

POSSIBLE IMPLICATIONS OF COMMON AGRICULTURE POLICY REFORM

Z. Toušek

Czech University of Agriculture, Faculty of Economics and Management, Prague, Czech Republic

Common Agriculture Policy of the EU is undergoing a fundamental reform. The enlargement process towards east in which the Czech Republic is aspiring for full membership is one of the most important external driving force. Because of the size of budgetary implication, the current CAP is not sustainable and requires reform of its instruments that was prepared under EU Commission supervision.

CAP; direct payments

Introduction

The common agricultural policy of the European union is under a fundamental reform pressure both internal and external powers. The process of the EU enlargement toward east with in which the Czech Republic applies for full membership is unambiguously one the most important external driving force.

The scope and especially financial resources intensiveness of current CAP is for several reasons unsustainable in its existing form and requires further reform that is prepared under supervision of the EU Commission. New proposal of ongoing reform will be submitted by the EU Commission, wide and detailed discussion among all relevant parties is expected. There can be observed certain level of optimism that the final form of reformed CAP will be known in the near future.

Initial CAP reform proposals delivered by Commission were based and unwound on the following fundamental ideas.

- *Payment decoupling* from production that implies direct payments decoupling from production activities. Instead, these payments are linked to 1 ha land area unit of farms.
- *Obligatory set-aside program* representing payment decoupling from production activities qualified by compulsory 10% set-aside of farm cultivated arable land for the period of 10 years.
- *Cross compliance criterion and consultancy* implying that subsidy calls are qualified by fulfilling and complying with EU environmental, animal welfare standards etc. In the case of violation of these commitments lost or reduction of support can be imposed. At the same moment, the consultancy participation obligation for employees of bigger entities (over 15 ths EUR of direct support/year) applies.
- *Support reduction and modulation* represent progressive direct payment decline within support modulation, additional savings are supposed to be transferred especially to financial sources supporting rural development.

- *Market acquisition* are related to specific commodities such as starch production, dry feedings and administrative prices for cereals and milk base products.

From the Czech Republic is point of view, as one of the candidate country that is expected to join the EU at the beginning of this year, it is essential to follow the developments and direction of commission reforming afford and to be prepared accordingly react and adjust its activities.

Conditions of the Czech farmers will be changed immediately after the accession to the EU and influenced by set terms included in the Accession agreement. This agreement is related especially to national production limits and quotas, direct payments and other terms and conditions.

The structure of potential support level can be divided in the following way:

- *Direct payments* – The starting direct payment level is 25% of the EU level for the year 2004 and additional 5% increase each year up to the year 2007. After this initial period the annual growth should be equal to 10%. There is a possibility of 30% supplementary payment from national resources during the period 2004–2007, i.e. 55%, 60% and 65% of final support.
- *Horizontal plan of rural development* – About half of the financial sources of this existing fund will be used to cover LFA payments. For agro-environmental program purposes the remaining part should be used. National co-financing is assumed.
- *Sector operational plan of agricultural development* – It is assumed that these sources will cover sector investment development in compliance with set priorities. National and private sources should be used for co-financing.
- *Market price assistance* – Prices of selected commodities are set by the common market rules indirectly supported by the EU commission and fully financed from EU funds, e.g. export subsidy, storage subsidy and so on.

Objectives and methodology

The object of this paper is to focus attention towards possible macroeconomic impacts of alternative support level of one particular structural help form namely direct payments.

Direct payments represent probably one of the most controversial issue in relation to reformed CAP. Used methodological approach is corresponding with the above stated objective.

Based on the alluded objective, the selection of suitable model structure is executed ensuring both full real condition adaptation of the Czech environment and partial complementation of broad variety of system analysis instruments used in the Czech Republic. After both criteria valuation the specific model structure GESIM (Toušek, 2002) reflecting unique conditions of the Czech Republic was selected. In the remaining part of this paper the quantitative analysis method of mutual comparison based on observation and comparison of particular result estimations representing predefined alternatives is employed.

Single alternatives further on called scenarios represent various economic acquisition that are estimated by measuring their impacts reflecting European integration process intensity on national economy level.

Because these impact effects are monitored on macro economic level there is no need to consider potential differences between classical and simplified direct payment system. In the classical direct payment system the value of compensation payments is linked to production of relevant commodity. On the other hand, the simplified direct payments system is not directly linked to production activities instead to cultivated farm land area, i.e. to 1 hectare of arable land.

European Commission explained its proposal of gradual compensation payments growth that considered acceptable and suitable for both counterparts, among other things by following arguments:

- Too fast full direct payments implementation for candidate countries could inhibit positive income effects on farmer side by negative implication on restructurization process. The issue of candidate countries restructurization is directly connected to dualization of their agrarian structure. On the one side, agricultural production sector needs additional investments for its further development and finish restructurization process and on the other hand, farms as a rural settlements play important role of safety social net in less developed rural areas.
- Significant financial inflow of compensation payments preferring only selected segments of agrarian sector constitutes jeopardy of income disparity and social break-up in the rural areas.
- Other argument of the European Commission is that financial EU outlook (including Agenda 2000) till the year 2006 is not considering compensation payment calls of candidate countries.

Based on these arguments, the final decision suggesting gradual growth that is ensuring income stability for farmers without negative impacts on unfinished restructurization process was drawn up.

Alternative political scenarios

As it has been stated, because of the lack of current CAP stage knowledge in the moment of the Czech Republic accession into a EU structure, there is a need to consider more alternatives that can be seen as the most plausible ones in short time horizon.

There were defined, later on also estimated by GESIM model and eventually compared 3 different alternative scenarios covering the issue of different level of direct payments.

Basic tree scenarios describing alternative stages of compensation support level

- The first scenario (**A₂₅**) is assuming zero additional national contribution to the total direct payment level.
- The second scenario (**B₂₅₊₁₅**) reduced “Top up” is presuming situation, where the national additional contribution funded by the national government is equal to 15%.
- The third scenario (**C₂₅₊₃₀**) is corresponding with the so called “Top up” variant, where the national bodies are exploiting the possibility of additional national 30% support raise.

Scenario **A₂₅** assumes completion of mutual bilateral import tariffs reduction among the Czech Republic and existing EU member states initiated by association agreement. The same presumption is applied to all member states of regional organization CEFTA aside from their full membership in the EU. This reduction is relevant to all considered sectors. The CR as a new regular member is obliged to contribute to the common budget amounting to 1.27% of its GDP. The accession of the Czech Republic to the EU can last but not least increase the direct aid from EU internal funds up to maximum 4% of national GDP. According to current experience and with respect to availability and quality of submitted projects the estimated financial inflow should be about 2.3–2.4% of GDP. Can be assumed that the CR will fulfill all conditions and qualify for financial aid coming from structural funds, i.e. it should become a net recipient. These resources represent a part of government income in the form of foreign transfers. At the same time, public expenditures are expected to remain constant in real terms (or slightly increase) and consequently public debt should be reduced by this sources inflow. Due to this, the level of aggregated investments should rise that is also a partial goal of the structural help.

The Common Agricultural Policy and its principles are modeled in the reform form. This policy reform is adopted in model by import tariffs and export subsidies

for agrarian sector and following food processing sector growth. Doucha et al. (1999) states that import tariffs should raise by approximately 210% counter to current domestic level. Based on proportional territorial structure evaluation of Czech imports, the growth of these tariffs was 70%. In this text for the direct payment purposes the official EU Commission proposal that is suggesting initial 25% of direct payments applied in current member states and national additional payments is used, see page 1.

Scenario **B₂₅₊₁₅** reduced "Top up" is almost identical with previous one in the sense of allowed support level only proposed additional 15% of support covered by national sources is considered.

Scenario **C₂₅₊₃₀** represents "Top up" for farmers the most suitable variant, because it presumes maximum allowed 30% support financed by the national government that leads to the overall additional support level of 55%.

The final amount of subsidies is derived from the official document produced by the Czech Ministry of Rural Development – National Development Plan. The assumption of investment orientation and character of these funds is applied. Therefore these funds are considered as investments in the alluded model structure. The issue of direct payments is managed in the decouple way e.g. direct payments do not have a character of direct production incentives. Tanagermann and Münch (1995) have come to conclusion in the context of partial equilibrium model ESIM that direct payments do not represent important direct production incentive. Estimated values of compensation transfers relevant for the Czech Republic are derived from the work of Doucha et al. (2002).

Table 1. Basic scenario assumptions

Scenario	A ₂₅	B ₂₅₊₁₅	C ₂₅₊₃₀
Structural funds resources	yes	yes	yes
EU direct payments	yes	yes	yes
EU budget contribution	yes	yes	yes
Additional national allowance 15%	no	yes	no
Additional national allowance 30%	no	no	yes

Suggested scenario evaluation

In this part of the paper the attention will be paid to interpretation of obtained results representing main characteristic determination the most principal findings derived from set parameters reflecting various scenarios. The macroeconomic stabilization is a basic condition for successful integration process completion. Stable external exchange rate, acceptable inflation rate development and proportional trade balance level are the most important factors. Only selected aggregates and their progress and changes are monitored and alleged in the following figures.

Fig. 1 demonstrates changes of selected macroeconomic magnitudes. The value of *GDP* has increasing trend for all intended scenarios that is due to both increasing aggregated output and increasing aggregated prices. The *CPI* curve shows development of price level by Stone's consumer price index. The price level identically growth for all alternatives because of rise of prices on all markets, i.e. on the input market as well as on output market. Higher price growth was detected on the output side. The common point intersection of curves *CPI* and *GDP* would represent breaking point of *GDP* between his real and nominal phase. The level of aggregated investment remains constant for all scenarios.

The investment inflow leading to economic country development is accompanying by the growth of dispensable household income that is generated from ownership of production factors labor and capital. The curve course of net household income *HINC* in Fig. 2 corresponds with development of expenditure per capita function *PCE*. This functional relationship is derived as a proportional part corresponding with saving level. Both mentioned functional forms are characterized by dynamic growth for all scenarios. Jensen et al. (1998), Hertel (1997) and others identically assume wellness growth in new associated countries. The finding differs only in the sense of the wellness measure value in the case of new member states and potential losses in the case of old member states. Cited Jensen et al. (1998), Frandsen et al. (1998) expect slight decline while Hertel (1997) and Swaminathan et al. (1998) slight growth. Result differences among authors are caused by different assumption about convergence process of candidate countries. As long as disposable income growth is considered for simplicity as a relevant wellness measure than simulation calculations confirm the same results.

The level of governmental income *GINC* is increasing because of additional growth of household and business taxes. On the other hand government expenditure part of state budget *GSPE* tends to growth that can be explained by additional governmental support to national economy to help production sector to increase its competitiveness and adjust to higher European market standards. Other important aspect from state budget expenditure point of view that should be stressed is a need for additional sources for co-financing of approved projects and also national contribution towards EU budget.

National state budget deficit is limited by exogenous parameter (one of the Maastricht criteria). In the case of our membership in the EU, there is no need to be afraid of unemployment rate rise as showed by curve marked *LPAR* that stands for total labor participation in the national economy. *LPAR* represents supply level of population able to work that depends only on the real average wage rate. The real average wage, i.e. compensation unit for supply unit of production factor labor has slightly increasing trend. On the other hand, this movement is only nominal one, because inflation rate represented by consumer price index *CPI* reaches higher value in real

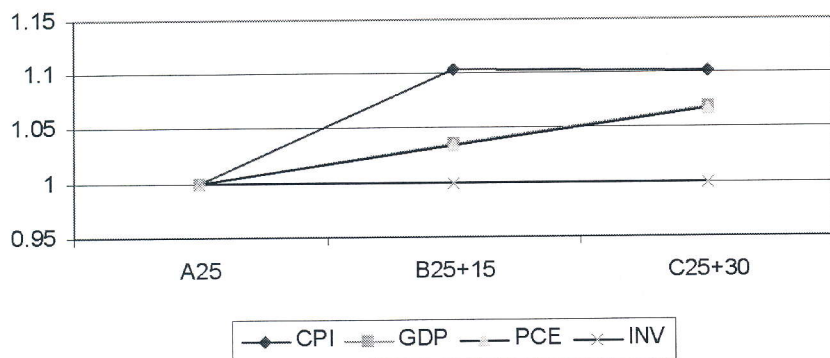


Fig. 1. Selected macroeconomic aggregates (in %)

Source: Author's model simulation

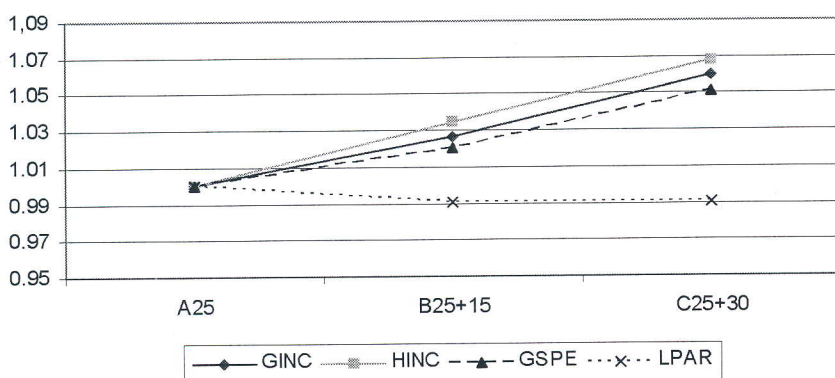


Fig. 2. Other selected macro aggregates (in %)

Source: Author's model simulation

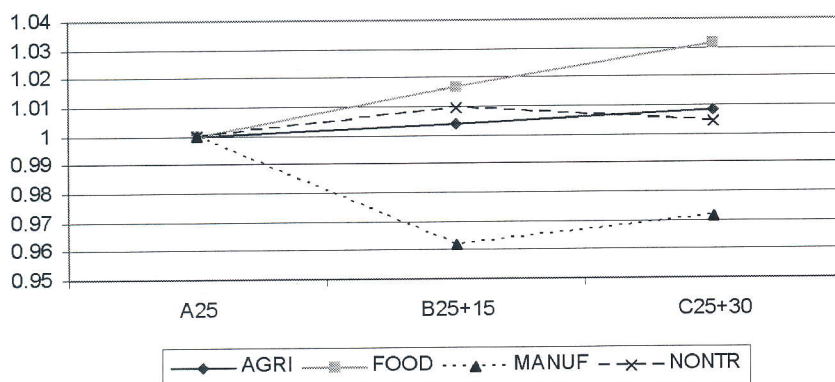


Fig. 3. Sector investment demand (in %)

Source: Author's model simulation

terms. As showed in Fig. 2 labor participation level remains almost unchanged for all suggested political alternatives.

In Fig. 3 the capital demand of agrarian sector *AGRI* has increasing tendency, food processing industry *FOOD* can be characterized by the same trend development, however, absolute value of demand capital is higher by orders. In comparison investment demand growth and subsequent aggregated sector output of particular sectors can be observed at the first sight that aggregated output growth dynamics of agrarian sector and food processing industry does not correspond with the investment demand level. There may be found several reasons of this state approximation to food consumption saturation level, limited export possibilities and necessity to increase quality standards of production especially food products with respect to higher standards that are commonly demanded within the EU. Then one possible conclusion can be drawn that rational farmers and represen-

tatives of processing capacities will oriented their strategy to fulfill these requirements by producing higher quality and standards production contrary to its simple quantitative growth. The sector of non-tradable services *NONTR* shows stagnation of capital demand.

Conclusion

By simulation calculations of three different political alternatives that seem to be the most relevant scenarios in relation to the real enlargement process development, covering structural parameters extension of economic climate at the actual moment of the Czech Republic admission into the EU, the forecasting and predictive abilities of GESIM model structure are demonstrated.

It is not exhaustive answer or description of all possible alternatives of Czech economy capacity at the moment of its integration. The aspiration of this paper is

rather to outline intensity and direction of possible action impacts of various acquisition sets including CAP and direct payments on the economic environment of the Czech Republic as one of new member state.

REFERENCES

- DOUCHA, T. et al.: Internal material VÚZE, 2002.
DOUCHA, T. et al.: Analysis of border tariffs protection level. Praha, VÚZE 1999.
FRANSEN, S. et al.: Expanding "Fortress Europe": Implications of European enlargement for non-member regions. Copenhagen, Danish Institute of Agricultural and Fisheries Economics 1998.
HERTEL, T. W.: Global Trade Analysis: Modeling and applications. Cambridge, Cambridge University Press 1997.
JENSEN, H. et al.: Agricultural and economic-wide effects of European enlargement: Modeling the Common Agri-

cultural Policy. Copenhagen, Danish Institute of Agricultural and Fisheries Economics 1998.

- SWAMINATHAN, P. et al.: Integration of the Central and Eastern European economies into the European Union. In: SWAMINATHAN, P. et al.: Economic Transition and the Greening of Policies: Modeling New Challenges for Agriculture and Agribusiness in Europe. Kiel, Germany, Wissenschaftsverlag Vauk Kiel KG 1998.
TANGERMANN, S. – MÜNCH, W.: Agriculture in Poland, Czech and Slovak Republics and Hungary and possible evaluation in the medium term, using the ESIM Sector Model. Final report for the European Commission (DG IV), 1995.
TOUŠEK, Z.: Některé modelové přístupy hodnocení hospodářských opatření (Some model approaches of evaluation of economic measurements). [PhD. thesis.] Czech University of Agriculture, Prague, 2002.

Received for publication on October 30, 2003

Accepted for publication on April 27, 2004

TOUŠEK, Z. (Česká zemědělská univerzita, Provozně ekonomická fakulta, Praha, Česká republika):

Možné dopady reformy společné zemědělské politiky.

Scientia Agric. Bohem., 35, 2004: 116–120.

Společná zemědělská politika zemí Evropské unie je pod reformním tlakem jak interních, tak externích sil. Proces rozšíření EU směrem na východ, v jehož rámci aspiruje i ČR na plnohodnotné členství, je jednoznačně jednou z nejdůležitějších externích hnacích sil.

Rozsah a zejména finanční náročnost stávající Společné zemědělské politiky (SZP) je z více důvodů do budoucna ve své stávající podobě neudržitelná a vyžaduje postupnou reformu, jež je připravována Evropskou komisí (EK). Nové návrhy pokračující reformy budou předloženy EK a očekává se široká a hluboká diskuse mezi všemi zainteresovanými stranami. S určitou mírou optimismu lze očekávat, že konečná a výsledná verze SZP bude v brzké době známa.

SZP; přímé platby

Contact Address:

Ing. Zdeněk Toušek, PhD., Česká zemědělská univerzita v Praze, Provozně ekonomická fakulta, Kamýcká 129, 165 21 Praha 6-Suchbát, Česká republika, e-mail: Tousek@pef.czu.cz
