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**Book Part**

## The future of EU agricultural and rural policy from the perspective of CEE candidate countries

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## **The future of EU agricultural and rural policy from the perspective of CEE candidate countries<sup>1</sup>**

### *Contents*

- 1 Eastward enlargement: a turning point in EU history?
- 2 Heterogeneity of the candidate countries group
- 3 The experiences from the association and pre-accession periods
- 4 Evolution of agricultural policies in CEECs during the transition period
- 5 Enlargement and the choice of agricultural support
- 6 The Community budget constraints and eastward enlargement
- 7 Eastward enlargement and the EU rural policy
- 8 Conclusions

### **1 Eastward enlargement: a turning point in EU history?**

Eastward enlargement of the EU is the most challenging event for the Community since its establishment. The new candidate-countries group is the largest single enlargement group in EU history. It is a very heterogeneous group by economic and social standards, and it is also a group of countries with relatively large rural and agricultural sectors. Adaptation by this large group of new members requires significant changes in EU policies and institutional structures. In many aspects, eastward enlargement plays an important role as a mobilizing factor for accelerating institutional changes in the EU, which should be undertaken anyway. It is especially true in relation to the CAP and rural policy.

The eastward enlargement is not only the accession of 10 or 12 new members to the existing EU-15; it is a real integration process requiring mutual adjustment. The adjustment is not symmetrical; there are much more profound and fundamental changes on the side of the CEECs, which should adopt *acquis communautaire*, and build institutional structures necessary for functioning in the EU economic and political system. Necessary adjustments on the EU side in relation to imminent enlargement concentrate on CAP and structural policies. J. Swinnen used the term “minimal-change-to-meet-the-critical-constraints” to describe previous CAP reforms (SWINNEN, 2001). There are several circumstances pressing for more than “minimal-change reform” of the CAP in next few years. The most important are as follows:

- budget constraints related to enlargement,
- WTO pressure to reduce EU agricultural protectionism,
- growing concerns over food safety and the environmental aspects of agricultural activity,

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<sup>1</sup> This paper was prepared as a contribution to the Working Group on “The Future Role of Agriculture in Europe of the Akademie für Raumforschung und Landesplanung (ARL), Hanover, Germany, 2000-2002. The paper was written in 2002 but some revisions to the text were made in June 2003.

- emerging new paradigms of rural development and rural policy,

The earliest opportunity for introducing the CAP and CAP-related reforms will be in 2003-2004. It is not only an opportunity: it is also a necessity. What determines this necessity and opportunity?

- In 2002 a mid-term review of the implementation of Agenda 2000 was issued and some corrections to the existing CAP were proposed;
- The term of Commissioner FISCHLER runs out in January 2005 and he seems highly motivated to propose significant reforms to the CAP before the end of his term;
- At the Nice, Goteborg and Laeken Council meetings, 2004 was mentioned as the possible time for accepting new members from the CEECs. On December 14-15, 2001 the Laeken Council meeting listed 10 candidate countries, including 8 countries from Central and Eastern Europe, which were invited for negotiations about accession in 2004. The 10 candidate countries finished accession negotiations at the end of 2002.<sup>2</sup>
- In 2003 the Peace Clause accepted under UR AoA will end.
- WTO negotiations will start in Cancun in September 2003

Eastward enlargement, including 10 CEECs, will change the size of the EU, in terms of both population and area, by one third.<sup>3</sup> The main dimensions of the EU will change as follows:

1. Population: from 372.7 million to 477.9 million (by 28.2%)
2. Area: from 3.1 million square kilometers to 4.2 million square kilometers (by 35.5%)
3. Agricultural area: from 135.3 million hectares to 195.5 million hectares (by 44.5%)
4. Agricultural employment: from 7.5 million to 17.8 million (by 137.3%)

Until the end of 2002, no significant changes to CAP or structural policies had been proposed by the EU authorities in conjunction with the eastward enlargement.<sup>4</sup> The lack of CAP reforms before 2006 is explained with the argument that such a move would complicate and even delay the enlargement. There are minor changes only in the EU agricultural-policy measures in the support packages offered to the new members. These proposals were presented in the EU documents related to negotiations with candidate countries, issued in January and April 2002. The main points of interest in these proposals are:

- Offering to the new members from CEE a direct-payment aid for agricultural producers, starting from 25% of the present EU level combined with a 10-year phasing-in period;
- Putting more emphasis on rural development in the allocation of financial resources from the EAGGF. In the EU proposal, over 50% was allocated to the second pillar;

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<sup>2</sup> The European Council decided that 10 applicant countries will join the EU on May 1<sup>st</sup> 2004.

<sup>3</sup> The 10 CEEC candidate countries are: Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia. Due to very the varied progress in preparations for EU accession among CEECs, it is expected that in 2004 only 8 countries from Central and Eastern Europe will join the EU: Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia.

<sup>4</sup> During preparation of the revised version of this paper, a mid-term review of CAP (“The Common Agricultural Policy – An Evolving Policy”) was published. This paper refers in some parts to this document.

- Some additional agricultural and rural support measures were added to the existing list of EU measures:
  - support for semi-subsistence farms undergoing restructuring (€ 750 per farm/year),<sup>5</sup> simplified system for distributing direct payments (for all users of agricultural land),
  - support for establishing producer groups,
  - support for advisory and extension service related to agriculture and rural development.
- New members can continue agricultural and rural support using the measures selected earlier for the SAPARD program; they can also add other measures from Reg. 1257/1999 for constructing Rural Development Plans.
- Access to the LEADER+ program for new members from CEE is very limited, due to the short programming period. The accession countries can select one of the two opportunities linked with LEADER+: the first one is the training program, preparing for future participation in LEADER activities, and the second one refers to the establishment of pilot Local Action Groups.

Basic questions which should be discussed in relation to the eastward EU enlargement in connection with agriculture and rural areas:

- 1) Are the goals and interests of the candidate countries in relation to CAP or CARPE (Common Agricultural and Rural Policies for Europe) identical or at least similar?
- 2) Do the outcomes of the transformation period significantly differentiate the interests of particular groups of farmers in CEECs towards the future structure of CAP?
- 3) What kind of changes in the CAP would be desired, taking into account special conditions existing in agriculture and in rural areas in CEECs?
- 4) How serious, and in what issues, are the interests and expectations of present members and candidate countries divergent in relation to the future CAP (or CARPE)?
- 5) What are the main experiences from the association and pre-accession periods which should be utilized in preparing CARPE for an enlarged EU?
- 6) Is the eastward EU enlargement a special factor influencing WTO talks on agricultural trade and protectionism?

## **2 Heterogeneity of the candidate countries group**

Countries which have applied for membership of the European Union form a highly diversified and heterogeneous group. The most important differences relate to the following features and areas:

- a. the level of economic development, measured by GDP per capita
- b. the performance of the economy during the transition period
- c. progress in the systemic changes in the economy
- d. the role of agriculture in the overall economy

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<sup>5</sup> During negotiations this amount per farm was increased to € 1,250,-.

- e. the structure of the agrarian sector before transformation and at the end of the 1990s
- f. the degree of “market orientation” among farmers, or commercialization of farm production
- g. competitiveness of agriculture in comparison with the EU
- h. the role of agriculture in the rural economy and society.

GDP per capita in the accession countries ranges from over € 18,000 in Cyprus and € 16,000 in Slovenia to € 5,400 in Bulgaria and € 6,000 in Romania.<sup>6</sup> There are also significant changes in respect of advancement in economic reforms in this group of countries. The most advanced are: Slovenia, Czech Republic, Hungary, Poland and Slovakia; less advanced in economic transformation are: Romania and Bulgaria.

The average share of agriculture in GDP in CEECs (10) is 6%, while in EU it is less than 2%, and varies from 14.5% in Bulgaria and 12.6% in Romania to 3.2% in Slovenia and 3% in Poland. As a result of systemic transformation and agricultural policies, agricultural production dropped to 30-40 % of pre-transition levels in the Baltic countries, to 70% in Hungary and 90% in Poland.

In the '90s the highest economic growth was achieved in Poland and the lowest in Bulgaria, Romania and in the Baltic republics. Until the end of the '90s Bulgaria, Romania and the Baltic republics had not reached the pre-transformation level of GDP.

There are also big differences in the rates of unemployment in the countries under consideration: from 42% in Romania, 19.6% in Lithuania, 18.8% in Poland to 5.1% in the Czech Rep. and 6.5% in Hungary. In all countries with a high rate of unemployment, a significant proportion of unemployed people live in rural areas. One of the most important causes of the high levels of unemployment was the restructured and privatized farming sector. Reduction of employment in agriculture during the transition period has been at its greatest in Hungary (by 70%) and in the Czech Republic (by 60%). Agricultural employment increased in the '90s in Romania and Bulgaria. In Poland agricultural employment has remained almost unchanged since 1990. In Hungary, Czech Republic, Slovakia and Estonia, post-socialist transformation has given the agricultural sector a chance to reduce employment, increase productivity and improve farm structure. In these countries, labor productivity in agriculture is higher than GDP per capita (DAVIDOVA; BUCKWELL 2000). The situation in other post-socialist countries is different. Agricultural and rural sectors in these countries have absorbed part of the labor force freed by the industrial sector.<sup>7</sup> Differentiation among CEECs in relation to agricultural employment, labor productivity and overmanning of agriculture should be taken into consideration in choosing agricultural and rural policies after accession of these countries to the EU.

The present structure of the farming sector in CEECs is very diversified. This is due to the pre-transformation structure and different privatization strategies during the transition period. Before transformation most of the agricultural land was in the co-operative and state sectors in all CEECs except Poland and Slovenia. In Hungary, Slovakia, Czech Republic and Lithuania, over 60% of agricultural land was in the co-operative sector and around 30% in the state-farm sector. Before 1990 the state-farm

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<sup>6</sup> GDP in purchasing power

<sup>7</sup> “During transition the poorer countries use agriculture as a buffer against high industrial unemployment and to ensure food supplies through subsistence farming. In such circumstances, people stay in agriculture or in some cases come back to agriculture from industry in times of recession. This maintains (or increases) the overmanning of the sector and results in low labor productivity.” (DAVIDOVA; BUCKWELL 2000)

sector was at its biggest in Bulgaria (90%) and in Estonia (50%). Most of the CEECs chose restitution as the main procedure for the privatization of land. Poland is an exception. In Poland 20% of the land which was previously in the state farm sector has been leased mostly to the new private operators. In the case of CEECs, privatization through restitution, privatization, voucher distribution and even through sale does not mean that collective or state farms are becoming private individual holdings. The so-called Farm Individualization Index (SWINNEN 2000) is over 80% in Poland and Latvia and below 50% in Slovakia, Czech Republic and Bulgaria. This index is especially low in Slovakia, where it does not exceed 5%.

CEECs differ significantly in relation to the agricultural land concentration ratio. The land concentration ratio, measured by the percentage of agricultural land in the biggest 10% of farms, is at its highest in: Slovakia (97%), Hungary (92%), Bulgaria (90%) and Czech Republic (82%). The lowest rate is in Latvia (20%) and Lithuania (30%). This concentration ratio in the EU-15 is 40%. In countries with a high concentration of land in large farms, a tendency can be observed to downsize them through division into smaller units (LERMAN 2000).

The results of transformation of agriculture in CEECs, especially in agrarian structures and in the levels of agricultural production, have great significance for selecting priorities linked to the future CAP:

- all CEECs have sufficient production potential and are interested in increasing agricultural production;
- countries with large commercial farms and a high concentration rate of land in these farms would be interested in the continuation of traditional price- and income-support CAP (pillar I);
- countries with a large rural population and prevailing small-farm agriculture would be more interested in establishing a well-balanced agricultural and rural policy, emphasizing structural change and regional development (reallocation between pillar I and II of CAP);
- differentiation of interests in particular forms of CAP or CARPE could be noticed also between groups of farmers or rural dwellers.

Nota bene: In the CEECs, little attention is placed on considering the future, alternative or desired type of agricultural and rural policy for the EU. The attention of the candidate countries is focused on preparations for the existing CAP. Following the publication of an EU proposal for agricultural and rural support for the CEECs after accession, the discussion has been dominated by the expected results of the EU proposal for the competitive position of agriculture in the CEECs and overall benefits for the agricultural sector and rural economy.

### **3 The experiences from the association and pre-accession periods**

Adjustment processes to the EU conditions during this period have been concentrated on trade issues and institution building, including *acquis communautaire* adoption. The CEECs signed the association agreement with the EU (Europe Agreement) in the first half of the '90s. This agreement was intended to build asymmetrical trade conditions favourable for post-socialist countries. In practice, it was quite the opposite, especially in the agro-food trade. Agro-food exports from the CEECs to the EU increased twofold between 1988 and 1998, while EU exports to CEECs increased almost tenfold. The net trade balance for the EU has changed from a negative € 1 billion to a positive € 2 billion

(SWINNEN 2001). In the case of Poland, agro-food exports from Poland to EU increased by 25% in the '90s, while exports from EU to Poland increased by 600% in this period.<sup>8</sup> The total EU trade surplus with Poland amounted to € 11.4 billion in 1999. Polish and other CEECs exporters have also faced growing competition from EU exporters on the markets of the former Soviet republics. This was a distorted competition since the EU exporters were supported with export subsidies while the CEECs exporters were not. This experience in agro-food trade between EU and CEECs in the '90s has caused fears among farmers in CEECs about their position on the Single Market after enlargement. The very low level of direct-payments support offered by the European Commission to the farmers from CEECs also contributes to their insecure position after enlargement. In such a context, it is not surprising that many farmers in CEECs are Euro-skeptics.

Since the beginning of 2000, all 12 candidate countries have been able to use the EU funds devoted to three pre-accession programs: PHARE, ISPA and SAPARD. The total amount of money available for implementation of pre-accession programs is almost € 3.5 billion annually. Poland, as the biggest state among candidate countries, receives € 920 million per year, out of which € 170 million is for the SAPARD program. Pre-accession programs should be devoted to supporting the candidate countries in their preparations for EU membership. All three programs are based on similar principles to the EU structural programs. They need the same institutions and procedures for their implementation as those existing in the EU. Pre-accession programs should support the institution building and experience accumulation necessary for the future utilization of the much bigger funds that will be available to CEECs after enlargement.

There is growing frustration in the candidate countries caused by the delays and difficulties in implementation of pre-accession programs, especially SAPARD. Necessary institutional arrangements for these programs are complex and costly. A delay of over two years in implementing the SAPARD program in some candidate countries (Poland, Romania, Hungary) has been caused partly by the late establishment of a legal framework and delayed decisions on the part of the European Commission. Complicated procedures as well as high and very detailed requirements related to the implementation of pre-accession funds have been criticized both by the candidate countries and by some EU bodies, including the Court of Auditors.

Implementation of pre-accession programs in CEECs – in my opinion – should be regarded, at least partly, as a missed opportunity. These programs have not achieved the major goals for which they were originally designed. It was assumed that in the years before accession (2000-2004) the flow of money under pre-accession programs would support the modernization of farms and food-processing firms, contribute to rural development by investment in rural infrastructure, by implementing village renewal and agro-environmental projects, and help in building a solid institutional basis for future EU agricultural, rural and regional programs. It has not happened yet, at least in some of the candidate countries. The failure of pre-accession programs threatens the successful adjustment of the new members after accession. The main consequences of the delayed implementation of pre-accession funds are as follows:

- the delay in institution building for future EU programs and funds will reduce the absorption capacity for these funds in the new members;
- a part of the EU aid offered to the CEECs will be lost;

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<sup>8</sup> An additional Protocol to the Europe Agreement concerning agricultural products entered into force in January 2001. According to this protocol, 91% of traditional EU agricultural imports from Poland are duty-free, while 43% of EU agricultural exports to Poland are exempted from duties. The negotiations concerning more sensitive sectors and processed agricultural products are ongoing (Regular, 2001)

- most pre-accession aid will be spent during two first years after accession and may “crowd out” the resources available under the EU programs (structural and rural) due to the co-financing problem;<sup>9</sup>
- dissatisfaction and demobilization of people involved in preparing pre-accession programs and projects during first years of the pre-accession period.

A report on “What went wrong with the pre-accession programs?” should be prepared as quickly as possible by EU authorities and the candidate countries in order to use these lessons and experiences to facilitate easier adjustment of the CEECs to EU conditions and for careful and profound analysis of these conditions. My personal – provisional – conclusion with regard to this aspect is: “The EU does not show the necessary flexibility and adaptability to the problems and specific conditions existing in the CEECs on its way to the enlarged Community. Eastward enlargement is treated by the EU as an accession process, not as real integration.”

An almost 10-year history of preparations in the CEECs for EU membership has delivered important lessons, which are instructive for the future adjustment of the CEECs to EU conditions:

- There are many distances and disparities between candidate countries and present EU members; the most important one is related to institutional structures (“institutional gap”). Institutions matter, but institution building is expensive, takes a lot of time and also requires human capital of the best quality.<sup>10</sup>
- The conditions established for membership in the EU for candidate countries are aimed at the institutional compatibility of political, social and economic systems in CEECs with the system in place in the EU. Therefore, preparations for EU membership should concentrate on institution building.
- In the '90s, the CEECs entered “dual systemic transformation”: first, to the democratic system and market economy, second, to the specific institutional system of the EU. It is an extremely complex process of historical significance. There is a “synergy effect” in this “dual systemic transformation”.
- In the Agenda 2000 we can find the opinion that the first group of CEECs to be invited for negotiations on EU membership has built well-functioning market economies. There is no mention of their being poorly institutionalized market economies. Insufficient institutional support for agro-food producers and traders in CEECs has caused a growing imbalance in trade between CEECs and the EU.

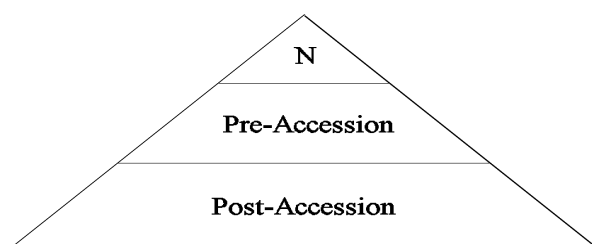
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<sup>9</sup> The SAPARD program started in Poland in July 2002, instead of January 2000, i.e. with a delay of two and a half years. According to the financial rules applied to SAPARD, resources allocated for a particular year may also be utilized during the following two years. This means that in 2004 and 2005 Poland (and other CEECs) has to efficiently absorb a significant proportion of pre-accession funds, which need co-financing from domestic sources. This process will overlap with the beginning of implementation of the EU structural programs in new member countries.

<sup>10</sup> The “World Development Report 2002” is devoted to the significance of institutions in a market economy. “Markets allow people to use their skills and resources and to engage in the higher-productivity activities if there are institutions to support those markets. What are these institutions? Rules, enforcement mechanisms, and organizations supporting market transactions. Extremely diverse across rich and poor communities and nations, they help transmit information, enforce property rights and contracts, and manage competition in markets. All market-supporting institutions do one or more of these things. And in doing so, they give people opportunity and incentives to engage in fruitful market activity.” (World, 2001)



### Adjustment Triangle



While preparing for accession and full integration with the EU, one must remember that it is a long and complicated adjustment process. The core of this process is institution building in the accession countries, institutional change and institutional adjustments in other countries of the Community. The scope and timing of these adjustments is presented in the “adjustment triangle scheme”

There are three stages of the adjustment process to the conditions in the enlarged EU: first, within the framework of the negotiation period; second, in the pre-accession period, and third, after accession. Main aspects and features of adjustments in these stages are presented below:

#### 1. (N) Negotiations on accession (1999-2002)

- Establishing general requirements and conditions for accession.
- The framework for “entry conditions” for new members is accepted.
- The concept of the future enlarged Community, mutual concessions and transition periods are discussed, and accepted.
- The negotiation phase involves a relatively small number of specialists and narrow circles of engaged societies; it is mainly a political and technocratic stage of enlargement.

#### 2. Pre-accession period (2000-2004)

- The most intensive period of building formal institutions necessary for accession and integration.
- Pre-accession funds are available for candidate countries during this period. They are approximately four-times higher per year than the previous EU aid to these countries.
- Pre-accession programs, based on EU structural programs and their philosophy, serve as patterns and support for institution building, and as a training opportunity for constructing the “absorption capacity” necessary for future utilization of the Community support funds. It is also an important learning process and accumulation of skills useful for functioning within the EU structures.
- Hundreds of projects covered by pre-accession programs contribute to the diffusion of “know-how”, engage thousands of people at all levels of societal structures, and transmit information about many aspects of the EU economy and society to individuals and organizations in the candidate countries.

- The pre-accession programs contribute to the strengthening of the market economy and civil society in CEECs.
- Social dialogue on the costs and benefits of accession is conducted in the candidate countries, aimed at a better understanding of integration process, involving more people in this process and contributing to the positive outcomes of referenda preceding the formal signing of the accession treaty.

### **3. Post-accession adjustments (2004-)**

- Most of the adjustment processes in social and economic spheres necessary for full integration are made after accession of new members to the Community.
- Formal institutional structures, established during negotiation and pre-accession periods, are tested and put into action.
- Necessary corrections and additions to them are made.
- Formal institutions (law and organizations) are supplemented by informal institutions (social norms, behavior patterns, attitudes, ways of thinking, etc.) which support “real” integration. It is commonly accepted in the social sciences that much more time is needed to develop informal institutions than to establish formal institutions, a legal framework and organizations.
- Availability of Community funds (structural, agricultural, cohesion, etc.) helps to adjust economic and social structures to the new reality of an enlarged Community. The structures become more compatible and efficient.
- Part of this adjustment is the “catching-up” process of new members to the higher level of development prevailing in the Community.
- In this stage of mutual adjustment, accession is becoming a matter of real integration.

## **4 Evolution of agricultural policies in CEECs during the transition period**

The group of CEECs differs very much in their strategies of agricultural restructuring and in agricultural policies. The former Soviet Baltic republics (Estonia, Latvia and Lithuania) and Poland took the “shock therapy” approach at the beginning of systemic transformation. In this initial period of the transformation, agricultural support, including border protection, was drastically reduced, the national economies were opened to foreign competition, and farmers became taxed rather than subsidized. Producer Support Estimate (PSE) measured by the OECD dropped in some CEECs from a high level (75-80% in Latvia and Estonia) to negative values. After this period, the level of agricultural support started to grow and by the end of the '90s Estonia, Latvia and Lithuania had reached the level of PSE similar to other CEECs.

Czech Republic, Slovakia and Hungary have taken a more gradualist approach to agricultural-policy reforms. They reduced the level of protection and support gradually, from around 50% at the end of the '80s to a very low level (7-9%) in 1996-1997. Later the level of agricultural support increased as a result of the adjustment of their national agricultural policies to a CAP-like policy. Among the candidate countries, only Slovenia has a level of PSE comparable with the EU. Romania and Bulgaria have had very unstable agricultural policies with changing levels of support.

Table 1: Estimate of Support to Agriculture in CEECs, 1986-2001. Percentage PSE

Country	1986-1990	1993	1996	1999	2001
Czech Republic	57	28	13	24	17
Estonia	75	-32	7	7	13
Hungary	32	20	9	23	12
Latvia	80	-40	3	22	16
Lithuania	77	-37	5	16	11
Poland	-4	15	23	19	10
Slovakia	50	26	11	25	11
Romania	45	16	12	20	24
EU-15	43	44	35	39	35
OECD	38	38	30	35	31

Source: OECD, 2000, "Agricultural Policies in Emerging and Transition Economies", Paris. and OECD 2002, "Agricultural Policies in Transition Economies. Trends in Policies and Support", Paris. In the latest report, most of the indices were revised, in comparison with earlier reports, due to some changes in the methodology of PSE estimation.

Generally speaking, in CEECs in the late '90s growing convergence of the level of agricultural support could be observed both inside the group and between them and the EU. There are still differences among CEECs in relation to instruments of support. Most of them use market-price support (high tariffs) as a main instrument of support and, to a much lesser extent, other CAP-like means, especially direct payments. Direct payments play a significant role in agricultural support in Lithuania, Latvia and in Slovakia. Direct payments are not used on a greater scale in Estonia and in Poland. In CEECs other instruments of agricultural support which are not accepted in the EU are still used, especially subsidized credit.

## 5 Enlargement and the choice of agricultural support

Is eastward enlargement an opportunity and incentive to reduce agricultural support in the EU, or is it mostly a factor pressing for change in the structure of support and in the "repertoire" of instruments? Is it possible and justified to proceed with the implementation of "degressivity", "modulation" and "cross-compliance" principles in relation to direct payments or to convert this instrument into agricultural bonds? Is the budget constraint a major obstacle in accepting new members before 2006 (including their rights to CAP instruments)? These questions seem especially important in the discussion on enlargement in relation to agricultural and rural issues.

Eastward enlargement, which is the biggest enlargement of the Community since its creation, is not the right moment for a significant reduction in EU support for agriculture. New members of the EU will need agricultural support for modernization of their farms in order to make them competitive on both a European and a global scale. This support could be treated in a dual sense: as "transitional adjustment assistance" to the EU conditions, and as "transitional adjustment assistance" to world market conditions. In a proposal of CAP reforms submitted by the research group directed by A. Buckwell, the "transitional adjustment assistance" (TAA) should replace compensatory payments (BUCKWELL, 1997). Direct payments in their present form are an income-support instrument. Transitional adjustment assistance is future-oriented and

a modernization-support instrument.<sup>11</sup> Before changing direct payments in the present form into transitional adjustment assistance, it is necessary to define the goals of adjustment and the means for achieving these goals. CARPE was an outline of that kind of proposal. This proposal needs extension and concretization for the new conditions of the enlarged EU.

Eastward enlargement is a very strong factor pressing for the retention of agricultural support in the EU on a relatively high level (around 1.5% of GDP, measured in terms of the Total Support Estimate). It is also a factor mobilizing for a change in philosophy and the legitimacy of agricultural support. WTO negotiations additionally contribute to this pressure for change.

Why is it necessary to extend direct payments (gradually converted into TAA) for CEECs after accession?<sup>12</sup>

- *Non-discrimination argument*: all members of the EU should have the same rights. Direct payments are more an income-support device than compensatory instrument and no member of the Community should be excluded from the right to benefit from them.
- *Single-market and competitiveness argument*: since “old” and “new” members function on the same single market, and in the same competition environment, exclusion of CEECs from direct payments would significantly reduce their competitive position in the single market. This argument is linked to the next.<sup>13</sup>
- *Modernization argument*: direct payments or TAA are a source of investment and modernization for farms. Most of the post-socialist farms are under-invested or mis-invested. The financial situation of the farm sector in CEECs in the '90s has been generally bad. Only a small fraction of farms (in most of CEECs less than 10%) were able to invest, expand and modernize their equipment.
- *CAP democratization and fairness argument*: enlargement is a good opportunity to make public policy towards agriculture more accessible to small farmers and to make the support for farms more equitable. Today the prevailing principle is: the biggest take the most.
- *Total benefits from enlargement argument*: According to some estimations, the accession of CEECs, at least in the case of particular countries, without extending direct payments for them, would result in negative net benefits from enlargement for accession countries, especially in the first years after accession.<sup>14</sup>

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<sup>11</sup> “... transition or adjustment refers to the future, it is an attempt to reorganize resources (land, labour, management and capital) so that farms (and rural businesses) are capable of surviving unaided in the future. (...) Transitional adjustment assistance is forward-looking, offering at least the hope of change and adaptation to future conditions and future prosperity.” (BUCKWELL 1997: 80)

<sup>12</sup> When we started our project, the official position of the European Commission towards the CEECs was: “no direct (compensatory) payments for new member states”. This position was changed at the beginning of 2002, after starting official negotiations with the candidate countries.

<sup>13</sup> This argument is supported in the report of the CEPS Task Force: “A fundamental critique on the differential treatment of CEECs in terms of DPs is that this would clearly cause a distortion of competition between East and West European farms in a single market. With DPs paid per hectare or per animal, they are linked to production, and hence an unequal payment of DPs within a single EU market will distort competition between CEEC and EU-15 farmers.” (TOWARDS 2002b: 10).

<sup>14</sup> In “Horizontal Opinion”, submitted by Polish experts to the Polish Committee for European Integration, the scenario titled “EU scenario” (EU Common Position in negotiations not including direct payments for Poland), a simulation based on the Computable General Equilibrium model to the year 2010, shows that the net transfer to Poland in this scenario would be negative in 2010, while being slightly positive for farmers. This scenario also shows negative net results for Polish consumers and GDP growth (CZYZEWSKI, A.B.; ORLOWSKI, W.M. 2001). Another

There are several other issues discussed in the EU in relation to CAP reforms. The position of CEE countries toward these issues is not clear. Here are my comments on some of these issues:

*Degressivity issue* – Reduction of the costs of the direct payments can be achieved by simplifying the procedures related to them, by “modulation” and by limiting the amount per farm.<sup>15</sup> Due to the special needs for direct payments (or TAA) in CEECs, significant reduction of direct payments over time should be extended (for 7-10 years after accession). There is a rationale for considering partial conversion from Pillar I (including direct payments) to Pillar II (rural development supporting also agricultural development). Proposals aimed at avoiding an extension of direct payments into the new members from CEECs by converting them into bonds before enlargement, and granting them to the “old” members only, are unfair and dangerous for the successful integration of the CEECs with the EU.<sup>16</sup> There is one important argument presented by the CEECs against significant reallocation of direct payments to the rural-development measures: the direct payments are fully financed by the EU and access to these payments is relatively easy; rural-development measures (second pillar of CAP) need co-financing, are complicated and their results are delayed.

*Modulation issue* – This is a difficult and sensitive topic from the perspective of the CEECs. Poland and other candidate countries with a large small-farm sector are interested in finding appropriate ways for extending direct payments (or TAA) to the part of small-farm sector which has some potential for development and modernization. One of the new measures offered by the EU for the candidate countries, “support for semi-subsistence farms undergoing restructuring”, goes in this direction. The character of this instrument is mixed: similar partly to direct payments and partly to structural support. The small-farm sector is also growing in other post-socialist countries. In CEECs we can observe a polarization of agrarian structure (bimodal structure): besides many small farms, there is a growing big-farm sector. Some of the restructured and privatized farms (former state and co-operative farms) are very big by European standards and have thousands of hectares of agricultural land. As mentioned earlier, the concentration ratio in most CEECs is much higher than the EU average. In CEECs we have a new “landlords group” (or class) and this group could be a major beneficiary of CAP (mostly through direct payments). Many owners of agricultural land do not live in rural areas and do not participate personally in farming (absentee-owners). The concentration of CAP benefits in a relatively small group of land owners or land operators would raise the question of the fairness and equity of CAP. Unrestricted according to the size of a farm, direct payments would also increase significantly the price of land. In these circumstances, some forms of “modulation” of direct-payments distribution could be desired. Obligatory modulation proposed by the Commission in

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estimations, done by M. BANSE for Poland, shows that in “Agenda scenario” (no direct payments) net transfers from EU to Poland in 2005 would amount to € 1.79 billion with very small benefits to rural households and negative results for urban households, investments and GDP growth. In the scenario with direct payments, the net benefit for Poland is 2.5 times higher (BANSE, M. 2000).

<sup>15</sup> This direction of the direct payment reform is also presented in the Agenda 2000 mid-term review (TOWARDS 2002a).

<sup>16</sup> A. SWINBANK and S. TANGERMANN in their proposal for introducing a “Bond Scheme” instead of direct payments treat direct payments only as compensatory payments. As a consequence, they suggest excluding CEECs from the scheme: “To the extent that they do not suffer a reduction in price or income support, there would be no need to extend the payment scheme to farmers in the applicant states in Central and Eastern Europe and the Mediterranean. (...) The Bond Scheme would reduce the budgetary costs of Eastern Enlargement, for bonds would only be issued to those farmers adversely impacted by a withdrawal of support.” (SWINBANK, A.; TANGERMANN, S. 2001)

the Mid-term Review of the Agenda 2000 will not be extended to the new members from Central and Eastern Europe since these countries begin with a low level of direct payments (25% of the present EU level). It would be justified, however, to give new members from CEE the right to use the modulation instrument and establish an upper limit of direct payments below € 300,000 per farm.

*Co-financing issue* – Co-financing first pillar of the CAP would be unacceptable for the CEECs. On the contrary: enlargement provides an additional argument for the strengthening and continuation of a common character and for the solidarity of agricultural policy in the EU. Co-financing could also increase differences and disparities between agriculture and rural areas in richer and poorer member states and works against cohesion in the EU. Reallocation between CAP pillars I and II is often seen as a re-nationalization of CAP “by the back door”. The majority of measures included in the second pillar support farmers and are of a sectoral character. There is a co-financing requirement for these measures, which sets a minimum rate for national contribution. Richer countries can allocate much more resources for co-financing second-pillar measures than is required by the EC regulation. In reality, it is an additional farm-sector support which undermines the “common character” of the CAP.

*Cross-compliance issue* – This issue is mostly related to eco-conditionality and the “greening of the first pillar of CAP”. Enlargement is a good opportunity to extend eco-conditionality to both new and old members of the EU. Strengthening eco-conditionality of direct payments would be the right tool for reducing budget burden caused by direct payments. There are two major problems with implementing eco-conditionality: the first is linked to the standards or reference points for conditionality, and second is the transaction-costs issue. In the EU there is no common Good Practice Code (Good Farming Code) and the difficulties associated with constructing such a code are tremendous.<sup>17</sup> Difficult to estimate, but rather high, are transaction costs connected with eco-conditionality policy.

Eco-conditionality has been put into a set of requirements linked with the proposal package for CEECs. Execution of these conditions in the first years after accession would be very difficult and expensive for new members. First estimations of the costs and benefits of some measures offered by the European Commission for CEECs in January 2002 show that the costs of matching ecological conditions required by the regulation would absorb most or even all support from the EU (for example € 750 per farm for semi-subsistence farms). Eco-conditionality should be extended for the transitional period and more precisely linked with the level of support.

## **6 The Community budget constraints and eastward enlargement**

It is a very common opinion that in the present EU budget plan for 2000-2006 there is not sufficient money for the extension of CAP to the new members after enlargement. The cost of CAP extension to the CEECs is estimated at € 9-13 billion annually (SWINNEN 2001). In the EU proposal published on January 30, 2002, the Commission is offering the 10 candidate countries only € 2,048 million to € 3,933 million per year for supporting agriculture and rural development (both first and second pillar of CAP). Additional costs of accession are connected with the extension of structural programs to

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<sup>17</sup> “It is not possible now to build and European Good Farming Codes. The house has to be built on a solid basis, and those have to be local standards. Do not ask bureaucrats, even eurocrats, to build standards in their office without concrete knowledge of what is happening on the ground.” (URFF, W., 2001)

new members (€ 7-10 billion yearly). In the EU financial perspective for 2000-2006, there are some financial resources for CEECs:

- 1) € 3,120 million annually for pre-accession programs;
- 2) € 4,140-14,220 million annually for enlargement, beginning in 2002.

We should add the contribution of new members to the Community budget after accession to these amounts. Let us assume that the enlargement with 10 CEECs takes place in 2004. In this case, pre-accession funds can be transferred to other purposes (e.g. additional CAP expenses). Funds for enlargement predicted for 2002-2003 amounting to € 10.8 billion should be saved and added to amounts for enlargement after 2004. According to the estimations done by the Polish Section for Economic Analysis of Agricultural Policy (SEAPR), it would be possible to finance the full costs of extending CAP to the new members, including full direct payments, by increasing the EU budget to 1.27% of the total GDP ceiling. Similar estimations to this prepared by SAEPR (2002) were presented by M. Schreyer (SCHREYER 2001). It is not easy to explain to the candidate countries why the share of the EU common budget of Community GDP will increase to 1.15% in 2003 and, in the first year after accession of the 10 new members, will start to decline to 1.09% in 2006. In the EU budget proposal for 10 new members, the total amount of Community support for these countries is less than was predicted for accession of 5 CEECs in the budget accepted at the Berlin Council meeting in 1999. It is hard to accept the opinions presented by some EU officials that the proposal of the Community for new members from CEECs is “generous”. When three new members – Greece, Spain and Portugal, with a GDP per capita below the Community average – joined the EC, one of the reactions to this challenge was the first “Delors Package”, which resulted in a doubling of the common structural funds in the period 1988-1993. The challenge to EU social and economic cohesion after eastward enlargement is much bigger than after the Community enlargement in the 1980s, but the response to this challenge is much weaker.

In most of the estimations of the costs of enlargement there is an assumption that new members will take up their rights to common funds fully, from the beginning. This is a wrong assumption. The capacity for absorbing the EU funds for agricultural and structural policies will develop gradually after accession, especially when taking into account complicated procedures and institutional barriers in CEECs. It will be a relatively slow “learning-by-doing” process. Human capital and institutional barriers in CEECs for preparing, implementing and managing complex EU programs are probably much stronger than most people, both in CEECs and in the EU, imagine. Implementation of pre-accession programs in CEECs can be treated as a test for the human and institutional capacity and as a “training ground” for absorbing much higher funds after accession. This test so far gives little optimism for the quick extension of existing EU policies to CEECs after enlargement.

## **7 Eastward enlargement and the EU rural policy**

Eastward enlargement should be done together with the introduction of a new rural policy for Europe. There is little time left for preparing such a policy. The main ideas for this policy presented in the CARPE model (BUCKWELL 1997) and in the SARACENO proposal (see the contribution of SARACENO in this volume) are – in my opinion – well suited to the needs of an enlarged EU and new international conditions, including WTO recommendations. Most of the economic and social problems that the agricultural population faces cannot be solved by means of agricultural policies alone. Agricultural

policy will be more effective when it forms a component of a comprehensive rural policy. Even in the countries with highly productive and large-scale farms (e.g. USA), agricultural income is a shrinking part of the incomes of farm households (BLANFORD 2001). The introduction of the Farm Bill 2002 in the US adds new “ammunition” to the discussion about methods for solving the “agrarian question”. In most cases, rural development contributes to farmers’ well-being more than agricultural development. Rural development through institution building, human capital formation and the development of social and technical infrastructure also contributes significantly to agricultural development.

Rural unemployment in CEECs is one of the biggest and most complicated socio-economic problems. In rural areas of Poland unemployment, both registered and concealed, is higher than in urban areas. It is also more difficult to reduce unemployment in rural areas due to the less developed human and social capital, and to institutional constraints (KOLARSKA-BOBINSKA; ROSNER; WILKIN 2001). High rural unemployment is a major socio-economic problem in all CEECs.

Rural development should play an important role in strengthening the civil society, which is presently poorly institutionalized in rural areas in CEECs. It would be very useful for rural development to implement in accession countries LEADER-type programs as quickly as possible, even prior to accession. The LEADER program supports grass-root group initiatives and mobilizes local communities for collective actions. It is difficult to explain why the EU did not include LEADER-type measures in pre-accession support and almost eliminated LEADER+ from the rural development support package for the CEECs in 2004-2006.

CEECs will contribute to the greater diversity of the EU in all dimensions: environmental, social, cultural and economic. There are also big socio-economic differences and disparities across regions and social groups in CEECs which threaten the socio-economic cohesion of the EU. This requires the implementation of effective, decentralized structural and regional policies that are well suited to both regional and local needs.

It is a common phenomenon in rural areas, both in CEECs and in the West, that socio-economic exclusion or marginalization is stronger than in urban areas. Most CEECs face growing disparities between regions and social groups. Difficulties with the implementation of structural and rural development programs in CEECs – both those experienced up to now and those expected after accession – can contribute to a worsening of this phenomenon rather than improving the situation in this aspect.

## **8 Conclusions**

- Eastward enlargement of the EU is the biggest challenge to the Community since its creation. This challenge requires profound reforms of major policies, especially agricultural and regional policy. The reaction of the EU to this challenge has so far been insufficient. Enlargement of the EU by 10 new members is treated more as accession than integration.
- The candidate countries are concentrating on the adaptation of the *acquis communautaire* and on preparation for the implementation of existing EU policies. They are not sufficiently active in the discussions about future common policies for an enlarged EU which would better suit the needs of CEECs.



- Eastward enlargement requires large financial resources for a successful adjustment to EU conditions and for improving socio-economic cohesion in the EU-25. Enlargement is not the right moment for decreasing the share of the Community's common budget in GDP. In the face of challenges and needs connected with enlargement, the common budget should rather increase to the ceiling: 1.27% of GDP.
- In the long perspective, structural and regional-development support should absorb most of the common budget resources. Rural development can contribute more to the well-being of the rural population than traditional agricultural policy. A gradual shift from agricultural funds to structural funds and between the two pillars of the CAP seems justified in the light of past experience.
- Due to the high socio-economic diversity of an enlarged EU, more flexible, decentralized and less bureaucratic structural and regional policy is needed.
- The critical reaction of the CEECs to the EU proposal for budget allocation to the new members in the period 2004-2006 is understandable and justified. The proposed level of support to new members is low. It is lower than expected by CEECs and even lower than the possible financial framework established under the Berlin EC agreement in 1999. It seems to me that the EU is trying to implement a "cheap" enlargement strategy. This could be a threat to the successful and efficient integration of CEECs within the EU.
- In the first years after accession, new members from CEECs need strong agricultural support. This is required for the modernization of farm and food-production sectors and for strengthening the competitiveness of the agri-food economy in CEECs. The financial state of agriculture during post-socialist transformation in all candidate countries is very difficult. Without sufficient support, most of the agricultural producers from CEECs will be marginalized in the enlarged EU. Direct aid to the farms in new member states is necessary and justified. Implementation of *degressivity* and *modulation* of direct payments in the EU should be connected with the extension of this form of support to new members.
- Eastward enlargement of the EU is the right moment for extension of *cross-compliance* of agricultural support to old and new members. This may contribute to the greater legitimization of public support for agriculture. Fulfilling high standards of eco-conditionality, food safety and animal welfare is costly and complicated. These requirements could be accepted by farmers in CEECs only when sufficient compensation for them is guaranteed under new CAP rules applied to new members. This condition is not met by the proposal from the EU submitted to CEECs in January 2002.<sup>18</sup>
- There are important lessons for the future adaptation of new members to EU conditions coming from the pre-accession period. Utilization of pre-accession funds

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<sup>18</sup> In the final stage of negotiations on accession conditions in Copenhagen (December 2002), the candidate countries from Central and Eastern Europe achieved some significant concessions in comparison with the initial proposal submitted by the Commission. The most important is linked with the direct-payment issue. New members from CEECs can reallocate part of the Pillar II money to increase direct payments during the first years after accession. They can also top up direct support from the EU budget with additional money coming from domestic sources. As a result of this agreement, in Poland, for example, direct payments for farmers can reach 55% of the EU level in 2004, 60% in 2005 and 65% in 2006, instead of the previously proposed 25%, 30% and 35% respectively in first three years after accession. In the new conditions accepted in Copenhagen, the phasing-in period for reaching 100% of direct payment was reduced from 10 years to 7 years. Poland and some other countries have also gained higher than initially proposed milk quotas and longer transition periods for adjustment to the EU requirements in relation to particular products, food-processing and market regulations.

and implementation of pre-accession programs has been much less successful than expected before starting these programs. Connected with this failure are long delays in program implementation, relatively small amounts of available money spent, a lot of dissatisfaction among potential beneficiaries, etc. There is a real threat that a similar failure may be repeated in the first years after accession in relation to structural funds and rural-development programs applied to CEECs.

- To safeguard the more efficient and just utilization of EU support, there is a need for more transparency, better “user-friendly” procedures and stronger involvement of those social groups who are the targets of support.
- Enlargement of the EU in May 2004 should accelerate a social dialogue in the Community on a new philosophy and a new policy for integrated development of rural areas in the EU-25.<sup>19</sup> “Policy Vision for Sustainable Rural Economies in an Enlarged Europe”, prepared by the ARL West-European Working Group, provides a good reference point for this dialogue.

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<sup>19</sup> The first positive sign of the beginning of such a dialogue is the result of the Council meeting in Luxembourg in June 2003, with the participation of 10 candidate countries, on the reform of agricultural policy. The reforms generally run in the directions proposed in the “Policy Vision” paper.

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