

EU enlargement and the Common Agricultural Policy

Rozšíření EU a společná zemědělská politika

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Abstract: The incorporation of the Central and Eastern European Countries (CEECs) to the common agrarian market of the European Union is an entrance the saturated market solving problems with surpluses of main agricultural commodities. That is why an increasing of competition among both current member states and the new members has been anticipated. The question related to productivity of factors as well as technology level influence on competitiveness on the occasion of lower prices of agricultural commodities that could bring about shift of trade between agricultural enterprises and food processors in the first stage of processing within commodity chain into some of new member countries (or changes within them) and steer flows of some of agricultural commodities utilised as raw materials. The decisive position of the second stage of agricultural products processing, characterised by highly finalised products, probably will push forward the existing member states, especially the main producers and major exporters of finalised food products in Europe. Their interest in generation and expansion of this kind of market with highly finalised food products on the CEECs food markets would be expected. Moreover, the “demand driven agriculture” implying qualitative criteria such as food safety and precaution, favourable method of production, environmental impact etc., presented by agricultural policies in last decade and for future, is largely influenced by final stages of agri-food commodity chains. Distributors and well-established processors are those who “translate” the consumer’s demand to agricultural producers. Those decide significantly about the dimension, structure and market share of agricultural production in concrete area in essence. This situation has influenced effectiveness of the Common Agricultural Policy (CAP) exactly. Based upon the last reforms of the CAP in the EU evaluation, the significant changes of commodity markets regulation tools and a new approach partly related to income stabilisation policy partly to support of technological change and restructuring in wider social and regional aspects of the CAP are demonstrated there.

Key words: agriculture, agri-food chain, common agricultural policy, competitiveness, direct payments, enlargement, food industry, income

Abstrakt: Začlenění zemí střední a východní Evropy (ZSVE) do společného agrárního trhu Evropské unie je vstupem do plně zásobeného trhu, kde se v současnosti řeší problémy spojené s přebytky hlavních zemědělských komodit. Za této situace lze očekávat další zesílení konkurence nejen ze strany stávajících členů, ale i mezi novými členskými zeměmi. Rivalita mezi vstupujícími zeměmi otevírá znovu otázku produktivity faktorů a úrovně technologií, které mohou při nižších cenách zemědělských produktů vést k posílení konkurenceschopnosti a přesunu obchodu mezi jednotlivými zeměmi v rámci komoditního řetězce na trzích mezi zemědělskými podniky jako dodavateli suroviny a potravinářskými podniky první fáze jejího zpracování. Tento přesun by podstatně ovlivnil strukturu i úroveň poptávky po zemědělských produktech v jednotlivých zemích či regionech vstupujících zemí. Ve druhé fázi zpracování zemědělských produktů, která je charakterizovaná vysoce finalizovanými potravinami, lze očekávat posílení pozice současných členských států. Týká se to především expanze hlavních producentů a exportérů potravin v Evropě. Navíc „poptávkově orientované zemědělství“ prezentované agrárními politikami v poslední dekádě a do budoucna, je spojeno s řadou kvalitativních kritérií jako jsou potravinová bezpečnost a prevence, příznivé metody pěstování rostlin a chovu zvířat, environmentální dopad apod., je výrazně ovlivňováno právě finalizujícími fázemi agro-potravinových komoditních řetězců. Obchod a dobře zavedení zpracovatelé jsou těmi, kteří „tlumočí“ poptávku spotřebitelů zemědělským výrobcům. Tyto firmy v podstatě rozhodují o rozsahu a struktuře výroby a o reálném tržním podílu zemědělců v dané konkrétní oblasti. Tato situace samozřejmě ovlivňuje i účinnost společné zemědělské politiky (SZP). Na základě rozboru posledních reforem SZP v EU jsou charakterizovány podstatné změny nejen v nástrojích regulace komoditních trhů, ale i nové přístupy v agrární politice zaměřené jednak na stabilizaci důchodů v zemědělství, jednak na podporu technologických změn a restrukturalizace v širších společenských a regionálních aspektech.

Klíčová slova: zemědělství, zemědělsko-potravinový řetězec, konkurenceschopnost, společná zemědělská politika, vstup, přímé platby, potravinářský průmysl, důchod

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Accession of the Central and Eastern European Countries (CEECs) into the European Union raises a large number of issues in the context of the conditions of accession among the new states and in the contexts of forthcoming reforms carrying quite new problems of development for the current and enlarged member states as well. Owing to both, the current and the new potential members of the EU operate in real world and on that account, they are intensely influenced by the global world process of markets integration, as well as newly introduced economic policies making up qualitatively new space for development of enterprises. All branches are confronted by new challenges resulting from the requirements of the transforming world economy. New conditions and criteria are also included within the evaluation of the agricultural sector prosperity and the insight of necessity of the policy level and tools within the Common Agricultural Policy (CAP) changeover.

REVIEW OF LITERATURE

Most economists since Adam Smith seem to have regarded it as axiomatic that productivity grows less rapidly in agriculture than in the manufacturing sector. The notion of a relatively slow productivity growth in agriculture has been central to many theories of economic development. The Lewis's dual economy models influence on the typical feature of distinction between a stagnant, traditional rural sector and a dynamic modern manufacturing sector is known sufficiently. The problem is now partly solved namely by generation of commodity production verticals and the agribusiness formation.

However, such conclusions are also analogised for evaluation of the possibilities for productivity growth of agriculture (or the total agrarian sector) in developing and developed countries. This is an additional view that might be important for the enlargement process influence and our producers expectations. For example Haymi and Ruttan (1985), Prebisch (1990) indicated that productivity growth did not spread from the centre to peripheral countries because the periphery is focussed on the supply of primary products (raw materials) whereas predominant countries are typical by supply of highly finalised products. These theories imply not only both low productivity growth and lack of convergence in productivity among developed and developing countries, but also the possibility of gains from the successive stages and synchronisation of production and marketing within the whole agri-food chains.

Deficiency of inputs needed to make high-payoff products is evaluated as the basic problem of rapid technological change in agriculture as a key prerequisite of modern, competitive agriculture, its productivity growth among the more and less prosperous countries inside the group of developing countries themselves as well.

If we define technological change as a development where the same input level allows a different output level, or where the same output level requires different in-

puts, in reality it is ordinarily a combination of both developments, along with changes in quality of inputs and outputs resulting in the form of quantity changes, where quality changes are incorporated either in the price or in the quantities. This mutual relationship is well known as well as that its solution is based on productivity growth of the total economy.

Economic literature often considers the incentive of increased profitability at enterprises level to be the main driving force behind technological change. Firms apply new technologies because they expect higher profitability and because individual farms in agriculture have no (or nearly no) market power, they consider prices as given. Their individual decisions do not influence input or output price levels. According to the rational expectation theory, e.g. Newberry and Stiglitz (1981), Pindyck and Rotemberg (1983), Rausser and Gorter (1991), Munk (1994), Oskam and Stefanou (1997), the application of new technologies is incorporated by the agricultural sector in price expectations. Owing to that, one of the clear connections between agricultural policy and technological change is positively identified. The principle of that is more or less successfully utilised within economic/agrarian policies, namely related to the extent and methods of (re)allocation of resources or their utilisation. Tax regulation, investment subsidies or interest subsidies form another important component of the decisions on input use, especially with respect to investments into capital goods and land. That tools of regulation can be important for decision too – that is another link between agricultural policy and the level of technology.

Besides those direct general economic motives, the third aspect playing an increasing important role in the decision to apply new technology is the capability of adaptation of demand in its structural and prices aspects. The availability of information is identified as a crucial condition. The new products and methods are implemented if they prove to provide an economic improvement – from enhanced profits or welfare gain point of view – over the current products and production practices. It is important to appreciate that there is an opportunity for economic/agrarian structural policy to influence of technical change at each stage along the commodity chains during the process of product generation, manufacturing, finalisation and distribution.

Lot of the research conclusions related to agriculture, e.g. Cramer and Jensen (1994), Mundlak and Larson (1997), Martin and Mitra (2000), Ahn (2002), stress that the increasing of effectiveness resulted of a conscious policy choice of tools for funding the initiation and (partly) the development of such activities which are demanded refer to the agrarian sector related to concrete locality environment and accepted by the society.

METHODS

Based upon the system analysis as a fundamental methodical approach, the basic principles and form of tools

of the Common Agricultural Policy of the EU, the relevance of market support and approach to structural matters impact, are evaluated.

The main conceptual changes within the last EU agricultural policy reforms are proved, namely from the point of view of their leverage of the essential prerequisites for agricultural enterprises competitiveness in more and less developed members and enlarged countries are estimated. The influence of qualitative changes within agribusiness and the other linked economic subjects of agri-food chain impact on economic regulation policy efficiency and possibilities of enlarged countries agriculture development are interpreted.

RESULTS AND DISCUSSION

The agricultural sector was to be managed by the means of support government regulatory policies rather than to be left to the real performance of market forces overall. The Common Agricultural Policy of the EU is one of the illustrious examples. The particular problems of agriculture which resulted from the social structure based on family farm, the fundamental necessity to have stability of supply and from the instability of the market, which arose from weather conditions and the inelasticity of demand for certain products, established a lot of question in connection with the shape of the CAP at its including into the general European common market at the beginning of 1950s.

Starting point of the Common Agricultural Policy formation and its achievement

Already the Spaak report for the Committee of Government Delegates preparing texts of the Treaty of Rome posed in 1955 has opened a number of fundamental economical and political questions which evaluated the situation and conditions for functioning of the common market in the agriculture field as a point of departure of discussion about the agricultural policy.

These were the following (by Fennel 1997):

- Given the importance of security of supply, what was the degree of self-sufficiency which the Community intended to achieve or, alternatively, the degree of specialisation which was intended to develop, as a function of the world economy and export circumstances?
- Assuming that agricultural structure continued to be based on family farms rather than on huge enterprises, how – in particular by what type of encouragement to many forms of agricultural co-operation – was this farm structure to be reconciled with the development of modern methods of production and marketing?
- Recognising that economic development could bring with it a progressive reduction in the proportion of the

active population engaged in agriculture, what was the extent and speed of transfer of other activities which could take place and, in particular, on the assumption that other decentralised activities – either full time or part time – were created to reabsorb them in their own locality, what was the size of labour force thus freed?

- Taking account of the fact that for certain products, following the harvest, the free play of the market led to price fluctuations, what was the degree of stabilisation which was intended to be achieved and, more particularly, for which products?
- Taking account of the scope for development of consumption for certain products in certain regions of the Community, for which products would efforts be made to hasten this development?

Looking at those issues after 50 years, it is possible to say that those questions for agricultural policy solution seem to be more or less permanently actual, even though the last decades have witnessed considerable changes in this sector.

Only some of them which were finally selected as a core to underlie the CAP were set out in the Treaty of Rome (increasing agricultural productivity, increasing individual incomes of persons engaged in agriculture, stabilising of agricultural markets, assurance of the availability of suppliers and guarantee that supplies reach consumers at reasonable prices).

In spite of some contradiction inherent in the objectives from the economic theory point of view (*e.g. an increasing of agricultural earnings could come either from increased productivity, which in practice requires permits of the specialisation of enterprises and regions, that have scale economies and disregard of structural problems in the member countries, or from higher product prices, which disregard the consumer interest with negative influence on commodity market functions*) relatively high price level of outputs attract more inputs into agriculture and make new technologies more attractive and profitable and objectively they have been stimulating technological change in agriculture under the CAP.

In connection with the overall evaluation of that policy, the following consequences are evident:

- price certainty in the domestic market has increased agricultural production in the EU,
- because high prices foster increased input use in agriculture, endogenous technological change has sped up,
- although there are no indications of important economies of scale in agriculture, this plays a role in the upstream and downstream industries; increased input use leads therefore to a positive effect on productivity because of the scale effect (endogenous growth effect),
- structural policies¹ for agriculture largely remained national policies within the CAP; for each country it is profitable to speed up technological change, because the price effects are often limited,

¹ As regards the structural policy for agriculture and rural areas, a first attempt to develop the CAP framework was introduced in the 1970s by socio-structural directives. Their main aim was to improve agricultural production, processing and marketing structures

– in the recent years, a link has been made between the EU expenditures on structural policy and market and price policy; this link has increased subsidies on investments and restructuring use in agriculture, which might be very productive.

In reviewing the origin and early goals of the CAP, one of the imaginative aspects of the policy was that its designers visualised it as an integrated policy combining market and commercial policy with structural and partly social policies. In practice, too much emphasis was placed on price support and market regulation that isolated the market policy, which under economic changes of environment resulted in the fundamental reforms during 1990s.

The high protection level kept many enterprises in operation which would have discontinued under a price regime with lower and more fluctuating (market) prices. The existing CAP market and price policy was of the type of “insurance” for agricultural producers that the technological improvements which led to output increases would not depress their income too much. This holds also for the quota regime and for income policy: e.g. the CAP reforms during 1990s². If effects of restructuring of agricultural production are well included, that creates a larger difference between the productivity for the individual (more and less structural oriented) producers, their

position in the market and necessity of further public support.

The main intention of structural policy is to stimulate productivity and to reduce costs. The effects are illustrated in Figure 1.

Because of structural policy, the supply curve (marginal costs curve) of agricultural production shifts from S_0 to S_1 . If prices are fixed, this would increase production from Q_0 to Q_s . Assuming a constant demand curve D , structural policy without price adjustment would create the surplus production. To clear the market again, the process should decrease to P_1 . At the end prices are lower, production has increased (Q_1) and market accepted only those producers who are able to supply production under those conditions and processors accept the most advantageous (and ordinarily cheaper) supply.

Compared with the present, production role of agriculture is largely represented by models based on development of production verticals of commodity markets accompanied with growing *market power* on the *demand side*, there we could find further of the contemporary economic reasons why the agricultural policy is and will be reformed permanently.

The last reform of the CAP from Luxembourg (June 2003) is an evidence of this. *Decoupling of direct payments* shifts them from production support to producer

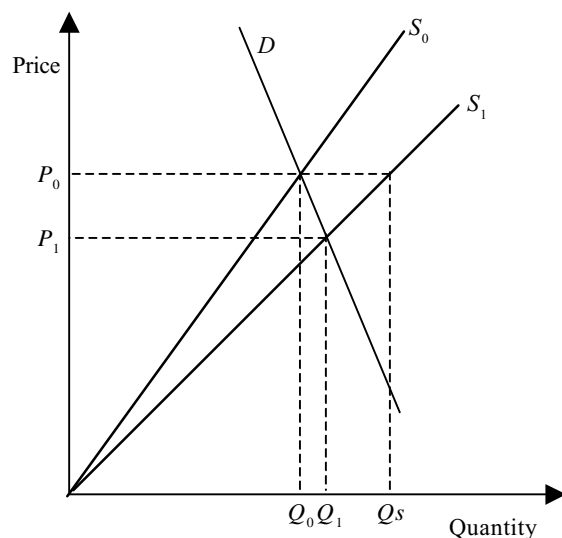


Figure 1. Effects of structural policy

(e.g. more than primary production support !!!) and to support farmers in less favoured areas. Increasing environmental aspects insight has drawn the public attention to the role agriculture plays or could play in this context. A more comprehensive policy was introduced under the 1992 reform and its accomplishment was compulsory for all member states. Nowadays, there is the possibility to introduce environmental cross-compliance requirements reducing direct payments if farmers do not respect statutory environmental standards that form part of the good agricultural practice.

² The MacSharry reform (1992) introduced for a few key agricultural sectors shifts from price support to direct (compensation) payments based onto historical references. They were accepted and implemented on the basis of shifting market and price support from the current production levels to a (disputable) historical level on which changes were made.

Under the Agenda 2000 reform, the shift from price support to direct income support continued so that in future it could well become the dominating (less market distorting) tools of agricultural support in the EU. Price support has been reduced in the main sectors and direct payments have been re-organised to partially compensate farmers for the price cuts.

support (to farm with limits per farm and year). "Single farm payments" imply that the predominant flow from public funding to agriculture will be paid independently from the volume of the present production (its amount and structure) and makes possible to choose the best structure of farm activities. Rural development programmes within "the second pillar" of the CAP framework are supported significantly. That pillar is typical by the integrated approach, using integrated development programmes, specifically targeted at rural regions. They are multi-sectional programmes with the combined support of different (largely structural) community funds, financial sources of member states and regions.

Owing to direct payments being reduced, the question for decision-making should be the share of the value of direct payments and whether the actual income of the farmer comes from farming activity. It could be a very sensible question related to the future of the European agricultural products efficiency and competitiveness. *Only if those payments are utilised for re-structuring of activities and/or technological innovation related to evaluation of market situation in the region, the level and structure of demand as well as the possibility to keep all quality and other standards, we can speak about a "good start" for future.*

The common market and the enlarged countries fighting chance

It is necessary to realise that the incorporation of the CEECs into the common agrarian market of the EU means opening for them the *saturated market* already solving problems with surpluses of the main agricultural commodities. That is why we should anticipate *increasing of competition* among both current member states and the new members and their success is based on the productivity gains.

From the demand side referring to agricultural products as raw materials, the market price and other conditions of products delivery keep one of the basic criteria influencing the level of costs in the following stages of processing. That is notably important for enterprises included in the *first stage of processing* with immediate relationships to agricultural enterprises in decision-making related to the choice among the best agricultural suppliers. We could expect increasing of *competition on this kind of market, especially among the new member states*. Lower prices of agricultural commodities could bring about shift of trade in this part of commodity chain into some of those countries (or changes within them) and to steer flows of agricultural commodities utilised as raw materials.

The *decisive position of the second stage* of agricultural products processing, characterised by highly finalised food products with substantially higher value added and growing share of food prices structure, probably will *push forward the existing member states*, especially the main producers and major exporters of finalised food products in Europe. We would expect their

interest in generation and expansion of *this kind of market with highly finalised food products* on the CEEC's food markets, often based on interconnecting with the decisive market-chains. Here manufactures can create and sustain markets by their use of brands and advertising, thereby maintaining margins and setting prices in a way that is not possible for primary commodities.

CONCLUSION

The "demand driven agriculture" implying both quantitative and qualitative criteria such as food safety and precaution, favourable method of production, environmental impact etc., presented by agricultural policies in the last decade and for future, is largely influenced by the final stages of agri-food commodity chains. Markets and well-established processors are those who "translate" the consumer's demand to agricultural enterprises in practice. They significantly decide about the dimensions, structure and market share of agricultural production and its producers in the concrete locality. There we should find one of the contemporary reasons why the agricultural (regulatory) policy is, and should be also in future, reformed.

Where are our possibility to become an equal component of the changeable system? Two effective ways for the future could be adopted in essential: (1) very quick and reasonable utilisation of the contemporary direct payments to improve orientation in the demanded agricultural production structures and their effectiveness. Focus on safety and high-quality products, branded articles and regional trade marks. That is why we need to support and collaborate with the following phases of processing that largely should sell our top quality raw materials. (2) to enforce our experienced scientist, specialists from agricultural enterprises, processing industries, from the services as well as from trade and other industry in the rural regions and their urban centres for collaboration and to create meaningful and practical projects for positive developments in our area partly supported by the EU structural funds.

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