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## ROMANIA AND CAP REFORM

### ABSTRACT

The first part of this article presents a general overview of the current situation in the Romanian agriculture emphasizing its extreme polarisation and the importance of this sector for the economy. In the second part the emphasis falls on CAP reform. The authors seek to evaluate how the Romanian agriculture has evolved since integration and to estimate the impact of future CAP reforms on this sector. The paper presents the estimated impact of CAP reform on market measures, direct payments and rural development.

The formulation of certain simplified scenarios of possible CAP reform provides the necessary benchmarks for a brief analysis of the effects upon consumers' and producers' welfare, as well as upon the rural area in general. Based on a simplified model, under some specific hypotheses, the net welfare effect due to the price changes for the selected products is positive in both reform scenarios, yet greater in the case of the radical reform.

Regarding direct payments, the authors' opinion is that for the large farms, some of them operating on thousands of hectares, cannot contribute to the objective of supporting farmers' incomes. Reform measures will bring in Romania's case a good operation of agricultural markets and the market orientation of farms, which will result in agricultural incomes based mainly upon the sale of agricultural products rather than upon subsidies or social allocations.

As the key-problem of Romanian rural areas is poor infrastructure and the generalized poverty, the solution for the modernization of rural areas seems to be their "urbanization", through investments in infrastructure, development of community services and a move away from farming to other economic sectors. In order to achieve this, the state has to mobilize internal and external resources for rural development rather than for agriculture. This implies a greater allocation of resources to Pillar II.

**Keywords:** CAP reform, agricultural markets

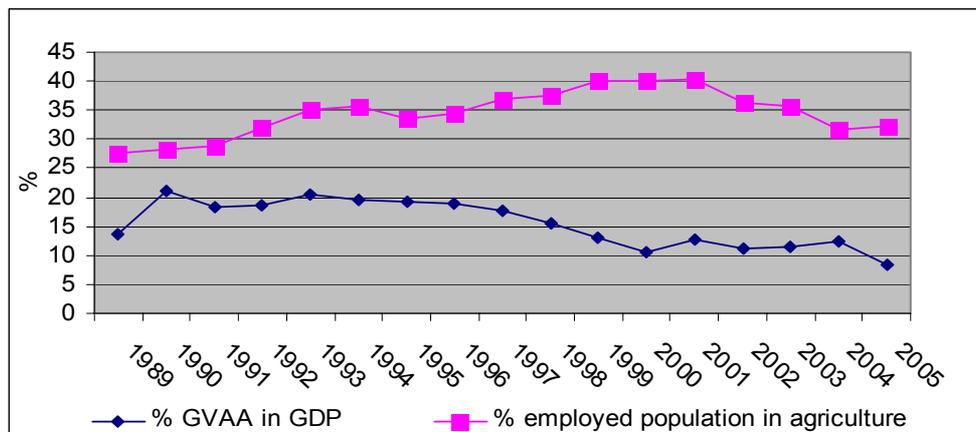
**JEL classification:** Q18, Q13

### 1. ROMANIAN AGRICULTURE AND THE SITUATION IN RURAL AREAS

The economic importance of the agricultural sector decreased in the last years. The share of Gross Value Added in GDP reached 8.5% in 2005, significantly lower than in the early transition years (1990–1996), when it had reached even 18%–21% (Graph 1).

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At the same time, the share of the population employed in agriculture related to the total employed population remained quite high (32% in the year 2005), but it decreased from over 40% in the period 1999–2001. In the period 1997–2000, a massive staff rationalization took place in the mining and manufacturing industry and many people went into farming, so that, atypically, the number of people employed in agriculture in Romania increased. In absolute terms, 2,939,000 people were employed in agriculture in 2005, 33.4 % of whom were over 55 years old, agriculture being the economic sector with the oldest labour force.



Graph 1. Evolution of the share of GVAA in GDP and of the share of population employed in agriculture related to the total employed population.

The gross agricultural output (GAO) fluctuated significantly from one year to the other, crop production experiencing most fluctuations, both in quantitative and qualitative terms, being very dependent upon the weather conditions. Regarding the production structure, the crop production accounts for 60–62% of the overall agricultural production, and this share can further increase in years with good harvests (*e.g.* in the year 2004 crop production accounted for 69%). The high share of crop production is the cause of the weather-dependent GAO and GVAA in Romania.

### Key figures in Romanian agriculture

Romania has 14.7 million hectares agricultural land, being one of the European countries with the best resources for agriculture in this regard. Most of this land is arable land (63%), followed by pastures (22.8%) and hayfields (10.3%). The structure of cultivated areas reveals the prevalence of cereals in the crop mix, which accounted for 69% of the cultivated area in 2005. The main cereals are

maize (about 50% of the area under cereals) and wheat (about 37–40 % of the area under cereals). At the same time, among the other cereals, barley and two-row barley are the most important (5–7%).

Cereal production is characterized by instability. For example, in the year 2000, it amounted to around 10.4 million tons, to reach 24.4 million tons in the year 2004. In the last 10 years, the areas under oil crops increased, due to the special export opportunities for oilseeds. In 2005, the oil crops covered 1.14 million hectares; out of this area, 83% was cultivated with sunflower, 9% with soybeans and 5% with rape. Other relatively more important crops are potatoes (3.2% of the cultivated area), vegetables (3%) and fodder crops (8.7%).

Although Romania has large agricultural land areas, the harvests are modest and highly unreliable, due to the weather excesses (drought or floods) and to the non-application of adequate production technologies on large areas (Table 1). Most of small grains and oilseeds are cultivated in the plain zone from the southern and southeastern part of the country, where the drought risk is excessively high. At the same time, the effectively irrigated areas are very small.

*Table 1*

Total productions and average yields per hectare for the main crops (2000–2005 average)

	<b>Total production – thousand tones</b>	<b>Average yield – kg/ha</b>
Cereals, out of which:	16,736	
<b>Wheat</b>	5,704	2,507
<b>Maize</b>	9,487	3,160
Sunflower	1,159	1,200
Soybean	187	1,774
Potatoes	3,910	14,003
Vegetables	2,960	15,573 <sup>1</sup>
Sugar beet	777	22,881

*Source: Romanian Statistical Yearbook, 2006, NIS, Bucharest; <sup>1</sup>tomatoes only*

The livestock herds and meat production experienced a significant decline starting in the 1990s, as the very large units of pig and poultry were no longer operational; these farms were specific to the former communist period and performed badly. This is why the livestock herds declined significantly and currently most animals are bred on small-sized farms, which do not have the possibility to supply the market with a stable amount of meat, in quantitative and qualitative terms. The number of bovines, pigs and poultry increased since 2002, as a result of support measures for livestock production adopted by the government in 2001. In 2005, the slaughtered meat production, expressed as live weight meat, totalled 1,508,000 tons, out of which 25% beef, 40% pork, 7.5% mutton and goat meat and 27% poultry. The domestic pork and poultry meat production is not sufficient and Romania has to import significant amounts so as to meet its domestic

consumption needs. The Romanian population's preference is mainly directed to pork, which covers about half of the consumption, followed by poultry and beef. The meat consumption per capita reached 68 kg in 2005.

Milk production increased after the 1990s, reaching 60.6 million hectolitres. Cowherds are scattered on many small-sized farms, being difficult to have an adequate management of milk quality, hygiene and sanitary conditions. At the same time, there is no specialization of bovines for meat production and for milk production.

The foreign trade with agricultural and food products experienced a deficit after 1989, Romania being a net importer of agri-food products. In the period 2003–2005, the trade with agricultural and food products accounted for about 3% of total exports and 6–7% of imports. The deficit of the agricultural balance of trade increased every year, as the domestic supply became insufficient and qualitatively inadequate, and demand became more sophisticated, mainly due to the increasing incomes of the urban population after 2000. In 2003, the deficit of the agricultural balance of trade was about 1 billion Euro and grew up to 1.4 billion Euro in 2005.

Regarding *agri-food exports*, the most important products are the agricultural (unprocessed) products with a 59% share, out of which: live animals (20%), cereals (14%), edible fruits and vegetables (12%), seeds, industrial crops and medicinal herbs (11%). Among the exported processed products, we should mention the alcoholic and soft drinks, cereal and pastry products, vegetable and fruit specialties and animal feeds.

Regarding *agri-food imports*, the processed products (foodstuffs and beverages) accounted for 68%, while the tobacco products accounted for 9% of total agri-food imports in 2005. The most important agri-food products imported in 2005 were meat (25%), fruits (6.5%), sugar and sugar-based products (6.4%). We mention that in the unfavourable agricultural years, the domestic wheat production is not sufficient for the domestic consumption coverage and significant quantities of cereals are imported. For example, in 2003 more than 2.4 million tons of cereals and cereal-based products were imported, out of which about 1.7 million tons of wheat. The European Union countries are the main source and destination for the Romanian foreign trade: 68% of total exports and 62% of total imports.

The agrarian structure is extremely polarized, i.e. 55% of the cultivated area belongs to a huge number of individual peasant household farms (4.2 million individual holdings with an average size of 2.2 ha). The remaining 45% of the cultivated area is operated by large agricultural units, totalling 22 000 ha in 2002, with an average size of 274 ha. Beyond these statistics the picture is one of extremes. Holdings of dozen thousand hectares, on which a modern type of farming is practiced, coexist with farms smaller than one hectare with a subsistence type of farming and a technological level that has not changed for at least a hundred years. This situation is commonly found on the large plains from the southern, southeastern and southwestern parts of Romania.

The individual holdings with less than one hectare account for 50% of the total number of holdings, yet they operate only 10% of the used agricultural area. These individual holdings do not benefit from the direct payments received per hectare (SAPS scheme), as the eligibility condition is that the farm should be at least 1 ha and the component parcels should be larger than 0.3 ha. At the same time, 97.5% of the land areas operated by large farms are over 100 ha on average.

### Agricultural policies in the last years

The domestic agricultural policy in recent years tried to get closer to the Common Agricultural Policy specific support forms, but this process lacked continuity following the electoral cycle and the economic program of the government in power. The period 2001–2004 started with support oriented to holdings larger than 100 ha or with more than 15 bovine heads. This measure was subsequently extended to smaller-sized farms, conditioned by delivering production to agro-processors. This was a reaction to the diminishing quantities of agricultural products going to the agri-food chains and the increasing self-consumption.

In the general debate on the distorting character of certain state funded support measures, the stabilization of market measures to around 40% is worth mentioning. These measures came in the context of a global trend of decreasing protectionism and they had a clear anti-liberalization character. A positive evolution is the focus on supporting investments (welcome in this period of structural transformation) and to the mountain areas (targeted by several forms of support, which may become a Romanian asset in the long term). The maintenance of decoupled payments (on hectare or animal head) is a positive evolution given the introduction of single area payments in 2007. Yet, due to the delays of making payments from EU funds, agriculture received support from the national budget in 2007, mostly assimilated to the state aids (but likely to be provided without EC approval for a three-year transition period).

*Table 2*  
Farmer's support from MAFRD budget in the period 2005–2007

	2005 payments (on 31.12), mil. RON	2006 payments (on 31.12), mil. RON	2007 payments (on 1.08), mil. RON
Market support measures	697.78	726.93	455.98
Payments per area/animal head	938.03	683.48	251.32
Input procurement subsidy	151.83	174.43	107.94
Investment support	118.43	164.05	38.53
Total support	1,906.07	1,748.89	853.77

*Source: Ministry of Agriculture and Rural Development*

Historically, in the period 2000–2001 the largest part of the budgetary funding went to the crop production sector, while in the period 2002–2004 the

allocations for the livestock sector and rural development increased. The number of crops and livestock that received subsidies decreased in 2006, under a single program for crop and livestock production and forestry development. Support was directed towards investments on farms (the Farmer Program). The change of targeted objectives and the lack of consistency from one year to the other led to the dissipation of the budgetary effort and small economic effects at farm level.

*Table 3*  
Estimates of support to agriculture (million RON)

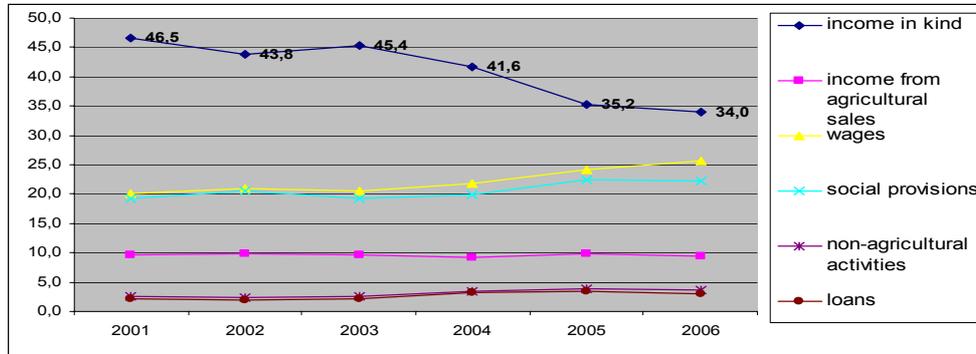
	1995-97	2003-05	2003	2004	2005
Producer Support Estimate (PSE), of which	186	14,406	10,365	17,371	15,481
–market price support (MPS)	–10	12,160	9,151	14,294	13,035
Percentage PSE (%)	5	27	24	28	29
General Services Support Estimate (GSSE)	66	698	222	1337	536
Consumer Support Estimate (CSE)	95	–15,447	–15,101	–16,233	–15,006
Percentage CSE (%)	1.00	1.54	1.63	1.55	1.43
Total Support Estimate (TSE)	347	15,104	10,587	18,709	16,017
Percentage TSE (expressed as share of GDP)	3.22	6.18	5.36	7.59	5.58

*Source: Agricultural Policies in Non-OECD Countries, OECD, 2007–09–28*

Support for agricultural producers increased in Romania, reaching 29% (%PSE) in 2005. Out of this, 84% is provided by the market support measures and the payments for output support (payments per hectare or animal head) (Table 3). 98% of the total support received by farmers (TSE) comes from consumers (year 2005). The relation between farmers and budget is quite well balanced, as 10% of TSE is provided by the tax payers, but at the same time – 9% of TSE is levied by the State Budget under different forms. The fact that TSE is almost fully provided by consumers appears to be a negative situation, in a country where the incomes are low and the share of food expenses remains relatively high (45.4% in 2006).

### **Role of agriculture in rural areas**

The interdependency between agriculture and rural area stems from the important role this economic sector has in the employment of the rural population and finally in providing their living means. Most of the rural population is working in agriculture (55% of the employed population in the rural area work in agriculture) and the agricultural incomes are of utmost importance for the survival of rural households. Rural households are producers but also consumers of agricultural and food products. This characteristic is specific to subsistence farms. Graph 2 reveals that among the sources of income, agriculture is an essential activity for rural households, although its share decreased in the last years from 56% in 2001 to 43.5% in 2006.



Graph 2. Structure of rural household incomes (%).

Given the large proportion of people employed in agriculture, significant gaps appear between incomes in rural and urban areas. Compared to reference year 1997, incomes per person increased by 54% in ten years (year 2006) in the urban area and by only 10% in the rural area.

The incomes in kind represent the last defense line in the survival strategies of households living under extreme poverty conditions. The subsistence farmers are among the poorest in Romania, given that their per capita income was 35% lower than that of the average household in 2006. Only the households of unemployed persons have lower incomes per household member (by only 2.6%).

### Contribution of agriculture to household consumption

Most subsistence farms are small-sized and their production is not delivered to processors but goes to self-consumption (household consumption of food produced on the household).

Food consumption continues to have a relatively high share in the household consumption expenses, revealing the vulnerability of all households, but mainly of the urban households, to the prices on the domestic and global markets. In fact, as we shall see below, the rural households have a higher level of food consumption coverage, in quantitative terms, compared to the urban households, although their incomes are significantly lower. This is obviously due to the consumption of food produced on their farms. On the average, in 2006, food consumption accounted for 45.4% of the total consumption expenses; this share is probably among the highest shares in an EU member state. In rural areas, this share is even higher, yet it decreased significantly in the last five years: from 67.1 % in 2001 to 54.7% in 2006.

*Table 4*  
Structure of food expenses on households by origin sources and residence areas (%)

	Urban households			Rural households		
	Total food expenses	In cash	In kind	Total food expenses	In cash	In kind
2001	100.0	73.7	26.3	100.0	38.0	62.0
2006	100.0	78.1	21.9	100.0	49.7	50.3

*Source: Living standard coordinates in Romania, Population's incomes and consumption in the years 2001 and 2006, NIS, 2006*

Most of the food consumed on subsistence farms is produced in the household. The proportion of self-consumption decreased in the last five years, from 62 % in 2001 to 50.3% in 2006 (Table 4). Even the urban households have a significant self-consumption level, of over 20% of food consumption expenses. These food products come from relatives in the rural areas or from the kitchen gardens that are commonly found in the small towns.

In the rural households, the proportion of self-consumption is extremely high for certain products. Thus, self-consumption accounts for 75% in fresh meat, 70% in fresh milk, 72% in cheese, 90% in eggs, 66% in fruits and vegetables, and 74% in alcoholic beverages. The only products for which self-consumption is low are: sugar, beer, soft drinks, and partially fats. These are generally products that are not usually produced on subsistence farms.

### Needs of rural areas

The living conditions in the rural areas are quite seriously affected by the lack of adequate infrastructure, as most rural households have no running water, sewerage system, etc. In the early period of SAPARD, a statistical survey conducted<sup>1</sup> at the end of the year 2002 revealed that the endowment of rural households was extremely precarious:

- only 16% were connected to the public drinking water supply system, while 24% had their own running water supply system;
- only 10% were connected to the sewerage system;
- only 12% had a flushing toilet inside the house;
- only 17% had a bath tub or shower;
- only 7% were connected to the gas supply system;
- only 15% had cable TV.

The SAPARD Program began its project funding activity in 2002, the Rural Infrastructure Development and Improvement being one of the measures approved for that year (Measure 2.1). The public funds used from the Community and

<sup>1</sup> Euro Rural Barometer, co-financed by the European Union, 2002.

national sources totalled 1.3 billion Euro, 10 measures being funded in total for the 2000–2005 period. 645 million Euro was allocated for infrastructure and the absorption rate was 93.4%.

A mid-term evaluation of the SAPARD Program, carried out in the period October 2005 – September 2006<sup>2</sup>, analysed the financial and technical efficiency of the Program up to that moment. It revealed low levels for these indicators (except for measure 2.1) and proposed measures for increasing the absorption level of funds and a better correlation between the needs, absorption capacity, objectives and costs. At the same time, it revealed that the delayed adoption of measures 4.2 (Technical assistance) and 4.1 (Improving vocational training) did not allow a sustained information campaign for the rural areas regarding the opportunities of the Program.

The Program had also good results, being appreciated as a relevant and coherent program compared to other national and EU intervention methods. It resulted in increased turnover for the beneficiaries who invested with financial support from SAPARD (through measures 1.1 and 3.1 in particular), in the creation of new jobs (about 45,000 new jobs, out of which 17,000 for women) as well as driving effects at Romanian economic level (as long as investments generated a demand of goods and services on the Romanian market with a value of 425 million Euro, *i.e.* 48% of total investments).

This evaluation also underlined the success of Measure 2.1 (Rural infrastructure development and maintenance) where the allocated financial resources were used up shortly after the measure was accredited, the financial efficiency being 100%. Additional funds were allocated for this measure. The number of applications was three times larger than the allocated resources, which confirms the need for investments in rural infrastructure in Romania. At the same time, the dependence of infrastructure investments upon the financial support provided by the SAPARD Program is highlighted. In the absence of this program, 2/3 of investments would not have been possible, as the amounts necessary for infrastructure investments are huge compared to the local community budgets. Another problem that was noticed throughout the program was the lack of co-financing sources. For most measures (except for measure 1.1 – Processing and marketing of agricultural and piscicultural products), most of the funds for co-financing came from the beneficiaries' own private savings, followed by the banking credits and to a lesser extent from foreign direct investments. In these circumstances, until this mid-term evaluation, the banks played a relatively small role in co-financing the projects, the main source being the personal savings of beneficiaries.

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<sup>2</sup> The evaluation was achieved by the consortium, including Kvistgaard Consult/DDH Consulting, in association with a number of local and international experts, in the period October 2005–September 2006

Overall, this mid-term evaluation highlighted the significant contribution of SAPARD to the economic growth of the beneficiaries, the creation of new jobs in the primary and processing sectors and the creation (although modest) of jobs in off-farm activities. Also, beneficiaries have become more aware of EU standards with regard to food quality and safety, environmental problems and animal welfare.

The SAPARD-funded infrastructure projects had the following output (*SAPARD Monitoring Tables, September 2006*):

- modernization and improvement of 2,058 km of roads;
- enlargement of the drinking water supply network by 4,341 km, serving 875,486 inhabitants;
- enlargement of the sewerage system by 857 km, for 335,005 inhabitants.

In 2007, the rural infrastructure situation still precarious continues to have a negative effect upon the quality of life in rural areas, hindering economic development.

For these reasons, we question the allocation of funds through the present National Strategy Plan for Rural Development (NRDP) 2007–2013, containing 20 measures grouped under 4 axes and a financial allocation of 3.1 billion Euro (Table 5). The most significant financial support is allocated to Axis 1, *i.e.* to support activities in the agricultural and forestry sector, accounting for 42% of total allocations (Table 5).

*Table 5*  
Financial resources of Rural Development Program (indicative allocations)

NRDP	EAFRD	
	million Euro	%
Axis 1: Improving the competitiveness of the agricultural and forestry sector	3,174	42.2
Axis 2: Improving the environment and the countryside	1,880	25
Axis 3: The quality of life in rural areas and rural economy diversification	1,979	26.3
Axis 4: Implementation of the Leader approach	188	2.5
Technical Assistance	301	4
Total NRDP	7,522	100
Contribution to CNDPs	500	
Total EAFRD	8,022	

*Source: National Strategy Plan for Rural Development 2007–2013*

This distribution of funds focuses mostly on increasing the competitiveness of the agricultural and forestry sector, thus actually promoting the development of certain activities in the primary sector of the rural economy. This sector is generally characterized by a very low capital marginal efficiency. Thus, there is a risk that the current economic and income gaps between the urban and rural areas will increase further if most of the funds are directed towards the development of agriculture, forestry and other activities from the primary sector. The counter-argument offered by decision-makers is based upon the fact that agriculture is still

the main economic activity and the main income source for the rural households. However, agriculture imposes a great inertia on the rural world, which thus becomes less involved in the economic dynamism manifested in the last years and does not benefit from Romania's general economic growth. In our opinion, an equal distribution of rural development funds of 35% between Axis 1 and Axis 3 would be much more beneficial for generating economic growth in the rural areas.

## 2. ASSESSMENT OF THE IMPACT OF POSSIBLE CAP REFORM SCENARIOS ON ROMANIAN AGRICULTURE

At EU level, the debates on the agricultural policies focused upon the medium-term issues related to the improvement of policy implementation (health-check) and to the continuation of the 2003 reform (sugar, wine, fruit and vegetables market reform). The long-term perspective must also be considered, regarding the future of CAP after 2013, under the pressure of the Doha Round within WTO and of EU budget reform.

Different reports and positions of EU Member States contributed to the vision upon the future of CAP. For a long-term perspective the UK Vision Paper of 2005 is worth mentioning and for a medium-term perspective (focusing on implementation) the French Memorandum of 2006. The Vision of the UK on the future agricultural and rural development policy has at its core the concept of sustainable agriculture patterns, focusing on competitiveness, environment protection, decreasing import tariffs and the removal of any subsidies for production or consumption. Agricultural expenses should focus upon the present Pillar II. In the last part of 2007, the French President Sarkozy's position opens the way to a bolder CAP reform than in the previous French Memorandum, by assuming a stronger market orientation of European farmers.

In Romania no formal official political reactions to the UK Vision were signalled out. At academic level, the radical reform proposal was received with interest (Alexandri, 2006), the liberal economic perspective being highlighted; in the long term this approach is likely to prevail, even though currently it would not obtain a consensus from all the member states. Romania's short-term interest might negatively influence its long-term strategy, and a sceptical position with regard to radical reform is likely. Romania gave an indirect unfavourable signal towards the UK Vision by associating itself with the French Memorandum of 2006 that proposed focussing on the implementation issue and considering challenges such as food security and the access to natural resources (water, arable land).

Helped by his previous position as Prime minister, a coherent vision upon the future of agriculture and the rural area in Romania was proposed by a politician (Nastase, 2006). The key-problem that he identified was the huge gap between rural and urban areas, mainly due to poor infrastructure and the generalized poverty. The proposed solution for the modernization of the rural area is represented

by its “urbanization”, through great investments in infrastructure, development of community services and the change of the inhabitants’ life style. The approach would be based on public funding of rural infrastructure and services from national funds supplementing the EU funds, subsidizing the consumption of rural public services and the development of a program for increasing the income of the rural population through the creation of non-agricultural employment opportunities. In this approach, modernization of agriculture will result from the modernization of the rural area, the state shifting its internal and external resources towards rural development rather than for agriculture.

It should be mentioned that in Romania in the last century and a half, the ambitious investment programs have not been generally successful in reaching their objectives to increase productivity and closing the gap between Romania and the developed countries of Europe. The special focus on funding activities that are not directly productive does not make this approach necessarily better, but its chances of success could be enhanced by Romania’s EU membership. However it is expected that the large farmers’ lobby will make such modernization program difficult to impose on the public agenda; an opportunity would be to include this approach in the electoral offer in future elections and to legitimate it by vote.

#### **International context: globalisation pressures**

For Romania, the EU accession and adoption of CAP represent the opportunity of going beyond the policy inconsistencies generated by the electoral changes. This could be the beginning of a period of consolidation of the agricultural sector based upon the stability of agricultural markets and the generous support provided both to agriculture and to the rural areas in general.

CAP will be faced with growing pressures caused by globalization and internal pressures for a more equitable use of the resources allocated to this common policy. The need to continue CAP reform is once again highlighted in a recent OECD study (Economic Survey of the European Union, 2007) which concludes that the EU should proceed with the diminution of its agricultural subsidies and with the opening of its markets.

The reform of agricultural policy represents an older concern of the OECD. Given that Romania intends to become a member of this organization, the OECD position should be taken into consideration. The need to reform the agricultural policies of the OECD member states has been officially recognized since 1987, and the emphasis of reform was placed on allowing the market to influence production, through the gradual diminution of the agricultural support. That is why it is recommended to provide income-related support to farmers rather than support through guaranteed prices or other production-related measures. The principles for policy reform, established in 1998, proposed a greater market influence, as well as the protection of natural resources and strengthening food security worldwide.

According to the OECD, the reform had to focus upon the diminution of producer support and of producer protection, the main recommendation being to provide a decoupled support form. The experience of reform processes in the last ten years shows that agricultural reform is difficult because of the complex links between farmers and politicians in defining the sectoral priorities. Farmers are fearful of change, exaggerating estimations of negative effects. Politicians over-estimate their dependency on the farmers' votes. The OECD recommendation for following the reform path is the consultation of and communication with all the stakeholders, by presenting the arguments on which the proposals are based and providing decoupled compensatory measures for a limited period of time. The reform results indicate that it is more difficult to reduce the level of support than changing its structure, by using less distorting support forms.

The global tendency to reduce trade barriers for agricultural products favours further reforms. The EU tariff level is still considered high resulting in higher prices on EU markets compared to the world market, which is a source of world trade distortion. Romania had a privileged situation during the Doha Round negotiations, mainly due to the Uruguay Round results, but once the EU accession negotiations were completed, Romania fully adopted the EU position.

The possible successful completion of the Doha Round negotiations would bring radical changes for the EU farmers regarding the diminution of the agricultural market protection (state of negotiations September 2007): a 50% average reduction of customs duties for agricultural products, a 70% decrease of subsidies that distort trade and the removal of all export subsidies by 2013. The position of the Commissioner for Agriculture is that a possible agreement in the Doha Round can be reached only through a balanced agreement within the agricultural section of negotiations, as well as between the agriculture, services and industrial goods sections.

Romania's experience regarding agricultural reform has positive lessons to offer. Before 1997, the protection level of Romanian agriculture was very high, with an average of 75% of applicable customs tariffs, which resulted in a quasi-generalized inefficiency of the agri-food sector. Nevertheless, the large farms most of them in state ownership received relatively high direct subsidies. In those circumstances, the absence of competition from imports, combined with the defective management of the agri-food enterprises and the controlled prices led to the almost generalized bankruptcy of the large production units. Thus, the 1997 reform (supported by the ASAL Program of the World Bank) revealed that the reduction of tariff protection, mainly for the agricultural sector that needed urgent adjustment, did not result in the collapse of the sector. It can be argued that this laid the basis for a solid development of the agricultural sector, in correlation with the adoption of certain decoupled support methods.

The results of the Doha Round are mixed for Romania: given the relatively low level of support received by farmers from the national budget until accession

(through payments decoupled from production, in case of crops, and partially coupled in case of livestock), the shock of the expected reduction of distorting subsidies after accession would be absorbed relatively easily. However, the reduction of tariff protection could negatively influence the agricultural production, as the most competitive Romanian exports are the lightly processed products, with low value added. Thus Romanian producers will have to face the competition of the products coming from the developing countries whose access to the EU market would be liberalized. An analysis of the competitiveness of Romanian food products traded with EU states over 1999–2004, based on the indicators of competitive advantage, considers that the following products are competitive: livestock, seeds and fruits, industrial and medicinal plants, edible roots and tubercles, animal grease and vegetable oils. The conclusion of that analysis is that Romanian food products are, generally speaking, at disadvantage, because the food industry is not competitive.

### **The Health Check and the future of CAP**

The Commission is trying to find the equilibrium between the proposals for a radical CAP reform, including the drastic reduction of strictly agricultural expenditures of the EU budget, and those for a moderate reform, seeking to maintain an agricultural policy as close to the present principles as possible.

Thus, the speeches of the Commissioner for Agriculture and Rural Development integrated most of the proposals from the Member States, although being mainly oriented towards the completion of the 2003 reform, *i.e.* the policy implementation improvement. The “CAP Health Check” is the internal exercise that should evaluate if the CAP objectives following the 2003 reform are reached with the highest possible efficacy, efficiency and facility. The reform evaluation is approached not only from the perspective of agri-food production but also from the perspective of climate change and rural development.

Fully decoupled direct payments, as one of the priorities of adjusting CAP under the pressure of Doha Round negotiations, is an objective assumed by the Commission. In Romania, several payments assimilated to state aids (that do not need the Commission’s approval) are also affected; these payments made in 2007 were circumstantial, given the delay in implementing IACS that would have allowed providing direct payments under the SAPS scheme. It is expected that with the introduction of SAPS payments, these measures will no longer be necessary. As regards the complementary national payments, these are partially decoupled from production.

Another foreseeable proposal of CAP reform is increasing the level of compulsory modulation. Currently, Romania as a new member state is exempted from this type of funds transfer from Pillar 1 to Pillar 2. Compulsory modulation

should be supported by Romania, taking into consideration that it will negatively affect, from the moment of its application, only a small number of farms (the large ones), but it will complete the necessary funds for rural area modernization.

The examination of the operation of “cross-compliance, the application of which is investigated in the recent Commission Report, will probably lead to the simplification of certain provisions. Romania will certainly benefit from any simplification in controlling the application of “cross-compliance”(GAEC). However, complying with these conditions should represent a strategic objective of Romania’s agriculture, given that agricultural land is one of Romania’s most important natural resources.

Regarding market instruments, mainly those for managing supply, it seems that their disappearance is inevitable in the context of world agricultural trade liberalization. The Commission will also analyze the procurement-based intervention, the milk quotas and the set-aside obligation. The signals obtained so far reveal an acceleration of their elimination: the maize intervention will cease in 2009, the obligatory set-aside was suspended for the year 2008; regarding the milk quota many voices are in favour of their elimination after 2015. From an administrative stand point Romania should favour the removal of these instruments as soon as possible, taking into consideration the difficulty to set them in operation.

In the context of giving up market instruments, it is expected that on medium term Pillar I will include only (decoupled) direct payments. The most interesting issue for all the states is related to the methods of receiving these direct payments although the level of payments is also a concern for farmers in Member States. Experience so far shows that while it is possible to transform the type of support provided to farmers, the diminution of this support is much more difficult to achieve.

Romania, starting from a low support level compared to the old member states, is likely to adapt more easily to the diminution of subsidies provided under Pillar I. This adaptation process will be easier if farmers are informed in advance about the new form of this Pillar after 2013.

The long-term equilibrium (2020) between the two CAP pillars can be considered as the core of the debate on the future of CAP. The transfer of funds from Pillar I to Pillar II has been and still remains the main tendency of CAP reform. However, the measures for speeding up this transfer, beyond the success of the 2003 reform, were limited to the proposal of a voluntary “modulation” that should reach up to 20% of Pillar I funds. This new instrument of supplementing the funds allocated under Pillar II does not seem to be favoured by the member states (UK is an exception in this respect). The European Parliament is considering it rather a form of CAP re-nationalization.

Romania could gain in the long term from a greater allocation of resources to Pillar II, taking into consideration the development gap between Romanian rural and the urban areas and the even greater gap between Romanian and Western rural areas. The scenarios in the table below define the possible features of the future CAP.

### **Likely effects of reform scenarios on Romanian agriculture and rural areas**

The formulation of certain simplified scenarios of possible CAP reform, from the perspective of the Romanian concerns regarding agricultural policy provides the necessary benchmarks for a brief analysis of the effects of reform upon consumers' and producers' welfare, as well as upon the rural area in general. The scenario named "Current CAP" implies the completion of the reform envisaged in 2003. On the other part, the "Moderate Reform" scenario would have as objective the drastic diminution of market interventions, while the "Radical Reform" would imply not only the removal of interventions, but also the phasing out of direct payments.

Given the complexity of its economic and social effects, CAP reform will affect several categories of stakeholders in Romania. Taking into consideration the high share of food expenses in the total expenses of a Romanian family, the fact that reform will lead to cheaper food is welcome. On the other hand, the diminution of prices of agricultural products will affect the small farmers who are not able to reach higher productivity levels. These are among the poorest category of people in the Romanian society by no accident.

Another opposition that can be identified is the one between the taxpayers and the beneficiaries of direct payments and subsidies. In the favourable context of economic growth in the last years, this problem has not had an important place on the public agenda. The currently deteriorating economic performance will bring it to attention. The administrative costs of European subsidies will have to be analyzed as well, as they cannot be considered insignificant, falling entirely into the responsibility of the national administrations.

### **Market measures**

Analyzing the effects of the complete or partial removal of supply control mechanisms should start from the specificity of the Romanian agricultural market. Although the European Union is Romania's main commercial partner in agri-food products, the price differentials between Romania and other EU Member States shows the clear market segmentation phenomenon. Thus, for most agricultural products, the prices on the national market are different from those of other large EU agricultural markets.

The case of wheat is typical: while in Germany the producer price throughout the period 2000–2004 was slightly higher than 11 Euro/100 kg, in Romania the annual average price for 100 kg fluctuated between 12 and 17 Euro in the same

period. In general the price level in Romania was higher than in Germany, yet the price fluctuations have been much greater, also as a result of the absence of an intervention mechanism. In 2005 the price decreased by less than 2 Euro in Germany, while in Romania it was higher than 4 Euro per 100 kg. The situation on the maize market is almost identical, the prices falling from 16 Euro/100 kg in 2004 to 12 Euro in 2005 in Romania. In the case of potato market, a commodity that is less suitable for long-distance commercialization, the segmentation is even stronger. In Romania the prices are quite high (around 20 Euro/100 kg) and the variations are sometimes quite spectacular (from 22 Euro/100 kg in 2005 to 34 Euro in 2006), unlike in Germany, where the prices and the price variations are lower (prices range from 6.5 to 9.2 Euro/100 kg).

Regarding the livestock sector, the evolutions are also atypical. In Romania the producer price for live weight calves is generally half the price of the traditional European producers: about 90 Euro/100 kg in Romania compared to 250 in Austria and 200 in Hungary or Poland. The price of live weight pigs is relatively high: in most years over 100 Euro/100 kg, compared to about 80 Euro in Denmark. The variations are also high in the case of pigs; for example, in 2004–2005 prices increased by 30 Euro/100 kg, and in 2003–2002 prices decreased by 40 Euro/100 kg. The producer price in the case of poultry (live weight price) experienced a collapse in Romania in 2004 (and the presence of the avian influenza in 2005 maintained the prices low) to less than 100 Euro/100 kg, compared to over 200 Euro in 2003. By comparison with constant prices throughout the period of about 70 Euro/100 kg in Germany or about 35 Euro in Portugal, it is obvious that a certain market distortion takes place, as a consequence of segmentation and commercial regime.

Starting from the specific situation of these main markets, an evaluation of the effects of certain future reform measures in the period after 2013 is not easy at all. In order to provide a certain coherence to the comparison between the two reform scenarios (moderate and radical), we predicted that in the 2008–2013 period, Romania's agriculture would reach the stage of an almost full integration in the EU markets for each product and the comparison is made between the situation at that moment ("Current CAP" Scenario) and each of the two reform scenarios. The hypothesis that define each scenario are synthetically expressed by the price of the respective product.

In these conditions, the effects upon the producer welfare will be obviously negative, while the effects upon the consumer welfare will be positive. The question is whether the positive effects exceed the negative ones, in each of the two reform scenarios. Furthermore, which of the two scenarios produces the desired outcome for the decision-makers? The change in producer welfare for the 6 selected products (wheat, maize, potatoes, pork, poultry and beef) is negative. The producers lose as a result of CAP reform, in both of the scenarios, yet the loss is greater in the case of the radical reform scenario. Consumers gain in welfare in both scenarios, and the overall gain is higher than the producers' loss, which result in a net positive

effect (at the level of the whole economy). Net welfare is higher in the radical reform scenario than in the moderate reform scenario, which means that a radical reform would be desired if the situation of producer welfare loss could be well managed.

### Moderate reform versus radical reform in the direct payments case

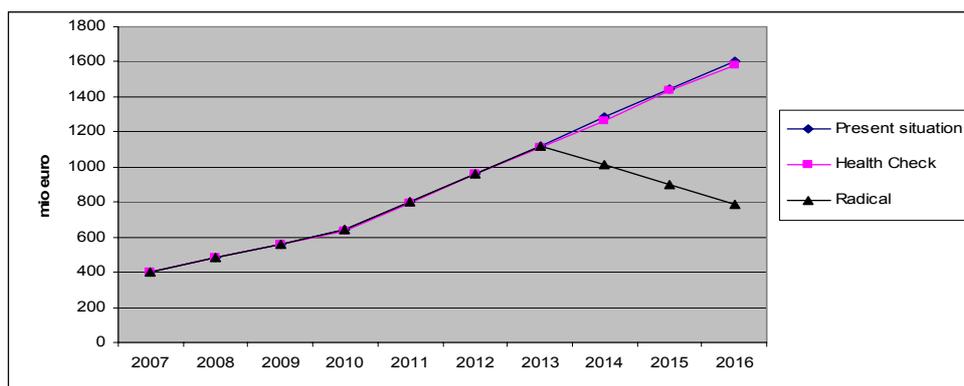
In Romania the number of farms that are to receive direct payments (registered in the Farm Registry) is about 1,230,000; these farms operate a total area of about 9.5 million hectares. 32% of this area is operated by farms with 100–1,000ha, 26% by farms under 5ha and 17% by farms over 1,000 ha.

The direct payments paid from EU funds will gradually increase, from about 400 million Euro in 2007 to about 1600 million Euro in 2016.

In order to see how the direct payments would operate under CAP reform, we made a few simple calculations, on the basis of three scenarios, referring to the period 2014–2016:

- Scenario 1 (Current CAP): the situation in which direct payments continue according to the current CAP, to reach 100% of the payments foreseen for Romania by the year 2016.
- Scenario 2: (Moderate reform) assumes that starting with 2014, the level of direct payments will be reduced according to the current Health Check proposal. Payments to farms will be reduced by 10% if the amounts exceed 100,000 Euro, by 25% for amounts that exceeds 200,000 Euro and by 45% for amounts that exceed 300,000 Euro.
- Scenario 3 (Radical reform) assumes that the level of direct payments per hectare will be reduced compared to the level of direct payments in 2013: by 10% in the year 2014, by 20% in the year 2015 and by 30% in the year 2016.

The direct payments in the three scenarios are presented in Graph 3.



Graph 3. Evolution of direct payments funded from EU funds.

The reduction of direct payments per hectare, according to the current proposal in Health Check, would have minor effects. The farms that would exceed the direct payment ceilings proposed in Health Check are the farms with over 1000 hectares. The average size of farms from this category is 2040 ha, and a farm would receive direct payments of over 100,000 Euro in the period 2008–2011, over 200,000 Euro in the period 2012–2014 and over 300,000 in the period 2014–2015. According to the moderate scenario, in 2016, an amount of about 15 million Euro would be saved. This would represent 1% of the direct payments that would be received in the same year under Scenario 1. We consider that this diminution is not significant, although it could lead to dissatisfaction among farmers who receive diminished payments. At the same time, the transfer of this amount to the measures under Pillar 2 will not bring a significant change in funding the rural development measures.

Scenario 3 (Radical), which proposes the annual reduction by 10% of the direct payments for all the farms, has much more spectacular effects. For example, the level of direct payments in 2016 under this scenario is half the level in scenario 1 for the same year. If we follow Scenario 3, in 2023 the direct payments per hectare will be totally removed. If the funds that are saved in this way are redirected to rural development measures, the funding under Pillar 2 could make a significant difference.

### **Can Romania benefit from a larger allocation for Pillar II?**

Within the HC debate, Romania's initial reaction was against compulsory modulation, although the development gap between the Romanian rural area and the rural areas of EU 15 would justify an immediate increase of funds for Pillar II.

The reason for this was the skepticism regarding the absorption of funds as the National Rural Development Program (NRDP) for 2007–2013 had been approved as late as February 2008. Certain changes compared to the SAPARD Program could result in uncertainties regarding the potential beneficiaries' interest or financial power. In fact a decision of allocating part of the funds from Pillar II for direct payments had been already made, in effect an approval of reversed modulation that seems unjustified. Hopefully, this was the only a short-term option. On long-term Romanian decision makers could support a radical reform of CAP which would mean a gradual transfer of funds to Pillar II while direct payments are phased out (after 2013), if the experience of the current financial programming reveals that the rural infrastructure can efficiently absorb the allocated funds.

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