difficulties" in the Accession Treaty. According to this, Finland is entitled to resort to national support measures directed to agriculture and horticulture that facilitate the integration to the common agricultural policy in order to deal with serious difficulties.

The degressive support for the transitional period facilitates the adjustment of agriculture to the price level of the EU and compensates for the costs that decrease only after some time. In the last stage of the negotiations it was agreed that the length of transitional period is five years. The total support is the sum of the support for the transitional period and the long-term support. Finland has applied transportation support to balance the differences in the prices. This form of support will be continued as part of the nordic support and partly as general transportation support.

Regional distribution of support

The total amount of support has been distributed on the basis of the regions, production lines, and farm size by means of various kinds of farm models. This is a very demanding task, and it is not certain that the distribution was fully equitable, as was intended. The support settlement can be considered to involve some political features. It is generally considered that the income development of cereal producers in Central and Northern Finland has been secured for the next few years, but the situation of cereal producers in southernmost parts of Finland is quite poor. However, the Accession Treaty included a clause on the so-called remaining serious difficulties. Finland may negotiate with the Commission on granting support to Southern Finland, too, if it is considered that the agriculture of this region is in serious difficulties due to EU membership. The negotiations will be conducted in 1996, and the preparations have already started. Research should provide background information for these negotiations.

Figure 1.

For the distribution of the support Finland has been divided into three areas, which partly follow the earlier regional distribution according to the hectare subsidies (see Figure 1). Nordic agricultural support is paid in area C. In order to differentiate the support, the area receiving nordic support is further divided into four regions. The northern border of the southern zone of the earlier hectare support forms the southern border of the nordic support. The second B is Central Finland, which receives LFA support, but not nordic support, and the remaining 15 % that does not receive LFA support forms the third area A.

By means of farm models the support has been determined for each area so that farmers' incomes should stay at about the earlier level or decrease to the same extent in all areas and production lines. It is not possible to prepare the new support system without any changes in the support level. National support has been differentiated so that it increases towards the north. In addition to this, in the northernmost parts of the country production support is paid to milk, as well as beef and mutton.

After the transitional period only the support to livestock production is differentiated according to the farm size; in the case of dairy cows the support is 50 % lower for the part exceeding 30 livestock units. National livestock support is paid to suckler cows in addition to the suckler cow premium of the EU.

Additional support based on hectares is paid for rye, wheat, malt barley, turnip rape, sugar beets, and potatoes for processing industry, except in the northernmost parts of Finland. This support to special crops is paid only to farms on which the area under crops entitled to this support is at least three hectares.

4. Critique on the Accession Treaty

Agriculture has criticised the Accession Treaty very heavily. It is considered that the original negotiation objectives were not fulfilled. The most important negotiation objectives were a long transitional period and adequate total support, most of which would come from the EU. Nordic support was intended to be permanent, but this is still open. Criticism has been directed to the facts that the transitional period was not granted and the EU was not prepared to pay permanent special support in the whole country.

Many farmers seem to fear that the support is not permanent, and that the profitability of agriculture is going to deteriorate considerably in the future. In the case of many producers the economic situation changed right in the beginning of the year, as the support started to be paid on

the basis of hectares or the number of livestock instead of the price support paid earlier. The most efficient producers suffered the most in both crop production and animal husbandry.

Farmers also criticise the support systems of the EU in general. In the actual cereal production areas the CAP reform support is two or three times higher than in Finland, because the yield level is much lower in Finland than in e.g. Central Europe.

The support package has been criticised, because it is considered to keep the structure of agriculture as it is at present. As a result of the support, most farmers are able to continue their production, which stops structural development. The support system does not include any initiatives to increase the efficiency of production and the size of enterprises. Production is likely to stay at the present level in the north, but in the south it will stagnate. This development is by no means what should be aimed at. The natural conditions are obviously the best in Southern Finland. The new Government that came to power in April 1995 has already changed the support so that support to small farms has been reduced. The new Minister of Agriculture has promised support only to viable (large) farms.

The high level of support has been criticised very heavily outside agriculture. Agricultural support has always been criticised, and as the state support actually increases during the transitional period, the amounts of support have angered the taxpayers. In reality the support will be lower after the transitional period and the state expenditure will also decrease in the future.