Competitiveness and farm incomes in the CEEC agri-food sectors.

IMPLICATIONS BEFORE AND AFTER ACCESSION FOR EU MARKETS AND POLICIES

Summary

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Introduction

This study aims to identify the major dynamics in the agri-food sectors of the CEECs, as regards their current and future competitiveness compared to EU-15 before and after accession, and the implications for Community markets and policies.

I. TRENDS IN EFFECTIVE COMPETITIVENESS

I.1. The overall economic recovery of the CEECs...

After one (Central Europe) or two (Balkans) phases of strong inflationary recession, the majority of the CEECs seem to have created the systemic basis for new sustainable overall growth, where foreign investment plays an important role.

I.2. ... was not transmitted to agricultural production,

After a short revival around 1995 due to favourable climatic conditions, production cycles and the world market, production has generally fallen back or, at best, stagnated in real terms.

I.3. ... nor to their internal markets,

Owing to a substantial reduction and then stagnation of agricultural consumption per capita, the ten applicant countries have maintained overall slight surpluses in temperate agricultural products. But in the animal sector, particularly meat production, these surpluses are much smaller than during the communist era when the animal sector was very strongly subsidised.

I.4. ... but into demand for transformed products and their net imports from the European Union

The balance in agri-food trade of the ten countries is as a whole negative and worsened during transition in all the countries, including the two only net exporters, Hungary and Bulgaria. The principal explanation is the much higher proportion of processed products in imports than in exports, in particular in trade with the European Union, which is largely responsible for the overall agri-food deficit of the CEECs. In other words, the CEECs have become big net importers of EU industrial and commercial value added.

On the other hand, the CEECs have found major outlets in the Community of Independent States (mainly Russia), and more modestly in other emerging or developing economies for less processed and lower quality products.

The development, composition and orientation of agri-food trade reveal therefore the low effective competitiveness of the agri-food sector of the CEECs in relation to the EU and its continuing deterioration.

I.5. ... despite more targeted and effective tariff protection than that of the Union

The food industries of the CEECs have benefited to date from "tariff escalation" (higher customs duties for processed products) which no longer exists in the Union. Furthermore the near stabilisation of their agricultural production was obtained only through prohibitive import duties on major products.

To some extent, the low effective competitiveness of CEEC staple products on the Single Market is evidenced by the fact that their exports to the Union often remained far from filling the moderate quotas of the European Agreements at reduced duty, although other factors may also play a role in this context.

At first sight, the new European Agreements signed since May 2000, confirm this analysis. Indeed the mutual liberalisation of trade between the CEECs and the EU has made some encouraging progress, but without considerable commercial risk because it is often limited to patterns of trade in recent years.

I.6. ... and the advantage of less demanding quality standards on their internal and third country markets

This current competitive advantage of low standards will disappear as a consequence of extending enforcement of EU standards, a precondition for acceding to the Single Market.

I.7. The illusion of the competitiveness of CEEC farm prices

I.7.1. Convergence of farm prices towards levels of the Union

With regard to staple products, a recent internal study by the Commission confirms the trend of convergence of average farm prices in the applicant countries towards Community levels, and sometimes to exceed them, from their marked inferiority in the beginning of the 1990s. It also shows that this tendency is conditioned by a trend towards alignment between the Community and world prices.

However, price support in the CEECs cannot reach the levels of the EU in certain sectors, because they are limited by WTO constraints, weak internal purchasing power and the relative inefficiency of the relevant agri-food chains. This concerns particularly milk, beef and sugar. For beef and milk, quality differences account for a large proportion of the price gap.

On the other hand, the prices of cereals (to a less degree, maize and rye) and of oilseeds are on the whole very close to Community averages, and that of Polish wheat exceeds them already notably. The trend towards overshooting is generally also the case for pig, poultry and the eggs, especially at equal quality. Given the very low profitability levels of production in the CEECs, this reflects increasing costs.

I.7.2. Non-price handicaps on agricultural production in the CEECs

I.7.2.1. Quality differences

Despite recent upgrading, most of CEEC agri-food production is still far from meeting Community standards and - more generally - the quality requirements of EU markets. So at equal quality, convergence and/or overshooting of Community prices would appear even more clearly, particularly for livestock products and in the least advanced countries.

The further application of Community standards will have two contradictory effects on CEEC agricultural production and prices. On the one hand, it excludes from the market cheap low standard products, still sought by poorer consumers, in the domestic market of the CEECs and in some of their external markets, in particular the CIS. On the other hand, these standards can have the opposite effect by accelerating restructuring and generating efficiency gains in agriculture and in the agri-food distribution chain. The first effect is likely to prevail in the medium term in those countries where restructuring is the least advanced.

I.7.2.2. Backward organisation and/or fragmentation of agricultural production

In the European Union as in all developed economies, the effective competitiveness of agricultural production depends increasingly on its aptitude to meet high and increasing requirements of concentration, organisation, flexibility, and “traceability”, imposed by the processing industries. These latter are subject to the same pressures from the retail trade. In this respect, agricultural production in the CEECs is still far from having overcome the legacy of the former “command” economy. Moreover, fragmentation, which is still particularly high in Romania, Poland and in Slovenia, has worsened in the majority of the other countries during the last decade.

I.7.2.3. Very low or negative agricultural profitability

As evidenced below, the profitability of agricultural production in the CEECs has remained overall much lower than Community levels and has worsened to the point of decapitalisation of the sector. This constitutes the key limiting factor on agricultural production and an obstacle to reducing unit costs.

I.7.3. Monetary appreciation made CEEC farmgate prices converge with the EU,

A mechanism “of real appreciation” of the currencies of the CEECs has been created by their overall growth, their gradual monetary stabilisation, their increasing integration into international trade, their commercial surpluses and foreign net investment. This translates real constant prices in domestic currency into increasing real prices in EURO. Their price competitiveness therefore deteriorated with respect to the Union, particularly when EU prices were falling relative to world levels.

I.7.4. ... then made domestic levels fall,

Since 1996 this monetary appreciation has continued in the CEECs. Even if world prices in ECU had then remained constant, this involved sooner or later a tendency towards a domestic drop in real farmgate prices in the CEECs, due to the limits of their possible price support. The sharp drop in world prices in ECU amplified this brutally. From 1996 to 1999 the real fall in the index of the farm prices reached - 26% in Poland, - 20% in Hungary and in Czech Republic.

Indeed, price support ran up against the "barrier of demand", i.e. the limits of domestic markets in the CEECs. In the CEECs this barrier is created by the relative weakness of per capita real incomes, the still high share of food in expenditure, and especially by the high relative levels of farm prices (in relation to other internal prices).

I.7.5. ... and aligned the prices of the inputs on the Union, creating a scissors effect,

Monetary appreciation and increasing trade (mainly imports) of inputs have made also their prices converge to EU levels. Their recent real fall in domestic currencies suggests that henceforth they will be in line with the Community levels, at comparable quality.

The overall result has been since 1995 a marked deterioration in the output/input price ratio in agriculture. This effect of "scissors" is a world major trend, which also affects Community agriculture, and to which the latter has responded by increasing productivity, besides growing direct support through both reforms of the CAP. Under these conditions, the acceleration of productivity gains, and therefore of the restructuring of the sector, has become an important precondition for simply maintaining agricultural production in the CEECs.

I.7.6. ...with a slow increase in downstream margins, smaller than in the Union,

Since 1996, the rapid fall in farm prices has allowed an increase in margins in processing and in trade, per unit of agricultural product. But these margins still remain smaller than in the Union, which puts a brake to modernisation and growth of the CEEC food industry.

I.8. ... but direct support for agriculture remains much lower in the CEECs: a current handicap, but a potential asset.

All the preceding analysis covers the effective competitiveness of agricultural production in the CEECs in relation to the Union within the framework of existing differences in agricultural support policy.

Except in Poland, these support rates were generally higher than that of the Union at the end of the communist era, or close to the EU in Hungary. Since then, they have fluctuated under the influence of currencies and world prices, and now remain generally lower than half of the Community level, except in Slovenia. This results from much lower macroeconomic capacity, in relation to the Union, to support agriculture at the expense of the remainder of the economy, because of its more important relative weight. This constrains especially the budgetary capacity to subsidise agriculture.

Under these conditions price support in the CEECs, mainly through border protection, tends to occupy a major place in their total support of the agriculture, and definitely more than in the Union where both reforms of the CAP substituted considerably increased direct support. The inferiority of direct support has penalised agricultural income in the CEECs, with negative consequences for capital formation.

In this respect an EU/CEEC comparison of the support rates by product, as inverse indicators of potential effective competitiveness in the enlarged single market is instructive in terms of order of magnitude, despite its limits. With regard to the cereals and oilseeds, it suggests a high competitive intensification potential in Hungary and in Czech Republic. More modest in Poland, this has moreover to be moderated by non-price handicaps due to the fragmentation of production. As far as the livestock sector is concerned, these handicaps and poor average quality make competitiveness probably illusory for Polish milk, and for the beef and veal sectors of the three countries, as well as for Hungarian and Czech pigmeat. Finally, it is clearly negative for poultry production in the three countries.

II. DETERMINANTS OF EFFECTIVE COMPETITIVENESS

After a decade of market economy, the stagnation or contraction of agricultural production, due to land and labour productivity much lower than the Community average, can no longer be attributed to delays in transition, or to the micro-economically irrational and/or inefficient use of production factors. Rather current production levels are the result of rational microeconomic adjustments of farm structures to their factor endowments and to input and output markets.

II.1. Factor productivity and combination

II.1.1. The relative weakness of agricultural production per hectare

Per hectare of utilised agricultural area (UAA), the gross agricultural production (crop production + animal production) of the applicant countries, converted into ECU, was in 1999 between 8,5 % and 35% of the Community average, apart from the Slovenian exception (68%).

Although described as “final” by certain statistical sources, these productions are final only for the vegetable and animal sectors envisaged separately. But for agriculture as a whole they are “gross” of the mutual intra-consumption of these two sectors, which are almost wholly fodder crops consumed by the animal sector. The double accounting of these "intraconsumptions" in gross agricultural production hides therefore the notorious inefficiency of fodder conversion by livestock-farming in the CEECs. Indeed this inefficiency leads livestock farming in the CEECs to absorb a much more important share of gross crop production than in the Union, at the expense of its final uses, i.e. non agricultural.

In terms roughly weighted by animal production in the CEECs, fodder conversion proves to be approximately half as efficient overall than in the EU-15 in physical terms, which further reinforces the relative weakness of gross agricultural production by hectare.

II.1.2. ...arises partly from less intensive production per hectare,

All in all, the animal charge and the proportion of intensive crops per UAA hectare are definitely lower than those of the Union. The three countries where wine-growing and the orchards are the most significant (Hungary, Romania and Bulgaria) reach only approximately 40% of intensity of plantations in the Union.

On the other hand, except in Slovenia, the share of worked surfaces is everywhere much higher than that of the Union. The EU leaves in permanent pastures 38% of its UAA, in broad part used for extensive beef, veal, mutton and lamb production, against only approximately 20% in the three principal Central Europe agricultures, where this type of production is marginal.

II.1.3. ...but also from the persistent weakness of physical yields,

In the applicant countries, the relative weakness of agricultural production per hectare also reflects low physical yields of crops and of livestock-farming, and is cumulated in this second case. The average crop yields are lower by 30% (Central Europe) to 50% (other CEECs) than Community levels, except in Slovenia. The inferiority of animal yields generally is about 30%, but less for milk in Hungary and in Czech Republic where they have improved in recent years.

Per capita, applicant countries devote overall to cereals approximately twice as much area compared to the Union. If one adds those surfaces left to permanent meadows or cultivated fodder, their total potential for feed production (after deduction of human consumption of cereals - between 120 and 150 kg per capita) appears even more abundant, per capita, than that of the Union, except in Slovenia. But a cumulation of inefficiencies in crop and livestock production, in addition to significant losses of products, deprives the applicant countries of the considerable overall exportable balance of grains and/or of livestock products, that crop and animal yields at the Community level would permit.

II.1.4. ... resulting from low use of bought inputs,

In the applicant countries, the low relative level of use, in quantity and quality, of the main inputs bought outside agriculture constitute a major limiting factor for crop and animal yields.

With the minor exception of Slovenia, the principal purchased inputs for crop products (fertilizers, improvers and plant health products, mechanical equipment) are two to three times less used per agricultural hectare than in the Union. Likewise, average use per animal of high nutrient feeds, veterinary products and services, etc., is much lower.

II.1.5. …and more fundamentally from lack of financing, which maintains the capitalisation of agricultural labour at low levels

The lack of financing on holdings is due to the very low profitability of agriculture on average, and to the narrow limits of possible budgetary support, combined with difficult and costly access to loans. These are the major direct causes of:

(i) the extensification of techniques and productive orientations of agriculture, following the end of the high subsidisation of the communist era, and

(ii) the very limited character of their re-intensification.

Consequently, in all the examined cases, the average capital per agricultural employed person remains much lower than French level, which is a good approximation for that of the Union. In addition, differences are much greater for depreciation and investment per employed person, which reflect much more advanced ageing of fixed assets in the applicant countries.

II.1.6. The result: low productivity of labour and of land

Productivity levels of labour and land (hence total factor productivity) are strongly responsive to capital endowments per worker with current technology. A systematic comparison of factor endowments and productivity levels between the EU and the ten applicant countries fully confirms this correlation and can be explained by farm structures.

In **Poland and Romania**, i.e. 61% of the agricultural value added of the CEECs, very low labour productivity (gross value added per worker of respectively 8 and 6% of the Community level) is associated with high average densities of agricultural employment per hectare (3,2 and 5.9 times higher than in the EU). Obviously, this arises from the weight (from 80% to 90%) of micro and small holdings in production, total agricultural employment and area. But paradoxically agricultural production has much better resisted transition in these countries than in the others.

In the **Baltic Republics**, similar structures covered gradually the majority of utilised agricultural area, which led, here too, to high average densities of agricultural employment (except in Estonia) and to very low productivity. But despite less land fragmentation than in the above-mentioned countries, agricultural production has dramatically fallen during all the transition period, until very recent upturn.

Like the Baltic States, **Bulgaria** associates very low labour productivity with a high employment density, which have been sanctioned by a severe agricultural recession. But these hide here a much more marked bipolarity in agricultural structures. On the one hand an extremely fragmented semi-subsistence sector carries out almost all intensive production, while on the other hand, most cereal and oilseed productions take place on very extensive large farms.

In Hungary, in Czech Republic and in Slovakia, where company holdings and their production have better resisted land fragmentation than elsewhere, densities of agricultural employment of Community or moderately higher level (Slovakia), correspond to respectively, labour productivity four, two and 1,5 times higher than the general average of the CEECs. But this has not spared these agricultures a sharp initial fall of production, then its stagnation or slow decline.

Overall, after ten years of market economy (Central Europe) or of transition towards it (in the East), we are confronted with the following double paradox, the elucidation of which is the major key to understanding competitiveness and forecasting agricultural production in the CEECs.

(1) Despite the extremely low labour productivity of semi-subsistence agriculture, its place in production and even more in the agricultural employment of the applicant countries has seen a significant relative or even absolute development during transition. Accordingly, its place is now considerable, although very varied according to the applicant countries. On the other hand, the dynamics of the agri-food sector in the current Member States of the Union over the last 50 years has resulted in the marginalisation of this sector.

(2) Despite structures a priori much more favourable to total productivity, and therefore to competitiveness on factor and product markets, the production of the “modern” sector, i.e. company and major individual holdings, has tended to stagnate at a low level per hectare or to decline.

II.2. Dynamic of structures and farm incomes

II.2.1. Total and rural unemployment, agricultural “over-employment’s” decisive role

Whereas the share of agriculture in total employment in the CEECs is still overall four times higher than in the Union, its reduction has been generally slowed, and sometimes even reversed (Romania, Bulgaria) by generally high unemployment rates, particularly in rural areas. These have been tending again to increase since 1998, except in Hungary and in Slovenia, after their considerable retreat in certain countries. Moreover rural unemployment is very underestimated by statistics, because these do not include “hidden” or “disguised” agricultural unemployment.

Such a context strongly pushes farmers to preserve their agricultural employment, even at the cost of very low earned income, by exploiting the opportunities inherent in structural dualism inherited from the communist era, and increased by the privatisations which followed. In this respect the principal opportunity is semi-subsistence agriculture, whose area has considerably increased. However, employees' ownership of the macro-holdings which succeeded socialised agriculture is also a way of protecting agricultural employment. But these are threatened by market trends and the emergence of major individual holdings, which are less labour intensive and productive per hectare.

II.2.2. General outline of restructuring

II.2.2.1. Individual holdings: semi - subsistence

During the last decade, “transition” caused a considerable relative or absolute expansion of this type of agricultural production in the CEECs, from its form inherited from the communist era – household plots or micro-farms providing a minority additional income- mainly in kind- to wages or pensions.

Its extension, in number of holdings and in area, came logically from the initial conditions of the post-communist transition: fall in employment and in wages, particularly in rural areas; restitution and distribution of plots of land; reduced subsidies and decline of the state agri-food distribution chains.

Moreover, in the absence or insufficiency of productivity gains in existing small and average commercial holdings (Poland) or newly emergent (Hungary, Baltic States, etc.) ones, the price scissors has strongly reduced farm incomes, to the point they became a minority of family income. Thus these holdings moved gradually (Poland) towards the method of semi-subsistence, or remained confined in it from their emergence.

The result is that the contribution of this sector to total agricultural production of the ten applicant countries is probably more than half, although this share is more modest in some countries’ agriculture: Czech, Slovak and Estonian. Contrary to the Union, one cannot therefore treat it as negligibly important in production, and even less in total employment in agriculture.

The maintenance of this important component of agricultural production in the applicant countries depends primarily on a family transfer of non-farm incomes from other sources. In the context of high rural unemployment, this loss-making agricultural activity is however completely rational from the micro-economic point of view, for the households concerned. The losses of semi-subsistence holdings, as agricultural undertakings, are covered in broad part, often in majority, by welfare transfers of budgetary origin, mainly from pensions.

The apparent price-competitiveness of farm sales that is allowed by this family transfer is not real. Indeed such a configuration excludes any significant net investment in agriculture, or any competitive expansion of farm production. Moreover, the latter is undermined by high fragmentation and low quality, which tend to exclude semi-subsistence farms from the main agri-food market channels, to the benefit of company holdings and large individual farms.

However, insofar as the reduction of commercial farm income would be compensated sufficiently by the growth of the non-agricultural incomes of the households concerned, semi-subsistence agriculture could durably resist by contracting to farmhouse consumption and to local direct sales, in a similar way to workers’ gardens.

II.2.2.2. Company macro-holdings

In the CEECs, these macro-holdings (700 to 2000 hectares UAA for the majority of this sector's area) still ensure most of the modern agricultural production i.e. completely commercial, concentrated and relatively capitalistic production by unit produced. Labour productivity is therefore definitely higher than in semi-subsistence agriculture, and is slowly increasing. But the handicap of a permanent salaried workforce (mainly employed in the major animal units), as well as - in the absence of financing and land guarantees - underinvestment and extensive crop production, maintain labour productivity on a level overall still much lower than that of professional holdings in the Union.

The major animal complexes, main employers but mostly loss-making, absorb inefficiently the production of a mechanised, extensive cereals sector, which is potentially profitable but employs little. Cereals production costs would be considerably increased by intensification. So, the apparent price and cost competitiveness of the major cereal units of the CEECs, in relation to the Union, should not lead to over-estimating their capacity of competitive growth and exports in an enlarged single market.

II.2.2.3. Large individual holdings, a difficult path for intensive stock breeding

This involves holdings of size, family character and degree of integration into the market which evoke, at first sight, the predominant forms of Community agriculture. They constitute therefore the first core of professional agriculture able to compete with its Community homologue, in particular in livestock-farming, and to overcome gradually the dualism disabling agricultural structures in the CEECs.

However, intensive and concentrated stock breeding inherited from the communist era has been taken up again only very partially and with difficulty by new individual large holdings. This has led to a high structural bipolarity in the animal sector, with the progressive retreat of the major commercial livestock farming and the relative resistance of the micro-livestock-farming of semi-subsistence agriculture.

Indeed, on the vast majority of the surfaces concerned, the principal orientation is the cultivation of cereals, with densities of livestock and of employment and production by hectare definitely smaller than in the large company holdings and/or semi-subsistence farms. This is largely explained by the insufficiency of finance and land guarantees necessary for heavy investment in animal production.

II.2.3. Elements of quantification: restructuring and farm incomes

II.2.3.1. Sectoral redistribution of agricultural land

In the “individual” sector, the concentration of land use appears much lower than that of the Union, even if official figures probably underestimate it, because of informal land leasing. Thus holdings of more than 50 ha use only

20% of this sector's UAA in most CEECs, against more than 60% in the Union. The Czech (40%) and Estonian (33%) situations are isolated. Throughout the CEECs holdings of less than 20 ha UAA use the majority of the land of the individual sector, against only 18.8% of the UAA in the Union.

However, if one takes into account company farms, the national share of the UAA occupied by all holdings of more than 50 ha UAA has orders of magnitude comparable with the 61% of the EU in the following countries: Czech Republic, Hungary, Slovakia, Estonia, Bulgaria. Insofar as the retreat of the company sector would encourage the emergence of major individual holdings, this group of countries could reach levels of concentration of land comparable with that of the EU, for professional agriculture.

But in the other countries, which produce 64% the agricultural value added of the ten CEECs, this potential for concentration of individual agriculture is much more limited. Indeed the total place of holdings of more than 50 ha is marginal or much more modest than in the Union.

On the whole, semi-subsistence agriculture has resisted, and extended to small and average holdings, old or new, to various national degrees. But, new professional agriculture has appeared as a minority of the UAA, the durable viability of which seems to require minimum surfaces of 50 to 100 hectares, or equivalent economic size in "landless" specialisation.

II.2.3.2. Accounting analysis by size and social forms of holding

In 1998 the contribution to agricultural production of the semi-subsistence sector was about 53% in Poland, 36% in Hungary, and at least 25% in Czech Republic. Having regard to the relative weights of these agricultures, this leads to a percentage of approximately 45% for the three as a whole, which account for 93% of the agricultural value added of the five CEECs of the Luxembourg group. In comparison, the agricultural structures which predominate in four of the five applicant countries of the Helsinki group (except Slovakia, of very small weight) suggest an overall contribution of this sector of about 60%. **Thus, at least half of the overall production of the ten applicant countries could be considered to fall in this category against approximately 14% in France and 20% in the EU-15,** with at best no prospects for competitive intensification.

Prospects are hardly more promising *for the company macro-holdings and the new «individual» holdings of the three countries examined*, having regard to their clear low or negative average profitability, except for the largest individual ones. But these latter are of very small weight in total production. Their extension at the expense of the company farms would worsen this prognosis, because it generally involves expansion of the product-mix. Thus there is a very low overall capacity of these three major types of agriculture to generate and/or attract net investment. This is a decisive non-price handicap for the competitive expansion of production.

II.3. Factor markets: weak integration of agriculture

Explicitly or implicitly, the argument of **the comparative advantages of less expensive and more abundant manpower and land** has inspired the diagnosis of strong current and/or potential competitiveness of agriculture in the CEECs in relation to the EU. Their factor combinations, which substitute work for capital, were seen as a competitive adaptation of their agriculture.

This vision underestimates dramatically the capital intensity per worker of the principal technical functions of agricultural production. Indeed this substitution greatly reduces labour productivity, to the point to make its costs generally prohibitive in wages and/or - in individual agriculture - in family consumption. Only by covering a large part of this labour cost by non agricultural incomes does this become viable, but at the price of stagnation or recession of overall production. This results from the following rational adjustments in the three types of structures:

(1) the relative expansion and/or resistance of **semi-subsistence** agriculture, on the basis of family and (indirectly) budgetary transfers - the households' rational answer to rural unemployment, although lossmaking and structurally backward from the agricultural branch point of view,

(2) the recessive adjustment of the **company macro-units** from socialised agriculture, sanctioning their "over-employment" which arises rationally from the governance of their employees- co-owners,

(3) the emergence of new major individual holdings, at the expense of company holdings, but considerably less intensive and less employing by hectare, rational individual response to the opportunities of land and product markets in the CEECs.

The first two types of holdings, still predominant in farm production, do not adjust directly to the factor markets, but rather to their exclusion from the labour and capital markets and to a slowly emerging land market.

II.3.1. Exclusion from the labour market

In the semi-subsistence agriculture of the CEECs, high rural unemployment and hidden agricultural underemployment suggest an opportunity cost of labour generally much lower than the average wage, or even zero. In other words this sector is practically excluded from the labour market and will remain insensitive to its development, as long as this situation lasts. Only a considerable general increase in employment, as well as in the possibilities for professional migration (training, subsidised housing) could absorb the sector's agricultural "over-employment".

Company macro-holdings are generally led by the de facto "governance" of their employees to maintain a relative "over-employment" in the medium term at the expense of profits. They are therefore disconnected partially from the general labour market, although to a less degree than the holdings in semi-subsistence. The general growth of income and competition from the major individual holdings tend to weaken this company sector and/or to bring it into line with the more extensive and less employment intensive profile of the individual holdings.

On the other hand in **the largest individual holdings**, the family agricultural labour force is generally in a situation of full agricultural employment, and farm income covers the remuneration and net investment necessary for the long-term maintenance of employment and of family income. The relation of the holdings to the labour market is the same as that of their homologues of the EU.

II.3.2. Exclusion from capital markets

On this market, the current comparative disadvantage of the agriculture of the CEECs in relation to the EU has several causes. Inflation is still about 10% in the principal applicant countries of Central Europe, against 3% in the EU, increasing banking risks. Another obstacle to these loans is the absence or the insufficiency of land guarantees, which affects the holdings potentially suitable for profitable restructuring and recapitalisation, namely the macro - company holdings and/or major individual holdings. But the most fundamental obstacle to net agricultural investment of own, borrowed and/or subsidised funds, is the persistence of very low or negative overall agricultural profitability.

On the whole, agriculture in the CEECs has proved in a large part and durably **disconnected from general capital markets**, as from the general labour market. This disconnection is particularly marked for fixed assets and in the large semi-subsistence sector. However, a connection exists and can develop in the profitable fraction of the major individual and company holdings.

II.3.3. Land markets: weak activity

In the CEECs, the market for agricultural land is not very active: sale-purchases cover shares of stock much lower than current rates in the EU and average land prices remain much lower than in the EU, without convergence. Land rents are also very low, although the rental market is more active, most often through informal and/or short-term leasing. Above all, this difference reflects **indirectly the very low profitability of agricultural activity in the CEECs in relation to the EU**. Furthermore, a very substantial appreciation of land values can be definitely expected on the agricultural enlargement of the Union, at least in the long run. The fact that this is not enough to stimulate the purchase of land involves current and future expectations of loss-making agricultural activity.

Institutional and political convergence will jointly encourage land and leasing markets in the applicant countries, while incorporating them gradually into those of the EU-15. For the comparative competitiveness of costs and of farm prices in the CEECs, this has a capital consequence. **Effective land costs, which are currently 5% to 20% of the Community average, will increase considerably, in particular for the major crops.** This strengthens the prognostic of moderate forecasts (pre and post-adhesion) for cereal and oilseed crop surpluses, and of an uncompetitive animal sector.

II.4. Food industries: persistent delays upstream, downstream dynamism

II.4.1. Central Europe

The first stage processing industry of the CEECs is still disabled by the structural heritage of the previous system. On the other hand, in Central Europe, the linked developments of the second stage processing industry and, even more of major food retail and distribution (hyper and supermarkets), has been remarkable at all levels: profitability, growth, restructuring, foreign investment and technical progress.

Thus, growth and productivity progress have a dual character in the principal agri-food chains: they are generally fast downstream, but very slow upstream. In the CEECs this was strongly amplified by the brutal passage from a food consumption model of “shortage” (low variety, low degree of processing and of stability, etc.), “constrained by supply”, to the Western model of the 1990s (opposite features), “constrained by demand”. Though limited by a still low purchasing power, the opportunities for industrial and commercially profitable investments created by this systemic change were considerable downstream in the agri-food chain.

II.4.2. Romania, Bulgaria

In these countries, the agrarian decollectivisation had a particularly destructive and regressive impact: extreme fragmentation and/or massive decapitalisation of state owned holdings. It is therefore in the name of food security, and in fact also to protect “over-employment” and economic rents of the companies concerned, that the authorities preserved until 1996 (Bulgaria) and 1997 (Romania) a managed and strongly subsidised regulation of prices and flows in the agri-food state chain both downstream and upstream from agriculture, and that it delayed its privatisation.

At the price of considerable inflationary subsidies, this policy deferred the restructuring of former state agri-food industries, without being able to avoid recession. In the absence of a sufficient private sector response, the reformist turn of 1996-1997 therefore amplified the deindustrialisation of the distribution chain bringing a return to on-farm consumption and highly fragmented alternative outlets.

II.5. Agricultural policies under tight macroeconomic and social constraints

II.5.1. Macroeconomic constraints

In the Czech Republic and Slovakia, countries with low agricultural value added per capita and notably net agricultural importers, the contribution of agriculture to GDP is close to the Community level. But it reaches 1,6 and 2,2 times the latter in Poland and in Hungary; 8 and 7 times in Bulgaria and in Romania, mainly because of their major overall economic backwardness. Except in the first two cases, this involves a much lower macroeconomic capacity to support the agricultural sector.

Overall, this penalises the agricultural policies of the CEECs in relation to those of the EU-15. Thus the Union could give to its agriculture in 1999, "total Support" (including support for prices and general services) per capita approximately three to four times higher than in Central Europe, in Romania and in Lithuania, and eight times more than in Estonia and Latvia.

The anticipated East-West differentials in overall growth will reduce only very slowly this macroeconomic and budgetary handicap for the agriculture of the CEECs.

II.5.2. The social constraint

Under pressure from rural unemployment, the dual agricultural structures which predominate in the CEECs tend to maintain extreme agricultural "over-employment", mainly in the semi-subsistence sector, at the expense of profit and of investment, and therefore of any competitive agricultural recovery. This agricultural "over-employment" affects the CEECs to very different degrees, which correspond roughly to the political influence of the lobbies representing farmers and the rural population. Under these conditions it is not surprising that the relative protection of structural agricultural "over-employment" determines, to varying national degrees, the corresponding policies.

The effective border protection of the CEECs appears focused, at high levels, on the main labour intensive products and agri-food chains: main livestock branches, major fresh fruits and vegetables (in full season), potatoes, sugar beets.

Mainly in the same branches, **the much less binding quality, health and environmental regulations** of the CEECs and the lower production costs which result from it (ceteris paribus) give them temporarily a competitive advantage on their internal market and certain third markets, in particular the ex-USSR, in relation to imports from the Union.

Lastly, **land policies act** in the same direction. On the one hand, the prohibition of purchases by foreigners, also sometimes by the national corporate holdings, restrict these to leasing. On the other hand, since the law provides little protection for agricultural land tenants, short-term and informal leasing predominate. All this hinders land reallocation that would be particularly threatening for current "over-employment" in agriculture.

III. FORESEEABLE IMPLICATIONS AFTER ELARGEMENT

III.1. The Agenda 2000 scenario

III.1.1. A decline in animal products and, even more, of dependent jobs

In the CEECs only the new family livestock-farming, with high labour productivity, therefore of Community format (family in the broad sense, including the smaller company farms), could compete durably in the single market under similar veterinary and sanitary norms.

Semi-subistence farming will considerably slow the restructuring of the sector in a number of countries. Most livestock farming by company holdings is unlikely to overcome the handicap of their employee structure. In both cases, restructuring would require considerable labour outflows. As regards the new large individual holdings, their extensive orientation would favour cereal and oilseed production rather than livestock.

In the beef and dairy sectors, production growth will be limited to those farms closest to EU production methods and norms. Without beef and suckler cow premia, beef production is likely to remain a side-product of milk production. A certain number of countries with a concentrated sector - Czech and Slovak Republics, Lithuania, may be able to increase their production potential. But globally, a stagnation or even contraction of beef and dairy production is to be expected. The outlook is probably more positive for the poultry sector, but due to price reductions, a contraction in the pigmeat sector is likely.

III.1.2. A modest growth in cereal and oilseed production

Current surplus production in the CEECs is low due to extensive cultivation, very low fodder efficiency and considerable losses. The net production beyond the farmgate of cereals could therefore grow a great deal by intensification, improvement of this efficiency and reduction of these losses, in addition to the animal recession highlighted above. Furthermore, rye will enjoy a significant price increase. But the structures of small and average semi-subsistence holdings will not give them economic access to these improvements, while continuing to involve high costs in cultivation of cereals. The larger holdings will have difficulties attracting finance for investment in more intensive production methods. Increases in production are likely therefore to be modest.

III.2. The impact of direct payments in the medium term.

III.2.1. The animal sector: likely stagnation of pork and dairy, modest perspectives for poultry and beef

In the animal sector, obtaining direct payments would reduce the recessive and social impact in the CEECs. Indeed, pork and poultry production on mixed farms could, as their counterparts in EU 15, profit indirectly from payments for cereals. This could even be the case for milk production (from the beef payments), in addition to the future direct compensatory payments anticipated by Agenda 2000.

However, due to the structural problem, it is unlikely that direct payments would encourage an expansionist scenario for the animal sector as a whole. Indeed, their indirect effects change little the perspectives for the pork and dairy sectors in the semi-subsistence or large company farm sector. The perspectives for the poultry sector- less dependant on land structures and stimulated by a growing demand- are relatively positive. But its recovery has been achieved under high border protection and much will depend on investment. Direct payments in the beef sector are likely to encourage a process of specialisation. However, the structural inadequacy of the CEECs, as well as the difficulties of raising production to EU standards should not be underestimated.

III.2.2. Intensification and expansion of cereal production

On the other hand, the access of the CEECs to the cereal direct payments, could increase this production notably, by strongly stimulating cereal intensification - potentially considerable - and specialisation of the major holdings, according to a scenario already observed in the new German Länder. However, as is the case for all direct payments, this would depend on the use of direct payments for investment rather than absorption in consumption or increased land prices. Furthermore, this impact would remain limited to this concentrated fraction of agriculture, currently a minority of total agricultural area of the CEECs. A further increase could be expected from the expansion of area under cereal production at the expense of other types of production such as potatoes.

III.2.3. Impact on community exportable surpluses

The weak perspectives for the improvement of production in the animal sector do not exclude the possibility of surpluses, given developments in domestic consumption. On the one hand, in recent years the traditional preference for pig and poultry meat in the CEECs has increased and could even create outlets for EU-15 production. On the other hand, even with a stagnation of beef and dairy production, price increases could reduce domestic consumption.

Dairy production is particularly difficult to analyse. It is necessary to separate countries with a dynamic sector (Czech Republic, Lithuania) from those with a large semi-subsistence sector. The former have a clear capacity to increase production above internal use. However, given the overall weight of the latter, the overall balance is roughly neutral. This could change, however, if consumption patterns of poorer consumers fail to adapt to an increased supply of more expensive processed milk.

Cereal production is likely to increase, particularly under the effect of direct payments. Feed consumption is likely to fall as a result of the stagnation of pork production and increased feed efficiency. However, some of this cereals surplus would be absorbed by increased pigmeat production in the EU-15 to meet increased consumer demand in the new member states. An additional surplus for the enlarged Union of about 5 to 10 million tons could therefore be expected.

III.3. From the surplus risk to the social risk: need for transitions

By excluding direct payments from the Community budget for enlargement, **Agenda 2000 almost eliminates the risk of agricultural surpluses in the CEECs** (probably only for cereals) and increases the potential outlets for the EU-15 for its animal products.

If, with the Commission, it is admitted that structural measures are more promising than direct payments for the **overall** economy and employment the CEECs, this budgetary option of the Union is a rational response to the **major challenge** that agricultural "over-employment" constitutes.

Indeed, simply to avoid or reduce their overall recession within the single Market, the agriculture of the CEECs will have to, with or without access to direct payments, increase considerably their labour productivity.

To reach only half of the average productivity of the EU-15 would already involve, with constant production, **the destruction of 4 million agricultural jobs** in the ten CEECs. These threatened jobs are in majority located in Poland and in Romania, which, with the presence of influential agricultural lobbies, could create political risks for the enlargement. On the other hand, this threat is definitely less dramatic in Hungary and in Czech Republic, having regard to their higher productivity.

The problem of restructuring in the CEECs is directly linked to the dualism of their agricultural structures. On the one hand, the commercial sector needs to invest and restructure. On the other hand, semi-subsistence farming continues to play a major role as a social safety net in rural areas. Direct payments can be a resource in this process, but they are not adapted to economic and social objectives of this restructuring.

It should not be forgotten that direct payments were introduced in the EU as a partially decoupled income support payment to farms which had already enjoyed a long and slow evolution towards the dominant form of the family farm, which is generally heavily capitalised. However, their introduction in the CEECs is unlikely to favour efficiently this evolution:

- For the large commercial farms (individual or company), direct payments offer the possibility of increased investment, but could as well be absorbed in household consumption, the maintenance of existing structures or increased land values. They therefore appear to be an inefficient investment tool subject to leakage, crowding out and deadweight. Furthermore, they would likely strengthen further the predominance of cereals and oilseeds production.

- For semi-subsistence farms the risk of undesirable structural impact is obviously greater. Compensatory payments would consolidate this type of production based on household consumption by ensuring its viability. There would be little incentive to invest this aid in production or alternative activities, objectives in all cases better targeted by rural development programmes. On the other hand, it is not to be excluded that medium sized farms, which have fallen into a semi-subsistence mode could return to more commercial orientation.

In short, direct payments appear poorly targeted investment or social safety net instruments. In particular, their capitalisation in increased land prices would slow the restructuring necessary to address "over-employment" and fragmentation. A number of candidate countries have requested transitions and derogations, which would have the effect of maintaining temporarily the protection of sensitive agricultural employment. But it is clear that the EU is unprepared to accept major derogations from the principles of the single market and consumer protection. In this context, we need to ask the question: what is the best way for the CEECs to achieve transition to full access to the EU budget?

IV. CONCLUSIONS

IV.1. Desirable adjustments of the EU policies for agricultural enlargement

IV.1.1. Major differences in agricultural policies: what transitions towards the CAP?

The difficulties of the accession negotiations reveal the differences between the agricultural policies of the CEECs and the CAP. These reflect to various national degrees budgetary and social constraints: 1) The low macroeconomic capacity of the CEECs limits the support needed for the emergence and expansion of commercial "intensive" agriculture. 2) General and rural unemployment levels have discouraged policies that would reduce their agricultural "over-employment".

After adhesion, the non-access of the CEECs to Direct Payments during a period of transition would maintain the budgetary disparity, even if structural aid can indirectly reduce it by covering other budgetary obligations. However the current financial perspective, which envisages resources only for market and rural development expenditure for the new members, commits the Union only until 2006. It is hard to see how this restriction could remain compatible with the principles of the CAP in the longer term, after the full integration of these agricultures into the Single Market.

Under these conditions, the gradual access of the CEECs to the totality of the resources of the Community agricultural budget, conditioned by their progress towards full integration into the single market becomes a key issue for agricultural enlargement. Thus, the fundamental question becomes: how to make a success of restructuring while ensuring progressive alignment on the instruments of the full CAP?

A reasonable solution could be to gradually increase direct payments by associating them with aid for the restructuring of the commercial sector, conditioned by progress towards effective competitiveness in the single market and durable viability (both economic and environmental). During the transitions necessary for the full adaptation to the single market, which could be long in a large number of countries, these conditions would limit EU assistance to targets justified, socially and economically, for the future enlarged Union.

Of course this Community aid constitutes only one of the tools necessary for the reinforcement of the competitive pole of the agri-foodstuff sectors of the CEECs. It requires a "package" of other policies and an institutional framework and infrastructure:

– **There is a crucial need to consolidate tenant farmer legal rights**, particularly through lengthening the minimum duration of the land leases.

– Older farmers without successors must be incited to release land which is beyond family own consumption**, for example through retirement pensions conditioned by sale or renting of land.**

– **The emergence of viable professional holdings is possible only by very major qualitative** (market integration) and quantitative (economic size) leaps forward, **unlike the gradualism of the EU** historical path. This raises the considered question of an **accompanying social safety net**.

– The acceleration of this type of agricultural and agri-food restructuring requires also - at least **transitorily** -certain forms of aid and institutional tools closer to the "voluntarist" national policies of the 1960s and 1970s than of that of the 2000s.

– Moreover, on the assumption that in the medium term the CAP will be the same for all members, the concrete questions of "phasing in" must also be taken into consideration in order to avoid massive shocks on factor markets.

IV.1.2. Rural development and/or controlled rural exodus

It can be estimated that "hidden" or "disguised" agricultural unemployment in the CEECs concerns at least half agricultural employment in the CEECs, i.e. about 5 million people. Since 1990, semi-subsistence agriculture has reduced considerably the social costs of the overall transition, in a particularly cheap way for the state budgets concerned. On the one hand, it slowed unemployment and the rural exodus, which would result from the rapid elimination of this sector. On the other hand, it provided the poor, under-employed and peripheral parts of the population a cheaper alternative to the increasingly elaborate and standardised products of the major towns. **The social and macroeconomic issues of policies for "rural" development policies and migration towards urban employment are therefore of scope and nature very different from those of the EU-15.**

In the EU-15, rural development policy at an EU level emerged after the very strong reduction of agricultural employment, resulting from modernisation and concentration of Community agriculture since the 1960s. This policy aims mainly to accompany the changes made by the reform of the CAP and the development of the sector by promoting investments, modernisation and diversification. It also seeks to reduce or correct the negative effects of these processes on rural areas, by preserving or restoring a minimum of rural society, as well as the environmental and cultural landscape and heritage. The support of multifunctional agriculture is part of this policy. But the increasing needs of urban residents are a principal determination of it through the services provided by farmers.

These problems have a certain relevance in some regions of the CEECs, especially in those most industrialised and urbanised, such as the Czech Republic, Slovakia and Slovenia. But overall and particularly in the countries with high levels of agricultural employment (Poland, Romania, Bulgaria, Lithuania and Latvia), as well as in certain regions of other countries, the major issue of rural development **is the alleviation of rural unemployment and hidden agricultural unemployment.**

In any event, "**rural** development" will be able to absorb only a very small fraction of the massive agricultural "over-employment" in these countries whether it is through diversification (as in farm tourism) or services (such as the environment). Its reduction will involve mainly **migration towards urban jobs**, with the risk of a uncontrolled variant of this shift. A more promising alternative for the economy and the overall society of the future enlarged Union would consist therefore in organising this rural exodus and in supporting it by appropriate **programmes of general and vocational training, associated with policies of economic development, of social security and of housing, notably in the small and mid-sized towns disposing of suitable infrastructures**.

Ultimately the solution of the major problem for agricultural enlargement, agricultural "over-employment", will come more through such programmes than by support for "rural development" in the traditional sense. As we saw, the restructuring of the labour markets and of the land is governed by institutional and social issues which go beyond the simple logic of micro-economic efficiency.

IV.1.3. Supporting the social function of subsistence agriculture: a social safety net

The social service that semi-subsistence agriculture renders by dealing with hidden agricultural unemployment - instead of the state budget - is considerable. But it is threatened by the increasing exclusion of this sector from the market, insofar as falling farm incomes of the households concerned are not compensated by the growth of other incomes. In the countries and regions most affected by relative rural poverty, and during a transitional period, targeted government aid could therefore be necessary.

Indeed, in these countries and regions and during the critical phase, this aid would be probably less expensive than open unemployment and other associated social costs, which would result from a too rapid decline in semi–subsistence agriculture. This would replace direct agricultural support and/or restructuring aid of this sector as such, which could not be economically justified, by support for the households concerned, which could be justified for local reasons on a transitional basis. In particular, this social support should be conditioned, for example through early retirement, by the release of the land exceeding needs for own food consumption.

IV.2. Well managed transitions, the key to agricultural recovery in the longer term

The "pessimistic" forecast (supra III) of an overall agri-foodstuff recession in the CEECs after accession, with increasing net imports from the EU-15, is limited to the medium term and to the scenario of a rapid and general agricultural enlargement under the conditions of Agenda 2000 (without direct aids and/or targeted investment and social policies).

Later on, in the context of full integration into the CAP, a **competitive recovery**, leading the CEECs to reconquer their internal market, then possibly to an overall position of agri-foodstuff net export, is **possible if overall economic growth continues**, especially if this growth is faster for the new members.

The reduction and/or the disappearance of agricultural “over-employment” in the CEECs is the key to this agricultural recovery since it creates directly (lack of profitability) and indirectly (policy pressures) obstacles to restructuring. It prevents a more efficient use of land and capital and therefore prevents the CEECs from realising their full agricultural potential.

Economic growth in the enlarged Union - especially if it is faster among its new members - will absorb sooner or later this agricultural “over-employment” through migration towards urban employment (and much more modestly in rural employment). But this study shows that an early recovery in the CEECs at acceptable social costs depend on the successful restructuring of the agri-food sector. Let us outline the principal necessary elements:

(1) Rapid access to the Structural Funds and to the rural development programmes of the Union.

(2) Relatively long transitional periods (at least ten years for a large group of countries) to carry out the economic and social adaptation of the sector, including:

- the strengthening of aid for restructuring of the commercial farming sector;
- the progressive and conditional introduction of direct aids in order to align the agricultural policies of the CEECs on the CAP without major destabilisation;
- integrated policies aiming to manage the rural exodus;
- a social safety net for semi-subsistence agriculture.

Transitions of this type - investment programmes and a social safety net integrated into a broader restructuring policy, and gradual access to direct aid- appear indispensable. Such transitions would enable the CEECs to reabsorb - on an acceptable timescale - the social and financial obstacles to the realisation of their potential comparative advantages in agriculture.