THE IMPACTS OF DIRECT PAYMENTS ON ROMANIAN FARM INCOME: WHO BENEFITS FROM THE CAP?

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Abstract

Using the most recent available data, this paper assesses who is likely to benefit, in the short-term, from the implementation of the CAP in Romania. Particularly, it focuses on the distributional impacts of the new form of agricultural subsidies under the CAP, i.e. SAPS and CNDP, identifying the main gainers and losers. Preliminary results reveal a highly uneven distribution of subsidies across farms, with the very large-scale ones, particularly those specialised in so-called "energy" crops, benefiting most from the flat rate direct aid. As a result, the existing gap between Romanian low-income and high-income farms will become larger, with those most vulnerable hardly benefiting from the introduction of (national and EU) direct payments.

Keywords: CAP, Single Area Payment Scheme, farm structure, Romania

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Introduction

Against a background of fairly solid economic growth, averaging 5 per cent per year since the beginning of the decade, the share of agriculture in Romania's GDP is declining slightly. Nonetheless, it continues to be the largest in the enlarged EU, at around 12 per cent between 2004 and 2006. Moreover, almost a third of the total labour force is still employed in this sector. Structural reforms within the general economy (inter and intra-sectoral) are an anticipated result of integration into the Single Market, strengthened by the removal of trade barriers, freed labour and significant capital injections. Although more difficult, the same is expected to apply in the case of agriculture, where adoption of the Common Agricultural Policy (CAP) should enhance competition and force local producers to adapt themselves to new efficiency standards, fostering the sector's 'catching-up'. Like most of the new EU member states, Romania opted to implement the Single Area Payment Scheme (SAPS), a simplified version of the Single Payment Scheme, the centrepiece of the CAP, introduced by the 2003 reform. In Romania, SAPS will be applied for the first three years (following accession), with the possibility of a two-year extension. Additionally, given the opportunity to compensate for the gradual implementation of direct payments, so-called "top-ups" or Complementary National Direct Payments (CNDP) from the national budget are also applied. There is little doubt that the implementation of the CAP, in its current form, will have significant impacts on Romanian farm income, and implicitly on the Romanian rural economy as a whole.

Based on the most recent available data, this paper estimates who is it likely to benefit, in the short-term, from the implementation of the CAP in Romania. Particularly, it focuses on the distributional impacts of the new form of agricultural subsidies under the CAP, i.e. SAPS and CNDP, identifying the main gainers and losers. The paper is organised as follows. Section 2 focuses on the current Romanian farm structure, followed in Section 3 by a short description of the key agricultural support measures after Romania opened the official negotiations for EU accession in May 2000. Section 4 describes briefly the introduction of the SAPS and the CNDP, estimating some short-term effects on farm income as a result of the implementation of these direct payments. Section 5 discusses the results and possible implications.

Romanian Farm Structure: Subsistence versus Commercial Farms

Transition to a market economy brought fundamental changes within the Romanian farm structure, and following the adoption of various laws regarding land property and agricultural business a very different farm structure has emerged. Currently, the Romanian agricultural sector is characterised by a strongly polarised farm structure and a severe land fragmentation, with a few very large holdings and a large number of very small farms. Out of a total of 4.12 million agricultural farms covering an agricultural area of about 14 million ha, 99.6 per cent are farms with an average size of just 2.2 hectares (Institutul National de Statistica, 2007). Base on the existing legal framework two major types of farms can be distinguished: (i) legal entities and (ii) traditional entities in the form of small individual farm households. Legal entities comprise a variety of farm types: private commercial companies (PCCs), agricultural associations (SAs) state farms (SFs), public domain units (PUs), cooperative units (CoUs) and other units. Although they account for less than 0.5 per cent of the total number of Romanian farms, legal entities cover over a third (35 per cent) of total utilised agricultural area (UAA) with an average a size of 270 hectares. Private commercial companies and agricultural associations and public domain units are the most important both in number and utilised area, and their average size varies between 400 hectares for a PCC and 1,500 hectares for a PU (Table 1).

Table 1 - Farm Structure by Ownership Status, Romania, 2005

	Number	**Farms which use agricultural land**	**UAA (ha)**	**Average size (ha/farm)**
Total farms of which:	4,256,152	4,121,247	13,906,701	3.4
1. Individual farms	4,237,889	4,103,404	9,102,018	2.2
2. Legal entities:	18,263	17,843	4,804,683	269.3
- SAs	1,630	1,614	742,065	459.8
- PCCs	4,574	4,325	1,720,792	397.9
- SFs	250	238	59,996	252.1
- Pus	4,818	4,750	2,124,737	1,447.3
- CoUs	108	89	3,246	36.5
- Others	6,883	6,827	153,847	22.5

Source: Ministry of Agriculture and Rural Development, 2008

The difficult experience of collective farming during the communist regime, followed by harsh economic conditions since transition to a market economy, made individual farms the most preferable type of farming in Romania. Undoubtedly, the small individual farms (and family associations) dominate Romanian agriculture both in terms of number (99.6 per cent) and agricultural output (over 82 per cent). The evolution of their number is highly correlated with the development of the legal and institutional framework regarding land restitution and land transactions (Firici, 2003). Hence, their number increased by almost a quarter from 3.4 million in 1993 to 4.2 million in 2005.

Most of the individual farms focus their crop production on maize and wheat (used both for human consumption and animal feed), potatoes and fodder crops, but less on industrial crops, such as soya been, rape seed and sunflower. They also produce an important quantity of fruits and vegetables and rear the majority of Romanian livestock. Typically, a small individual farm has at least one animal (e.g. pig or cow) and a number of fowl and sheep. Cow milk is an extremely important product for these farms, which supply more than 95 per cent of the total quantity. However, almost two thirds of total cow milk production is used for home-consumption (human and animal). The majority of these small farms rely mainly on unpaid (close family, relatives and friends) labour and they are poorly equipped with machinery. The main characteristic of this type of farm is subsistence and its disconnection from business, with very little produced to be sold on the markets.

The importance of the traditional individual entities is reinforced in Table 2. Mixed farms (crop and livestock) predominate within the individual households (& family associations), whereas legal entities are more crop-oriented (84 per cent of total number of legal entities). Indeed, most of the Romanian industrial crop output is provided by legal entities, particularly the large-scale SAs and PCCs (e.g. 83 per cent of total quantity of rapeseed and soybean and over half of sunflower production and sugar beet). Moreover, these two groups taken together supply some 45 per of total wheat production and around 70 per cent of total quantity of poultry. Given their average size and production pattern it is clear that the majority of legal entities are commercially oriented.

The distribution of Romanian agricultural holdings (after UAA) by farm size also yields some interesting information (Table 3). Almost half (45 per cent) of the total number of Romanian farms are very small individual farms with less than 1 hectare and covering 5 per cent of total UAA. In contrast, farms with over 100 hectares account only for 0.2 per cent of total number but control 38 per cent of the UAA. Unsurprisingly, most of the UAA (90 per cent) in this class category is managed by legal entities, mainly SAs and PCCs, which either own and/or lease land. The remaining 10 per cent are distributed across individual farms, most probably family associations.

Table 2 - Romanian Farms by Ownership and Enterprise, 2005

Type of farms	Crop farms	Mixed farms (crop & livestock)	Livestock farms	Total
Total farms	802,918	3,318,329	134,905	4,256,152
Individual households (& Family associations)	787,607	3,315,797	134,485	4,237,889
Legal entities:	15,311	2,532	420	18,263
- SAs	1,402	212	16	1,630
- PCCs	3,408	917	249	4574
- SFs	200	38	12	250
- PUs	4,161	589	68	4,818
- CoUs	77	12	19	108
- Others	6,063	764	56	6,883

Source: Institutul National de Statistica, Anuarul Statistic al Romaniei, 2006

In terms of land tenure, in 2005, some three quarters of the total Romanian farmed area was owned by the agricultural holdings, 14 per cent was leased, while the rest represented long-term concessions and other (free charge) arrangements. Overall, nine out of ten of total Romanian farms have less or 5 hectares and produced mainly for their own consumption. Some previous studies highlight that an average a Romanian small individual farm sells only about 20 per cent of its farm production (e.g. OECD, 2000).

Table 3 - Distribution of Farms by UAA Size Classes and Ownership Status, 2005

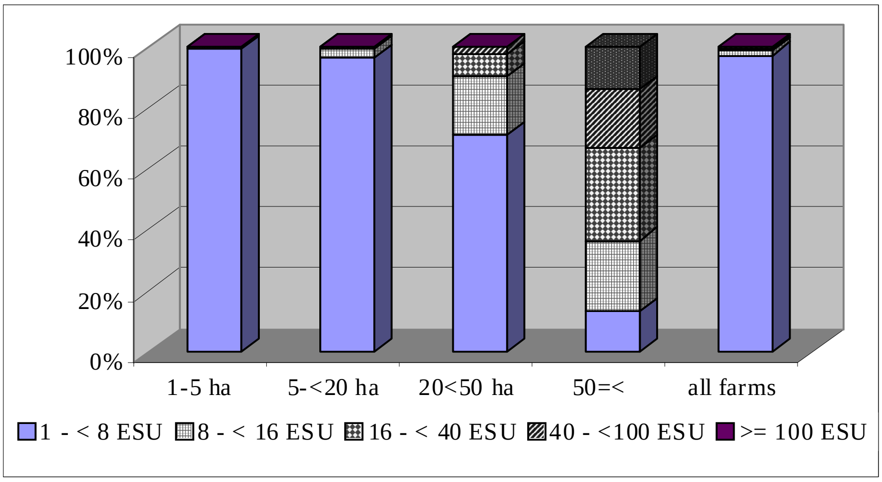
Size class & ownership	Total number	% of total	UAA (ha)	% of UAA
Less than 1 ha	1,851,835	44.9	694,511	5.0
1 - 5 ha	1,883,983	45.7	4,407,600	31.7
-Individual farms	1,878,666	45.6	4,398,100	31.6
- Legal entities	5,317*	0.1	9,500	0.1
> 5 - 10 ha	289,575	7.0	1,926,391	13.9
-Individual farms	286,987	7.0	1,909,791	13.7
-Legal entities	2,588	0.1	16,600	0.2

> 10 - 50 ha	82,024	2.0	1,319,957	9.5
-Individual farms	79,982	1.9	1,257,257	9.2
-Legal entities	2,242	0.1	44,700	0.3
> 50 - 100 ha	4,939	0.1	336,183	2.4
-Individual farms	3,919	0.1	261,883	1.9
-Legal entities	1,020	0.0	74,300	0.5
Over 100 ha	8,891	0.2	5,222,058	37.6
-Individual farms	2,215	0.1	562,458	4.1
-Legal entities	6,676	0.2	4,659,600	33.5
Total farms	4,121,247	100.0	13,906,701	100.0
-Individual farms	4,103,404	99.6	9,102,018	65.5
-Legal entities	17,843	0.4	4,804,683	34.5

Source: based on Turtoiu *et al.* (2007) and Cionga & Luca (2008); * it is assumed that there are no legal entities of < 1 ha

Yet, if farm structure is analysed taking into account the measurement of the economic size of a farm, only 1.24 million Romanian farms have at least 1 European Size Unit (ESU) making use of about 10.3 million hectares of agricultural area (Benoist and Marquer, 2007). This reinforces the subsistence character of the Romanian farm structure, with the remaining three million (or 71 per cent of total) farms below the threshold of 1 ESU. Furthermore, Benoist and Marquer (2007) estimates that 69 per cent out of the total of 1.24 million farms produce mainly for their own consumption. Figure 1 presents the distribution of Romanian farms by ESU and farm size in 2005, highlighting that the majority (98 per cent) of all farms have an economic size between 1 and 8 ESU. Farms with 100 ESU and over represent only 14 per cent of total and the majority have 50 hectares or more.

Figure 1 - Farm Structure by ESU and Farm Size, Romania, 2005



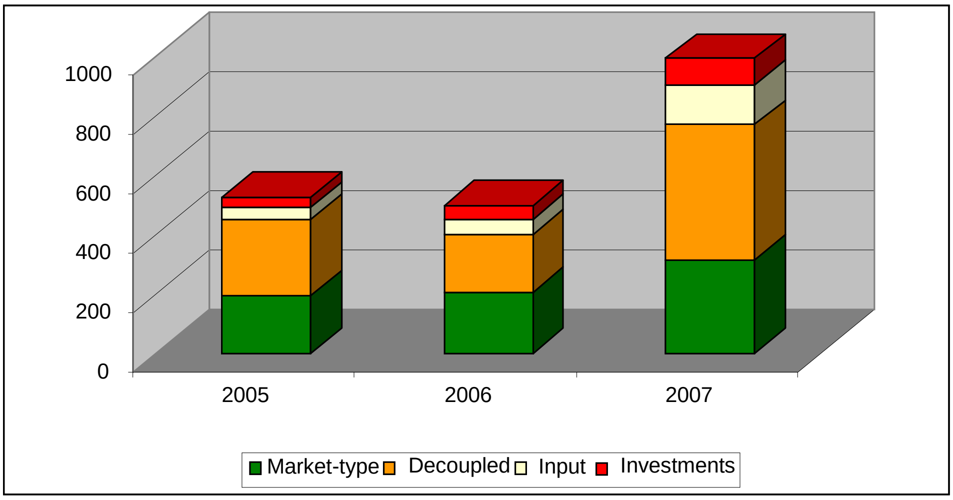
Source: based on Benoist and Marquer (2007)

Romanian Pre-accession Agricultural Support Measures

The official opening of the negotiations for EU accession in May 2000 represented a crucial step in re-shaping Romanian agricultural policy. Since, this was geared to emulating the CAP (Hubbard and Hubbard, 2008), and as membership was getting closer, Romania was increasing its effort to provide farm support (OECD, 2007). Hence, total agricultural support in 2003-2005 stood at six per cent of Romania's GDP, exceeding by far the OECD average (one per cent). From five per cent in 1995-1997, producer support estimate (PSE) jumped to 29 per cent in 2005, as against the OECD average of 30 per cent. Still, numerous support measures continue to be coupled with production (accounting for 88 per cent in the PSE), while input (the most distortive) subsidies contributed with another six per cent. Area based payments accounted for some four per cent of the total support at farm level. Domestic farmgate prices were 54 per cent above the levels prevailing in the international markets (except for some commodities like oilseeds and sheep meat). Further into 2006-2007, Romania maximised the possibility to provide subsidies as "state aids", under the transitory arrangements. To these, like in most recent years, various compensations were agreed with the Commission, in response to difficult circumstances created by animal disease outbreaks (classical swine fever, avian influenza) or whether conditions (e.g., the 2007 exceptional drought).

Figure 2 below depicts the evolution of different support measures provided by the Romanian government to domestic producers between 2005 and 2007. These are grouped into four main categories (making possible, comparisons with the CAP-type support and partly consistent also with the OECD taxonomy): market-type, decoupled support, input purchase subsidisation and support to investments.

Figure 2 - Romania's Agricultural Support Measures, 2005-2007 (€million)



Source: Ministry of Agriculture and Rural Development;

The three-year period features a large share held by market measures, with a negative impact from the perspective of the liberalisation trend worldwide. Nevertheless, this shrank from 42 per cent in 2006 to around a third in 2007. As expected, a positive development is the large share of the decoupled payments (per area unit or animal head) in total (46 per cent in 2007), in an anticipation of the direct payment scheme introduction. Yet, due to the delays leading to the effective payment of the amounts received from the EU budget only beginning with March 2008, the specificity of the national budget for 2007 for agriculture is given by large-scale national support, mostly assimilated to the state aids. The level of support went up significantly (almost doubled compared to the 2006 total allocation), reflecting large amounts disbursed as such compensations in a particularly difficult year, with extreme weather conditions.

Implementing the CAP: Who benefits from direct payments?

The central piece of the CAP introduced (by the 2003 Mid-Term Review) to distribute direct income support to the EU farmers, is the Single Farm Payment Scheme. De-coupled from production, and thus introducing less trade distortions, these direct subsidies were designed to support EU15 farm income and budgetarily accommodate the EU new member states (NMS) from Central and Eastern Europe. This was also perceived as a much simplified and sustainable support measure that will enhance farmers' flexibility in production decisions and opportunities. However, for the NMS it was agreed (in the accession talks) that this scheme would be gradually introduced over the first decade of membership. As none of these states handled CAP-type direct payments prior to accession, as well as for avoiding the requirements of a quite sophisticated administration, the NMS were offered the option of a simplified version, named Single Area Payment Scheme (SAPS). SAPS provides for an annual flat rate, per hectare payment to farmers, irrespective of the type of crop produced or whether crops are produced at all (under the assumption that the farmer respects the cross-compliance principle). For each NMS a total financial envelope for SAPS was established taking into account a number of considerations, such as production yield levels for a reference period (e.g. 2000-2002) and historical production of commodities eligible for subsidies (arable crops, milk and dairy products, beef and veal).

Romania will apply SAPS for a period of three years, with the possibility of a two-year extension. Meanwhile, the country is required to improve its administrative capacity, including its Integrated Administration and Control System (IACS), so as to be able to handle more complex schemes in the future. The direct payment financial envelope corresponding to Romania's first membership year stands at €443 million (disbursable in 2008), which divided by the total *eligible utilised area*, gives roughly €50/ha. For comparison, the Hungarian farmers receive €70/ha, the Bulgarians about €51/ha, while Latvians about €20/ha (Kray *et al*., 2007). Like most of the NMS, Romania set up its minimum threshold for farm eligibility at 1 hectare, both for farm efficiency considerations as well as for avoiding additional administrative burdens.

To compensate for the gradual implementation of direct payments, the NMS were allowed to complement these with "top-ups". The complementary national direct payments (CNDP) are funded from the national budget, up to 30 per cent of the EU15 level or up to the pre-accession support level plus 10 ten per cent, but without exceeding the EU15 direct payment level. Exceptionally, in the first three years of membership, the CNDP can be partly (up to 20 per cent) funded by diverting money allocated for rural development under the CAP Pillar 2. The matching funds are to be covered from the national budget. From 2010 Romania would have to finance the CNDP entirely with national funds.

Romania opted for the following. For the crop sector, 80 per cent of the CNDP will be provided from the national budget, the rest being co-financed from Pillar 2. In contrast, "top-ups" for livestock will be entirely financed from the national budget. Legislation passed at the end of 2007 set up the CNDP for the first accession year at €47/ha for most crops (Table 5). This means that eligible recipients will receive a total of €98/ha as (national and EU) direct payments. Additionally, energy crops (e.g. maize, soybeans, rapeseed and sunflower), are granted an "energy premia" (€45/ha). Moreover, "top-ups" depending on output levels will be granted for some specific industrial crops such as flax linseed and hemp, hops and tobacco, sectors that otherwise might be abandoned in the absence of such incentives. A special program is designed for sugar beet, for encouraging production so to that Romania can fulfil its sugar quota. Hence, sugar beet producers will receive from the national budget some 220 €/ha (special scheme plus other CNDP from other schemes) in addition to total (national + EU) direct payments.

For livestock production, support measures for 2007 have reportedly aimed at the sector's restructuring as well as encouraging market liberalisation for animal products; hence, subsidies ("premia") have been partly decoupled from production. For example, a flat rate of around €147/head will be provided to dairy and beef producers, whereas sheep and goat farms will get a premium of €10/head. For 2007, over 1 million cattle and 4.3 million sheep and goat were found eligible for direct aid in the livestock sector. The 2008 IACS information reveals that some 1.23 million Romanian farmers submitted an application form for direct payments for 2007. Total eligible UAA entitled to (national and EU) direct payments stands roughly at 9,500,000 ha; hence the amount to be disbursed (in 2008) as total direct payments reaches around €930 million (Table 5). This means that just 30 per cent of total Romanian farms controlling 68 per cent of total UAA will actually benefit from the CAP.

Table 5 - Distribution of total direct payments, by farm size & ownership, Romania, 2008

Size class & ownership	Total eligible farms	Total eligible UAA (ha)	Total estimated direct aid (€)	as % of total direct aid
1 - 5 ha	**1,001,409**	**2,436,816**	**237,589,560**	**25.7**
-Individual farms	998,583	2,431,564	237,077,467	
- Legal entities	2,826	5,252	512,093	
> 5 - 10 ha	**159,428**	**1,058,554**	**103,209,015**	**11.2**
-Individual farms	158,003	1,049,432	102,319,647	
-Legal entities	1,425	9,122	889,368	
> 10 - 50 ha	**52,273**	**982,022**	**95,747,145**	**10.4**
-Individual farms	50,972	935,374	91,199,007	
-Legal entities	1,301	46,648	4,548,138	
> 50 - 100 ha	**5,436**	**384,073**	**37,447,118**	**4.0**
-Individual farms	4,313	299,189	29,170,908	
-Legal entities	1,123	84,884	8,276,209	

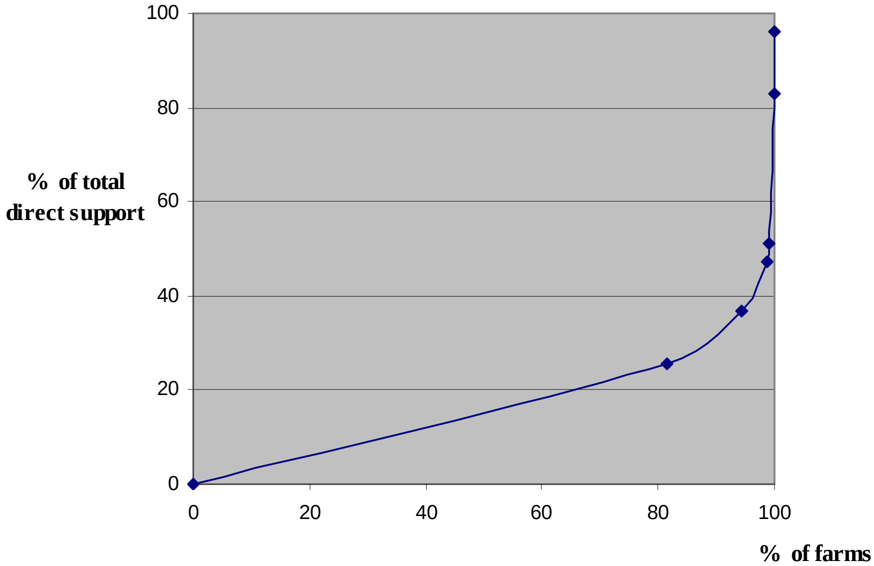
Over 100 ha	**10,819**	**4,624,540**	**450,892,650**	**48.8**
-Individual farms	2,695	498,100	48,564,795	
-Legal entities	8,124	4,126,440	402,327,855	
Over 100 ha of which:				
>100 -1,000 ha	10,029	3,024,540	294,892,650	31.9
>1,000- 5,000 ha	752	1,217,000	118,657,500	12.8
> 5,000 ha	38	3,83000	37,342,500	4.1
Total farms	**1,229,365**	**9,486,005**	**924,885,488**	**100**
-Individual farms	1,214,566	5,213,660	508,331,826	55
-Legal entities	14,799	4,272,345	416,553,662	45

Source: own estimation based on data from the Ministry of Agriculture

Table 5 also depicts that the value of total direct support to be received by 80 per cent of the eligible farms vary between €98/farm and €490/farm. The majority of these are individual farms. Based on their eligible area for subsidies, this translates into €240 million or 26 per cent of total Romanian direct aids. By contrast, less than 1 per cent of all recipients, i.e. farms operating over 100 hectares, could receive a minimum of €9,800. Almost half of total Romanian direct support will be distributed amongst these large and very large farms. Furthermore, an estimated 156 €million (or 17 per cent of total direct support) will go to just 800 farms with over 1,000 hectares. Most likely these are legal entities, which focus their production on the so-called “energy” crops and manage a large number of livestock (e.g. beef), hence they will benefit significantly from other national payments. Operators in this pole are already highly competitive, made substantial investments and have increased their relative efficiency. Thus, they meet all conditions to receive CAP Pillar 1 support and are also the most equipped (including access to knowledge) to benefit from the Pillar 2 incentive programs.

The highly uneven distribution of the total direct support across Romanian farms is captured by the Lorenz curve in Figure 3. The curve reflects clearly that the direct support is distributed mainly to the larger-scale farms, particularly to those above 100 ha.

Figure 3 Lorenz Curve for Total Direct Support, Romania, 2008



It should be also noted that the subsidies, that a farm is able to attract under the CAP income support component, depend both on its land concentration and production specialisation. Given the large amounts budgeted by Romania as CNDP for the livestock sector (€231 million), farmers that concentrate on large livestock will enjoy a substantial income growth in the first year of accession. However, this will be altered as the proportion between SAPS and CNDP will change over time. The more the SAPS share will grow as a result of the phasing-in, the more livestock producers will be penalized, since direct payments will be oriented to agricultural land only (as mentioned above, direct payments for livestock are granted only from the national budget).

Concluding remarks and discussion

There is little doubt that the adoption of the CAP, particularly the implementation of the SAPS and CNDP will have a significant impact on Romanian farm income and on the rural economy as a whole. Moreover, the manner in which the SAPS and CNDP are applied in Romania will influence its farm structure and the pattern of production. Under this approach only 30 per cent of total Romanian agricultural holdings are eligible for direct farm income support. This paper shows that even amongst these eligible farms distribution of the (national and EU) direct support is dramatically uneven. It is also suggests that the main recipients of direct subsidies are not those in need, which represent the majority, but a small number of very large-scale operators (legal entities), which receive the "lion-share". Additionally, given their production specialisation, these will benefit significantly of other supplementary national payments, such as "energy" and "livestock" premium. Some may argue that even in the EU15 there is a highly uneven distribution of direct payments as 50 per cent of beneficiaries received only 3 per cent of direct payments, while 2 per cent of beneficiaries received 30 per cent of total direct aids. In Romania, however, the disparity is far more extreme, after the first year of the CAP, with 80 per cent of the beneficiaries eligible for only 26 per cent of total direct aid, as opposed to less than 1 per cent receiving half of the subsidies. Furthermore, farms of 1,000 hectares or more are hardly to be found in Western Europe, where manageable family farms are predominant. Yet, in Romania, 17 per cent of the total estimated direct aid goes to a handful of farms of 1,000 hectares or more.

Area payments, nevertheless, introduce less distortion in production patterns and have the advantage of being less difficult to administer. From this perspective, Romania's choice to provide "top-up" evenly (regardless of the commodity) and mostly in a decoupled manner may be considered justified at this stage. It is expected that producers would be able to react quicker to market signals than in the pre-accession period, when numerous sectors received special attention through specific incentive programs. As the administrative capacity increases, the authorities should consider improving targeting, in line with the main objectives of the CAP. However, the application of CNDP and the other national incentives coupled to production, if continued, may reverse the expected outcome in the medium and long run, with crops such as maize, soybean, rapeseed, sunflower and sugarbeet becoming preferable amongst producers. Additionally, as EU direct payments will be phased-in preference for crops in general will increase as opposed to livestock, which relies only on national payments. In Hungary, for example, there is a clear shift in favour of specialist crops and large mixed farms after the country's EU accession (Hubbard *et al*., 2007).

Another possible outcome is that the allocation of direct support in its current form, single farm area payment, may also slow down structural changes in Romanian agriculture allowing small and relatively inactive holdings to survive longer than they otherwise would have done. These farms will choose not to sell or lease their land, as the small amount of direct payments will be regarded as an additional income. This will reinforce the subsistence character of the Romanian farming system. In Sweden the number of farms rose by 12 per cent between 2003 and 2005. Interestingly, the increase was particularly significant in the category of small-scale farms (e.g. less than 5 ha), whereas, for the same period, the number of large-scale farms fell (e.g. between 50 and 100 ha) or remained unchanged (e.g. over 100 ha). The explanation lies with the implementation of the CAP Single Payment Scheme in Sweden, rather than an increase in farming activity (Copus & Knobblock, 2007).

The distributional aspect of the direct subsidies has become recently one of the key points of the CAP Health Check, where discussions for amending CAP, with reference to limiting excessive support to very large farms and establishing a maximum amount payable per farm took place. There are also proposals for the introduction of a minimum annual support limit per farm, either based on a minimum annual support level or a minimum area. The European Commission (EC) suggests that the introduction of these limits should be cautiously approached, both to avoid increasing disparities between large and small farmers as well as for not affecting the farms that are already engaged in commercial production (EC, 2008). However, until these proposals will become reality, this study shows that in the Romanian case those most vulnerable, the landless poor, will benefit least or not at all from the EU taxpayers' money. Moreover, the discrepancies in farm income between small-scale and very-large farms will become more acute, with those who benefit from the CAP being better off as opposed to the majority of (70 per cent of Romanian farms) non-eligible to this support. Flat rates provided to large-scale farms that enjoy high-income levels (as some of them operating thousands of hectares of land under concession arrangements with the state or leased in from small individual owners) are obviously regressive. Thus, providing direct payments to these farms does not really contribute to reaching the objective of supporting farmers' incomes for those most vulnerable.

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