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**FUTURE OF THE CAP
IN THE NEW FINANCIAL PERSPECTIVE 2014-2020.
CHALLENGES AND CONSEQUENCES FOR POLAND**

1. Introduction

Since the beginning of the European Communities (EC) the Common Agricultural Policy (CAP) has been one of the most important fields of economic cooperation among Member States, which can be proved, among others, by relatively high share of agricultural expenditures in the EU budget.¹ During the first 50 years of its existence the CAP remained unchanged. The process of the CAP reforms first started in the last 15 years. This policy was criticized because of its high costs, creating tidy food surpluses and the growing concentration of agricultural support in a few beneficiaries, mainly large-area farms. The level of agricultural support of the EU was also strongly criticized on the international arena, especially within the negotiations of the World Trade Organization (WTO). In the conditions of growing economic welfare and the food security it was more and more difficult to find social justification for the strongly protective agricultural policy. The picture of the CAP became even more complicated after 10 new countries joined the EU in 2004 and another 2 in 2007. The impact of the latest EU enlargement on the agricultural sector is enormous. Labour resources increased from 6 million to 13 million people and farm land resources grew from 130 million to 180 million hectares. However, the level of income on the rural areas of the new Member States is lower and the rate of unemployment higher, which creates a new challenge for agricultural policy of the EU.

The CAP requires further reforms and the hot debate on the finished in 2008 review of the CAP “Health Check” proves it. The message and the role of the

¹ The share of agricultural expenditures in the total EU budget amounted even to 70% in the mid-1980s.

“Health Check” is, however, deeper than just few soft changes it introduced. In fact, it is supposed to prepare us for the next crucial CAP reform after 2013, that is in the new financial perspective 2014-2020. Poland, as a full member of the EU, received an opportunity to play an important role in creating the new shape of the CAP and to look after the interests of Polish agriculture. Hence, a public debate about the future of agricultural policy in the EU among Polish scientists, politicians as well as entrepreneurs is desirable and that is also the main aim of this paper. In the first part, the short evolution of the CAP and its current state is presented. Then, the authors analyze the consequences of the five-year period of Polish membership in the EU from the perspective of the agricultural sector. In the last part, the authors consider the future shape of the CAP after 2013 and its challenges and consequences for Poland.

2. Evolution of the CAP and its current state

The basic principles of the CAP have been defined already in the Treaty of Rome from 1957. The main aim of the CAP was to stimulate agricultural production growth in order to improve food self-sufficiency in Europe destroyed by the war. The increase of the productivity in agriculture was supported by the technological progress and optimum use of production factors, in particular labour. Since the beginning, the CAP was based on policy measures such as intervention prices, import tariffs, export subsidies and import levies, which enabled producers of agricultural products to receive relatively high prices on domestic market and simultaneously to sell on foreign markets [Kowalski 2004]. At the same time the CAP caused some negative phenomenon like troublesome food surpluses (especially on the grain and milk markets) and high cost of intervention (between 1960 and 1968 expenditures on market support grew four times). Besides, this policy was not helping in solving structural problems of the European agriculture. The first reform of the CAP from 1969 (so called Mansholt Plan) reduced the scale and level of market support in favour of structural measures aimed at decreasing the number of farmers, farm consolidation and reduction of cultivated land. Although not all of the Mansholt Plan assumptions were fully implemented, they started the process of structural changes in the European agricultural sector.

The first changes of the CAP mechanism did not solve the problem of food surpluses and agricultural income was still much lower than in other sectors. Agricultural policy of the EU required further reforms. In 1992, the EU implemented so called Mac Sharry Reform aimed at reducing agricultural production, improving internal and external competitiveness of agriculture and preserving natural environment and traditional landscape. These aims were

achieved by the reduction of price support measures and the introduction of direct payments [Błaszczyk 2001] and other measures such as obligatory land set-aside, forestation, early retirements and environmental regulations supporting more extensive methods of production. Mac Sharry Reform fostered also diversification of the economic activity on the rural areas and creation of work places outside agriculture, that is alternative sources of income for rural population. As a result of this reform the consumption and incomes of the farm households increased and the level of production and stocks decreased. Simultaneously, it helped also to reach the compromise between the USA and EU during the GATT agricultural negotiations and to sign the Uruguay Round Agreement on Agriculture.

Next crucial changes of the CAP were implemented during so called Agenda 2000. Its priority was to improve market orientation, efficiency and competitiveness of agricultural sector in Europe, as well as to support structural and ecological development of rural areas. It was an attempt to create the European Model of Agriculture, which might be described as more competitive, environmentally friendly, producing high-quality goods, creating new work places and more socially legitimized. Implemented solutions outlined the direction for further reforms of agricultural policy in the EU. During the 2003 meeting in Luxemburg a new shape of the CAP for the years 2007-2013 was defined (so called Fischler's Reform) [De Castro, Adinolfi 2004]. The key element of this reform was the extension of the support for the development of rural areas (second pillar of the CAP) and also the introduction of cross-compliance² rules for all beneficiaries of direct payments. What is important, this reform did not change the level of agricultural support, but only its structure and measures.

During the 50 years of the CAP evolution, and especially during the last 15 years, one might have observed that the mechanism of agricultural support in the EU has been changing from supporting market prices to direct support of agricultural income. The current form of agricultural policy in the EU allows farmers to produce these goods which are desired on the market and it takes account of consumers and taxpayers interests [Dybowski et al. 2005]. The new CAP is also less trade distorting, which is essential in the light of the WTO negotiations. The priorities of the European agricultural policy have also changed. Food self-sufficiency, though still important, is not the main aim of the CAP anymore. European agricultural policy is now concentrated more on rural development considering economic, social and environmental role of agriculture.

² Cross-compliance rules concern environment protection, animal welfare, food safety and they are compatible with the assumption of the new European Model of Agriculture.

3. Consequences of Polish membership in the EU for the agricultural sector

Polish membership in the EU means that agricultural sector and rural areas have received the opportunity to participate in the mechanisms of the CAP and to benefit from the EU financial support. Preparations for the accession required a lot of efforts and adjustments, however, the advantages are significant: much higher financial support for the agricultural sector, gradual increase of farm household incomes and improvement of life quality in rural areas, recovery of investments in agriculture, higher standards of production, better quality of food products and also improvement in agricultural trade balance. Agricultural sector became an object of the intensive scientific research and public debates, which contributed to the increase of social prestige of farmers. The participation of Polish agriculture in the mechanisms of the CAP led to the growth of expenditures for agricultural sector both from the EU and Polish (see Table 1).

Table 1. Budgetary expenditures on agricultural sector in chosen parts of budget in the years 2004-2009 (in PLN millions, %)

Years	2004	2005	2006	2007	2008	2009
Budgetary expenditures on agriculture*	5721.8	7999.5	8379.1	17136.8	26383.64	19380.21
Change (%)	–	39.8	4.7	104.5	53.9	–26.5
EU measures**	5357.2	8528.4	10927.5	11813.99	14927.85	16293.97
Change (%)	–	59.2	28.1	8.1	26.4	9.2
Share of budgetary expenditures on agriculture in total budgetary expenditures	2.89	3.29	3.74	6.67	8.58	6.02

* Budgetary expenditures on agriculture are calculated as a sum of the following budget parts: part 32 – Agriculture, part 33 – Rural Development, part 35 – Rural Markets, part 85 – Regional Budgets, part 83 – Reserves.

** EU measures are calculated as a sum of the EU transfers and expenditures on pre-financing of CAP and Operational Programs.

Source: own elaboration based on the expertise of Polish Budgetary Act Proposals [Czyżewski 2004, 2005, 2006, 2007, 2008, 2009] and the expertise of Polish Budgetary Act Proposals for the years 2004-2009 published by the Senate's Office for Information and Documents, Department of Information and Expertise.

Financial situation of the agricultural sector in Poland changed already before the integration with the EU, that is in the years 2003 and 2004, which was the first sign of upcoming breakthrough in the policy towards agriculture and rural areas. Budgetary expenditures on agricultural sector after the integration with the EU have been rising mainly due to co-financing and pre-financing of the EU programmes and financing of complementary national direct payments. The level

of these measures was systematically growing between 2004 and 2008, however in 2009 it is projected to be lower than in 2008. The share of budgetary expenditures on agriculture in total budgetary expenditures during Polish membership in the EU is also much higher than it was before. In 2009, that is after 5 years of Polish membership in the EU, it is going to be 2.7 times higher than before the integration.

The main sources of financial transfers from the EU to Polish agricultural sector are: direct payments, measures from the Program for Development of Rural Areas (PROW) and measures from the Sectoral Operational Program (SPO) *Restructuring and Modernizing of Food Sector and Development of Rural Areas*. The yearly average values of these transfers in the old and current financial perspective are presented in Table 2.

Table 2. Financial support for agricultural sector in Poland from the CAP measures in 2004-2013, yearly average values (euro billion)

Measures of the CAP	2004-2006	2007-2013
Direct payments	1.8	2.8
PROW + SPO	1.5	2.2
Together	3.2	5.0

Source: own elaboration based on J. Wilkin, *Wpływ reform Wspólnej Polityki Rolnej na przekształcenia w polskim rolnictwie i na obszarach wiejskich*, presentation from the Ministry of Regional Development web site.

Financial support received by Polish farmers has led to an essential improvement of the agricultural income and the reduction of disparity between average agricultural income and average income in national economy (see Table 3). One can notice, however, that the economic situation of Polish agriculture is becoming more and more dependent on the EU financial support. What is more, the improvement of incomes did not evoke desired structural changes in Polish agriculture. The number of people working in agriculture holds steady around 2.3 million. Although the number of farms slightly declined (from 1.95 million in 2002 to 1.80 million in 2007) and the average size of farm increased (from 8.4 ha in 2002 to 8.8 ha in 2007), these values are still worse than in other EU Member States, which obstructs Polish agriculture to obtain the economies of scale [*Charakterystyka gospodarstw...* 2007, 2008; *Systematyka i charakterystyka...* 2003].

On the other hand, Polish integration with the EU has had a positive impact on the agricultural trade balance. The first years of membership proved that Polish food products hold comparative advantages at the common market. Between 2004 and 2006 value of agricultural export doubled and amounted to 8.5 billion euro and because import growth was much slower, the total balance of agricultural trade reached plus 2.1 billion euro. What is worth noticing, the growth of export with agricultural product was the strongest in trade with other new Member States [*Polski handel ...* 2007].

Table 3. Significance of payments from the EU budget in the agricultural incomes in Poland in 2003-2008

Years	2003	2004	2005	2006	2007	2008
Agricultural income (PLN/AWU*)	4259	10290	8252	9984	12690	10609
EU payments per AWU (PLN)	402	4009	3882	5198	5352	4772
Ratio of average agricultural income and average income in national economy (in %)	24.2	56.2	43.3	50.3	58.8	45.5
Share of payments in agricultural income (in %)	9.4	39.0	47.0	52.1	42.2	45.0

* AWU (Annual Working Unit) – number of wage- and salary-earners employed full-time for the whole year.

Source: own elaboration based on L. Goraj, *Wpływ Wspólnej Polityki Rolnej na dochody polskich gospodarstw rolnych*, Ministry of Agriculture and Rural Development web site.

Summing up, although one has observed many positive changes after the integration with the EU, the economic situation of Polish agricultural sector is still worse than in old Member States. Polish agriculture reached significant progress, however, it is still low productive because of structural and technological problems. It means that the continuation of the CAP mechanisms has a significant meaning for the Polish agricultural sector and from its point of view the maintaining of financial support is crucial to continue structural changes and development.

4. Future shape of the CAP from the point of view of Polish agriculture interests

Future reforms of the CAP are going to be formed in the conditions of the new WTO requirements, environmental challenges and a pressure of some Member States to reduce the EU budget on agriculture. Hence, the next financial perspective 2014-2020 is going to face completely different internal (12 new Member States) and external (growing competition on the world market) conditions. Poland, as one of the biggest EU members, should actively join the public and political debate, which will decide about the future changes in the CAP. It requires a critical attitude to the current EU agricultural policy, defining clear priorities for Poland and being ready to reach compromise. The first decisions about the future of CAP shape were already made during the 2008 mid-term review of the CAP called “Health Check.” Most of them continue the reforms started in 2003 and further reduce market intervention, almost totally cut relations between direct payments and current production and increase financial support for the rural areas development. It is worth noticing that the established agreement was a compromise between a proposal formulated by the new Member States and proposals from the European Commission, which although should act on behalf of the whole European Union, is strongly influenced by the old Member States [Czyżewski, Stępień 2009].

One of the key issues of the future CAP debate is an idea of agricultural policy renationalization. In 2005 the discussion about the EU budget for 2007-2013 revealed the intentions of some countries (in particular Great Britain) to introduce limits on the level of the CAP measures allocation. Such a scenario would have led to the reduction of the total support for agriculture. New Member States would have lost an ability to compete with countries rich enough to finance agricultural payments from the national budget. This proposal was unacceptable for countries like Poland not only because of being a net beneficiary of the CAP, but also because of the possibility that different support level in different regions of Europe would have distorted competition conditions on the common market. Hence, the common character of the EU agricultural policy was and should be maintained and its further financing from the EU budget is desirable [Czyżewski, Stępień 2008]. What is more, food producers in the EU have to respect one of the world's most restrictive rules concerning environmental protection, animal welfare, bio-diversity and rural areas conditions, which means that production costs are much higher than outside Europe. Payments for producers are then necessary to secure both high agricultural income and high quality and environmental standards expected by consumers. The final compromise reached in "Health Check" maintains the common financing of the CAP, but it changes the rules of modulation³ (the lower rate of modulation growth and the introduction of progression⁴) in the direction postulated by rich EU members and withdraws the cohesion criteria for dividing measures from modulation.

Another crucial issue to be discussed is the shape of the direct payments system. Some of the new Member States demand that the level of direct payment per hectare should be equal in each EU country. Leaving historical bindings of direct payments level behind should lead to the transfer of measures from old to new Member States. The current mixed system of direct payments in the EU⁵ causes essential differences in the level of payments, which distort competition among countries. The potential of value added growth by increasing direct payments is much higher in new than in the old Member States, where such possibilities are limited. Additionally, direct payments in the old Member States support income

³ Modulation mechanism means an obligatory transfer of funds from direct payments and market support (CAP first pillar) towards rural development measures (CAP second pillar). It concerns only farmers who receive payments over a certain level. For example in 2005 direct payments for the farmers who received more than 5 thousand euro were reduced by 3%, in 2006 by 4% and in 2007 by 5%.

⁴ In the first proposal of EC modulation in 2012 was supposed to reach the level from 13% (for farmers receiving between 5 and 100 thousand euro yearly) to 22% (for farmers receiving more than 300 thousand euro). Finally, the modulation will oscillate between 10% (for farmers receiving between 5 and 300 thousand euro yearly) and 14% (for farmers receiving more than 300 thousand euro) [IEEP CAP... 2008].

⁵ Old Member Countries use the SPS system (in which some of the countries use regional model, some use historical model and most of them use hybrid model) and new Member Countries use the SAPS system.

but do not motivate producers to increase the efficiency of production. That is why the results⁶ of “Health Check,” which aim to align direct payments after 2013 by withdrawing regional model, seem to be reasonable [Rezultaty przeglądu... 2008]. At the same time, in the new SPS model, payment per arable unit is going to be related with the fulfilment of cross compliance criteria.⁷

In order to simplify the system of direct payments, these measures are getting more and more independent from the current level and structure of production [CAP Health ... 2008], which is called *decoupling*. Although *decoupling* has already been introduced during the reforms in 2003, there still existed a possibility to relate a part of the support with the current level of production.⁸ Such a solution stimulated farmers to produce these goods which had been receiving the highest financial support and which in the past were the reason of high food surpluses on chosen markets [Czyżewski, Poczta-Wajda 2009]. That is why total *decoupling* seems reasonable. It will lower the pressure to rise the production and will allow farmers to follow market signals. Hence, further *decoupling* is crucial for improving economic efficiency both on domestic and international market, especially during the WTO negotiations [Analysis of the Health... 2008].

It also seems to be a natural direction for the future CAP reforms to concentrate the financial support on the rural areas development (second CAP pillar) through already discussed modulation mechanism. Changing the structure of financial support from supporting incomes to supporting rural development is more acceptable for taxpayers, who finance the CAP and who criticize the current state of the EU agricultural policy. Agriculture might be seen as a public good which supplies landscape, cultural values and support bio-diversity. In order to receive these “services” from agriculture, farmers must be paid, otherwise they will resign and engage only in food production, because this activity will be more profitable. Moving the part of the funds from the first pillar to the second pillar is reasonable also because agricultural incomes are less and less dependent on the level of production and more related with the activities outside the sector but still occurring on the rural areas. The structure of employment in Polish agriculture needs to change. Hence, supporting non-agricultural activities and economic, social and environmental condition of rural areas is crucial [Matuszczak 2007].

A debate on the future CAP shape will also concentrate on the reduction or total withdrawal of market intervention, for example through the withdrawal of milk quotas and land set-aside. Resigning from the market intervention meets

⁶ New Member Countries can continue to use SPS system up to 2013.

⁷ Cross compliance criteria require from a producer to maintain agricultural land in good agricultural and environmental condition and to fulfil requirements regarding public, animal and plant health.

⁸ For example for crops and oilseeds it was 25%, for durum wheat 40%, for calves and suckler cows 100% of production [WPR – Nowoczesna... 2007].

expectation of both European consumers and international environment, in particular the WTO. However, a certain level of price intervention should remain as it might be used as a safety net in case of worse situation on agricultural markets. This solution seems to be favourable, because the total withdrawal of market support measures would be irreversible and might raise the risk of income fall. Gradual withdrawal of market intervention should take an account of keeping competitive position of European agriculture and reduction of market price support must be replaced by budgetary measures and adjustment actions.

5. Conclusions

The Common Agricultural Policy of the European Union during 50 years of its existence has significantly evolved. Until 1980s it was based mainly on supporting market prices by use of tariffs, export subsidies and direct market intervention. In conditions of low food self-sufficiency it was effectively protecting the internal market and supporting agricultural incomes. However, due to the technological progress, the productivity of European agriculture was rising, which after some time led to high food surpluses. At the same time the costs of budgetary expenditures on agriculture were dramatically rising, which became the main problem of the CAP and an incentive to the CAP reforms. Since that time the CAP has concentrated more on the improvement of the European agriculture competitiveness on the world markets and maintaining an adequate level of agricultural incomes. Following CAP reforms were an answer to the changing external condition (WTO negotiations) and internal criticism from the consumers and taxpayers. As a result, agricultural policy has started to support not only productive but also non-productive functions of agriculture. Current CAP heads to the idea of multifunctional and sustainable agriculture, which reflects economic, social and environmental criteria.

As of yet, the reforms of the CAP seem to have been coherent with the challenges facing Polish agriculture and they favoured Polish competitive potential. It can be seen in the gradual increase of agricultural production profitability, the improvement of life quality on rural areas, positive changes in area structure, growth of investments in agricultural sector and positive agricultural trade balance. The results of the future CAP reform might have essential consequences for the Polish agricultural sector. Although certain consensus has been reached during latest CAP review "Health Check," the debate continues and its final result is still unknown. As far as Polish agricultural sector is concerned, following priorities of the future CAP reform seem to be crucial:

- current level of financial support should be maintained, however, with regard to the criteria concerning animal welfare, environmental protection and food safety,
- changes in the structure of financial support should be continued. The reduction of market support in favour of direct income support and further decoupling seems to be reasonable. At the same time, one should aim to the equalization of

- direct payment level in all EU countries which would transfer a part of the funds to the new Member States,
- increase of financial support for the development of rural areas (through modulation mechanism) is going to lead to positive structural changes in Polish agricultural sector,
 - maintaining certain level of market price support might be used as a safety net in case of temporary worse situation in agriculture. Total withdrawal of market support mechanism would be irreversible and might lead to unjustified decline of incomes in agricultural sector.

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