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# THE IMPACT OF CAP REFORM ON ROMANIAN AGRICULTURE

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Rete di informazione  
della Commissione Europea

Paper prepared for the 109<sup>th</sup> EAAE Seminar " THE CAP AFTER THE FISCHLER REFORM: NATIONAL IMPLEMENTATIONS, IMPACT ASSESSMENT AND THE AGENDA FOR FUTURE REFORMS".

Viterbo, Italy, November 20-21<sup>st</sup>, 2008.

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**Abstract**

The paper attempts to evaluate, on the basis of two scenarios (moderate and radical), the effects of CAP reforming compared to the situation of current CAP scenario and its effects upon welfare. Direct payments for the large farms, some of them operating on thousands of hectares, cannot contribute to the objective of supporting farmers' incomes. 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.

**Keywords:** CAP reform, welfare effects, direct payments, rural development

**JEL classification:** Q10, Q18

## **Introduction**

The economic importance of the agricultural sector decreased in the last years in Romania. 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%. 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. 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.

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.

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. 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.

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.

## **Romania as EU member and CAP reform**

The themes of the internal debate on agricultural policies and those of the European and the international debate overlap only to a small extent. At internal level, in the last years (2005-2007) the focus was directed towards: -the absorption of pre-accession funds; -the adoption of the *acquis communautaire* and getting the institutions ready for the operation of the European funds; -the absorption of the post-accession funds for agriculture and rural development; -methods of national support -

alternatives for /or complementary to the support from European sources. 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.

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 "Current CAP" scenario 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.

### **Markets and prices**

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. Starting from the specific situation of the 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.

Prices used in different scenarios were for the period 2004-2005: for the "Current CAP" scenario, the average EU prices or the prices from the great producer countries were used (while implicitly assuming that the level of prices will be

equalized at EU level); -in the “Radical reformed CAP” case, the prices were those on the world market (or of some of the most competitive producers); -and for the “Moderate reformed CAP” scenario some derived prices were used, at half distance between the CAP prices and the world prices (i.e. maintaining the protection at half of its level from the period 2004-2005 was considered).

As expected, the change in producer welfare for the 6 selected products (Table 1) 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 in the case of the 6 products is higher than the producers’ loss, which result in a net positive effect (at the level of the whole economy).

**Table 1: Welfare effect of CAP reform in Romania (2015) - change from current CAP (mil. RON)-**

Commodity	Radically reformed CAP			Moderately reformed CAP		
	Producer Surplus	Consumer Surplus	Net Welfare Effect	Producer Surplus	Consumer Surplus	Net Welfare Effect
Wheat	-304	218	-86	-154	109	-45
Maize	-1072	1023	-49	-787	719	-68
Potatoes	-268	479	211	-223	381	158
Beef	-977	270	-707	-636	109	-527
Pig meat	-242	864	622	-152	644	492
Poultry	-102	456	354	-54	300	246

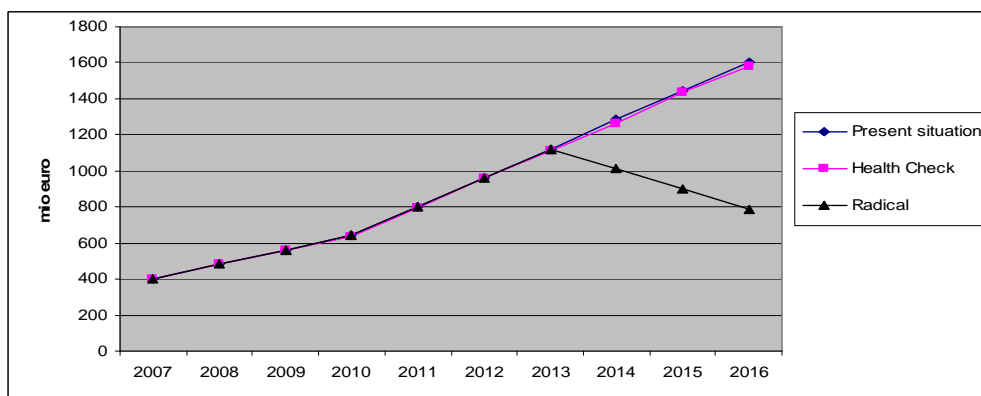
The results of this exercise are valid in the conditions mentioned in the hypotheses, being part of the expectations related to the world agricultural trade liberalization. However, the results do not represent a forecast given that the recent increases of world grain prices and the trend of increasing prices for other agricultural products seem to change completely the reference framework of assessing EU’s agricultural protectionism.

### **Direct payments**

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: - Current CAP scenario present 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; -Moderate reform scenario assumes that starting with 2014, the level of direct payments will be reduced according to the initial 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; -Radical reform scenario 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 1.

**Graph 1: Evolution of direct payments funded from EU funds**



The reduction of direct payments per hectare, according to the initial proposal in Health Check (Moderate reform scenario), would have minor effects. Radical reform scenario, 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 Radical reform scenario, 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.

## **Rural development**

Under the conditions of a large-scale (semi-) subsistence agriculture, the general development of rural areas cannot be promoted without ample investment programs, both at farm level (large-sized, small-sized and medium-sized in particular) and at the (public or even private) infrastructure level. From this perspective, strengthening Pillar 2 of CAP, through the allocation of additional financial resources, is the only solution for Romania to reduce the gaps compared to the EU-15. The concerns that a generous allocation of financial support to Pillar 2 might lead to an incomplete absorption of this support reveals a short-term outlook. Also it could signify a lack of courage to simplify the bureaucratic mechanisms in providing the support. For the present stage in the development of Romanian agriculture, it is obvious that a good implementation of the transitory measures is essential. The

equilibrium between the Axes is important for the orientation of rural players on the medium and long term.

Romanian decision makers could support a radical reform of CAP which would mean a gradual transfer of funds to Pillar 2 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.

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 2.

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