

RURAL DEVELOPMENT AND AGRICULTURAL POLICY IN THE CONTEXT OF NEGOTIATING THE EUROPEAN UNION ACQUIS

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Abstract: Elaborated during the first half of 2004 as an UNDP-financed project and never published in a complete form before, this study documents the failures of prolonged and significant state interference in the agricultural sector in Romania, focusing on the post-communist period. Given the unavoidable facts that in the absence of private property it is impossible to have either a rational allocation of resources and the right incentives, we reach the conclusion that the failures of the Romanian agriculture were not at all accidental, but inherent in its statist design. An assessment of the European Common Agricultural Policy and its potential impact on our agricultural sector is provided in the last part of the study.

1. Introductory remarks: why adopt the acquis?

Romania is currently engaged in the effort of concluding the accession negotiations with the European Union. Agricultural issues, dealt with in the 7th negotiation chapter ("Agriculture"), represent one of the toughest challenges for our endeavour, taking into account at least these factors:

- the European negotiators face a relatively big country (as Romania likes to call herself, "the smallest among the big countries"), with a large agricultural sector and a large part of the population employed in agriculture, and relatively poor. Given the nature of the European Common Agricultural Policy (CAP)¹, based on significant transfers and tight regulations, and the working of the Union's budget, from which 80% goes to agriculture and regional development (45% and 35%, respectively), it becomes obvious that:

- a) Romania's accession would imply huge transfers of European funds to the agricultural sector (therefore a burden for European taxpayer, a "financial challenge");

- b) Romania should adopt and strictly enforce European agricultural regulations, otherwise the whole intricate fabric of the CAP will be disrupted (a "regulatory challenge")².

The first part of the challenge is already solved: the financial package offered by the EU is "generous", so Romanian authorities called it.

- as far as the Romanian side is concerned, "the regulatory challenge", the task of harmonising domestic legislation with the European acquis, is in itself, by its sheer size, a "mammoth task". But to have an idea of what is in stock for the authorities, we may add that *harmonisation* is just one part of the process, the others being the *implementation* part, to be successfully fulfilled only if Romania solves its "administrative capacity" shortcomings, and

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¹ *Which will be briefly explained later on in this study.*

² *It seems that Turkey's unsuccessful efforts to become a member could be accounted for by the EU budgetary dynamics: Turkey is "too big and too poor", a too heavy burden for Europe. The geographical considerations, although not entirely insignificant, are perhaps mere byplay in the whole picture*

the *absorption capacity* (the ability to effectively use the funds allocated, which very often implies complementing the European money with national money) playing a part at least as important as the harmonisation. By its efforts to harmonise legislation and reform the administration, Romania should persuade the Europeans that she is able and deserves to become a member of the EU, representing an "asset", not a "liability". There are no other means to do it.

Now, is there any argument, any benefit for Romania deriving from adopting the *acquis*?

Several answers come to mind while seriously considering the above-mentioned problem:

- The first comes by looking at the general picture of the economy in Romania and in the EU. It is clear that the economic system in the EU generally is relatively much freer than what we have in Romania, therefore more business-friendly and conducive to production and prosperity. This fact is empirically illustrated by the *Index of Economic Freedom in the World*, which ranked Romania (in 2001) 116 among 124 nations (getting a 4.7 mark, out of 10). To be sure, Romania has made some progress since, but the fact remains that almost all that progress was achieved as a result of accession negotiations and not much has yet been done to catch up with the EU countries³.

Accession, if understood as a systemic transformation, and not only as foreign aid, will certainly move the Romanian economy toward a more business-friendly economic environment,

this being generally the sine-qua-non ingredient of economic development. From this vantage point, even if agriculture were not a strong point of the European system, the agricultural *acquis* would not be too heavy a price to be paid for achieving a critical mass of reforms;

- Nevertheless, Romanian agriculture has been so heavily regulated and subsidised that it is out of question to believe that even the CAP could make matters worse;

- On the contrary, compared to our national agricultural regime, the CAP is just a market-based, interventionist arrangement. Its main aim is to manipulate the market in order to achieve certain results deemed good at the European level. But the basic structure of production in the EU is represented by privately owned farms and enterprises, on which it is super-imposed an entire web of regulations and subsidies. This aspect explains the Union's insistence on *privatisation, land market, and rural development in Romania*.

- The twin challenge of WTO

Romania— Some general data(1999)
Too big and too poor?

Population 22.5 mill.
Area: 238 391 km²
Rural area: 212.7 thousand km² (89% of country's area)
Total agricultural area 14.8 mil. ha.
Arable land 9.3 mill. ha. (63% of the agricultural area)
Rural population: 10.14 mill. (45,1%)
Population employed in agriculture: 7.5%
Rural population employed in agriculture: 70%
Agricultural income in total rural income: 65%
GDP/capita: 3.964 \$
Agriculture's share in GDP: 11,4% (2000)

³ Great Britain is the freest economy in the EU (occupying the 4th place in the world with a mark of 8.2), followed by Ireland (7th place, 8.0) and the Netherlands (10th place, 7.8). France and Greece are the laggards (place 44th in the world, 14th and 15th in the EU with the same mark, 6.7).

The freest economies among transition countries are Estonia (16th, 7.5, an impressive performance), Hungary (35th, 7.0), and the Czech Republic (39th, 6.9).

negotiations and enlargement could lead to a more rational approach toward agriculture in Europe. Romania can only benefit from such a move.

2. Romanian agriculture in transition: what went wrong?

2.1 The socialist heritage: Why socialist agriculture was inefficient?

Before 1989, Romania was one of the most autarkic and statist economies in the region. Agriculture was no exception. In 1989, the structure of land ownership was as follows:

- state sector: 30%;
- "collective" sector (production cooperatives): 55%;
- private sector: 15%⁴.

Three main points (concerning results, private property, and socialist inefficiency) deserve to be briefly highlighted at this stage.

a. Results

As the state was the overwhelming actor in the sector (85% of ownership concentrated in state's hands), it is obvious that it had a major incentive to make the results appear better than they really were. Socialist "achievements" had to be seen by everybody, inside and outside the country. This is a compelling reason not to make extensive use of the fake statistics of the period and to refrain from pronouncements such as "production has decreased in Romania after 1989" or "the standard of living is now much lower than before the Revolution."

The socialist policy destroyed the villages, created powerful interest groups,

and encouraged gifted young people to leave the rural area, leaving behind an aged and ageing population. Production was a complete mess, the structure of production being distorted by irresponsible decisions aimed at almost complete autarky. (see also point 3)

b. "Private property"

Particular attention should be paid to the last information concerning land ownership: 15 % private property.

The image induced by this percentage, that of the existence of a private sector or field in agriculture is a misunderstanding. The truth is different: the whole organisational structure of Romanian agriculture was socialist through and through, with small plots of land around private homes in the countryside and larger ones in the mountain regions left in private administration. Perhaps this move prolonged the life of the regime, because those small plots effectively provided food for rural families and prevented hunger, very often being the case when these private plots supplied the rural and urban population with various products on the black market.

In a word, there was no private market, no private environment. As the data tell us, 85% of the land was in the hands of the state; there existed no land market whatsoever, the downstream and upstream of agricultural production were also monopolized by the state. No small, successful private entrepreneur could have ever expanded his business in such an environment. And that was precisely the point: not to expand, but to survive. The centrally planned, big state agriculture was the one that mattered.

⁴ See Irina Râmniceanu, *Probleme structurale ale agriculturii românești în perspectiva aderării la Uniunea Europeană*, Institutul European din România, Working Paper Series, no. 6, Bucharest, 2004, p. 13.

c. Inefficiency

A crucial aspect is related to the inefficiency of the socialist agricultural system. Two explanations are provided:

i) The received, "mainstream" explanation connects agricultural failure in socialist countries with the "too large size" of state farms. Large farms have a series of disadvantages:

a) the policy of lifetime employment for workers makes them immune to firing, the ultimate resort for enforcing effort;

b) the large size of the labour force and fields make monitoring work behaviour extremely difficult;

c) the policy of equal remuneration breaks the link between effort and reward, heavily penalizing work⁵.

If we add the pervert incentives governing managers' and planners' behaviour, the picture is complete.

ii) Even if correct, the above explanation overlooks a fundamental problem of collective ownership: the possibility to make rational economic decisions in a socialist ownership regime.

It is of course true that socialism faces a grave incentive problem. But that is not all. Is it not possible, by changing people's mentality, to overcome that problem and make socialism effective? Moreover, is it not possible, by downsizing the state farms, to gain in efficiency? The answer to both these questions is an emphatic "No".

Almost all factors of production have *alternative uses*, i.e., could be involved in various production ventures and could bring various consumers' goods in existence. As the factors of production are *scarce* (we live in a world of scarcity, where the sphere of ends/needs is much larger than the sphere of means/resources), only *some* consumer

goods can be produced. It is obvious that, if waste is to be prevented, only *the most important* of the final goods should claim the factors of production available. In this world, we have only *one possibility* to figure out what those most important goods are: by comparing the *expected proceeds* to be obtained by their sale to consumers or other entrepreneurs with the prices to be paid for the *inputs* necessary for their production. In this *profit-oriented* economy, only the most *profitable* activities will be undertaken, those resulting in generating the most important goods in the eyes of the future consumers. The over-optimists will suffer losses, the penalty for not forecasting correctly consumers' needs and squandering scarce resources. The successful entrepreneurs will make profits and they could expand their activities. Only successful forecasting, over and over again, would maintain and expand one's share in production and ownership.

No in-kind calculation is possible. Only a world with *private* entrepreneurs, projecting their plans in the material world (factors of production) by means of private, voluntary exchanges, mediated by money, would do the job. Socialism destroys the possibility to meaningfully answer the question: "where to invest my resources?" by abolishing private property; interventionism destroys it by abolishing (for enterprises in its sphere of action) the profit criterion.

The final answer is that by abolishing private property and profits, neither downsizing, nor a change in mentality, would help to extricate socialism from chaos. No planner and no manager would ever know if he has made a good or bad investment decision. He has no clue whatsoever whether to expand, decrease, or

⁵ See Zvi Lerman, Csaba Csaki, Gershon Feder, *Land Policies and Evolving Farm Structures in Transition Countries*, World Bank, 2002.

to liquidate an undertaking. It is only logical that planners and managers together would do what they can rationally do: engage in lobbying, political manoeuvring, and bettering one's lot generally⁶.

2.2 First stage of transition: 1990-92

The failure of socialist management could have been cured only by creating a truly private economic environment, based on private ownership of land, transferable (exchangeable) titles to land (what is called "the land market"), full privatisation of upstream and downstream activities, removal of price-support schemes and subsidies, and a free trade and exchange-rate policy. Nothing of the sort was even attempted. The main events in the beginning of our transition were:

1. the dismantling of production cooperatives. It is worth pointing out and symptomatic for Romanian transition that this change was brought about single-handedly by the former owners and/or their heirs (dispossessed during the 1948-1962 period), and not by any ideological commitment to reform on the part of the political class.

2. the political class recognized the new reality by adopting in 1991 a land law.

The outcome can be seen in table no. 2.

Looked at from a quantitative point of view, the process was impressive: the former production cooperatives (around 5 000) were replaced by 4 million persons, the new owners of a sizable area of 8 million ha. The other resources of the cooperatives have been either sold or given back to the owners (animals), or transferred to agricultural associations (premises, machinery) or simply demolished, destroyed, or stolen.

Many experts deem the restitution/privatisation process outlined above as the root cause for land fragmentation and, as a consequence, for low productivity and inefficiency in agriculture.

The untold part of the story of this "original sin" is illuminating and significant. It can be summarized by saying that all that impressive privatisation process was nothing more than extending the 15% of the land held in nominal "private property" before 1989 to 4 million nominal "owners" of 8 million ha. of land. That was all that happened, almost all the other features of the former system being replicated in another form. The former socialist state collapsed, but the statist mentality survived and condemned agriculture for one more decade to stagnation and poverty. A drought and bad results in 1992 were enough to

Table no. 1: Land fragmentation in Romania 1948/1998 (%)

Exploitation	1948	1998
< 1 ha.	36 %	45 %
1-2 ha.	27 %	24 %
> 2 ha	37 %	31 %
Grand total	100 %	100 %

Source: Emil Tesliuc, Romanian Agriculture: Achievements and challenges, *Tranzitia economică în România: trecut, prezent și viitor*, Editura Economică, București, 2000.

⁶ See Ludwig von Mises, *Human Action*, Ludwig von Mises Institute, Auburn, 1999.

make the statist agriculture lobby to call for renewed action on the part of "the heavy hand of the state"⁷ starting in 1992.

What justifies an economist to say that no real privatisation was undertaken but a mere extension of the old "15%" regime is the lack of a private environment in agriculture. The features of the "new" statist environment were:

1. delaying the distribution of legal titles to land (see tables 2&3);

2. no possibility to exchange land on the free market (no "land market" in existence). This aberration continued until 1998;

3. practically all inputs, i.e. the "upstream sector" (mechanisation services, fertilisers, pesticides, certified seeds, irrigation (what was left) remained state monopoly;

4. all distribution channels and the "downstream sector" generally (storage, processing etc.) were also left in the hands of the state;

5. a not insignificant part of the land remained state-owned;

6. the inefficient public court system was slow at enforcing (if it had what to enforce at all) legal titles.

Table no. 2: *Titles to land to be issued and effectively issued (2003)*

Type of land	No. of applications	No. of titles issued
Agricultural land	4,223,067	3,897,176
Forest land	540,660	438,803

Source: Ministry of Agriculture

Table no. 3: *Total land area requested and covered by titles (2003)*

Type of land	Requested area (ha.)	Area covered by titles (ha.)
Agricultural land	10,113,704	8,784,414
Forest land	1,755,765	1,256,782

Source: Ministry of Agriculture

Table no. 4: *Evolution of the number of land titles issued (%)*

1993	1994	1995	1996	1998	1999	2002	2003
17.3	37.1	56.8	67	74.9	85	91	92.6

Source: Dragos Negrescu: "Un deceniu de privatizare in Romania", 2000

⁷ See Emil Tesliuc, "Romanian Agriculture: "Achievements and Challenges", in *Tranzitia economica în România: trecut, prezent si viitor*, Editura Economică, Bucuresti, 2000.

With small plots of land, few legal titles, no possibility to buy and sell land, with the state in control of both ends of the production process (means of production and marketing infrastructure) and of 40% of agricultural land, no access to credit, with a severe drought and no time to adjust, the agricultural sector did what it could: the production dropped in 1992 and the state stepped in. We forgot to mention that, given the general economic policy stance, the industrial sector production dropped too, another blow for the agricultural production on the demand side. But strangely- no one called for eliminating the state as manager of the Romanian industry and for its privatisation.

2.3 Second stage: 1992-97

The main developments of this period are the following:

a) the "15%" policy of maintaining isolation and fragmentation of nominally

it kept depressed the independent, non-governmental demand for agricultural products; and third, as the share of food expenditure in the budget of a Romanian was significant, the state tried not to lose control of agricultural supply and prices as a means of staving off social unrest in the country, especially in urban areas;

c) to implement the strategy, the Ministry of agriculture effectively became "the ministry of big state farms": fixed prices were imposed for meat, milk and wheat; a system of state holdings ("integrators") was created and huge fiscal and quasi-fiscal transfers were put in place (see table no. 2). The big state farms benefited from this arrangement, together with a part of agricultural associations⁸, small private owners being left out. In this way, big state farms became the main supplier of agricultural products to urban markets.

d) this policy of favours granted to big state farms and agriculture found no place for a rural development policy.

Table no. 5: Fiscal and quasi-fiscal support (%)

	1991	1992	1993	1994	1995	1996	1997	1998
Budgetary Support for Agriculture	8.9	23.9	11.6	13.8	13.2	15.1	11.0	10.3
Quasi-Fiscal Support for Agriculture	0.0	0.0	2.6	3.7	6.3	6.0	0.5	0.5
Budgetary and Quasi-Fiscal Support	8.9	23.9	14.1	17.5	19.5	21.0	11.5	10.8

Source: Tesliuc, op. cit.

private land in a statist environment continued;

b) the poor results of delaying reform in the other sectors of the economy (first and foremost in industry) had repercussions on agriculture: first, it initiated a migration from urban to rural areas (see table no. 7); second,

e) the problem of land fragmentation was tackled through the attempt to create a Land Agency (never set-up in fact), to buy the small plots of land and to resell them later in larger units.

The whole experiment ended in bankruptcy. The big state farms, devoid of

⁸ Many of these associations reflected the better access to mechanisation devices of the old "elite".

any possibility to allocate resources rationally and without any incentives to manage resources carefully (see point 2.1) proved able to waste everything: credit lines from the National Bank of Romania; direct financing from State Ownership Fund; and benefit (in vain) from debt cancellation. Agriculture financing became a threat for the banking system, for the government budget, a major source of inflation, and a liability (state farms went so heavily in debt that they were not any more "assets" to be sold but debts, liabilities)⁹.

In the 2002 National Plan for Agriculture and Rural Development, an official document, the general agricultural policy is said to have been so designed as

"to come out to a shortage of foodstuffs in order to show that the private ownership is not compatible in Romania. It seems that this was also true when the Land law was applied without the insurance of mechanical means for carrying out the farming activity. On those occasions, it was nurtured the belief that the private sector

*would not be able to ensure the food supply for the food security of the population and that the old structures would be restored again."*¹⁰

2.4 Stage 3: 1997-2000

The financial difficulties wrought by previous agricultural policies were enough to persuade the new administration that something had to be done, no matter the ideological commitment (or lack of commitment) to reform and private property.

1) the policy of lavish, hidden subsidies for the big state farms has been discontinued.

2) agricultural prices have been freed (the first important step in the right direction) and a new, more "neutral", subsidy policy has been elaborated (by means of vouchers, which were not so discriminatory against the small landowners as the old methods). The ministry of agriculture ceased to be "the ministry of big state farms".

Table 6: Privatisation of Agricultural and Food Industry

Type Of Enterprise	Total	Dec -97		Dec-98		Jul -99	
		Number	P	L	P	L	P
State Farms (Former IAS)	517	0	0	0	0	14	17
Poultry And Pig Farms	114	21	42	37	57	43	65
Storage Companies	71	0	0	19	0	52	5
Service Providers	1758	1033	na	1430	43	1628	50
Food Industry	428	na	na	216	na	266	25

Source: SOF Press Release, July 1999 (P=privatised, L= liquidated)

⁹ The example of Banca Agricola is a classic.

¹⁰ See the National Plan for Agriculture and Rural Development over the 2000-2006 period under the EU Special Accession Program for Agriculture and Rural Development (SAPARD), revised version, July 11, 2002, p. 33.

3) the most important action was the consecration in 1998, almost 9 years after the Revolution, of the freedom to exchange land.

Perhaps those in power at that time had high expectations concerning the results of those measures. What happened illustrated the truth highlighted earlier in this study, that only private property has means and the incentives to undertake a radical transformation of the economy in general and the agricultural sector in particular.

What the governants did was to change the structure of incentives, which was good, but not enough. Freedom to buy and sell land and price liberalization are important steps in the right direction. But here is how the general picture looked like and why the reform failed:

a) first, we need to look at the migratory flows between urban and rural areas (see table no. 7)

The key to understand the failure of

real reform hit back and firing and poverty followed in its wake for the urban masses. For many, transplanted or not from the communist villages, the only way out was to go back in the countryside, where they could rely on subsistence farming, and where their tiny "unemployment compensation" would have been more valuable. The trend continued after 1997, as reforms were still missing from the general landscape¹¹.

b) for these people and for the peasants already there, the small plots of land represented a valuable asset, one affording them to live. Free prices for their meager agricultural surplus were nothing new (they sold their products at free market prices even before, because they did not benefit from subsidies). Only freedom to buy land really benefited them. But even this freedom was just a potential advantage, given the fact that almost everybody was in

Table no. 7: *Migratory flows between urban (U) and rural (R) (with residence change)*

Direction	1991	1992	1993	1994	1995	1996	1997
R U	10.7	9.4	6.9	6.6	5.9	5.9	5.6
U R	2.5	3.8	3.4	4.7	5.8	6.7	7.9
R balance	-8.2	-5.6	-3.5	-1.9	-0.1	+0.8	+2.3

Source: National Plan for Agriculture and Rural Development

the policy mix chosen after 1997 is to put agriculture back into context. The inflationary, populist, expansionist, ultimately unsustainable economic policies conducted at the beginning of the '90s attracted population from the rural area. By the middle of the decade, the effects of this populist program were visible: the lack of

the same, subsistence situation, with no alternative but to live from the proceeds, a definitely not feasible move.

c) the necessary and sufficient steps for agricultural reform would have been:

1. substantial *systemic change* (privatisation) in the rest of the economy. This is the only solution for providing *real*

¹¹ Again, the dynamics is correctly described in the National Plan for Agriculture and Rural Development: "generally, it is about a return of initially migrated population, a return which is not due to the increase of rural quality life, but is the consequence of the difficulties encountered by the unemployed persons in the urban areas as a result of the restructuring of the economy". In fact, it was the lack of "restructuring" that had to be blamed.

alternatives of gainful employment for “peasants” and real, non-politic *demand* for agricultural products, supplying the successful agricultural entrepreneurs with the means to expand their businesses (now finally possible by the establishment of a land market).

2. privatisation of the big state farms and marketing channels. As one can see in table no. 6, privatisation of big farms was left to other, more willing people to do it. For cereals, production and storage remained in the hands of the state.

The state farm segment continued to produce with the help of high-interest loans from the banks (and subsidies), and to sell to the urban buyers, accumulating high debts and bankrupting the creditors. No natural relation private suppliers-urban buyers could develop due to these circumstances, and the private segment remained in isolation. The handful of vouchers was to no avail.

d) the legal system had its share in delaying the transformation. Besides the land titles, so slow to come, transactions in land were made more difficult by the high notary and other taxes and by the expensive access to arbitration and enforcement services.

e) Moreover, the irresponsible borrowing policy of state farms, well connected to the banking and state elites, backed by explicit or implicit state guarantees, left little credit for the small landowners, who were also crippled by the lack of property titles.

3. The European Challenge

We pause here with the independent accounting of agricultural evolution in Romania because, toward the end of the

decade, a powerful factor appeared in the picture, a factor of change: European integration.

Romania submitted its application for membership to the EU in 1995. In 1999 Romania was given the status of a candidate country and began accession negotiations in 2000.

Romania is now, in 2004, knocking at EU's doors. Perhaps agriculture is one of the main puzzles to be solved before celebrating accession. The agricultural dossier is arguably the most difficult among the eight left.

With all the intricate details of the Common Agricultural Policy, we should not lose sight of the fundamental issues in Romanian agriculture: fostering market relations in the rural area and, paradoxically, as we have argued before, reforming the rest of the economy (above all the industrial sector) as a necessary condition for agricultural reform. After all, our concern here is agriculture and rural development *in Romania*, the European requirements being a “context”.

Before reviewing our efforts to negotiate and implement the CAP, assessing the impact of the European agricultural policy on our rural life and concluding, a short description of the working of the CAP would be useful.

3.1 The CAP in brief: what is it about?

This is not a standard, book approach, but an attempt to look to European agriculture from the point of view of its capacity to move things forward, in the right direction in Romania.

Here are some general data about European agriculture:

European Union (EU -15) – General data
(1999)

Population 374.6 mill.
Area: 3.191.000 km²
Rural population: 17.5%
Population employed in agriculture: 5%
GDP/capita: 18.075 \$
Utilized agricultural area (Arable land):
40.6%
Agriculture's share in GDP 2% (2000)

A fundamental insight into the nature of CAP is provided by the above box: EU is 1) a rich entity; 2) with a small population employed in agriculture; and 3) an agricultural sector insignificant as a relative contribution to the overall wealth. All these features are dissimilar compared to Romanian realities.

And indeed, European countries did not refrain from supporting agriculture. The essence of the CAP consists in huge transfers from the relatively free, private, efficient sector of the economy to the tiny agricultural sector. The concrete form of support varied over time and the CAP is in a process of transformation even now.

Leaving aside irrelevant details, the scheme comprises, in a nutshell, the following elements:

- a minimum price, called *intervention price*, set yearly by the Council of Agricultural Ministers for all the main foods. All the problems faced by the CAP flow from this political decision: the prices set were too high (often a third higher than international prices). As the EU authorities committed themselves to buy up any produce offered by food traders and processors, it is obvious that this

intervention price became *the market price*. The arrangement was not sustainable without a series of expensive accompanying measures:

- intervention stores, where the "surplus" bought flowed (processed foodstuffs, not raw commodities). Intervention prices being too high, production skyrocketed and the stocks grew larger and larger, with storage costs also higher and higher¹².

Table no. 8: *The bill for market intervention operations (billion \$)*

1972	1978	1986	1994
3.5	17	22.4	45

Source: Brian Gardner, *European Agriculture*, p. 66

Agricultural expenditure regularly consumed two-thirds of the EU budget and stabilised lately at about half the budget; in nominal terms the increases were significant (see the above table), but other budget items grew rapidly, especially regional development funds.

- export subsidies. Pretty modest at the beginning, the export subsidies grew over time (see the footnote for an illustration on butter), in the desire to hide the effects of intervention, captured by such expressions as "mount butter" and "lake wine". In 1990, the Community spent 19.6 billion for export subsidies.

- a highly protectionist trade policy. Free trade in agricultural products would have allowed European consumers to buy from outside producers, making unbearable the cost of the CAP. To avoid that, a minimum import tariff was imposed, a

¹² In 1986, only for butter, buying up and storage of surplus cost the Union taxpayer more than 2 billion dollars. The Council of Ministers spent an additional 4.5 bln \$ to dump 1.3 million tonnes of butter on the international market. A tenth of the stockpile so badly deteriorated that it was inedible even by animals. The high cost of these price-setting-and-support policies explains why un-developed countries did not adopt such unnatural schemes and why such proposals advanced at the international level by the latter group of countries went unheeded. One CAP was enough.

threshold price, higher than the EU internal market price. A *variable levy*¹³, equal to the difference between the threshold and the world price, effectively isolated the European market from the rest of the world.

This agricultural regime of subsidies entailed of course a number of *consequences*:

a) huge costs for the taxpayers and consumers;

b) degradation of the environment, the outcome of intensive agriculture, and products with a high concentration of chemical elements (due to the heavy use of pesticides, fertilisers etc.);

c) conflicts within the EU. After long and hot debates, Great Britain obtained a rebate, due to its disproportionate contribution to the EU budget.

d) conflicts outside the EU. European subsidies really destabilised world markets, becoming a source of intense conflict with the USA and other exporting countries (the Cairns Group).

e) the export subsidy policy developed into a foreign aid doctrine, a powerful force in creating dependence in the developing world and preventing the reconstruction of a viable agricultural sector there by means of free or low cost European products.

f) extensive fraud and corruption.

g) the CAP benefited large farmers rather than small landowners. 80% of EU support goes to the largest 20% of the farms.

The CAP is usually presented in a principles-and-objectives framework. It is easy to recast our presentation in such a form. The principles of the CAP are: 1) a free internal agricultural market; 2) community preference; and 3) financial solidarity. The second is but an expression of the highly protectionist policy, while the third catches

the common financing of agricultural expenses (EAGGF).

The objectives feature such goals as: 1) to increase agricultural productivity; 2) to ensure a fair standard of living for the agricultural community; 3) to stabilise markets; 4) to assure availability of supply; and 5) to ensure reasonable prices to consumers. The high intervention prices provided tremendous financial incentives for farmers to increase productivity. They succeeded in this task (it was a private sector), by investing resources in research & development, making heavy use of fertilisers and pesticides, increasing the number of tractors (and mechanisation services generally), using hybrid seeds and advanced methods of disease control and, nowadays, taking recourse to the revolutionary methods of biotechnology¹⁴.

But the CAP did not succeed in achieving the other goals, especially the foremost goal of raising farmers' incomes (at one time it was mentioned the achievement of a "parity of income with the other sectors"). The 80-20% is revealing in this respect. A signal failure was registered also regarding the 5th objective.

Given this context, a series of reforms has been undertaken during the '80s but especially during the '90s. The 80s added production quotas (too large to be effective), while the '90s tried more but achieved little:

- *the MacSharry reform* (1992) operated a small reduction in support prices, promptly compensated by new direct payments linked to historic yields (coupled with production). Nothing changed, except the fact that farmers now had to apply for a part of their revenue to the government, a step many farmers considered humiliating;

- *Agenda 2000* (agreed in 1999) continued the MacSharry approach of price

¹³ The variable levies were removed as a result of tariffication.

¹⁴ See Brian Gardner, *European Agriculture*, Cambridge University Press, 1999, for a description of these productivity-enhancing

cuts compensated by direct payments.

The pressure put on the CAP by the environmental and consumer protection groups and the need to reform in the expectation of another WTO negotiation round resulted in a series of transformations meant to dress CAP in new clothes:

- environmental standards have been added;
- a new, "second pillar" (Rural Development), expanded the traditional, "subsidies for production approach", designed to recognise the environmental, social, and cultural aspects of farming. Pillar II support is decoupled from production, being more in line with WTO requirements. 10-15% of total agricultural support falls into this category.

- the agricultural budget ceased to be open-ended (ex-ante ceilings were added).

Because of its productivity-enhancing potential, genetically modified organisms and biotechnology have received a rather unpleasant treatment in Europe until now. The latest evolutions tend to show a more tolerant EU in this area.

- the reforms agreed in June 2003 in view of enlargement.

Direct payments will start at 25% of the present level (EU-15) in 2004, and will reach 30% in 2005 and 35% in 2006. Starting in 2007, the percentage increase will be 10% per year, the parity with the support for the EU farmers being achieved in 2013.

The new member states have the possibility to top-up EU direct payments with national subsidies, but within strictly defined limits (first option: 55% of EU level in 2004, 60% in 2005, 65% in 2006 and no more than 30% of the phasing-in level in the relevant year after 2006; second option: the old national support increased by 10%). The payments should not be higher than 100% of EU-15 level of direct payments.

As for rural development schemes, special additional financial aid will be granted and some exceptional measures created (a higher proportion of EU co-financing, support for semi-subsistence farms etc.).

All these (quotas, set-aside measures, budget ceilings, animal welfare, environmental standards, rural development, decoupling, direct payments, export subsidies etc.) made the CAP perhaps the most incomprehensible among all EU policies. And the most difficult among all accession negotiations dossiers.

3.2 Negotiations

The level of support for European farmers did not diminish with the adoption of reforms; it even slightly increased in real terms. But, to maintain that level, the EU had to engage in an "exercise in survival", meant to transform agricultural policy so as to satisfy the demands of environmental, social, consumer protection and other powerful lobbies. Bureaucracy expanded as well as the complexity of regulation. Many of these regulations, extremely costly and intricate, benefit the large farms, but, at the same time, they are instrumental in production control. Complying with these sanitary, veterinary, animal welfare, phytosanitary, quality, environmental etc. standards, in both harmonisation and implementation aspects, is not an easy task.

The standards just mentioned are going to be essential for Romania's capacity not only to conclude negotiations in this field (and for all chapters), but also for our ability to absorb European funds and to export on the European market. A non-compliance in this field would leave Romanian farms in isolation.

The ability to absorb rural development funds depends mainly on two elements: the availability of domestic (public or private) funds and the capacity to elaborate complex projects, in line with the European requirements in this area. These bureaucratic conditions will not be within our reach without major changes in Romanian agriculture and economy.

The agricultural chapter deals in a systematic way with the European *acquis* in the field. We will sketch the main points, highlighting the European Commission's opinion on the progress Romania made in adopting and implementing the *acquis*, opinion expressed in its last (2003) Regular Report:

1. Horizontal issues:

a) implementation of institutional and legislative requirements regarding the EAGGF;

b) statistical issues: Romania launched preparations to establish the *Integrated Administration and Control System (IACS)*, to set up a *Land Parcel Identification System (LPIS)* and to develop the *Farm Accountancy Data Network*;

c) organic farming: establishing certification and inspection services in this area continued;

d) quality policy. The list of protected geographical indications has been adopted.

e) trade mechanisms.

2. Common market organisations.

13 products have been designated as of "national importance" for the 2003-6 period. Some progress has been made, but more has to be done in such areas as setting up inter-professional organisations, regular market and price monitoring, implementing regulations regarding quality criteria, developing administrative structures for the management of common market organisations.

3. Rural development and forestry

No significant progress has been reported in agri-environmental measures.

The accreditation of the SAPARD agency in 2002 will improve funding for rural development measures, the priorities being processing and marketing of agricultural products, development and improvement of rural infrastructure and technical assistance. The financing amounts to 350 million euro for 2000 and 2001. SAPARD is a useful national experience in managing funding within a EU framework of rules.

Rural development includes such measures as:

- improvement of processing and marketing for agricultural products;
- improving the structures for quality, veterinary and plant-health control, and consumer protection;
- development and improvement of rural infrastructure;
- management of water resources for agriculture;
- investment in agricultural holdings;
- support for environmentally-friendly methods
- development and diversification of economic activities and developing alternative sources of income¹⁵.

4. Veterinary and phytosanitary measures. Romania's efforts to harmonise legislation with the provisions of the *acquis* is appreciated, but "enforcement is hampered by very limited management and administrative capacity. [...] Romania should focus further efforts on reinforcing the administrative capacity to implement the *acquis*, in particular in the veterinary and phytosanitary fields.". Perhaps this fact explains the declaration of a Romanian official that "in the sanitary-veterinary fields, EU has a "zero toleration policy".

¹⁵ See the *National Agriculture and Rural Development Plan 2000-2006*.

The Commission also noted that state support for agriculture was in need of reform, much more consideration was to be given to rural development and that privatisation should be continued. The adoption of the *Agriculture and Rural Development Strategy* for accession was commended, as was the progress in land restitution.

The authorities hope to conclude the chapter by June this year¹⁶.

3.3 *The financial package for agriculture granted to Romania*

The financial assistance granted to Romanian agriculture was "generous", as Enlargement Commissioner, Guenther Verheugen, said. It went even beyond the Ministry's expectations.

The principles agreed in negotiating accession for the 2004-wave countries will also apply for Romania.

For the first pillar, the aid is distributed as follows:

- Romania will receive in direct payments an amount of 881 million euro (over three years: 2007-2009);

- for market measures, the assistance will reach 732 million euro (for the same period).

As regards the second pillar, rural development, the financial envelope is estimated at 2.42 billion euros.

Conclusions and recommendations

It is time now to summarize and to conclude the long journey undertaken by the Romanian agriculture.

The impossibility to sustain an extensive division of labour in the industrial sector by socialist or highly interventionist

policies transformed agriculture into a buffer zone, an area of survival for the peasants and for the industrial workers laid off in the urban area.

A public policy designed to benefit the large, state-owned, big farms, cut the natural link (never in existence even before) between the urban population and the private agricultural sector. The state-owned farms maintained their status as main suppliers for urban markets, displacing the small landowners in this capacity, with the generous support of the state. Serious macroeconomic consequences followed (threat of banking bankruptcies, budgetary problems, inflation).

The private entrepreneurs were further hampered by the impossibility to engage in land transactions to expand their operations (until 1998) and their leasing contracts were not protected by the legal system.

Romania struggles even now with the heritage of these unfortunate policies: a fragmented, subsistence, backward agriculture, unable to meet the challenges of EU integration.

Recommendations:

1. engage in serious reforms in the rest of the economy.

It sounds paradoxical to recommend reform in the rest of the economy as the main policy solution for *agriculture*. It is nonetheless our conviction that only by freeing the rest of the economy will the necessary conditions for agricultural reform be created.

In the first half of the 1990s, populist, unsustainable policies resulted in a migratory flow from rural to urban. This is a warning not to repeat those inflationist-interventionist policies. After 1994, the

¹⁶ *Successfully concluded in June, as promised.*

bankruptcy of those policies became obvious and the rural area absorbed the poor, unsuccessful people left in their wake. This “survival surplus” could be absorbed back into towns by well-designed reforms.

The good results for agriculture of the freeing of the rest of the economy could be observed everywhere, but we believe that the EU is the prime example. So free was the rest of the economy in the Western countries that even a heavily interventionist policy in agriculture did not prevent the shrinking of the agricultural sector and agricultural employment in the economy. In France, a model CAP country, the farm population fell by 59% between 1960 and 1990, from 3.43 million to 1.39 people. In the EU-6 countries, the farm population fell by 54% (from 10.4 million to 4.8 million).

This is not an abnormal approach. After all, reform measures, like the economy, form a whole, they are inter-linked. And we must not forget that agriculture is chapter no. 7, one among 30 negotiation chapters. Thirty inter-dependent negotiation chapters. Perhaps EU is also instrumental in bringing about general reform in Romania.

b) at any rate, Romania should pay particular attention to its economic structure and avoid at any cost the pumping of excessive resources in agriculture. As one expert warned, carelessly applying the CAP in Romania would result in “a distortion in resource allocation of planetary proportions”¹⁷. Because of the low level of incomes in the rest of the economy, instead of reforming agriculture, “simple pumping” would provide financial incentives capable to further distort our economic system by attracting masses of people to agriculture and creating an unnatural dependence of large categories in Romania on the European

taxpayer.

This danger is recognised by EU negotiators: „granting Romania and Bulgaria the full scope of direct payments will not give the right incentives to restructure their agriculture.”

c) *the privatisation process should be completed in agriculture.* The process is already in delay, the last deadline being 2002. The Agriculture Ministry seems determined to find a solution to this problem, 110 big farms being even now in state hands. We have argued in the text for the benefits entailed by this measure. We need to add here that an important source of corruption and rent seeking would be removed from the system.

Privatisation of marketing and input services is also instrumental in linking the owners to the market.

d) clarifying the problem of land titles and land privatisation will *speed up privatisation in the other sectors of the economy* as well.

e) *in order to reconnect agriculture to the credit system*, it is first necessary to distribute all legal titles to land and solve the other problems related to ownership-recognition. Having legal titles (to land, to the crops (warehouse receipts etc.)) means having the capacity to offer guarantees, a very important condition for obtaining loans. Removing the big state farms by privatisation is also essential to free substantial amounts of credit.

f) *remove the remaining transaction barriers from the land market.* Buying and selling land is made more difficult by notary fees, land registration costs, stamps etc.¹⁸

g) the simultaneous application of these measures has the potential of radically changing Romanian agriculture. They imply only *legislative effort* and not taxes or other

¹⁷ Dragos Negrescu, “Integrarea in piata unica”, intervention published in *Exigente europene si realitati romanesti*, European Institute of Romania, 2001, p. 24.

¹⁸ See Irina Ramniceanu, *op.cit.*, p. 2

financial expenditures. But changing the law is extremely difficult due to the powerful interests opposing such legislation. It is in this field that political skill is needed.

h) interventionist solutions proposed for reducing land fragmentation are illusory. The long-debated measure of *taxing the owners who do not cultivate their land* is an error. We have already explained how land fragmentation has been created and maintained during transition. Taxing for not cultivating the land is also bad because: a) it is an invasion of property rights, betraying a paternalistic attitude (perhaps it should be supplemented by such measures as imposing fines on the owners of several homes for not inhabiting them, or, better, not allowing the ownership of several homes!); b) any owner choosing not to cultivate his land has limited resources, which he decides to allocate to other, more important alternatives; it is wealth destroying, not a wealth enhancing measure.

i) launching a *decentralization process* would help systemic transformation. Leaving more resources at

the local level, plus as significant as possible a degree of fiscal independence, promotes many important and positive changes: 1) more resources will be managed at the local level, where local needs are better known; 2) fiscal competition will put pressure on the most interventionist municipalities and regions; 3) the *political* process of redistribution, top-down, centrally-run, will be eliminated or reduced in scope.

j) *The heavily subsidised European agricultural sector could become a danger for agricultural reform in Romania.* A revival of agriculture could be exploded, as in other third world countries, by cheap imports from the EU. Of course, we do not advocate tariffs to avoid that outcome. General economic reform, already recommended, is a better alternative. With general reform, the outcome of the distorting CAP would be to make Romania more industrial than normal and the EU more agricultural than normal. The socialist-industrialist camp should be pleased. The best solution would be, of course, reducing/eliminating the support supplied by the CAP.

Appendix: New Zealand: a model

New Zealand provides a powerful illustration of the capacity of freedom to transform an economy and to succeed in agriculture without government interference.

Of a size similar to Romania, New Zealand has been a relatively free and prosperous country. Its problems began in the early 1970s, when the former liberal stance has been abandoned in the vain hope of countering two major external shocks: Britain's entry into the European Community (1973) and the first oil crisis (1974). The United Kingdom represented the most important trading partner of New Zealand, taking 40% of its exports in late '60s and supplying 33% of the imports.

The interventionist reaction (it is a feeling of *déjà vu* for Romania) featured measures such as:

Increasing production grants for industry;

Isolating the internal market by high tariff walls;

Providing significant assistance to agricultural producers (minimum prices, government product payments, fertiliser subsidies, incentives for land development schemes, loans at below market interest rates, high tariffs and restrictive licensing). In 1984, 40% of New Zealand farmers' gross income came from the government.

“think big” policies, intended to diminish the dependence on energy imports.

All these actions did nothing but provide a confirmation of the fact that economic science has nothing to learn from industrial and agricultural interventionism, but people must first suffer and then learn.

The effects of these self-styled “big policies” were big indeed:

New Zealand exports lost their competitiveness in international markets. Unemployment, debt, inflation, and budget deficits increased. Cumulative intervention resulted in a wage and price freeze in 1982;

Subsidies encouraged over-production in agriculture and burdened taxpayers and consumers;

Land prices were driven high, preventing the young people to get into farming;¹⁹

Water and land quality declined, due to the intensive exploitation of unsuitable land, an outcome of the high subsidies;

The international community contemplated retaliatory actions against wildly protectionist New Zealand.

This whole mess was put to rest in 1984. An economic program similar to that outline above, in our “recommendations”, was adopted:

General economic reform: the abolition of foreign exchange controls, deregulation of financial markets, privatisation, removal of subsidies, trade liberalisation, tax reform, deregulation of the labour market, sound monetary policies. Those measures made New Zealand a “top ten” country in the *Index of Economic Freedom*.

Agricultural reform: removal of agricultural subsidies (see table no. 9, removal of price controls and external tariffs).

This “general” approach had another important feature: it was not undermined by government programs intended to “ease” the transformation (practically making impossible any change by removing the financial incentives for factor owners to change the allocation of resources). Only some one-off “exit grants” and temporary entitlements to extremely low income farmers were provided. Moreover, this general approach was universal, rapid, and simultaneous, including the whole economy, a significant factor of consent building.

¹⁹ The case is similar in the EU; that's the reason why such measures as “incentives for young people to establish in the rural area” are now part of the “rural development” package.

The results were spectacular:

We will mention first the environmentally friendly consequences, given the modern obsession with the environment. “Profit management” proved to be more conducive to “green” practices: water quality improved, while the land was more rationally used (submarginal land, unable to sustain agricultural activities has been left to other, non-agricultural activities). The use of fertilisers decreased as subsidies were removed. Subsidy-driven land management problems ended.

Production, productivity, and international competitiveness increased significantly, despite the competition of heavily subsidised countries.

In 1999, 80% of New Zealand’s total farming outputs was exported; agricultural exports accounted for more than 50% of the country’s total merchandise exports.²⁰ Agriculture’s contribution to GDP and employment is rather “large”: 16 % of GDP and one in eight jobs. Again, this illustrates that freely chosen economic structures are best, not governmentally sponsored “knowledge-based” or “industrial” economies.

The dependence on Great Britain ended: its share is now a mere 6% in exports and 5% in imports.

Producer subsidy equivalents per country (2000)

Producer Subsidy Equivalents (PSEs) per country		PSE support per acre	
Country	%	Country	US\$
New Zealand	2	New Zealand	3
Australia	6	Australia	1
Canada	20	Japan	4772
EU	49	Korea	3903
Japan	65	EU	336
United States	24	US	52
OECD Average	40	Canada	21

Source: Tom Lambie, *Farming in a Competitive Food Chain*, Institute of Economic Affairs, London, 2003, p. 2.

²⁰ Exporting agricultural products could be profitable for a country if it is based on comparative advantage. Too often the old and bad policy prescription of “industrialisation” is taken for granted.