Enlargement of the European Union

EFMA's View of the New Challenges for an Enlarged European Fertilizer Industry

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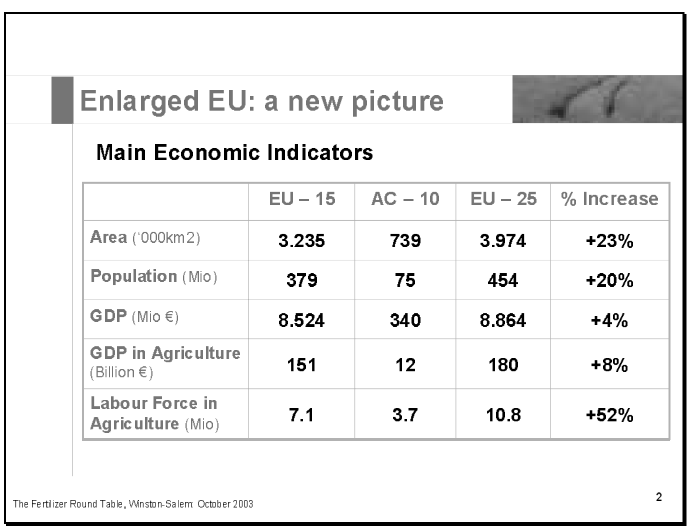
The Fertilizer Round Table, Winston-Salem – October 2003

SLIDE 1

The coming enlargement of the European Union will result in the most dramatic change in its history. Never has the European Union added so many new member states and never have those been so different from the existing ones. This enlargement will therefore present totally new political challenges; but it will also present enormous new challenges for the European Fertilizer Industry. Furthermore, the existing challenges will continue, but take on a totally new dimension.

SLIDE 2

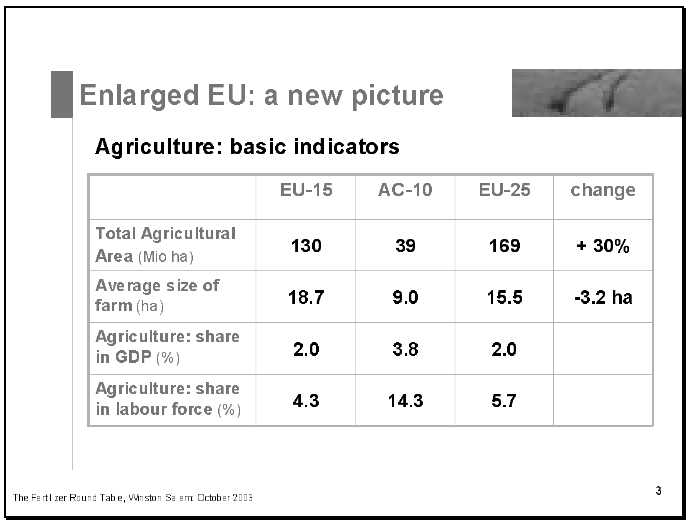
Let us first look at the integration challenges faced by the European Union.



	EU – 15	AC – 10	EU – 25	% Increase
Area ('000km2)	3.235	739	3.974	+23%
Population (Mio)	379	75	454	+20%
GDP (Mio €)	8.524	340	8.864	+4%
GDP in Agriculture (Billion €)	151	12	180	+8%
Labour Force in Agriculture (Mio)	7.1	3.7	10.8	+52%

The new union will present a totally new picture. The land area will increase by 23%, the population by 20%. The gross domestic product overall however, will only increase by 4%. By contrast in agriculture the gross domestic product will increase by 8%; however, the labor force employed in agriculture will increase by a full 52%.

SLIDE 3



	EU-15	AC-10	EU-25	change
Total Agricultural Area (Mio ha)	130	39	169	+ 30%
Average size of farm (ha)	18.7	9.0	15.5	-3.2 ha
Agriculture: share in GDP (%)	2.0	3.8	2.0	
Agriculture: share in labour force (%)	4.3	14.3	5.7	

The total agricultural area will grow by 30%. The average size of a farm in the EU 15 is 18.7 ha, whereas in the accession countries the average size is less than half of it, namely 9 ha. In the EU 15 agriculture's share of the gross domestic product is 2% whereas in the accession countries it amounts to 3.8%. In the accession countries 14.3% of the total labor force is employed in agriculture. In the EU 15 this figure is 4.3%. In summary, the agricultural sector is much more important in the accession countries; it is, as a general rule, small scale, less intensive and as a result often less competitive.

SLIDE 4

Enlarged EU: a new picture

Agriculture: EU Funding 2006

	EU – 15	AC – 10
Total EU Funding 2006 (Bio €)	41.8	2.6
Total agricultural land ('000 ha)	130 004	38 620
EU Funding per hectare (€/ha)	321.5	68.6
EU Funding per hectare adjusted (PPS/ha) **for purchasing power standards**	321.5	153.1

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The EU funding under the Common Agricultural Policy will neither dramatically nor immediately change this structure, since in absolute figures it is still substantially lower: 68.6 € per ha in the accession countries versus 321.5 € per ha in the EU 15 for the year 2006. Only in 2010 will there be parity.

Adjusted for purchasing power standards the disparity seems to shrink a little bit. However, in the EU 15 support is still twice the amount of the accession countries.

In October 2002 the European Commission published a strategy paper – "Towards the Enlarged Union" - where the Commission tries to evaluate where the new accession countries stand, what progress they have made in meeting the acquis communautaire - meaning the entire body of laws, rules, regulations and standards which constitute the European Union – and which further efforts are still needed.

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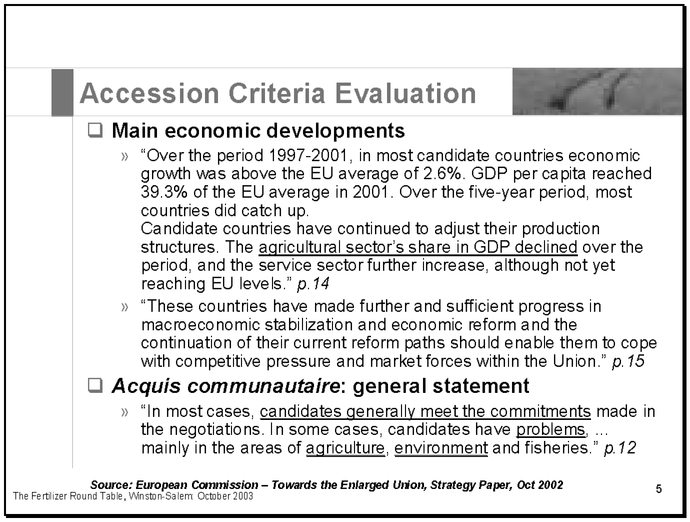
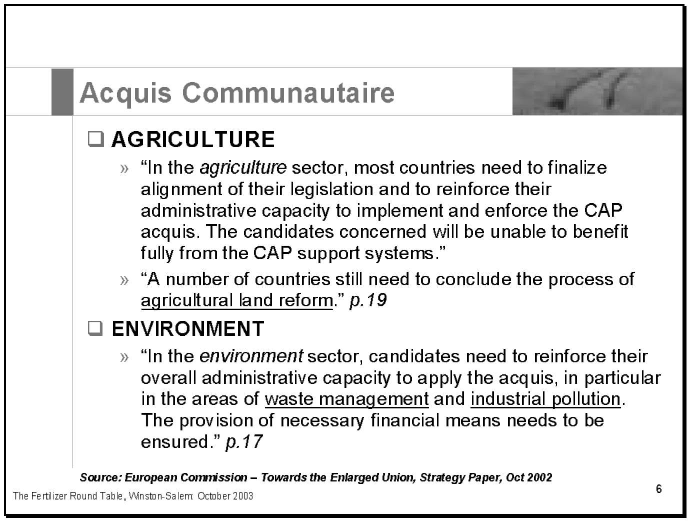


To summarize let me just quote from this report. As to the main economic developments, the report states "over the period 1997 to 2001, in most candidate countries economic growth was above the EU average of 2.6%.

In 2001 gross domestic product per capita reached 39.3% of the EU average. Over the 5-year period most countries did catch up. Candidate countries have continued to adjust their production structures. The agricultural sector's share in gross domestic product declined over the period and the service sector further increased, although not yet reaching EU levels"….. "These countries have made further and sufficient progress in macro economic stabilization and the economic reform and the continuation of their current reform paths should enable them to cope with competitive pressure and market forces within the Union" …

As to the acquis communautaire, the report stated that "in most cases candidates generally meet the commitments made in the negotiations. In some cases, candidates have problems, mainly in the areas of agriculture, environment and fisheries" ……..

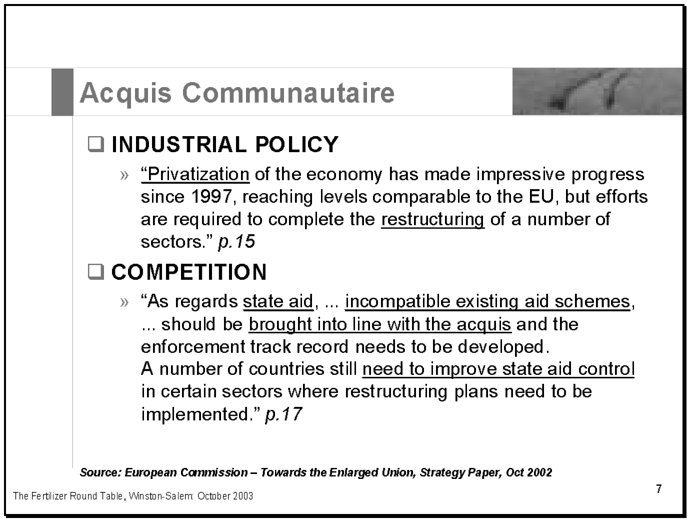
SLIDE 6



"In the agricultural sector most countries need to finalize alignment of their legislation and to reinforce their administrative capacity to implement and enforce the CAP acquis. The candidates concerned will be unable to fully benefit from the CAP support system" …"A number of countries still need to conclude the process of agricultural land reform"...

In the environment sector, "candidates need to reinforce their overall administrative capacity to apply the acquis, in particular in the areas of waste management and industrial pollution. The provision of necessary financial means need to be insured".

SLIDE 7



As to industrial policy the report states that "privatization of the economy has made impressive progress since 1997 reaching levels comparable to the EU, but efforts are required to complete the restructuring of a number of sectors"… and let me add as an example the fertilizer sector in Poland.

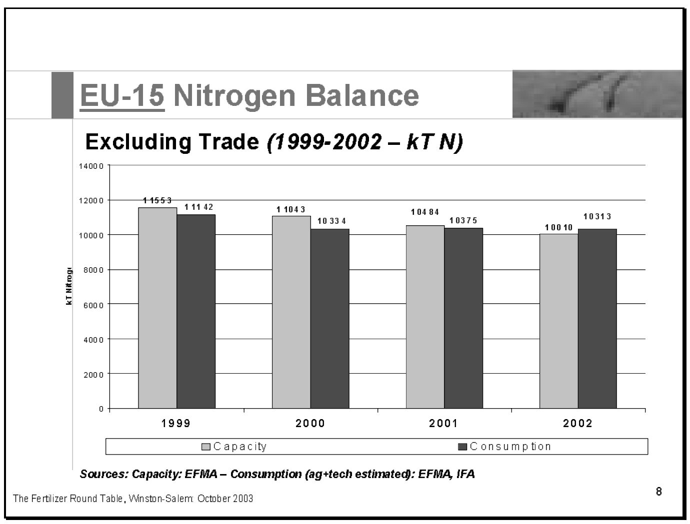
Addressing competition, the strategy paper criticizes that "as regards state aid… incompatible existing aid schemes should be brought into line with the acquis and the enforcement track record needs to be developed. A number of countries still need to improve state aid control in certain sectors where restructuring plans needs to be implemented". Again part of the Polish fertilizer sector would be an example.

As these short excerpts from the Commission's strategy paper show, the positive developments on many fronts have been extremely impressive, however, in the area of agriculture, of the agricultural input industries, in industrial policy, more specifically when it comes to privatization of state owned enterprises and to state aid some of the accession countries still have homework to do before they fully meet the acquis communautaire and will be fully integrated in the single European market. These challenges are also very direct challenges for some of the fertilizer industries in the accession countries.

At this point I should probably make a disclaimer.

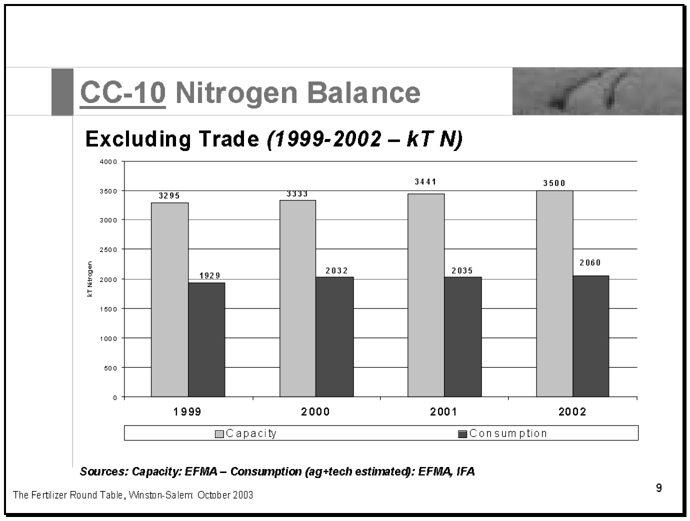
In my presentation I will not make an overly detailed analysis about all these factors for each member state. What I will rather do is give you general trends on developments in the EU 15, EU 10 and, where appropriate, in the EU 25 combined. Of course the situation is much more complicated. But focusing on general trends is the only way to define overall challenges.

SLIDE 8



As this slide shows, capacity and consumption in the EU 15 has been brought very much into balance over the last four years.

SLIDE 9



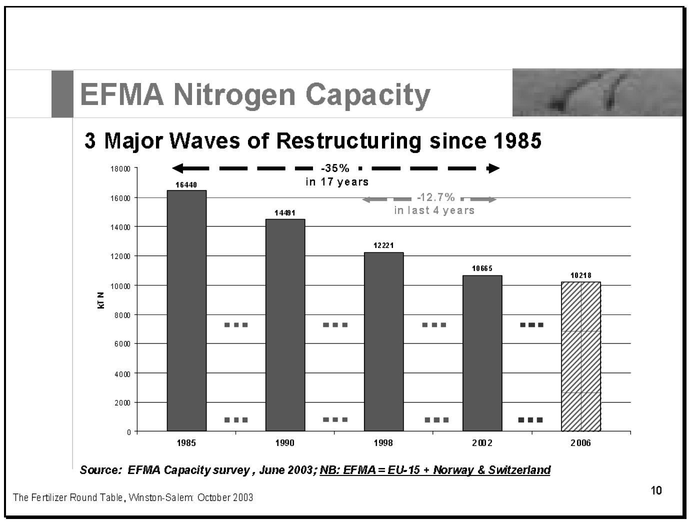
For the accession countries this is different. In all, there is a discrepancy of almost 1500 KT N.

What I do not show because of its high variability is the trade function. For the EU 15, the trade balance is still negative. In this context, however, it should be kept in mind that the trade balance in Europe including in the Accession Countries is heavily distorted in two ways: first, imports which do not meet the criteria of free and fair trade are still coming in, although the anti-dumping instrument tries to rectify some of it and, second, at the same time exports from the EU 15 or AC 10 are competing on the world markets with products which, again, have been imported into those foreign markets without respecting the rules of free and fair trade - although some of it is also corrected in those markets through the anti-dumping instrument.

It has always been the position of the European fertilizer industry that the fact that Russian producers still get gas at substantially lower costs than that which European fertilizer manufacturers have to pay for that very same Russian gas out of the very same wells, is something which is fundamentally out of line with the fair trading rules of the

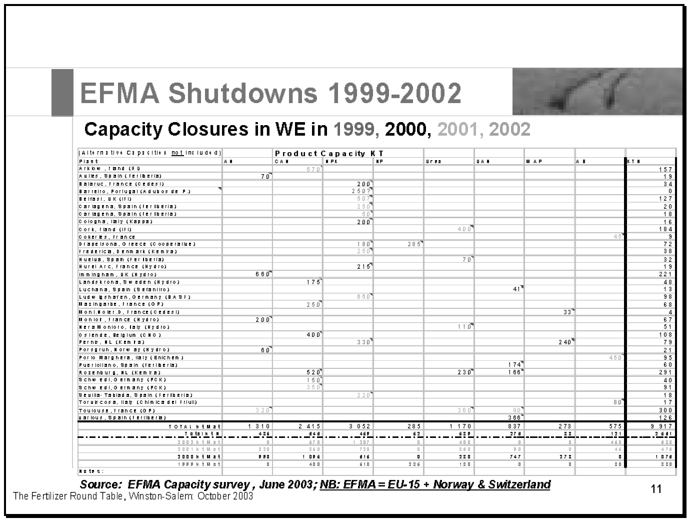
World Trade Organization and therefore needs to be corrected. EFMA recognizes that the Russian position and that of the EU is controversial. There might be different views and justifications for the low domestic Russian gas prices, but we strongly believe that, ultimately, reform should also be in the interest of the Russian gas sector itself.

SLIDE 10



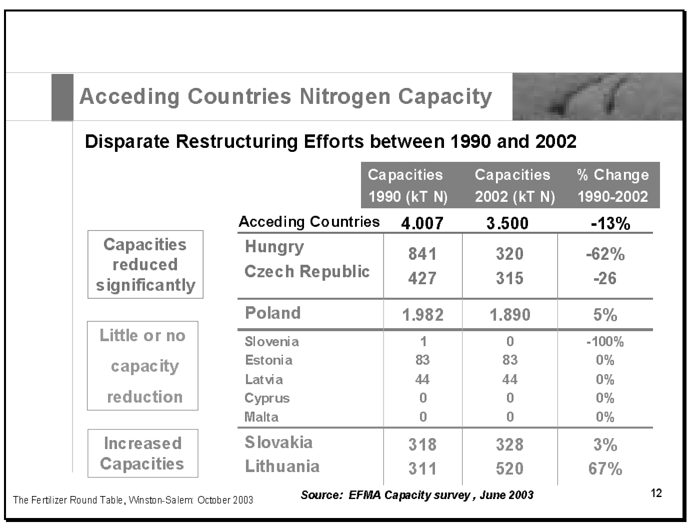
Capacity and consumption are in balance in the EU 15 because of substantial restructuring efforts, which the EU 15 Fertilizer Industry has undertaken since 1985. In the last four years alone almost 13% of capacity has been closed and future closures are already announced. You will find details on these shutdowns on the next slide, an impressive list of over 35 plants.

SLIDE 11



SLIDE 12

Restructuring efforts in the accession countries present a mixed picture.



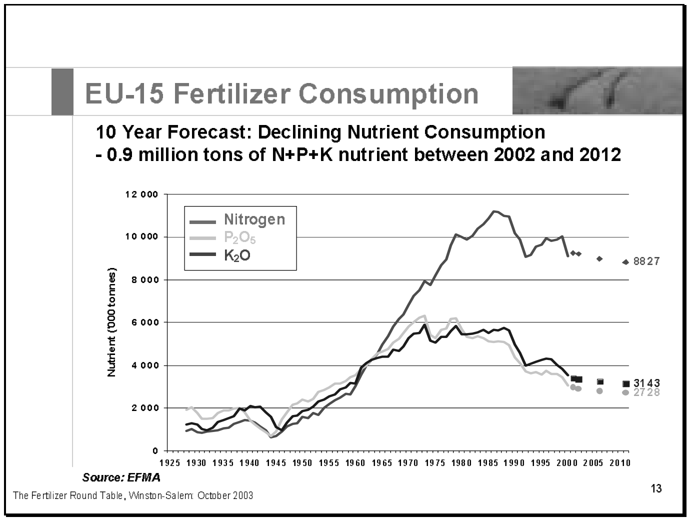
	Capacities 1990 (kT N)	Capacities 2002 (kT N)	% Change 1990-2002
Acceding Countries	4.007	3.500	-13%
Hungry	841	320	-62%
Czech Republic	427	315	-26
Poland	1.982	1.890	5%
Slovenia	1	0	-100%
Estonia	83	83	0%
Latvia	44	44	0%
Cyprus	0	0	0%
Malta	0	0	0%
Slovakia	318	328	3%
Lithuania	311	520	67%

Hungary and the Czech Republic have reduced capacity significantly. But there is a second group of countries starting with Poland with little or no capacity reduction..

Finally there was a 67% capacity increase in Lithuania.

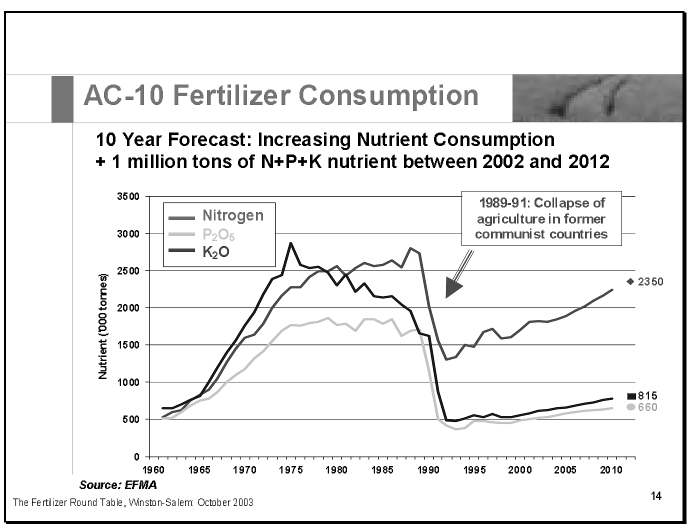
SLIDE 13

The capacity adjustment in the EU 15 Fertilizer Industry also was a response to declining consumption, as the next slide shows.



In the EFMA *10 Year Fertilizer Consumption Forecast by 2012*, we anticipate a further decrease of NPK nutrient consumption of 1 mio t.

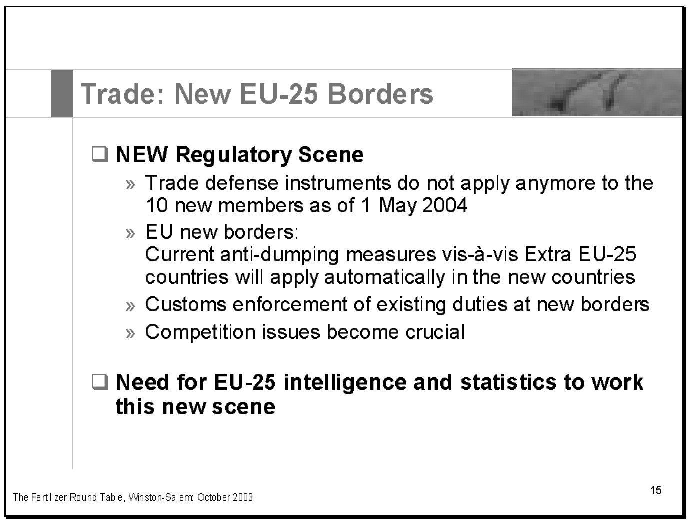
SLIDE 14



By contrast, in the ten accession countries we see an increase in nutrient consumption of 1 million tons of NPK for the same period. However, this increase in fertilizer consumption in the accession countries will not be enough to fill the excess capacity existing today in those countries.

SLIDE 15

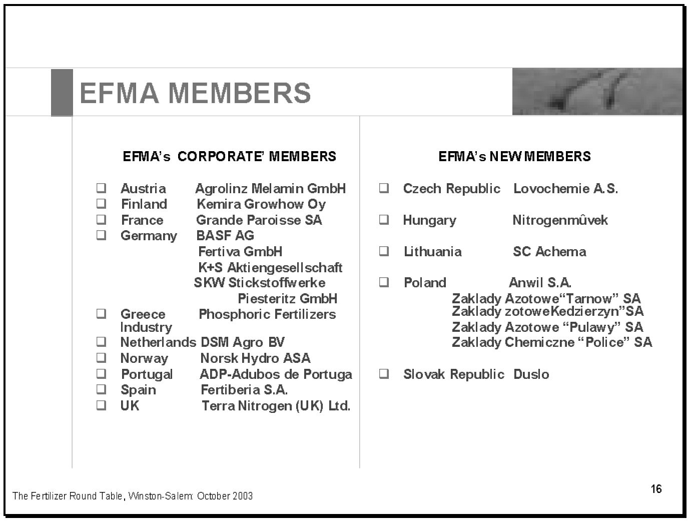
With accession, there will be a new regulatory scene.



From one day to the other, on 1 May 2004, the existing trade defense instruments, which the accession countries now have in place, will cease to exist. On the same date the current EU 15 anti-dumping measures will apply to the new outer borders of the EU 25 and, thereby, automatically apply to the new countries. The big challenge will be to enforce the existing duties at the new borders. It will be vital for the Fertilizer Industry to have this secured, not only for the EU 15, but also for the EU 10. As I already mentioned, those countries are giving up important anti-dumping or safeguard measures which they have in place for their own markets. In future there will be an enormous need for intelligence and statistics to work in this new regulatory context. It is therefore of paramount importance that the new enlarged industry works together and, in particular, becomes fully integrated into EFMA.

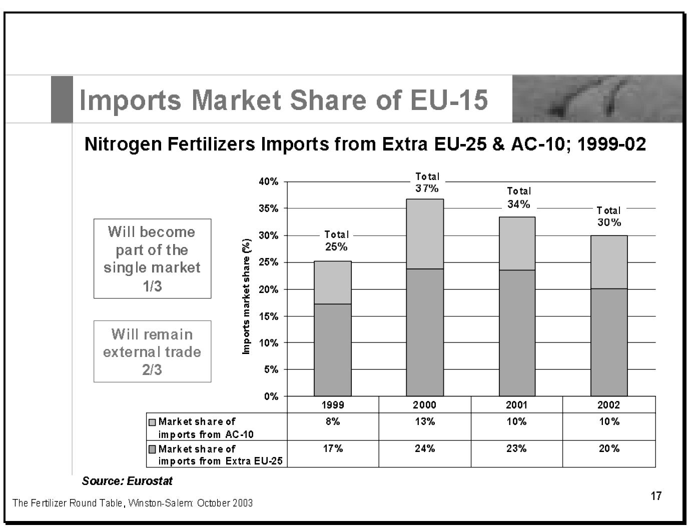
SLIDE 16

The next slide shows you the potential new EFMA members.



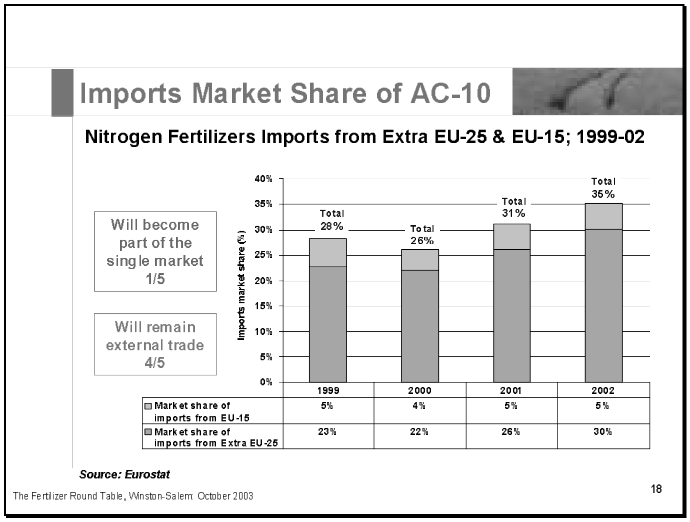
There is more or less commitment from all these companies to join EFMA, although, in the case of the Polish fertilizer industry, they still have to wait for the outcome of the government's restructuring plan before they can make a formal commitment. As I already mentioned, the continued successful application of the trade defense instruments will be of paramount importance for the future well-being of the EU 25 fertilizer industry.

SLIDE 17



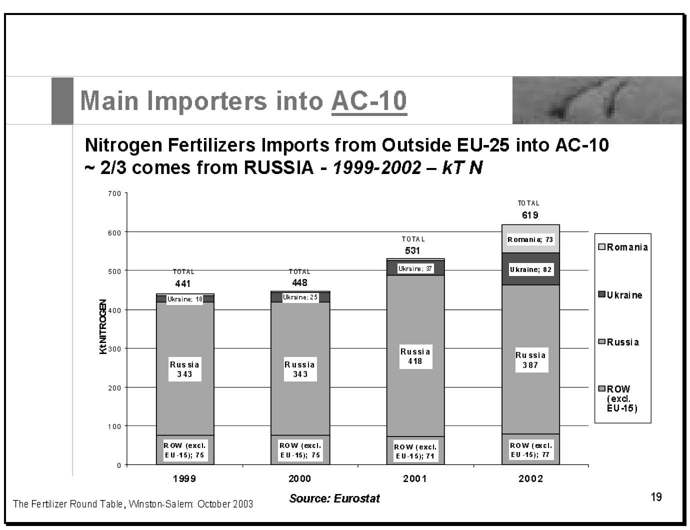
This is even truer for the EU 10 countries. In the EU 15 one third of the imports today come from the accession countries, and two thirds of the imports come from outside.

SLIDE 18



In the accession countries one fifth of the imports are from the EU 15 and four fifths of the imports are coming from outside. In the future the one third of the imports from the accession countries will become part of the single market and two thirds will remain external trade, whereas for the accession countries one fifth will become part of the single market, but four fifths of all their imports will remain external trade.

SLIDE 19

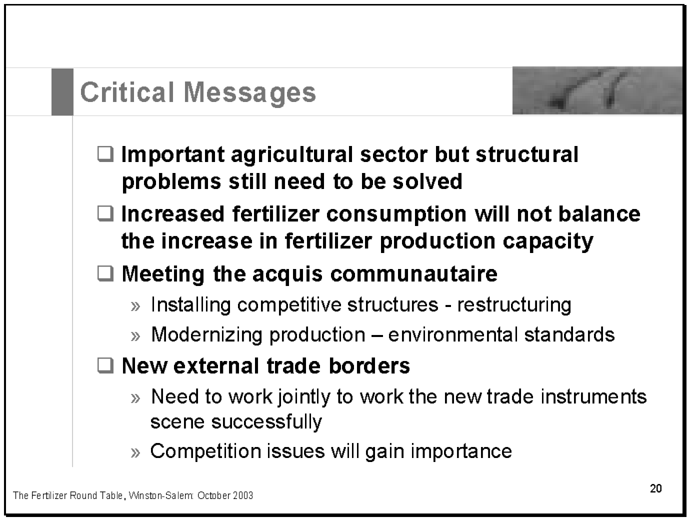


Most of this external trade comes from Russia and does not appear to meet the criteria of free and fair trade. Therefore it is subject to potential anti-dumping measures. In other words, for the accession countries the continued successful use of the EU anti-dumping instrument will be of even greater relevance than for the EU 15 countries.

In contrast, for the EU 15 the question of whether those imports from the new member states of the European Union are meeting the acquis communautaire will be an important issue. Or put it differently: some of those imports today are subject to EU anti-dumping measures and the future question will be whether the competition rules will be met. More precisely: whether some of these imports are benefiting from government intervention or other forms of state aid. In the past this was also an issue with some of the existing member companies of EFMA. These questions have now been settled. Therefore it should not come as a surprise that also for the new member states these issues are emerging. After accession there will be a new European fertilizer industry and, hopefully, all players will be members of EFMA. Potential state aid complaints will most likely not be brought under the umbrella of EFMA, since EFMA will be representing the entire industry and we do not single out specific members. If those issues will be raised , they probably will be raised by member states which in the past were typically bringing this kind of complaints.

At the end of my presentation let me just finish with some critical messages.

SLIDE 20



The new accession countries will bring an important agricultural sector to the EU 15. But structural problems exist. Although substantial progress has been made, further progress is still necessary. Some accession countries still have to make progress in meeting the full acquis communautaire. Some of the industries still need to be privatized and restructured with the objective to install competitive structures. In certain cases, production still needs to be substantially modernized, to increase competitiveness but also in order to meet the EU environmental acquis. Increased fertilizer consumption is forecasted for the EU 25. However, it will not balance potential supply and demand forecast. On the trade front, because after May 1 2004, the trade instruments will apply at the new external borders, the EU 15 and EU 10 industry needs to work clearly together in order to be succesful. Competition issues will gain importance. The competition issues will be challenged, most likely decentralized by national governments.

I started my presentation saying that "the coming enlargement results in the most dramatic change of the European Union". I have mainly spoken about the resulting challenges for the EU 25 industry or, if you want to express it negatively, the "problems".

But a changing world is always full of opportunities. It is for the individual member companies of EFMA to develop individual strategies on how to maximize benefits from these opportunities, and I am sure they will.

Thank you.